

**THE CISG AFTER MEDELLIN V. TEXAS:
DO U.S. BUSINESSES HAVE IT?
DO THEY WANT IT?**

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INTRODUCTION

The Convention on the International Sale of Goods (the “CISG”) is a multilateral uniform sales treaty adopted at a diplomatic conference in Vienna in 1980.¹ The objectives of the CISG, as outlined in its preamble, are to “remove legal barriers to international trade and promote the development of international trade.”² In practice, the CISG is a set of default rules developed for the purpose of maximizing and streamlining efficient international trade.³ The Convention is commonly understood to have entered into force for all the states a party to it, on January 1, 1988.⁴

Two assumptions about the CISG have prevailed since it supposedly came into force in the United States.⁵ The first assumption concerns the very

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¹ United Nations Convention on Contracts for the International Sale of Goods, Final Act (Apr. 10, 1980), U.N. Doc. A/CONF.97/18, Annex I (1980), *reprinted in* S. Treaty Doc. No. 98-9, 98th Cong., 1st Sess., *and in* 19 Int'l Legal Materials, 668 (1980), *also available at* <http://www.uncitral.org/pdf/english/texts/sales/cisg/CISG.pdf> [hereinafter “CISG”].

² *Id.*

³ *See generally* *Id.*; Nicholas G. Karambelas, *International Sale of Goods: An International Law as Domestic Law*, WASHINGTON LAWYER, Apr. 2009, at 27 (noting that the CISG is a set of “uniform and coherent” default rules).

⁴ CISG, *supra* note 1.

⁵ United Nations Commission on International Trade Law: Status-1980: United Nations Convention on Contracts for the International Sale of Goods, *available at*

meaning of the phrase “came into force in the United States.” Since 1988, the U.S. courts that have not ignored the CISG altogether have assumed that the CISG is self-executing, and have therefore assumed that the CISG has come into force in the U.S. without the need for any congressional action.⁶ The second prevailing assumption is that the CISG is efficient and beneficial for U.S. businesses engaged in the international sale of goods.⁷ Most treatises and commentators have either assumed the CISG’s benefits by explicitly stating so or by ignoring the question of the CISG’s usefulness altogether.⁸

On March 25, 2008, the Supreme Court majority in *Medellin v. Texas* arguably asserted a new standard for determining the self-executing status of all international treaties to which the U.S. is a signatory.⁹ This new standard has thrown into doubt the self-executing status of the CISG.¹⁰ This note will argue that because of the ruling in *Medellin v. Texas*, the two prevailing assumptions about the CISG must be reexamined.¹¹ Both the status of the CISG and the benefits accruing from the CISG’s implementation will be examined for the purpose of answering two simple questions: (1) Is the CISG a self-executing treaty in force in the U.S. and (2) Do U.S. businesses want it to be?

Before the analysis begins, however, the scope of this article must be explicitly defined. First, this article is not a general analysis of the history of the Supreme Court’s interpretation of self-executing and non-self-executing treaties. This topic has been covered extensively in many books, treatises, and articles by eminent jurists and commentators, and any analysis of that history in this article would be superfluous and unnecessary.¹² It suffices to say that the opinions of both the majority and the dissent in *Medellin* approach the

http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html.

⁶ See Claire R. Kelly, *The International Sale of Goods: The Back and Forth of the CISG and International Law*, A.L.L.-A.B.A. Continuing Legal Education—The U.C.C. and Beyond: Current Developments in Commercial Law, SN086 ALI-ABA 47 (2008).

⁷ See Gilles Cuniberti, *Is the CISG Benefiting Anybody?*, 39 VAND. J. TRANSNAT’L L. 1511 (2006).

⁸ See *id.*

⁹ *Medellin v. Texas*, 128 S. Ct. 1346, 1356 (2008).

¹⁰ *Id.* at 1361.

¹¹ See generally Posting of Jeremy Telman to Contracts Law Prof Blog: *Medellin* and Contracts Revisited II, http://lawprofessors.typepad.com/contractsprof_blog/2008/04/medellin-and--1.html (Apr. 8, 2008).

¹² See, e.g., 3 JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES, 696-97 (1833), available at http://www.constitution.org/js/js_000.htm; Carlos Manuel Vasquez, *The Four Doctrines of Self Executing Treaties*, 89 AM. J. INT’L L. 695 (1995); Martin S. Flaherty, *History Right?: Historical Scholarship, Original Understanding, and Treaties as “Supreme Law of the Land”*, 99 COLUM. L. REV. 2095 (1999); John Yoo, *Treaties and Public Lawmaking: A Textual and Structural Defense of Non-Self-Execution*, 99 COLUM. L. REV. 2218 (1999).

interpretations of a treaty's self-executing status from the two major, yet divergent, historical theories of treaty interpretation, and in the end, the *Medellin* majority's theory is now the new dominant theory in force.

Second, this article is not an analysis of the efficiency of the CISG when the parties include a "choice of governing law" provision in their contracts. Every analysis in this article assumes that the parties have not included any provisions in their contract providing for a specific governing law. In a hypothetical world where the parties do not include a contractual provision for a specific governing law, and where the CISG is not in force in the United States, the default rules of the Uniform Commercial Code (the "U.C.C.") would be applied. Therefore, this article compares the efficiency of the CISG's default rules against the U.C.C. default rules that would be applied if the CISG was not in force.

Finally, this article concludes that (a) pursuant to the *Medellin* decision, the CISG is a self-executing treaty and is in force as such in the United States today, and (b) even when compared to the U.C.C. default rules hypothetically applicable to international sales of goods in the absence of the CISG, the CISG is economically efficient and beneficial for U.S. businesses.

I. MEDELLIN AND SELF-EXECUTION

Because the CISG has been assumed to be self-executing by nearly all U.S. courts and commentators,¹³ any ruling on the definition and understanding of "self-executing" has the potential to have an enormous impact on the CISG. Therefore, the *Medellin* analysis of "self-execution" must be studied in order to reveal whether or not the CISG ever was, or is now, self-executing.

At first glance, the *Medellin* majority's opinion seems to never clearly state that a treaty requires an actual statement within the treaty, explicitly declaring the treaty to be "self-executing."¹⁴ However, ambiguity is inserted into the analysis by the dissent's misreading of the majority's statement that a treaty must "convey an intention" to be self-executing.¹⁵ In coming to the conclusion that a treaty must convey an intention to be self-executing, the majority cites *Igartua-De La Rosa v. United States*.¹⁶ However, the court in *Igartua* is presumably the first court to make the leap from the original understanding of the Supreme Court that the language itself must "act directly

¹³ See Kelly, *supra* note 6.

¹⁴ *Medellin v. Texas*, 128 S. Ct. 1346, 1356 (2008) (holding that in order to be self-executing a treaty need only convey an intention to be so).

¹⁵ *Id.*

¹⁶ *Id.*

on the subject [of the treaty],”¹⁷ to the understanding that a treaty must “convey an intention” to be self-executing.¹⁸ This seems to show that the dissent’s theory that the Court’s opinion requires explicit language in the text acting directly on the subject¹⁹ could be logically and interpretively correct.

The interpretation of this major part of the majority’s opinion turns completely on the understanding of the word “convey.” Since in this context the word “convey” is not a legal term of art, the plain meaning of the word can be derived from its standard definition.²⁰ Merriam-Webster defines “convey” as meaning “to impart or communicate by statement, suggestion, gesture, or appearance.”²¹ Therefore a “conveyed” intention need not be explicit in a text in order to be present; to be a conveyed intention, that intention may be implied.²²

Of course, the *Medellin* majority’s standard is the new precedent to be followed by all future courts. However, the majority’s and dissent’s divergent opinions on the proper interpretation of the majority’s standard is a source of ambiguity and, when applied in the future, could lead to completely opposite outcomes. Therefore, these two questions must be analyzed in order to properly understand the implications the *Medellin* majority’s standard will have on the CISG: Does the CISG language convey an intention that the treaty is self-executing (a) pursuant to the majority’s own characterization of its standard, and (b) pursuant to the dissent’s understanding of the majority’s standard?

A. Is the CISG Self-Executing under the Majority’s Own Interpretation of Its Standard?

The CISG is self-executing under the majority’s own interpretation of its expressed standard. After emphatically stating that the treaty language itself is of the utmost importance in interpreting the nature of a treaty,²³ the majority goes on to state that neither its cases nor its standard requires a “talismatic”

¹⁷ *Foster v. Nielson*, 27 U.S. 253, 314-15 (1829).

¹⁸ *Igartua-De La Rosa v. U.S.*, 417 F.3d 145, 150 (1st Cir. 2005) (improperly citing *Foster v. Nielson* for the contention that in order for a treaty to be self-executing, it must convey an intention to be so).

¹⁹ See *Medellin*, 128 S. Ct. at 1380 (“[T]oday’s majority looks for language about ‘self-execution’ in the treaty itself, and . . . it erects ‘clear statement’ presumptions . . .”).

²⁰ No law dictionaries include a definition for the word “convey” as it is used in this context.

²¹ <http://www.merriam-webster.com/dictionary/convey>.

²² “Imply” being a synonym for “Suggest.” See <http://www.merriam-webster.com/dictionary/suggesting>.

²³ *Medellin*, 128 S. Ct. at 1356-57.

word in the text in order for a treaty to be found to be self-executing.²⁴ The majority's explanation of its own standard (and its refutation of the dissent's interpretation of its standard) shows that the language of the treaty must convey an intent to be self-executing, but that it must not necessarily do so explicitly.²⁵ The majority's opinion, when understood on its own terms (as even the dissent points out),²⁶ considers numerous treaties to be self-executing even when they lack specific and explicit language on the matter of self-execution.²⁷ In the words of the majority, "[W]e have held treaties to be self-executing when the textual provisions *indicate* that the President and Senate *intended* for the agreement to have domestic effect."²⁸ The majority also states that it will look secondarily to the negotiation and drafting history of the treaty, and to the post-ratification understanding of the treaty.²⁹

Therefore, in order to determine if the CISG is self-executing, the analysis must start with an examination of the text of the CISG in order to determine whether it contains provisions indicating its drafters intended for the agreement to have immediate domestic effect and to be self-executing.

There are only two specific sections in the CISG which could be understood to speak to the issue of the CISG's self-executing status: the preamble and article 99(2).

The Preamble

The preamble of the CISG broadly states the purposes, objectives, and goals of the treaty.³⁰ However, attempting to find language in the preamble of the CISG that would be dispositive to proving that the CISG is self-executing is problematic because the preamble does not contain the oft-used phrases that tend to prove either self-execution or non-self-execution, such as "the states may" or "the states shall" or "the states will undertake to."³¹ The preamble merely states that "the States Parties to this Convention . . . Have Agreed as follows."³² This statement is ambiguous and can be interpreted to mean that the

²⁴ *Id.* at 1366.

²⁵ *Id.*

²⁶ *Id.* at 1381 ("Indeed, the majority does not point to a single ratified United States treaty that contains the kind of 'clea[r]' or 'plai[n]' textual indication for which the majority searches.")

²⁷ *Id.* at 1363, 1368.

²⁸ *Id.* at 1364 (emphasis added).

²⁹ *Id.* at 1357.

³⁰ CISG, *supra* note 1.

³¹ *See id.* at 1358-59 (discussing interpretations of "must" and "shall," and "undertake" in a larger discussion of Article 94 of the UN Charter).

³² CISG, *supra* note 1.

states agree to execute the convention and make it part of their domestic law, or, conversely, that the states agree that upon ratification the convention is immediately in force as law. Unfortunately, the preamble does not provide any interpretive guidance because it does not contain any language that the treaty conveys, either explicitly or implicitly, an intention to be self-executing.

Article 99(2)

Article 99(2) addresses when and how the CISG comes into force for each state. It reads:

When a State ratifies, accepts, approves or accedes to this Convention after the deposit of the tenth instrument of ratification, acceptance, approval or accession, this Convention, with the exception of the Part excluded, enters into force in respect of that State, subject to the provisions of paragraph (6) of this article, on the first day of the month following the expiration of twelve months after the date of the deposit of its instrument of ratification, acceptance, approval or accession.³³

Article 99(2) could be read to assert that after the deposit of the instrument of ratification, acceptance, approval, or accession, the CISG will “come into force.” If construed this way, it would necessarily follow that the CISG was meant to be self-executing for each state where the CISG was ratified, accepted, approved, or accessed, after the tenth state ratifies the convention.³⁴

However, Article 99(2) must be read in light of the relevant passage in Article 7 of the CISG. Article 7 states that “[i]n the Interpretation of this Convention, regard is to be had to its international character.”³⁵ Reading Article 99(2) within the context of Article 7 could be interpreted to implicitly mean that the drafters of the CISG understood that, because the CISG is a multilateral international treaty, all signatory states have multiple and varying ways of bringing a treaty into force as domestic law within their own legal system.³⁶

³³ *Id.*

³⁴ Posting of Antonin I. Pribetic, http://lawprofessors.typepad.com/contractsprof_blog/2008/04/medellin-and--1.html (April 9, 2008, 12:42:54 EST).

³⁵ CISG, *supra* note 1, art. 99.

³⁶ *Id.*

The listing of the four options—ratification, acceptance, approval, accession—could be meant to imply that the convention comes into force with respect to that state *only* after the treaty is also approved in that state’s own unique way.³⁷ However, the very ambiguity of this section, and the equal possibility that the section could be construed either way, proves that the section does not meet the Court’s requirement that a treaty provision either explicitly or implicitly convey an intention to be self-executing.

The clear ambiguities within the only two sections that could possibly speak to the issue of self-execution means that, pursuant to the majority’s opinion, recourse must be had to the “secondary” interpretive tools: the drafting history and the post-ratification understandings of the treaty.³⁸

Recourse to the drafting history can be quickly discarded as an interpretive tool. A thorough search of the drafting history reveals no interpretive guidance for determining whether or not the CISG is self-executing.³⁹ Therefore, according to the majority’s opinion, the only tool left to determine whether the CISG is self-executing is the U.S. government’s post-ratification understanding of the CISG.⁴⁰

It seems significant that in the “Message from the President of the United States to the Senate about the United Nations Convention on Contracts for the International Sale of Goods,” the President stated that, “[t]he Convention is subject to ratification by signatory States (Article 91(2)), but is self-executing

³⁷ For example, no one would make the argument that the CISG cannot come into force within a state if that state signs the CISG and its local rules do not have procedures equivalent to the four listed. If that state had its own procedures for bringing the CISG into force, the CISG would be considered in force in that state once those procedural requirements are satisfied *regardless* of the fact that the state’s procedures do not fit exactly into one of the four categories listed in Article 99(2).

³⁸ *Medellin v. Texas*, 128 S. Ct. 1346, 1357 (2008) (“Because a treaty ratified by the United States is ‘an agreement among sovereign powers,’ we have also considered as ‘aids to interpretation’ the negotiation and drafting history of the treaty as well as ‘the postratification understanding’ of signatory nations.”).

³⁹ See generally United Nations Conference on Contracts for the International Sale of Goods, Vienna 10 March - April 11 1980: Official Records, Documents of the Conference and Summary Records of the Plenary Meetings and of the Meetings of the Main Committees JX1977 .A2 A/CONF. 97/19 (New York: United Nations, 1981); JOHN O. HONNOLD, DOCUMENTARY HISTORY OF THE UNIFORM LAW FOR INTERNATIONAL SALES (Deventer, Netherlands: Kluwer, 1989).

⁴⁰ Technically, the Court requires an examination of the “post-ratification understanding of signatory nations.” See *Medellin*, 128 S. Ct. at 1357. However, the post-ratification understandings of signatory nations *other than* the United States are unhelpful in providing any guidance for whether or not the U.S.’s domestic legal system considers the CISG self-executing or non-self-executing. Therefore, the U.S. government’s post-ratification understanding of the CISG’s executory status is the only signatory nation’s understanding that is relevant in this particular context.

and this requires no federal implementing legislation to come into force throughout the United States.”⁴¹ While this does not fit neatly into the category of a “post-ratification understanding,” it clearly conveys the intention of the President and the Senate for the treaty to be self-executing.⁴²

The President’s statement on the CISG’s self-executing status, the Senate’s ratification of the CISG with full knowledge that the President understands the CISG to be self-executing, and the ambiguous nature of the preamble and Article 99(2) that *could* point to the self-executing nature of the treaty, all act as strong evidence that the CISG will still be considered self-executing pursuant to the *Medellin* majority’s interpretation of its own standard.⁴³

B. Is the CISG Self-Executing According to the Dissent’s Interpretation of the Court’s Standard?

The *Medellin* dissent interprets the Court’s holding to mean that the treaty language itself must explicitly state an intention to be self-executing in order for the treaty to be considered self-executing.⁴⁴ Thus, because it has been shown that the language of the CISG does not explicitly convey any intention to be self-executing, the dissent’s interpretation of the majority’s standard would render the CISG non-self-executing.⁴⁵

⁴¹ Message from the President of the United States to the Senate Transmitting the United Nations Convention on Contracts for the International Sale of Goods, Sept. 21, 1983, S. Treaty Doc. No.98-9 (1983). See also Posting of Jeremy Telman to Contracts Law Prof Blog: *Medellin* and the CISG, http://lawprofessors.typepad.com/contractsprof_blog/2008/03/medellin-and-th.html (Mar. 26, 2008).

⁴² See *Medellin*, 128 S. Ct. at 1367 (implying that the intention of the President and the Senate is dispositive of the nature of the treaties executory status. See also John D. Gregory, *Implementing the Electronic Communications Convention: Ratification Isn't What It Used to Be*, 18-FEB BUS. L. TODAY 43.

⁴³ Contracts Law Prof Blog: *Medellin* and the CISG, http://lawprofessors.typepad.com/contractsprof_blog/2008/03/medellin-and-th.html (Mar. 26, 2008).

⁴⁴ *Medellin*, 128 S. Ct. at 1389 (noting the dissent’s understanding that the majority’s standard requires “explicit textual expression about self-execution” in order for a treaty to be considered self-executing).

⁴⁵ *Id.* at 1383-84 (Breyer, J., dissenting) (expressing fear that the Court’s holding would undermine multiple important international treaties that, until the *Medellin* decision, were considered self-executing).

C. The CISG Is Self-Executing

It is clear from an examination of the *Medellin* majority's and the *Medellin* dissent's different interpretations of the majority's holding, that under the majority's interpretation the CISG would be considered self-executing, while under the dissent's interpretation the CISG would be considered non-self-executing. Had the majority merely stated its holding without addressing the *proper interpretation* of its holding, the dissent's analysis would most likely have had a very significant effect on future applications of *Medellin*. However, because the majority explicitly addressed how its holding should be understood and applied, the majority's explanations on the proper application of its own holding will very likely be the dominant analysis used by U.S. courts in future cases involving treaties and the determination of their status as self-executing or non-self-executing. Thus, future courts properly applying the majority's standard must necessarily understand the CISG to be self-executing. Pursuant to the Court's holding in *Medellin v. Texas*, the CISG is a self-executing treaty in full-force in the United States today.

II. THE BENEFITS OF THE CISG: AN ECONOMIC ANALYSIS

The economic analysis of law provides a system to study the efficiency of the law.⁴⁶ Economists define an efficient transaction as one in which at least one person is made better off while no one is made worse off.⁴⁷

In his article, "The Problems of Social Cost," Ronald Coase argues that, regardless of the initial assignments of property rights, the freedom of contract will efficiently distribute property rights to the owner who most values them.⁴⁸ Known popularly as the Coase Theorem, Ronald Coase's theory

⁴⁶ See RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 1-10 (2007).

⁴⁷ This kind of efficient transaction, where at least one person is made better off and no person is made worse off is called "Pareto-superior efficiency" or "Pareto efficiency." See *id.* Many economists, finding the pareto-superior concept too strict and unrealistic, use a concept of efficiency where a transaction is efficient if at least one person is made better off and the people who are made worse off actually are *or theoretically could be* compensated from the ones made better off. This kind of efficiency is called "Kaldor-Hicks efficiency" or "potential Pareto efficiency." See Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 *YALE L.J.* 1211, 1221-22 (1991) ("[A] move is efficient whenever the winners win more than the losers lose, in the sense that, if the winners compensated the losers to their satisfaction, the winners would still be better off than they were before the change . . . This test is sometimes called potential Pareto superiority . . ."). Regardless of which concept of efficiency is used, it is economically true and logically intuitive that a transaction making at least one person better off while not making any people significantly worse off is a beneficial and "good" transaction.

⁴⁸ Ronald Coase, *The Problem of Social Cost*, *J. L. & ECON.* (1962). Dr. Coase explains that, in a

hypothesizes that these property rights will be allocated in this efficient way when the parties come together and make contracts. Therefore, many economists have argued that the entire point of the laws of contracts should be to decrease ex-ante⁴⁹ transaction costs which would discourage the act of contracting, in order to efficiently allocate property rights to their most valued and most valuable use.⁵⁰ In order to decrease these transaction costs, economists have advocated enacting laws that would mimic “what the parties would have wanted” had they actually bargained for the specific provision and possessed full information.⁵¹ These economists have argued that these “majoritarian rules”⁵² would allow the majority of parties to spend less money negotiating these provisions in their own private transactions.⁵³

However, in 1989, law scholar Ian Ayres and economist Robert Gertner outlined a groundbreaking theory arguing that there is another important goal of contractual rules when those rules are “default rules” as opposed to “immutable rules.”⁵⁴

Immutable contract rules, such as the restriction against contractual provisions disclaiming obligations of good faith or care,⁵⁵ are rules from which there can be no derogation.⁵⁶ Parties cannot vary these rules by contract, and

world where there are no transaction costs, the person who puts the most value in something will pay for the opportunity to have that thing that he or she values.

⁴⁹ “Ex-ante” is an economics term meaning “before the transaction.” Its corollary term is “ex-post” meaning “after the transaction.” See Online Glossary of Research Economics: Ex-ante, <http://www.econterms.com/glossary.cgi?query=ex-ante>; Online Glossary of Research Economics: Ex-post, <http://www.econterms.com/glossary.cgi?query=ex-post>.

⁵⁰ Cuniberti, *supra* note 7. Cuniberti analyzes the CISG’s ability to reduce transaction costs and concludes that the CISG is not efficient from a Law and Economics perspective.

⁵¹ Full information merely means the full amount of information relevant and related to the particular transaction at issue. See generally Frank H. Easterbrook & David R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1410 (1989) (proposing a general theory on the economic efficiency of default rules that mimic what the parties in a transaction would have chosen with “full information and costless contracting.”).

⁵² “Majoritarian rules” is the economics phrase encompassing the concept of contractual rules and laws that mimic what “most parties would have wanted had they actually negotiated the provision.” See CASS R. SUNSTEIN, *BEHAVIORAL LAW AND ECONOMICS* 139 (illustrated ed., Cambridge Univ. Press 2000).

⁵³ See Easterbrook & Fischel, *supra* note 51.

⁵⁴ Ian Ayres and Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989).

⁵⁵ See U.C.C. § 1-302(b) (1978) (“The obligations of good faith, diligence, reasonableness, and care . . . may not be disclaimed by agreement.”). See also Restatement (Second) of Contracts § 205 (“Every contract imposes upon each party a duty of good faith and fair dealing in its performance and enforcement.”) (emphasis added).

⁵⁶ See Ayres & Gertner, *supra* note 54, at 88 (“Immutable rules cannot be contracted around.”).

any contractual provision that runs counter to these immutable rules will not be enforced.⁵⁷ Because today's free-market society is based on the freedom of individuals to make bilateral and multilateral exchanges through bargaining,⁵⁸ and immutable rules necessarily restrict this freedom, the overwhelming majority of contemporary rules of contract are "default rules."⁵⁹

Default rules are contract laws that will be applied in the absence of a contractual provision to the contrary.⁶⁰ However, when the parties include a provision in a contract that derogates from the default rule, the contractual provision prevails as the "private law" between the parties.⁶¹

Ian Ayres's and Robert Gertner's 1989 theory, known popularly as the Ayres-Gertner Model, argues that while all immutable rules and some default rules should be majoritarian, there are other defaults that should be designed to induce at least one party to a contract to "draft around" the default rule, in order to openly clarify the parties' preferences in the transaction.⁶² Furthermore, they argue that the goal of default rules should not *solely* be to lower transaction costs, because transactions costs are not the only impediments to complete contracts.⁶³

The following section will first explore the different goals of default rules. It will then apply these goals to five of the most important concepts/provisions in contract analysis, in order to determine whether these rules are (1) majoritarian defaults or penalty defaults, and (2) economically efficient or economically inefficient.

A. Transaction Cost Reducing Defaults

When two parties make a contract in a commercial transaction, their ultimate goal is to make a deal that will result in benefits for both parties. In a perfect world, the two parties would have the ability to come together and quickly make a deal without spending any significant amount of time, money, or resources. In that perfect world, the contract would cover every possible contingency, so that any litigation arising from a breach of the contract would

⁵⁷ *See id.* ("[Immutable rules] govern even if the parties attempt to contract around them.").

⁵⁸ E. ALLAN FARNSWORTH, *CONTRACTS* 5 (Aspen Publishers 2004) (noting that exchange in the "mainspring" of our economic system of free enterprise).

⁵⁹ *Id.* at 37 ("[T]he great bulk of the general rules of contract law, including those of the Uniform Commercial Code and the Vienna Convention [the CISG], are subject to contrary provision by the parties.").

⁶⁰ Ayres & Gertner, *supra* note 54, at 87.

⁶¹ *Id.*

⁶² *Id.* at 92-93.

⁶³ *Id.*

be instantaneously solvable by reference to the pertinent provision in the contract. Moreover, because every provision of the contract is both “obligationally complete” and “contingently complete,” the publicly subsidized court system would have little involvement, and thus the contract would impose the bare minimum amount of social costs⁶⁴ onto the taxpayers.⁶⁵

However, in the real world, valuable amounts of time, money, and resources are spent in the simple act of drafting and completing a contract. These transaction costs, including ex-ante legal fees, can become so large that they deter parties from spending much, if any, time properly drafting and negotiating the contract provisions covering the rights, duties, obligations, and legal exigencies involved in the business deal.⁶⁶ This, in turn, can result in even greater costs for both the parties and society as the courts spend large amounts of time and money determining an equitable and efficient outcome of litigation in which a party breaches a provision of an incomplete contract.

Therefore, in order to get closer to the “perfect world” of complete contracts, lawmakers have enacted gap-filling default rules tailored to what the majority of parties “would have wanted” had they actually spent time negotiating those particular provisions.⁶⁷ These “majoritarian” default rules have the benefit of reducing transaction costs by bestowing on the parties the benefit of these rules as if they had bargained for them, without requiring the parties to expend the large amount of money, time, or effort that is typically needed to get these provisions memorialized into the deal. However, more recent scholarship has shown that transaction costs are not the only issues lawmakers should be concerned with when drafting default gap-fillers.

⁶⁴ “Social Costs” is an economics term referring to the overall cost of an economic activity on the welfare of society. See Online Glossary of Research Economics: Social Costs, <http://www.economist.com/research/economics/alphabetic.cfm?letter=S#socialbenefitscosts>. In the context of this article, the generally referred to social costs are mainly the citizen tax-dollars spent on maintaining and operating the justice system.

⁶⁵ “Obligationally Incomplete” is a law and economics term referring to “contracts in which [all] the obligations are not fully specified.” See Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 730 (1992). “Contingently Incomplete” is an economics term referring to “contracts that fail to fully realize the potential gains from trade in all states of the world.” See *id.*

⁶⁶ Transaction costs can include any costs that are associated with the deal making process (including the contract drafting) before the signing of the contract. These costs can include, but are not limited to, lawyer’s fees, time-value, and human resources and their associated expenses.

⁶⁷ Ayres & Gertner, *supra* note 54.

B. Information Forcing Defaults

Since the early 1990's, law and economics scholars have focused more of their attention on the importance of default rules that do exactly the opposite of "what the parties would have wanted" had they bargained for the rule.⁶⁸ These default rules are structured in such a way that the parties will be forced to "contract around" the default rules in order to avoid being penalized by the harsh results of the rule.⁶⁹

For example, assume A is a manufacturer and seller of widgets and B is a purchaser of these widgets. Further assume that a contract for the sale of 100 widgets is negotiated between A and B, but they fail to specify a price for the widgets in the contract. In subsequent litigation over a breach in the contract, the court would easily be able to determine a "reasonable" price for the widgets "that the parties would have wanted" by looking to the market price of widgets at the time that the contract was concluded.

However, assume instead that the contract included a provision specifying that B agreed to buy widgets from A for the price of \$1.00 per widget, but the parties failed to include in the contract the number of widgets to be purchased. In subsequent litigation, how would the court determine the quantity of widgets that both parties would have wanted had they bargained for the amount in the contract?⁷⁰ There is no equivalent to "market value" when it comes to determining quantities. Therefore, having no default rule at all in these circumstances would be inefficient for the parties, and a "majoritarian" default rule would be both impossible and inefficient. In this situation, the most efficient solution for the parties involved, and for society at large, would be a default rule that is so harsh it would stand out and force the parties to take notice and provide the relevant and necessary information by contracting around the rule in order to avoid the harsh results of the default rule.⁷¹

The CISG, as mentioned above, is made up almost entirely of default rules.⁷² There is no indication in the legislative history as to whether or not the

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ At the very least, the subsequent litigation would require hours, if not days, of testimonial and physical evidence of what the parties claim they contracted for, common business practices, and past business arrangements between the parties.

⁷¹ Ayres & Gertner, *supra* note 54.

⁷² The only mandatory rules of the CISG are found in Article 12. CISG, *supra* note 1, art. 12 ("Any provision of article 11, article 29 or Part II of this Convention that allows a contract of sale or its modification or termination by agreement or any offer, acceptance or other indication of intention to be made in any form other than in writing does not apply where any party has his place of business in a Contracting State which has made a declaration under article 96 of this Convention. The parties

rules were drafted using only the majoritarian standard or if the drafters took into account the equal importance of penalty default rules.⁷³ The legislative history gives no guidance to determine whether or not the CISG drafters even took efficiency into account when drafting the CISG. However, there *is* a method to determine general efficiency of the CISG as a whole. This method requires a comparison of the CISG and the U.C.C.

The U.C.C. is the standard set of (mostly) default rules applied for all commercial sales transactions in the United States.⁷⁴ When the CISG is not applicable to commercial sales transactions in goods, U.S. courts generally apply the U.C.C.⁷⁵ An examination of the efficiency of five of the most important contract rules,⁷⁶ and a comparison of how the CISG and U.C.C. apply these rules can be used to determine whether or not the CISG is more or less efficient than the CISG. Therefore, if the U.C.C. is determined to be more efficient and beneficial for U.S. businesses, the CISG would necessarily be inefficient for, and detrimental to, U.S. businesses.

The Statute of Frauds

The first statute of frauds was enacted in England in 1676 for the purpose of preventing fraud in contractual dealings.⁷⁷ The English original, and its American common-law progeny, traditionally required that any contract, in order to be enforced in a court of law, must be memorialized in writing.⁷⁸ The

may not derogate from or vary the effect of this article.”).

⁷³ Most likely, if the drafters of the CISG even took economic efficiency into account, they applied the majoritarian approach to the CISG's default rules. The CISG was drafted throughout the late 1970's, when the majoritarian approach was the dominant view and the Ayres-Gertner model on penalty defaults was not yet published.

⁷⁴ See FARNSWORTH, *supra* note 58, at 33, 37 (noting that Article II of the U.C.C. is generally applied to all domestic sales transactions in goods and is made up of mostly default rules).

⁷⁵ Before 1988, US businesses engaged in international sales transactions in goods were generally still subject to the U.C.C. This would have continued to be the case were the CISG not in force in the United States. See *id.* at 33-35 (noting that the U.C.C. generally applies to domestic sales transactions in goods, but the CISG generally displaces the U.C.C. for international sales transactions).

⁷⁶ These rules are the statute of frauds, the parol evidence rule, “foreseeability of damages” rules, price term rules, and quantity term rules.

⁷⁷ Language and Law: Statute of Frauds (1677), <http://www.languageandlaw.org/TEXTS/STATS/FRAUDS.HTM>.

⁷⁸ The original statute referred only to contracts in land, but modern statutes of frauds based on the English original have been applied to numerous other transactions, including contracts for the sale of goods. See generally JOSEPH M. PERILLO, CALAMARI AND PERILLO ON CONTRACTS, § 19.1 (5th ed. 2003) (explaining the general history of the Statute of Frauds and its relation to similar

statute of frauds does not fit perfectly into the model of “gap filling” defaults.⁷⁹ Its purpose is not to fill in a specific contract term that the parties left out of their negotiated contract. Rather, the purpose of the statute of frauds is to encourage parties to actually put their contracts in writing.⁸⁰

Clearly, the statute of frauds is not a majoritarian default. When parties come together to negotiate a deal, their logical preference is to have any deals made between them, including non-written ones, be enforceable in a court of law.⁸¹ Rendering a contract non-enforceable simply because it was not memorialized in writing is not “what the parties” would have wanted when they entered the deal. Quite the opposite, parties normally want all their contracts, regardless of their forms, to be enforced.

Therefore, the statute of frauds must operate as either an Ayres-Gertner model information forcing penalty default, or merely as an economically inefficient default rule. At first glance, it would seem as though the statute of frauds was the ideal version of a penalty default. It seems to operate in such a way that the penalty for failing to put contractual provisions in written form is a completely useless and unenforceable contract. Such a harsh consequence seems to force the parties to take notice and contract around the default by putting the provisions of the contract in writing.⁸² But a closer look at the

American statutes).

⁷⁹ Economist Eric Posner would most likely not consider the statute of frauds a contractual gap-filling default rule because the statute of frauds “does not fill a gap in an otherwise valid contract . . .” Eric A. Posner, *There Are No Penalty Default Rules in Contract Law*, 33 FLA. ST. U. L. REV. 563, 578 (2006) (explaining that only doctrines which fill gaps in otherwise valid contracts are “true” gap-filler default rules). *But see* Ian Ayres, *Ya-Huh: There Are and Should be Penalty Defaults*, 33 FLA. ST. U. L. REV. 589, 593 (2006) (“[I]f the operation of a rule is functionally equivalent to a default, it is both acceptable and advisable to analyze it as a default.”).

⁸⁰ This encouragement is formally known as the Statute of Fraud’s “evidentiary” and “cautionary” functions. *See* Monroe H. Freedman, *Contracts: An Introduction to Law and Lawyering* 338 (unpublished casebook, on file with author).

⁸¹ Otherwise, why make any contract in the first place? If people came together and negotiated contracts, without any expectation that the contracts would have the force of law behind them, their thinking would be rather similar to Charles Marlow in the novel *Heart of Darkness* when he says, “It occurred to me that my speech or my silence, indeed any action of mine, would be a mere futility.” JOSEPH CONRAD, *HEART OF DARKNESS* 66 (Penguin Classics 1995).

⁸² The statute of frauds in U.C.C. § 2-201 is actually rendered a default rule because it can be varied by agreement and contracted around pursuant to U.C.C. § 1-102(3). However, “contracting around” the statute of frauds default actually results in complying with the very rule one is attempting to contract around, since in order for there to be a written contract provision expressly not requiring the contract terms be written, it is assumed that there is an existing written contract to which this provision can be added, thus rendering the provision that “contracts around” the statute of frauds essentially pointless, and the attempt to “contract around” the statute of frauds in the traditional sense unintelligible.

language of the rule as found in the U.C.C. shows that the U.C.C.'s statute of frauds default rule⁸³ fails to force the parties into providing any useful information whatsoever. U.C.C. § 2-201(1) states:

Except as otherwise provided in this section a contract for the sale of goods for the price of \$500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties . . .⁸⁴

This provision proceeds to explain that the only term that need be written in order to satisfy the U.C.C.'s statute of frauds is the quantity of goods.⁸⁵ The official comments further elaborate that the writing need only "afford a basis for believing that the offered oral evidence rests on a real transaction."⁸⁶ Even an indication of which party is the buyer and which party is the seller is not needed to satisfy U.C.C. § 2-201(1).⁸⁷

At the expense of raising ex-ante transaction costs,⁸⁸ penalty defaults are meant to force the parties to provide *important and significant* information that would lower the otherwise high ex-post litigation costs for both the parties and the publicly subsidized court system.⁸⁹ But the statute of frauds fails to force the parties to provide any important information whatsoever.⁹⁰ The terms of all traditional and modern statutes of frauds, and more specifically, the U.C.C.'s typical version of the statute, allows a valid contract be so informal

⁸³ The U.C.C. statute of frauds is supplemented by common law understandings and legal concepts related to the U.C.C. provision at issue, including the common law analysis of the statute of frauds. See U.C.C. § 1-103 (1978) ("Unless displaced by the particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions.")

⁸⁴ U.C.C. § 2-201 (1978).

⁸⁵ *Id.* ("A writing is not insufficient because it omits or incorrectly states a term agreed upon but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.")

⁸⁶ U.C.C. § 2-201, Official Comment 1 (1978) (commenting that even a contract "written in lead pencil on a scratch pad" may satisfy the statute of frauds).

⁸⁷ *Id.*

⁸⁸ Michael Braunstein, *Remedy, Reason, and the Statute of Frauds: A Critical Economic Analysis*, 1989 UTAH L. REV. 383, 426 n.154 (1989) ("Certainly, to the extent that a writing requirement raises transaction costs it will make some contracts too expensive to be worthwhile.")

⁸⁹ Of course, the "social costs" would be significantly lowered if all contractual litigation were settled by private court systems funded by the litigants themselves. However, in the current system of a publicly subsidized judicial system used for litigating contract disputes, the social costs of litigation are of primary importance in any economic analysis of laws and default rules.

⁹⁰ The sole exception being the quantity, discussed *infra*.

and incomplete that it is ineffectual at both preventing fraud (its original justification)⁹¹ and providing any of the information that would lower ex-post litigation costs. The actual result of the statute of frauds is higher transaction costs for the parties with no significant decrease in ex-post litigation costs or social costs. The statute of frauds as used in the U.C.C. is at best superfluous, and at worst, an inefficient default rule.

The CISG expressly rejects any version of the statute of frauds.⁹² Article 11 of the CISG states, “A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form.”⁹³ This language stands in stark contrast to the U.C.C.’s insistence that a contract be evidenced in at least “some kind” of writing.⁹⁴ The CISG’s rejection of the statute of frauds in its entirety is completely consistent with efficiently reducing transaction costs for the parties while recognizing that unless *every* provision of a contract is required to be in writing, the statute of frauds increases ex-ante transaction costs without reducing any of the ex-post court costs or litigation costs. The CISG’s rejection of the statute of frauds default is economically efficient for U.S. businesses engaged in international transactions.

The Parol Evidence Rule

The parol evidence rule requires that *if* the parties put all or part of their agreement in writing, they may not contradict the terms of the written agreement with evidence from either a prior oral or written agreement, or an oral agreement made contemporaneous with the signing of the written agreement.⁹⁵ The parol evidence rule is similar to the statute of frauds in that they are both provisions dealing with writings in general, however unlike the statute of frauds, the parol evidence rule is properly categorized as a classical example of a majoritarian default.

If parties to a contract were to invest all the ex-ante transaction costs involved in sitting down and memorializing their contract in writing, it would be illogical to assume that “what they want” is the ability of the contract to be contradicted by other outside agreements made before or contemporaneous to the signing of the written agreement. Even if the written agreement is of the most minimalistic type, there is no reason to believe that the parties would want the few provisions that they incurred transaction costs in drafting to be easily

⁹¹ Braunstein, *supra* note 88, at 426.

⁹² CISG, *supra* note 1, art. 11.

⁹³ *Id.*

⁹⁴ See U.C.C. § 2-201 (1978).

⁹⁵ Freedman, *supra* note 80, at 532.

contradicted.⁹⁶ Instead, the parol evidence rule gives the parties the benefit of their contract term's definiteness without requiring the parties to actually incur the transaction costs of negotiating and drafting this type of provision into the contract itself.

The U.C.C.'s version of the parol evidence rule⁹⁷ allows for a written agreement to be explained or supplemented by evidence of *consistent additional* terms agreed to prior, contemporaneous, or after the signing of the written contract.⁹⁸ The U.C.C.'s inclusion of these exceptions makes the rule a reliable and efficient majoritarian default.⁹⁹

Despite its proven utility, the CISG rejects the parol evidence rule.¹⁰⁰ Article 11 of the CISG states that "[a] contract . . . may be proved by any means, including witnesses."¹⁰¹ As opposed to its economically efficient

⁹⁶ For example, if the parties drafted a contract containing only a provision specifying the quantity of goods to be sold, there is no reason to believe that these parties would want this one written term to be so amorphous that it could be directly contradicted by some other agreement written prior (or some other oral agreement made contemporaneous) to the signing of "one-provision" contract. To the contrary, if the parties made the conscious decision that the transaction costs were worth the benefits to memorializing this one specific provision in the written contract, it would be irrational to assume that any person would want the benefits of those incurred transaction costs easily erased by simply presenting evidence of another agreement. The very act of their agreeing to memorialize the term in the first place, negates the possibility that either party did not *actually* want that term to be the true evidence of their agreement.

⁹⁷ U.C.C. § 2-202 (1978).

⁹⁸ If the Court finds evidence that the parties intended the writing to have been a complete and exclusive statement of the terms of the agreement, no extrinsic evidence will be allowed to explain or supplement the contract. U.C.C. § 2-202(b). This provision is majoritarian in that it requires the court to look to what the parties wanted or would have wanted in the situation.

⁹⁹ For example, assume that A is a seller and B is a buyer of widgets. A and B write a contract stating that A will sell B 10 widgets for \$1.00 each. Further assume that A sells and B buys many different types and kinds of widgets. In subsequent litigation, assume that A wants to present evidence of another written agreement made between A and B prior to the signing of the written contract for the sale of widgets. This agreement defines what type of widgets A and B are contracting for, and without this writing, the definition of "widgets" is unexplained and unambiguous. Pursuant to the U.C.C.'s exceptions to the parol evidence rule, most courts would allow this prior written agreement to "explain and supplement" the ambiguous written contract. However, assume that instead of a written agreement defining "widgets," A wants to present a prior written agreement as evidence that "widget" in the contract actually meant "banana." This prior written agreement directly contradicts the exact provision that the parties spent time and effort negotiating. Therefore, pursuant to the U.C.C.'s parol evidence rule and consistent with economically efficient majoritarian default rules, most courts would not allow into evidence this prior written agreement contradicting a written provision of the contract.

¹⁰⁰ CISG, *supra* note 1, art. 11.

¹⁰¹ *Id.*

exclusion of the statute of frauds,¹⁰² the CISG excludes a classic majoritarian rule which reduces both the ex-ante transaction costs of the parties, and the ex-post litigation costs to the parties and society. The CISG inefficiently rejects an economically efficient default in the form of the parol evidence rule.

Foreseeability of Damages

Ian Ayres and Robert Gertner first pointed out in their article, "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules," that the limiting of consequential damages to only damages "that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made,"¹⁰³ operates as an information forcing penalty default, not as a classic majoritarian default.¹⁰⁴ The *Hadley* default is a purposeful inducement for the more informed party to reveal the information about possible consequential damages to the party that could most efficiently prevent these damages at a lower cost (the "least-cost avoider").¹⁰⁵ While this article cannot give a detailed explanation of the intricate and complicated game-theory analysis¹⁰⁶ done on the *Hadley* rule by Ayres and Gertner, and other economic game-theorists, Ayres and Gertner's eventual conclusion is that the *Hadley* rule limiting recovery only to foreseeable damages operates as an information forcing penalty default.¹⁰⁷

¹⁰² Ironically, the CISG's economically efficient rejection of the statute of frauds and its economically inefficient rejection of the parol evidence rule are contained within the same exact provision. *See id.*

¹⁰³ *See* Restatement (Second) of Contracts § 351(1). The U.C.C. applies the Restatement's understanding of "foreseeability." *See also* FARNSWORTH, *supra* note 58, at 795 ("[T]he loss need only have been foreseeable as a probable . . . result of the breach.")

¹⁰⁴ *See* Ayres & Gertner, *supra* note 54, at 101 ("The *Hadley* default of denying unforeseeable damages may not be consistent with what fully informed parties would have wanted.")

¹⁰⁵ *Id.* ("In *Hadley* a miller in Gloucester contracted with a carrier to have a broken crank shaft transported to Greenwich. The shipment was delayed, and the miller sued the carrier for consequential damages of the profits lost while the mill was inoperative. The court, holding that only foreseeable consequential damages should be awarded, reversed a damage award and remanded for a new trial."). *See* Least Cost Avoider, <http://home.uchicago.edu/~jmellis/least%20cost%20avoider.html>.

¹⁰⁶ Game theory is a complex economical and mathematical technique for analyzing how parties should behave in certain strategic situations where certain parties may react in numerous different ways to other parties' actions. *See* Economist.com: Research Tools: Economics A-Z: Game Theory, <http://www.economist.com/research/economics/searchActionTerms.cfm?query=game+theory> (last visited April 08, 2009).

¹⁰⁷ Ayres & Gertner, *supra* note 54. *See also* Ian Ayres and Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 735 (1992) ("[T]he limitation on consequential damages [in *Hadley*] was a 'penalty' or 'information forcing' default

The U.C.C. and the CISG seem to apply the same *Hadley* standard limiting the recovery of consequential damages. However, a slight difference in the language of the CISG renders the actual meaning of the CISG completely different than both the U.C.C. and the *Hadley* rule.

Most courts and commentators agree that the U.C.C., in accord with the rule in *Hadley*¹⁰⁸ and the Restatement (Second) of Contracts,¹⁰⁹ requires that consequential damages are only recoverable when the breaching party had reason to know that the damages were “probable” to result from the breach.¹¹⁰ It has been assumed that CISG’s provision limiting consequential damages to only those that are foreseeable is also in accord with the *Hadley* rule.¹¹¹ However, Article 74 of the CISG reads:

Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract . . . as a *possible* consequence of the breach of contract.¹¹²

At first glance, this difference seems negligible. However, the difference between “probable” and “possible” has the potential to lead to extremely different results. Under the U.C.C.-*Hadley* rule, the party that is well-informed about future risks is induced to reveal that information to the party that can more efficiently prevent these future risks at a lower cost. Under this rule, the well-informed party is only required to reveal information about “probable” consequences and risks. Any losses caused by damages that have less than a 50% chance of being a consequence of the breach cannot be recovered.¹¹³

rule.”).

¹⁰⁸ *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng.Rep. 145 (1854) (“Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and . . . reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it.”).

¹⁰⁹ Restatement (Second) of Contracts § 351 (“Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.”).

¹¹⁰ FARNSWORTH, *supra* note 58, at 795-96.

¹¹¹ *Id.* at 796 n.21 (citing *Delchi v. Carrier SpA v. Rotorex Corp.*, 71 F.3d 1024 (2d Cir. 1995) (explaining that the CISG follows the foreseeability rules of *Hadley*)).

¹¹² CISG, *supra* note 1, art. 74 (emphasis added).

¹¹³ For example, assume that a manufacturer of widgets contracts with a carrier to transport the

However, under the CISG scheme, the well-informed party is required to reveal information about any “possible” consequences and risks.¹¹⁴ The inclusion of the word “possible,” as opposed to the word “probable,” introduces an entirely new foreseeability of damages concept that is entirely at odds with the traditional *Hadley* rule. Thus, under the CISG’s rule, only losses caused by damages that had absolutely no chance of being a consequence of the breach cannot be recovered.¹¹⁵ This rule effectively expands the transaction costs infinitely, since the well-informed party is encouraged to strategically inform the least-cost avoider of every possible consequence of every possible breach, so that the well-informed party can recover all the damages which the least-cost avoider had the knowledge or the reason to know of as being *possible* consequences of its breach. Thus, far from efficiently forcing a party with relevant information to give this information to the least-cost avoider, the CISG rule encourages a party with relevant information to exponentially increase transaction costs by negotiating for provisions covering an almost infinite amount of contingencies in the hope that the other party will breach and the well-informed party may recover an extremely large amount of consequential damages.

The CISG’s foreseeability rule *would* be efficient if it were consistently construed as being identical to the U.C.C.-*Hadley* rule. However, because of the CISG’s use of the word “possible” instead of “probable,” the CISG’s foreseeability rule induces the well-informed party to increase transaction costs.

widget factory’s main conveyor belt to a new factory that has no conveyor belt. Without this conveyor belt, the factory cannot make widgets. If the manufacturer informs the carrier that the factory would lose at least \$100 dollars for every day that the conveyor belt is late in getting to the factory and the carrier delivers the conveyor belt one day late than specified in the contract, the carrier will be liable for \$100 dollars because he knew or had reason to know that the delivering the conveyor belt one day late would probably result in the manufacturer losing of at least \$100 dollars.

¹¹⁴ CISG, *supra* note 1, art. 74.

¹¹⁵ Assume the same facts as in footnote 107. But in addition to the manufacturer’s probable loss of \$100 dollars for the one day delay, assume that the manufacturer also informed the carrier that for every day the conveyor belt is not delivered on time, the factory would lose \$1,000,000 because the factory was planning on using its’ earnings from the new factory in order to buy New York mega-millions lottery ticket. Although the carrier had reason to know that this could be a consequence of the breach, it is not a “probable” consequence of the breach, and thus under the U.C.C and *Hadley*, these losses would not be recoverable as consequential damages. However, because these losses are “possible” (even if the possibility is very slight), Article 74 of the CISG allows the manufacturer to recover these damages. See CISG, *supra* note 1, art. 74.

Price Terms

Price terms are considered to be one of the two most fundamental aspects of any contract.¹¹⁶ Therefore, any economic analysis of contractual default rules would be incomplete without an exploration of the rules' treatments of price terms.

U.C.C. § 594 reiterates that a contract may be validly concluded even if it does not contain a settled price term.¹¹⁷ The section goes on to state a classic majoritarian default rule: "In such a case [where a contract is concluded without settled price terms] the price is a reasonable price at the time for delivery. . . ."¹¹⁸ This default rule requires that when no price term is specified in a contract, the courts, in ex-post litigation, will supply a "reasonable term."¹¹⁹ Typically, this reasonable term will be based on market prices for the goods at the time that the contract was signed.¹²⁰ This rule operates as a majoritarian default because an overwhelming majority of self-interested parties would (and do) negotiate for the market price when buying or selling products.¹²¹ This rule eliminates the ex-ante transaction costs of complex negotiations for every price term detail. A reasonable price typically based on

¹¹⁶ The other being quantity terms, discussed *infra*. See Ayres & Gertner, *supra* note 54, at 594 ("Quantity and price are the two central terms of any contract.").

¹¹⁷ U.C.C. § 594(1) ("The parties if they so intend can conclude a contract for sale even though the price is not settled.").

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ Although it is asserted that "reasonable price" does not necessarily mean "fair-market value," U.S. courts will typically look to "prices charged by other sellers of similar products," which, when taken altogether and average, is the very definition of a "market price," in most situations. See generally 67 AM. JUR. 2D SALES § 280; *TCP Industries, Inc. v. Uniroyal, Inc.*, 661 F.2d 542 (6th Cir. 1981) (nothing that a reasonable price is not necessarily market value). In any case, the easily obtainable market value of the goods in the contract at issue provides a simple, low-cost, low-time method of determining the reasonable price of goods in a contract that does not specify the price term. See Ayres & Gertner, *supra* note 54, at 96 ("To estimate a reasonable price, courts can largely rely on market information . . ."); *Coltec Industries, Inc. v. Elliot Turbocharger Group Inc.*, Nos. CIV. A. 99-1400, 99-MC-36 1999 WL 695870, at *7 (E.D. Pa. Sept. 9, 1999) ("[U]nder ordinary circumstances the reasonable price will be the market price for particular merchandise.") (citing *Kuss Machine Tool & Die Co. v. El-Tronics*, 143 A.2d 38, 40 (Pa. 1958)).

¹²¹ This is not so much an "economic" assertion, as it is an *a priori* logical assumption about the rational decisions of economic actors and the very nature of the market. If the majority of parties negotiated for a price significantly lower or higher than a product's "market value," then the market value of those products would actually *become* that lower or higher price. Therefore, it logically follows that the price which a majority of parties bargain for is the almost always the "market value," and conversely that the "market value" is almost always the price which a majority of parties bargain for.

contemporaneous market pricing is not difficult to ascertain, meaning that this rule will not result in large *ex-post* litigation costs for the parties or the publicly subsidized court system.¹²² The U.C.C.'s "Open Price Term" majoritarian default rule is economically efficient.

Article 55 of the CISG contains an almost identical majoritarian default rule for contracts lacking price terms.¹²³ Article 55 states:

Where a contract has been validly concluded but does not expressly or implicitly fix or make provision for determining the price, the parties are considered . . . to have impliedly made reference to the price generally charged at the time of the conclusion of the contract for such goods sold under comparable circumstances in the trade concerned.¹²⁴

This language mirrors the U.C.C.'s "reasonable price" language, and, in practice, allows the court to supply the contract with a price term with the same market-value analysis as is used in these situations under the U.C.C. Thus, the CISG and the U.C.C. both remedy missing price terms with the same economically efficient majoritarian default rule.¹²⁵

Quantity Terms

Considering that quantity terms are considered equally as important to contracts as price terms, one would expect the default rules of quantity terms to be similar to those of price terms. However, neither the U.C.C. nor the CISG treat price and quantity terms in the same fashion.

U.C.C. § 2-201(1) has already been analyzed as a statute of frauds provision. This section also includes the U.C.C.'s default rule on missing quantity terms. It states, "[T]he contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing."¹²⁶ This rule operates in such a way that if the parties do not supply any quantity in their contract, the contract is unenforceable. As opposed to the price term default of a "reasonable price," the quantity term default is effectively zero."

¹²² In other words, this default rule results in low transaction costs and low social costs.

¹²³ CISG, *supra* note 1, art. 54.

¹²⁴ *Id.*

¹²⁵ See also Ayres & Gertner, *supra* note 54, at 96 ("The U.C.C.'s reasonable-price standard can be . . . reconciled with the received wisdom that defaults should be set at what the parties would have contracted for.").

¹²⁶ U.C.C. § 2-201(1) (1978).

Clearly this rule is not majoritarian. A majority of parties would not want to go to the trouble of contracting just to have their contract not enforced because their writing did not include express quantity terms.¹²⁷

This rule is, in fact, a classic example of a penalty default rule. When the parties fail to specify a quantity, they are effectively specifying the quantity as “zero.” Because the provision provides that the law will only enforce the contract insofar as the amount written in the contract, the failure to specify any amount results in the entire contract being rendered unenforceable. This harsh penalty causes the parties to take special care to contract around the rule and include quantity terms in all of their contracts for fear of the penalty default rendering their entire contract unenforceable.¹²⁸ The exorbitant ex-post costs of determining a “reasonable quantity” term to be supplied in the contract would render a majoritarian default economically inefficient. Therefore, the U.C.C.’s zero-quantity penalty default efficiently shifts the costs of determining the quantity to those who have the best information to make this determination at the lowest cost—the parties to the contract.¹²⁹

Article 14 of the CISG is clear when it precludes a valid contract from being formed (and thus enforced) when it does not include quantity terms.¹³⁰ Article 14 states that if no provision providing for quantity terms is supplied, there is no offer, and therefore, no valid contract is formed.¹³¹ The CISG does not provide a quantity term provision similar to the price term provision in Article 55. This results in the CISG’s Article 14 quantity default rule operating exactly like the zero-quantity penalty default in the U.C.C. by rendering contracts without quantity terms unenforceable under the CISG. Although less clear than their similarities in price term defaults, the CISG and the U.C.C. both contain functionally identical, economically efficient zero-quantity default rules.

¹²⁷ Ayres & Gertner, *supra* note 54, at 96 (“Obviously, the parties would not have gone to the expense of contracting with the intention that nothing be exchanged.”).

¹²⁸ *Id.* (“The zero-quantity rule can be justified because it is cheaper for the parties to establish the quantity term beforehand than for the courts to determine after the fact what the parties would have wanted.”).

¹²⁹ *Id.*

¹³⁰ CISG, *supra* note 1, art. 14.

¹³¹ *Id.* It may be argued that Article 14 also requires definite price terms, rendering invalid any contract allegedly formed after an offer without definite price term. However, Article 14 specifically states that the offer may “implicitly” fix terms for the quantity and price. Article 55 explains the seemingly cryptic idea of “implicit price terms,” when it states that a contract not specifying any price terms at all is assumed to have “impliedly made reference to the price generally charged at the time of the conclusion of the contract . . .” The CISG contains no analogous provision explaining “implicit quantity terms,” which most likely means that a complete lack of quantity terms renders an offer and the subsequent contract invalid.

C. The CISG Is Economically Efficient

After studying what are arguably the five most important contractual concepts/provisions, it is clear that the U.C.C. is economically efficient in its treatment of four out of the five provisions,¹³² and the CISG is economically efficient in its treatment of three out of the five provisions.¹³³ By themselves, the numbers seem to suggest that because the U.C.C. is the usual set of default rules applied to the sale of goods by U.S. businesses, and because the U.C.C. is slightly more efficient than the CISG, the CISG is undesirable. However, these numbers may be misleading. Had there been an extreme disparity between the amount of efficient provisions in the U.C.C. and the CISG, the answer would have been clear. But a more comprehensive analysis of the comparative importance between these five contract provisions/concepts could provide a better picture of the desirability of the CISG as compared to the U.C.C.¹³⁴

As it stands today, the fact that the CISG has only one less economically efficient provision than the U.C.C. can be seen as a testament of the CISG's ability to unify disparate legal systems under one common set of rules (which is an economically efficient accomplishment in itself). Therefore, it would ultimately seem that the CISG contains enough economic efficiency in its important provisions to render it a highly desirable set of default rules for U.S. businesses involved in the international sale of goods.

CONCLUSION

The Supreme Court's holding in *Medellin* made many legal scholars and jurists (including the *Medellin* dissent) fearful that numerous multi-lateral treaties in force in the United States would now be considered non-self-executing. The CISG is one of these treaties. After studying the *Medellin*

¹³² These four are the parol evidence rule, the foreseeability of damages rules, the price terms, and the quantity terms.

¹³³ These three are the statute of frauds, the price terms, and the quantity terms.

¹³⁴ Furthermore, it could be argued that the five provisions/concepts explored and analyzed in this study are not the only ones that should be characterized as the "most important contractual provisions/concepts." For examples see Catherine Piche, *The Convention on Contracts for the International Sale of Goods And the Uniform Commercial Code Remedies in Light of Remedial Principles Recognized Under U.S. Law: Are the Remedies of Granting Additional Time to the Defaulting Parties and of Reduction of Price Fair and Efficient Ones?*, 28 N.C. J. INT'L L. & COM. REG. 519 (2003) (discussing and comparing the efficiency of the perfect tender, fundamental breach, and *Nachfrist* rules in the U.C.C. and the CISG); Avery W. Katz, *Remedies for Breach of Contract Under the CISG*, 25 INT'L REV. L. & ECON. 378 (2006) (discussing the three main default remedial rules of the CISG).

majority's holding and its interpretations, it is clear that these scholars and jurists can rest easy with the knowledge that that the CISG is safely ensconced in our laws as a self-executing treaty. Even under the *Medellin* Court's new standard, the CISG is still considered self-executing, and is still the default rules applicable to U.S. businesses involved in the international sale of goods.

But do U.S. businesses want the CISG? For strictly domestic transactions of goods, U.S. businesses are subject to the U.C.C. The U.C.C.'s provisions have been shown to be very economically efficient. But the CISG's ability to harmonize and unify international sales law, thus opening up the international sales market to more U.S. businesses, plus the CISG's relative economic efficiency make the CISG a fairly desirable set of default rules for U.S. businesses. Hopefully, future empirical studies and surveys on the CISG and its popularity with U.S. businesses will highlight and emphasize the efficiency of the CISG for U.S. businesses, and the CISG will take its rightful place as an indispensable and beneficial instrument of international sales law.