

THE CISG AS THE TOOL FOR SUCCESSFUL MSME PARTICIPATION IN GLOBAL TRADE

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I. INTRODUCTION

Micro, small and medium-sized enterprises (“MSMEs,” “SMEs”) are the predominant business form. About 97 to 99% of enterprises in any country are SMEs.¹ However, it has to be acknowledged that the size of SMEs vary significantly between states.² The common feature of the statistic

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¹ See MINISTRY OF BUS. INNOVATION & EMP’T, SMALL BUSINESSES IN NEW ZEALAND: HOW DO THEY COMPARE WITH LARGER FIRMS? 1 (2017) (N.Z.), <https://www.beehive.govt.nz/sites/default/files/2017-12/Small%20Business%20-%20Annex%203%20Small%20Business%20Factsheet.pdf> (small businesses comprise 97% of enterprises in New Zealand); see also *Entrepreneurship and Small and Medium Sized Enterprises*, EUROPEAN COMMISSION (Jan. 3, 2017), https://ec.europa.eu/growth/smes_en (last visited Feb. 19, 2019) (small and medium-sized enterprises represent 99% of all businesses in the EU.); see also U.S. SMALL BUS. ADMIN. OFFICE OF ADVOCACY, 2018 SMALL BUSINESS PROFILE 1 (2018), <https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf> (small businesses comprise 99.9% of businesses in the U.S.); see also William Hofmann, *Are Singapore’s SMEs Really Prospering?*, VALUE CHAMPION (Mar. 30, 2018), <https://www.valuechampion.sg/are-smes-prospering-singapore> (SMEs make up 99% of all enterprises in Singapore). See also Joseph Asare, *Approach to Assess and Select Small and Medium Enterprises (SMEs) for Incubation on the Base of Angel Model—a Case on Developing Economies and ENGINE Program*, 17 BRITISH J. ECON. MGMT. & TRADE 1, 1, 3 (2017) (The OECD estimates that small and medium enterprises account for 90% of firms and employ 63% of the workforce in the world.).

² See MINISTRY OF BUS. INNOVATION & EMP’T, *supra* note 1, at 1 (defining an SME in New Zealand as an enterprise with less than 100 employees); see also ORG. FOR ECON. COOPERATION & DEV. [OECD], CTR. FOR ENTREPRENEURSHIP, SMES AND LOCAL DEV., *Fostering SMEs’ Participation in Global Markets: Final Report*, 34–35, OECD Doc. CFE/SME(2012)6/FINAL (July 4, 2013) [hereinafter OECD, CTR. FOR ENTREPRENEURSHIP] (defining SMEs in multiple European countries as firms with

and its significance for the purpose of this research is that SMEs make up the majority of the businesses of any given country or trading block.³ There is agreement among states, business councils, and international organizations that SMEs are vital for economic growth. As the OECD representatively emphasized: “Small and medium sized enterprises (SMEs) are important for their contribution to employment, innovation, economic growth and diversity.”⁴

The growth of today’s economies is highly dependent on international trade.⁵ Expansion into international markets is critical for SMEs’ continued growth, and for the economy’s (and ultimately the consumers’) wellbeing.⁶ Despite the obvious case for expansion, for example, only 26% of New Zealand’s SMEs with over six employees currently export their products and the majority are not interested in generating overseas income.⁷ In the United Kingdom, it is estimated that only 10% of MSMEs export.⁸ Interestingly and in contrast, the United States Department of Commerce found that 98% of U.S. companies exporting goods were MSMEs being responsible for 33% of goods exported.⁹ Fifty-nine percent of U.S. SMEs export to only one

fewer than 250 employees, in Japan as firms with fewer than 300 employees, and in the U.S. as firms with fewer than 500 employees).

³ See Gentrit Berisha & Justina Shiroka Pula, *Defining Small and Medium Enterprises: A Critical Review*, 1 ACAD. J. BUS. ADMIN. L. & SOC. SCI. 17 (2015) for a discussion of the different definitional approaches.

⁴ *SMEs and Entrepreneurship*, ORG. FOR ECON. CO-OPERATION & DEV., <http://www.oecd.org/cfe/smes/> (last visited Feb. 19, 2019). See also *Facts & Data on Small Businesses and Entrepreneurship*, SMALL BUS. & ENTREPRENEURSHIP COUNS., <http://sbecouncil.org/about-us/facts-and-data/> (last visited Feb. 19, 2019) (“Small businesses continue to be incubators for innovation and employment growth during the current recovery. Small businesses continue to play a vital role in the economy of the United States.”).

⁵ See U.N. Conference on Trade and Development, *The Role of International Trade in the Post-2015 Development Agenda*, 2 U.N. DOC. TD/B/C.1/33 (Feb. 24, 2014) (“International trade is a powerful enabler of economic development. Empirical literature supports this with strong evidence that increased participation in international trade can spur economic growth, which itself is a necessary condition for broader development outcomes to be realized.”). See also OECD, CTR. FOR ENTREPRENEURSHIP, *supra* note 2, at 13.

⁶ OECD, CTR. FOR ENTREPRENEURSHIP, *supra* note 2, at 9.

⁷ MINISTRY OF BUS. INNOVATION & EMP’T, THE SMALL BUSINESS SECTOR REPORT 2014, at 47 (2014) (N.Z.).

⁸ DEP’T OF BUS., INNOVATION & SKILLS, BIS ESTIMATE OF THE PROPORTION OF UK SMEs IN THE SUPPLY CHAIN OF EXPORTERS 2 (2016).

⁹ U.S. DEP’T OF COMMERCE, INT’L TRADE ADMIN., U.S. EXPORT FACT SHEET (2016), <https://www.trade.gov/press/press-releases/2016/export-factsheet-040516.pdf>.

country.¹⁰ There is overwhelming support through international studies that firm size, at this point in time, is an important determinant whether enterprises trade internationally.¹¹ This is evidenced, as well in the majority of OECD countries where businesses of more than 250 employees,¹² i.e., large businesses, are responsible for more than 50% of total exports.¹³ The United States is, therefore, an outlier in MSME export behavior.

One of the reasons for the limited foray into foreign markets by MSMEs is the risk associated with doing so. The most commonly cited barrier for New Zealand MSMEs is limited experience.¹⁴ The OECD study into barriers of MSMEs in regard to conducting international business similarly found limited firm resources, limited international contacts as well as lack of requisite managerial knowledge about internationalisation to be critical constraints to MSME trading cross border.¹⁵ Embedded in the resource, experience and knowledge barrier is the risk associated with potential cross border dispute resolution whereby firms are not confident that they will be provided with effective justice should a cross border dispute arise.¹⁶ The resource, experience and knowledge barrier sets MSMEs apart from large enterprises which generally have the resources to counter any lack of experience and/or knowledge. Many large enterprises have their own in-house counsel or the means to engage specialised counsel.

¹⁰ *Id.*

¹¹ See Elhanan Helpman et al., *Export versus FDI with Heterogeneous Firms*, 94 AM. ECON. R. 300, 315 (2004) (“[The results] show a robust cross-sectional relationship between the degree of dispersion in firm size and the tendency of firms to substitute FDI sales for exports.”); see also Thierry Mayer & Gianmarco Ottaviano, *The Happy Few: The Internationalisation of European Firms*, 43 INTERECONOMICS 135 (2007); see also Joachim Wagner, *The Causal Effects of Exports on Firm Size and Labor Productivity: First Evidence from a Matching Approach*, 77 ECONOMICS LETTERS 287, 292 (2002) (identifying a positive relationship between starting to export and growth of employment among German firms with an average of 89.66 employees one year before starting to export).

¹² OECD, CTR. FOR ENTREPRENEURSHIP, *supra* note 2.

¹³ ORG. FOR ECON. CO-OPERATION & DEV. [OECD], *Entrepreneurship at a Glance 2012*, 60 (June 6, 2012).

¹⁴ MINISTRY OF BUS. INNOVATION & EMP’T, *supra* note 7.

¹⁵ ORG. FOR ECON. CO-OPERATION & DEV. [OECD], WORKING PARTY ON SMES AND ENTREPRENEURSHIP, *Top Barriers and Drivers to SME Internationalisation*, 28 (2009).

¹⁶ Petra Butler & Campbell Herbert, *Access to Justice v Access to Justice for Small and Medium-Sized Enterprises: The Case for a Bilateral Arbitration Treaty*, 26 N.Z. U. L. Rev. 186, 187 (2014). But see EUROPEAN COMMISSION, EUROPEAN CONTRACT LAW IN BUSINESS-TO-BUSINESS TRANSACTIONS, 15 (2011). See also Daniel Girsberger, *Eine optimale Form der Streiterledigung fuer KMU?*, WEGNER VIELI BESLER (2002) (Switz.), <https://www.wengervieli.ch/de-ch/publikationen/publikationen/eine-optimale-form-der-streiterledigung-fur-kmu>.

II. THE STATUS QUO

Parties which engage in cross border trade are free to agree to a particular, for them favorable, applicable domestic (contract) law. If parties do not agree to a particular applicable domestic law the private international law of the forum will determine the applicable law to the contract.¹⁷

To appreciate the value the CISG adds to the contractual relationship of MSMEs, it is worthwhile firstly to provide a brief comparison of two different contract law regimes, namely common law and civil law. The each of the different jurisdictions that make up the common law family are of course unique. Hence the Article will out of necessity work with broad generalisations. Regarding the common law the Article will rely in particular on examples from English, New Zealand, and U.S. contract law. The civil law jurisdictions will be represented mainly by Austrian, German, and Swiss contract law.¹⁸ Secondly, it is important to appreciate the contractual reality for MSMEs. Hence, this Article will provide a snapshot of the contractual behavior of MSMEs in New Zealand and Austria, based on over 40 interviews conducted with MSMEs across New Zealand in 2018 and 2015, and based on over 10 interviews conducted in Austria by the Institut für Zivilrecht, Ernst Keppeler University of Linz under the leadership of Christina Geissler.¹⁹

A. A Common Law and Civil Law Jurisdiction Compared

The purpose of this part is to highlight some of the differences in contract law regimes of two of the main world legal systems, common law

¹⁷ LORD COLLINS OF MAPESBURY, DICEY, MORRIS & COLLINS ON THE CONFLICT OF LAWS (15th ed. 2012); UGLJESA GRUSIC ET AL., PRIVATE INTERNATIONAL LAW 7, 724–25 (Paul Torramens ed., 15th ed. 2017); John McMillan, *Private International Law*, in INTERNATIONAL COMMERCIAL CONTRACTS—LAW AND PRACTICE (Petra Butler ed., forthcoming 2020).

¹⁸ See generally PIER GIUSEPPE MONATERI, COMPARATIVE CONTRACT LAW (2018). See generally Allan Farnsworth, *Comparative Contract Law*, in THE HANDBOOK OF COMPARATIVE LAW 899 (Matthias Reimann & Reinhard Zimmermann eds., 2006) for a more comprehensive and in depth discussion of the different contract law regimes.

¹⁹ Christina Geissler is the assistant to Professor Andreas Geroldinger and is examining the contractual behaviour of MSMEs in Austria as part of her PhD. She holds a degree in law as well as in economics. See the following regarding the world-wide reach of the research project and affiliated universities: <https://www.msmejustice.com/>.

and civil law.²⁰ For the comparatist this will only serve as a reminder. For the stranger to the subject it will hopefully underscore the differences in the contract law regimes. Those differences can lead to misunderstandings between the contractual parties. They also will undoubtedly influence the strategic decisions regarding the party's contractual risk management and allocation²¹ and the four issues chosen have particular weight in that regard.

1. Interpretation of the Contract

Exchange, grounded in the bargaining between parties, is the driving force of any economic system that relies on free enterprise. In these exchanges each party gives something to the other party and receives something in return in order to maximize its own economic advantage on terms tolerable to the other. Because of differences in value judgements, interests pursued, and because of the division of labour, it is usually possible for each to gain from the exchange.²² Both parties' understanding of what they have bargained for is the basis of the contractual agreement. The law that sets out the parameters of how to deal with the situation when the parties, after the conclusion of the contract, have different views about the bargain they made, is therefore of utmost importance. Regarding this pivotal question of contract interpretation, the common law and civil law could not be more different in its underlying premise.²³

a. Common Law

The common law's principle rule in contract interpretation is the parol evidence rule. The parol evidence rule states that any oral or any other extrinsic evidence cannot be permitted to alter, contradict or explain the

²⁰ In the space of an article a comprehensive comparison is of course not possible. See for a comprehensive discussion. For the claim that the most essential dichotomy is between common and civil law jurisdictions, see JOHN HALEY, *COMPARATIVE CONTRACT LAW* (2017); Farnsworth, *supra* note 18; Oscar Chase et al., *Civil Litigation in Comparative Context* (2d ed. 2017).

²¹ See generally Frank Menetrez, *Consequentialism, Promissory Obligation, and the Theory of Efficient Breach*, 47 *UCLA L. REV.* 859 (2000) regarding the purpose of a contract.

²² Farnsworth, *supra* note 18, at 899.

²³ See Giuditta Cordero-Moss, Professor of Law, Univ. of Oslo, Panellist at the Vienna Arbitration Days: Perception and Reality: Psychology and Arbitration (Mar. 1, 2019).

terms of the written parts of a contract.²⁴ The purpose of the rule is to promote commercial certainty by holding the parties bound by the written contract and by it alone.²⁵ Recognising that the rule is capable of leading to injustice where parties have in fact agreed to terms not set out in the contractual document(s) common law courts have mitigated such injustice by recognising exceptions to the rule or by limiting its scope.²⁶ However, recently the English and New Zealand courts have reiterated the importance of the written pronouncement of the parties' bargain.²⁷ Australian courts have favoured the traditional approach of contract interpretation, allowing extrinsic evidence to aid the interpretation of a written contract only in very

²⁴ See generally UCC § 2-202 (AM. LAW INST. 2001) ("Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented: (a) by course of dealing or usage of trade (Section 1-205) or by course of performance (Section 2-208); and (b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.") (format altered). MELVIN A. EISENBERG, *THE FOUNDATIONAL PRINCIPLES OF CONTRACT LAW* 533–47 (Stephen M. Sheppard ed., 2018) (providing the U.S. approach to the parol evidence rule); Ian McKendrik, *Contract Law*, in *ENGLISH PRIVATE LAW* § 8.85 (Andrew Burrows ed., 2013); Farnsworth, *supra* note 18, at 920.

²⁵ See *AIB Group Plc v. Martin* [2001] UKHL 63, [2002] 1 WLR 94 [4] (appeal taken from AC). See also Petra Butler, *The Doctrines of Parol Evidence Rule and Consideration: A Deterrence to the Common Law Lawyer?*, in *CELEBRATING SUCCESS: 25 YEARS UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS* 54, 61 (Sing. Int'l Arbitration Ctr. 2006).

²⁶ See EISENBERG, *supra* note 24, at 533, 537–38. English courts have been very careful to deviate from the parol evidence rule whereas New Zealand courts, for example, have allowed pre-contractual negotiations to be relied on for contract interpretation. See *Vector Gas Ltd v. Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444. See also Bruno Zeller, *The Parol Evidence Rule and the CISG—A Comparative Analysis*, 36 *COMP. L.J.S. AFR.* 308, 308 (2003) ("[T]he sacred cows of common law namely the inadmissibility of evidence of a pre-contractual nature and hence the subjective intent of the parties are outdated and change is required.").

²⁷ Compare Lord Hoffman, *Language and Lawyers*, 134 *LQR* 553 (2018), with Lord Sumption, *A Question of Taste: The Supreme Court and the Interpretation of Contracts*, 8 *UK SUPREME COURT YEARBOOK* 74. See Tim Smith & Sam Cathro, *The interpretation of contracts*, N.Z.L. SOC'Y, <https://www.lawsociety.org.nz/practice-resources/practice-areas/commercial-and-business-law/the-interpretation-of-contracts> (Feb. 8, 2019) (exploring the extrajudicial discussion between Lord Hoffmann who propagates a contextual approach to contract interpretation, i.e., a softening of the strict parol evidence rule, and Lord Sumption criticism that that approach has led the courts to substitute the meaning of contract with the court's view of what would be reasonable). The New Zealand courts in their recent decisions seem to fall into line with Lord Sumption. See generally *Lakes Int'l Golf Mgmt. Ltd. v. Vincent* [2017] NZSC 99, [2017] 1 NZLR 935; *M v. H* [2018] NZCA 525; *The Malthouse Ltd. v. Rangatira Ltd.* [2018] NZCA 621.

limited circumstances.²⁸ The Canadian courts on the other hand seem to be the most willing to deviate from the written text. According to the Canadian Supreme Court the proper approach to contractual interpretation is a practical, common-sense approach not dominated by technical rules of construction, but rather is focused on the intent of the parties and the scope of their understanding.²⁹

In summary, the underlying principle of common law contract interpretation is that any written part of the contract is taken as the embodiment of the true bargain of the parties.³⁰ Courts limit the effect of the parol evidence rule only in rare circumstances. The more lenient approach by the Canadian courts have to been seen in light of the core principle. Hence the approach should not be equated with the approach taken generally in civil law jurisdictions.

b. Civil Law

Like with common law jurisdictions, every civil law jurisdiction is unique.³¹ However, generally speaking, in civil law jurisdictions the written (part of the) contract is evidence of the parties' bargain which can be refuted by other evidence including, for example, by evidencing contrary agreements during the pre-contractual negotiations of the parties or their post contractual conduct. Section 133 of the German Civil Code is a good example for a civil law approach:

²⁸ See *Royal Botanic Gardens v South Sydney City Council* [2002] HCA 5 (Austl.); *Western Export Services Inc v Jireh Int'l Pty Ltd*, [2011] HCA 45 (Austl.).

²⁹ *Sattva Capital Corp. v. Creston Moly Corp.*, [2014] 2 S.C.R. 633 (Can.).

³⁰ According to Allan Farnsworth, the parol evidence rule is not an evidentiary rule but a rule of substantive law. Farnsworth, *supra* note 18, at 920. However, jurisprudence does not support this view. See Law Commission, Report No. 154, *The Law of Contract: The Parol Evidence Rule* (1986) at 2.6-2.15; Zeller, *supra* note 26. Farnsworth's view indicates the standard of proof necessary to refute the bargain evidenced by the written contract document. For further critique of the parol evidence rule, see the decision of *Zell v. American Seating Co.*, 138 F.2d 641, 643 (2d Cir. 1943) (Frank, J.).

³¹ Civil law jurisdictions make up the preponderant part of the world's jurisdictions. See *Univ. of Ottawa, JURIGLOBE—WORLD LEGAL SYSTEMS*, <http://www.juriglobe.ca/eng/> (last visited Feb. 20, 2019).

When a declaration of intent is interpreted, it is necessary to ascertain the true intention rather than adhering to the literal meaning of the declaration.³²

The Swiss First Civil Court held:

A judge will first seek to establish the real and common intention of the parties, adopting an empirical approach, without stopping at the inaccurate expressions or denominations they may have used. If he or she is unable to do so, he or she will seek, by applying the principle of trust, the meaning that the parties could and should have given, pursuant to the rules of good faith, to their reciprocal manifestations of intent, taking into account all the circumstances.³³

It has to be noted that it would be wrong to consider the contract document worthless in civil law jurisdictions. The contract document provides the prima facie evidence of the bargain between the parties. However, that evidence embodied in the written document can be challenged by other evidence connected to the bargain of the parties, such as documents or witness statements.

³² Compare Bundesgerichtshof [Federal Court of Justice] [BGH] Sept. 11, 2009, Az.: II ZR 34/99 ¶¶ 8, 9 (stating that the written agreement of the parties signifies prima facie the objective declarations by the parties which can be refuted by extrinsic evidence); ALLGEMEINES BÜRGERLICHES GESTZBUCH [ABGB] [Civil Code] § 914, <https://www.ris.bka.gv.at/eli/jgs/1811/946/P914/NOR12018638> (Austria) (“Bei Auslegung von Verträgen ist nicht an dem buchstäblichen Sinne des Ausdrucks zu haften, sondern die Absicht der Parteien zu erforschen und der Vertrag so zu verstehen, wie es der Übung des redlichen Verkehrs entspricht.”) [“When interpreting a contract one should not get stuck on the literal meaning of the words, but should determine the intent of the parties and should understand the contract like fair minded people would.”], with Michael Esser, *Commercial Letters of Confirmation in International Trade: Austrian, French, German and Swiss Law and Uniform Law Under the 1980 Sales Convention*, 18 GA. J. INT’L AND COMP. L. 427, 428 n.6 (1988) (highlighting the German principle of Kaufmännisches Bestätigungsschreiben, which is representing an agreement by confirmation notices) (Swiss law takes a two-tier approach—determining the real and common intention of the parties but also invoking the principle of trust between the parties which has an objective element.).

³³ Tribunale federale [TF] [Federal Supreme Court], 4A_124/2014, July 7, 2014, ¶ 3.4.1 (available in English at <http://www.swissarbitrationdecisions.com/sites/default/files/7%20juillet%202014%204A%20124%202014.pdf>) (last visited Feb. 20, 2019); Legge federale di complements del Codice civile svizzero (Libro quinto: Diritto delle obbligazioni), Codice Civil [CC] [Civil Code], Mar. 30, 1911, RS 220, art. 18 (Switz.).

c. Summary

Some authors describe the difference between the common law and civil law approach to contract interpretation as the common law having object approach to contract interpretation whereas the civil law having a subjective approach.³⁴

The weight of the written document evidencing the bargain between the parties will undoubtedly determine the contractual behaviour of the parties. A party from a common law country, well versed in contract drafting, will try to stipulate as precisely as possible its expectations about the relationship in writing. The German, Austrian, or Swiss counterpart might sign such a contract but placing equally additional weight on the contract negotiations colouring the contract clauses.³⁵

2. Good Faith

The divergence regarding the rules of contractual interpretation is, in practical terms, the essential and critical difference between common and civil law. The underlying core philosophical difference between the two legal systems is the recognition of the principle of good faith as one of the fundamental principles of private law and its effect on the bargain between the parties.³⁶ Whereas the doctrine of good faith is the underpinning of many private law civil law jurisdictions, common law jurisdictions rely on equity instead of good faith. The former applies only when certain requirements are met (i.e., in extraordinary circumstances) while the latter is an underlying principle of any private law relationship.³⁷ The doctrine of good faith implies for the contractual relationship between commercial parties that an obligation is imposed on the parties to observe reasonable commercial standards of fair

³⁴ See generally Jack Beatson & Daniel Friedmann, "Introduction—From 'Classical' to Modern Contract Law," in GOOD FAITH AND FAULT IN CONTRACT LAW, Chs. 1, 3, 10 (Jack Beatson & Daniel Friedman eds., 1995).

³⁵ See Claire Hill & Christopher King, *How Do German Contracts Do as Much with Fewer Words?*, 79 CHI.-KENT L. REV. 889, 904, 907–09 (2004).

³⁶ See Beatson & Friedmann, *supra* note 34, at Chs. 1, 3, 14.

³⁷ EWAN MCKENDRICK, CONTRACT LAW: TEXT, CASES AND MATERIALS 489–512 (Oxford Univ. Press 6th ed. 2014). See also Francesco G. Mazzotta, *Good Faith Principle: Vaxata Quaestio*, in INTERNATIONAL SALES LAW A GLOBAL CHALLENGE 127 (Larry A. DiMatteo ed., 2015).

dealing. It requires faithfulness to the agreed common purpose. Hence, the doctrine of good faith means acting with honesty and the observance of reasonable commercial standards of fair dealing throughout the contractual relationship of the parties.³⁸ Good faith as it pertains to contract law is an approach towards the duties the parties have undertaken and not a separate duty undertaken by the parties.³⁹

a. Common Law

Classical common law contract law is based on two values: freedom of contract and certainty of contract.⁴⁰ Both values do not sit easily with the doctrine of good faith. The former value allows the parties to stipulate and to execute the bargain that is the most advantageous for it. The value of certainty signals clearly to the courts that it is clearly outside their purview “to adjust” the bargain between the parties to level out unfairness in the bargain.⁴¹

However, common law countries have embraced the notion of good faith as an underlying principle in contract law over the years. Above all, the U.S. Uniform Commercial Code sets out in § 1-304:

Every contract or duty within the Uniform Commercial Code imposes an obligation of good faith in its performance and enforcement. (U.C.C. § 1-304 (AM. LAW INST. 2001)).

Good faith is defined in UCC § 1-201(19) as “honesty in fact in the conduct or transaction concerned.”⁴² Section 205 of the Restatement (Second) of Contracts confirms good faith as general principle of contract law that

³⁸ See generally Daniel Markovits, *Good Faith as the Contract's Core Value*, in PHILOSOPHICAL FOUNDATIONS OF CONTRACT LAW Ch. 14 (Gregory Klass, George Letsas & Prince Saprai eds., 2014) (providing a more extensive discussion from a U.S. perspective).

³⁹ See *ASB Allegiance Real Estate Fund v. Scion Breckenridge Managing Member, L.L.C.*, 50 A.3d 434, 440–41 (Del. Ch. 2012), *aff'd in part, rev'd in part on other grounds sub nom. Scion Breckenridge Managing Member, L.L.C. v. ASB Allegiance Real Estate Fund*, 68 A.3d 665 (Del. 2013). See also Beatson & Friedmann, *supra* note 34, at 266–67 (“[o]ne of the hallmarks of English common law is that it does not have a doctrine of abuse of rights: if one has a right to do an act then, one can, in general, do it for whatever reason one wishes”).

⁴⁰ See generally Beatson & Friedmann, *supra* note 34, at Chs. 1, 3, 8, 10.

⁴¹ *Id.* at Chs. 1, 3, 8.

⁴² In the case of a merchant, good faith means “honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.” UCC § 2-103(1)(b) (AM. LAW. INST. 2018).

permeates the contractual relationship of the parties.⁴³ However, jurisprudence and commentary is clear that the doctrine of good faith in U.S. law is not as broad as in civil law jurisdictions⁴⁴ and “leaves the parties free to be self-interested within their contracts—as self-interested as they were without them, subject only to honouring the terms of their agreements.”⁴⁵ The English courts and academic literature have found it more difficult to warm to a general principle of good faith. Instead English law has developed piecemeal solutions in response to demonstrated problems of unfairness.⁴⁶ As Lord Bingham observed:

In many civil law systems, and perhaps in most legal systems outside the common law world, the law of obligations recognises and enforces an overriding principle that in making and carrying out contracts parties should act in good faith. This does not simply mean that they should not deceive each other, a principle which any legal system must recognise; its effect is perhaps most aptly conveyed by such metaphorical colloquialisms as “playing fair,” “coming clean” or “putting one’s cards face upwards on the table.” It is in essence a principle of fair open dealing. . . . English law has, characteristically, committed itself to no such overriding principle but has developed piecemeal solutions in response to demonstrated problems of unfairness.⁴⁷

The enactment of the Unfair Contract Terms Act 1977 is a legislative example how the notion good faith has been brought to bear in contract law. The case of *Yam Seng PTE Ltd v International Trade Corp Ltd* is an example of a judicial response. The case established that an implied duty of good faith can be applied to English contract law in certain circumstances.⁴⁸ Justice Leggatt observed, *inter alia*:

⁴³ RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. LAW. INST. 1981) (“Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”). *See also* *Wigand v. Bachmann-Bechtel Brewing Co.*, 118 N.E. 618, 619 (N.Y. 1918) (citing *Industrial & General Trust, Ltd. v. Tod*, 73 N. E. 7 (N.Y. 1905)).

⁴⁴ Robert S. Summers, *The Conceptualisation of Good Faith in American Contract Law: A General Account*, in *GOOD FAITH IN EUROPEAN CONTRACT LAW* 118 (Reinhard Zimmermann & Simon Whittaker eds., 2000).

⁴⁵ Markovits, *supra* note 38, at 278. *See also* *Mkt. St. Assoc. Ltd. P’ship v. Frey*, 941 F.2d 588, 593–95 (7th Cir. 1991) (Posner, J.).

⁴⁶ Beatson & Friedmann, *supra* note 34, at Chs. 1, 3, 14, 15. The enactment of the Unfair Contract Terms Act of 1977 is an example. *See also* *Interfoto Picture Library Ltd v. Stiletto Visual Programmes Ltd.* [1989] QB 433.

⁴⁷ *Interfoto Picture Library Ltd v. Stiletto Visual Programmes Ltd.* [1989] QB 433.

⁴⁸ *Yam Seng PTE Ltd v. International Trade Corp.* [2013] EWHC (QB) 111, 145.

A paradigm example of a general norm which underlies almost all contractual relationships is an expectation of honesty. That expectation is essential to commerce, which depends critically on trust. Yet it is seldom, if ever, made the subject of an express contractual obligation. Indeed if a party in negotiating the terms of a contract were to seek to include a provision which expressly required the other party to act honestly, the very fact of doing so might well damage the parties' relationship by the lack of trust which this would signify.⁴⁹

In Australia, the existence of a contractual duty of good faith is well established, although the limits and precise juridical basis of the doctrine are less clear.⁵⁰ The springboard for this development has been the decision of the New South Wales Court of Appeal in *Renard Constructions (ME) Pty v Minister for Public Works*, where Priestley JA held:

... people generally, including judges and other lawyers, from all strands of the community, have grown used to the courts applying standards of fairness to contract which are wholly consistent with the existence in all contracts of a duty upon the parties of good faith and fair dealing in its performance. In my view this is in these days the expected standard, and anything less is contrary to prevailing community expectations.⁵¹

The Canadian Supreme Court has leaned towards recognising a duty of good faith. In *Bhasin v Hrynew*, the Court held that there was an organising principle of good faith underlying the doctrines governing contractual performance.⁵² The principle was not considered to be a free standing rule, but a standard underpinning more specific doctrines that carry different weight in different situations.⁵³ In New Zealand a doctrine of good faith is not yet established law but it has its advocates.⁵⁴

In summary, common law jurisdictions have to different degrees embraced a doctrine of good faith in contract law. Those respective doctrines have in common that they generally support already existing contract

⁴⁹ *Id.* at 135, 141.

⁵⁰ *Alcatel Austl Ltd v Scarcella* (1998) 44 NSWLR 349 (Austl.); *Burger King Corp v Hungry Jack's Pty* [2001] 69 NSWLR 558 (Austl.); *Vodafone Pac Ltd v Mobile Innovations Ltd* [2004] NSWCA 15 (20 Feb. 2004) (Austl.).

⁵¹ *Renard Constr (ME) Pty v Minister for Pub Works* [1992] 26 NSWLR 234, 268 (Austl.).

⁵² *Bhasin v. Hrynew*, [2014] 3 S.C.R. 494 (Can.).

⁵³ *Id.* at 64.

⁵⁴ *See Bobux Marketing Ltd v. Raynor Marketing Ltd* [2002] 1 NZLR 506 (CA) at 517 (N.Z.) (Thomas, J., dissenting); *see also Vero Insurance New Zealand Ltd v. Fleet Insurance & Risk Management Ltd* HC Auckland CIV 2007-404-1438, 21 May 2007 (N.Z.).

doctrines and unfold their effect within the established contractual framework which is determined, for example, by the parol evidence rule.

b. Civil Law

Most civil-law systems know a default rule that requires a contracting party to behave according to good faith. For example, Article 1134 of the French Civil Code, states that agreements must be performed in good faith. Article 2.1 of the Swiss Civil Code embodies the same sentiment and states:

Every person must act in good faith in the exercise of his or her rights and in the performance of his or her obligations. 2 The manifest abuse of a right is not protected by law. (Codice Civile [CC] [Civil Code] Dec. 10, 1907, RS 210, art. 2 (Switz)).

And German law has imbedded the notion of *Treu und Glauben* in its *Bürgerliches Gesetzbuch* (BGB) which does not only underpins private law relationships but has also some bearing in public law.⁵⁵ Section 157 BGB spells out what *Treu und Glauben* means regarding contract interpretation:

Contracts are to be interpreted as required by good faith, taking customary practice into account. (Bürgerliches Gesetzbuch [BGB] [Civil Code], § 157, *translation at* https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p0731).

The doctrine of good faith fulfils three basic functions in German contract law. Firstly, it acts as the legal basis of law-making by the judiciary. Secondly, it provides for the legal basis of defences in private lawsuits; and lastly it is a statutory basis for reallocating the contractual risk between the parties. In particular, the doctrine of good faith has been used by the courts to create new causes of action where no cause of action existed in statutory law.⁵⁶ Jurisprudence developed a defence relying on the doctrine of good faith in cases where, unforeseen by the parties, the basic assumptions

⁵⁵ Bürgerliches Gesetzbuch [BGB] [Civil Code], § 242, *translation at* https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p0731 (“An obligor has a duty to perform according to the requirements of good faith, taking customary practice into consideration.”); SVEN MUELLER-GRUNE, *DER GRUNDSATZ VON TREU UND GLAUBEN IM ALLGEMEINEN VERWALTUNGSRECHT: EINE STUDIE ZU HERKUNFT, ANWENDUNGSBEREICH UND GELTUNGSGRUND* (1st ed. 2006).

⁵⁶ See Bürgerliches Gesetzbuch [BGB] [Civil Code], § 311, *translation at* https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p1013 (Ger.); see also Bürgerliches Gesetzbuch [BGB] [Civil Code], § 241, para. 2, *translation at* https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p1013 (Ger.).

underlying their contractual relationship had changed fundamentally between the formation of the contract and the agreed upon time of performance.⁵⁷ Lastly, the doctrine of good faith was the underlying basis for the reallocation of risk between parties to a contract where stringent adherence to traditional principles and rules of law would have led to undesirable results.⁵⁸

The examples of how the doctrine of good faith in German law has been the doctrinal underpinning of the development of the law in different areas of contract law evidences how the doctrine of good faith permeates all aspects of the law, i.e., also the contractual relationship of the parties. The doctrine is not ringfenced by contractual principles but rather extends and develops those.

c. summary

The reliance on good faith as the essential basis of the contractual relationship in civil law jurisdiction is the fundamental difference between common law and civil law jurisdictions in the realm of private law. A contractual relationship that is rooted in the enforceable expectations of the parties that each has to behave with a certain good will towards the other party does not need to stipulate every performance issue in the contract. “That the cat cannot be put in the microwave to dry, does not need to be specified in the contract—common sense dictates that.”⁵⁹

3. Modification of the Contract

During the life time of a contract the circumstances of the parties might change, new opportunities might arise which prompt the parties (generally on the initiative of one party) to want to amend the bargain. The ability to modify the bargain is of practical importance to both parties. One of the requirements to modify the contract signifies, albeit in theory, another fundamental difference between the common law and many civil law countries.

⁵⁷ Bürgerliches Gesetzbuch [BGB] [Civil Code], § 313, para. 1, *translation at* https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p1013 (Ger.).

⁵⁸ *See id.* § 313.

⁵⁹ Spanish SME owner, Logrono, 24 Jan. 2019.

a. Common Law

In principle, to modify the contract both parties have to give consideration. The doctrine of consideration is based on the idea of reciprocity: in order to be entitled to enforce a promise as a contract, the promisee must have given “something of value in the eye of the law.”⁶⁰ Consideration does not have to be “adequate” or “sufficient,” even though those adjectives are sometimes added by courts.⁶¹ Nor does the consideration have to be substantial in value, though marked disparity in value may signal the absence of bargain—of merely “nominal” consideration. Furthermore, the requirement of an actual bargain is not taken so seriously as to exclude routine transactions concluded on the basis of standardised agreements to which one party simply adheres without any real negotiation of terms.⁶² The doctrine of consideration is, it should be noted, not a device for policing contracts to assure that they are fair to both parties.⁶³

In bargains between commercial parties, in particular in the sale of goods, the modification of the contract will generally involve the exchange of something of value. However, there are cases where the requirement of consideration might be at issue. In the New Zealand case of *Tupe v Tupe*, the seller under an agreement for sale and purchase agreed in writing to allow the buyers additional time to obtain finance.⁶⁴ Before the additional period had expired, the seller terminated the agreement on the basis that the buyer had failed to satisfy the finance condition.⁶⁵ The Court held that the modification of the contract was unenforceable, because the buyers had not given consideration for the seller’s promise to extend the time for fulfilment of the condition.⁶⁶

The law in the United States is bridging common and civil law in § 2-209 UCC which provides that “[a]n agreement *modifying* a contract . . . needs

⁶⁰ Thomas v. Thomas (1842) 114 Eng. Rep. 330, 333–34 (Eng.).

⁶¹ RESTATEMENT (SECOND) OF CONTRACTS § 79 (AM. LAW INST. 1981).

⁶² Farnsworth, *supra* note 18.

⁶³ Ewan McKendrik, *Contract Law: General*, in ENGLISH PRIVATE LAW 8.31 (Andrew Burrows ed., 2013).

⁶⁴ *Tupe v. Tupe* HC Auckland CIV 2009-404-1050, 19 June 2009 at [5] (N.Z.).

⁶⁵ *Tupe v. Tupe* HC Auckland CIV 2009-404-1050, 19 June 2009 at [5] (N.Z.).

⁶⁶ *Id.* at 8.

no consideration to be binding.” (emphasis added) U.C.C. § 2-209 (AM. LAW INST. 2001))

In summary, the requirement of consideration adds, from the civil lawyer’s point of view, a layer of complexity to contract formation but in particular to the modification of an existing contract. It is beyond the scope of this Article to explore jurisprudence that has developed to take account of the practical realities. In practice a party, as seen in the case of *Tupe v Tupe*, might have a good reason to agree to a modification of the contract without a consideration.⁶⁷

b. Civil Law

The English doctrine of consideration does not find its mirror image in the civil law contract law regimes. The French Code Civil describes a contract as:

Le contrat est un accord de volontés entre deux ou plusieurs personnes destiné à créer, modifier, transmettre ou éteindre des obligations.⁶⁸

In the German speaking countries a contract is “simply” the meeting of the minds between parties to want to be legally bound to fulfil a promise.⁶⁹ The promise does not have to have any value. Hence a gift is a contract under German law.⁷⁰ The modification of a contract therefore does not depend on both parties giving something of legal value. The requirement is a meeting of the minds of the parties to modify the contract. In the case of *Tupe v Tupe*, set out above, an Austrian or Swiss court would have most likely come to the view that the parties had modified the contract.

In summary, civil law binds parties to their promises at an early stage than common law. It also allows the parties to rearrange their contractual relationship more easily. The core idea behind freedom of contract might be better served by civil law jurisdictions. However, parties might find

⁶⁷ McKendrik, *supra* note 63, at 8.36.

⁶⁸ Code Civil [C. Civ.] [Civil Code] art. 1101 (Fr.).

⁶⁹ Heinz-Peter Mansel, § 241, in JAUERNIG, BÜRGERLICHES GESETZBUCH (Rolf Stürner ed., 2018).

⁷⁰ Bürgerliches Gesetzbuch [BGB] [Civil Code], § 516, para. 1, sentence 1, *translation at* https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p1885 (“A disposition by means of which someone enriches another person from his own assets is a donation if both parties are in agreement that the disposition occurs gratuitously.”).

themselves bound by legally enforceable promises they had not appreciated making.

c. Summary

In practical terms, the issue of consideration might not be one of great significance. The knowledge of the doctrine by a common law party and the ignorance of it by a non-common law party can however lead to a misunderstanding of the legally binding nature of the certain behaviour, in particular when it comes to the modification of the bargain.

4. Remedies

For the parties to a bargain the remedies available to them in the case of breach of the bargain by the other and/or the remedies available should the purpose of the bargain be fundamentally defeated are (or should be) important considerations when negotiating the contract. Contractual rights are a major form of commercial wealth.⁷¹ The availability of appropriate remedies is important to protect the value of the parties' contractual rights. In the constraints and the purpose of this Article, the Article will focus on two aspects, firstly whether the remedy of specific performance is available to the party and whether the parties have a remedy available should the purpose of the bargain be fundamentally changed to the detriment of one party.

a. Common Law

When one party breaches a contract, the central purpose of most legal systems is to put the aggrieved party in the position in which it would have been had the contract been performed. Common law jurisdictions perceive the award of money damages as achieving the purpose of protecting the contractual rights of the parties. Awarding money damages imposes a new

⁷¹ Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1, 23 (1989).

obligation, one to pay money, for the breach of the old.⁷² The objective of damages is to redress loss by compensating the promisee. The common law accepts that it is within the rights of the promisor to breach the contract, for example, to contract for a better deal (efficient breach theory). The purpose of the damages award is therefore not one of deterrence by punishing the party in breach.⁷³ In common law systems, specific performance is an equitable remedy, i.e., an discretionary remedy: an order of the court requiring the defendant to personally perform the promise made. The defendant must actually fulfil the contractual obligation, for example deliver the chattel, or be held in contempt of court.⁷⁴

The common law values the freedom of contract and with it the freedom of one party to breach the contract for a better bargain. It also, and this is not contradictory but follows, values the doctrine of *pacta sunt servanda*,⁷⁵ i.e., once the parties have exercised their freedom to contract that exercise is honoured. On that basis the common law releases parties from their contractual obligations only within narrow constraints. English courts ask whether as a result of the impediment performance would be “fundamentally different.”⁷⁶ American courts ask whether the non-occurrence of the impediment was a “basic assumption” on which the contract was made. In the United States the term “impracticability” rather than “impossibility” is used to suggest that a party may be discharged if performance becomes much more burdensome even though not absolutely impossible.⁷⁷ Common-law courts have traditionally rejected the notion that they have any power to adapt or modify contracts in the light of supervening events. If those events satisfy the requirements of discharge, the contract is wholly discharged, though courts have been reluctant to do this if the parties could reasonably have dealt with the events expressly. English courts developed the doctrine of “frustration of purpose,” under which a party may be discharged if the other

⁷² See generally Fionnghuala Cuncannon, *The Case for Specific Performance as the Primary Remedy of Contract Law*, 35 VICT. U. WELLINGTON L. REV. 657, 660 (2004) (discussing a brief but more detailed discussion on the history of the common law remedies for breach of contract).

⁷³ See generally RICHARD POSNER, *THE ECONOMIC ANALYSIS OF THE LAW* (1st ed. 1972).

⁷⁴ GARETH JONES & WILLIAM GOODHART, *SPECIFIC PERFORMANCE* (2d ed. 1996).

⁷⁵ See EDWIN PEEL, *TRITTEL ON THE LAW OF CONTRACT* (14th ed. 2015).

⁷⁶ *Taylor v Caldwell* (1863) 122 Eng. Rep. 309, 315.

⁷⁷ Farnsworth, *supra* note 18, at 927.

party's return performance has become so worthless as to frustrate the first party's purpose in making the contract. American courts have followed suit.⁷⁸

In summary, common law emphasises freedom of contract and the party as an economic agent whose choices are respected but who has also to be held to his or her choice. It is within the freedom of the party not to honour a contract and the consequence is the exercise of that freedom is not punishment but "doing right" by the other party. Seeing the party as an economic agent also underpins the common law's generally adherence to the doctrine of *pacta sunt servanda*. The common law courts have therefore be reluctant to intervene in the parties' bargain even if the foundations of that bargain have unexpectedly and unforeseeably changed.

b. Civil Law

As has been observed throughout the comparison, contract law in civil law jurisdiction is based on the good faith dealings between the parties. Freedom of contract is inherently curtailed by the responsibility of the parties to act fair and responsibly regarding the contract. Hence, in civil law jurisdictions specific performance is not an equitable remedy lying in the discretion of the judiciary but a remedy available to the parties in addition to or instead of the award of damages.⁷⁹ The term specific performance is used more broadly and also includes actions to recover the price of having

⁷⁸ RESTATEMENT (THIRD) OF THE LAW OF CONTRACTS § 265 (AM. LAW INST. 2011) (defines frustration of purpose). *See also* Taylor v Caldwell (1863) 122 Eng. Rep. 309. *See also* Krell v. Henry [1903] 2 KB 740 (for common law approach).

⁷⁹ *See* BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], § 362(1), *translation at* https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p1013 ("an obligation is extinguished if the performance owed is rendered to the oblige"). *See also* ALLGEMEINES BÜRGERLICHES GESETZBUCH [ABGB] [Civil Code] § 918, <https://www.ris.bka.gv.at/eli/jgs/1811/946/P918/NOR12018643> (Aust.); *but see* Civil Code of Québec, S.Q. 1991, c. 64, art 1590(1) ("An obligation confers on the creditor the right to demand that the obligation be performed in full, properly and without delay."). *See* Markus Müller-Chen, *Der Erfüllungsanspruch—primärer Inhalt der Obligation?*, <https://www.alexandria.unisg.ch/16986/> (last visited Mar. 1, 2019). *See* JANWILLEM OOSTERHUIS, SPECIFIC PERFORMANCE IN GERMAN, FRENCH AND DUTCH LAW IN THE NINETEENTH CENTURY (C.H (Remco) van Rhee, Dirk Heirbaut & Matthew C. Mirow eds., 2011) (discussion of the remedy of specific performance and traces the history of the remedy and the use of the remedy to date).

somebody else (including the plaintiff) perform the contract, the cost of curing a defect, or the cost of substitute goods.⁸⁰

Given the aim in civil law jurisdictions to achieve fairness between the contractual parties it is not surprising that the adaptation of the contract in cases of hardship is a known remedy. Section 313(1) BGB states:

If circumstances which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change, adaptation of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case, in particular the contractual or statutory distribution of risk, one of the parties cannot reasonably be expected to uphold the contract without alteration. (Bürgerliches Gesetzbuch [BGB] [Civil Code], § 313(1), *translation at* https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p0731.)

Similarly Article 1195 Code Civil acknowledges that in a situation of hardship the disadvantaged party has a right to re-negotiate the contract.⁸¹

In summary, civil law jurisdictions offer a wider range of remedies for breach of contract⁸² or a situation where the underlying purpose of the contract is frustrated than common law jurisdictions.

c. Summary

Parties are able to contract for the available remedies should they be aware of the different remedies available. However, as the next part will demonstrate, more often than not even commercial parties will not be aware of their options and the fact that other jurisdictions might have different or more limited remedy regimes. Contract law is a default mechanism provided by the state for when the parties do not exercise their freedom of contract. Allowing for a smorgasbord of remedies should the parties not have exercised their freedom to contract on that issue is an advantage of the civil law jurisdictions.

⁸⁰ GUENTER TREITEL, REMEDIES FOR BREACH OF CONTRACT: A COMPARATIVE ACCOUNT 46 (1976).

⁸¹ Compare with Tekla Papp, *Frustration and Hardship in Contract Law from Comparative Perspective*, http://acta.bible.u-szeged.hu/24808/1/juridpol_077_421-430.pdf (last visited Mar. 1, 2019).

⁸² See BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], § 441(1), *translation at* https://www.gesetze-im-internet.de/englisch_bgb/englisch_bgb.html#p1013 (“Instead of revoking the agreement, the buyer may, by declaration to the seller, reduce the purchase price. The ground for exclusion under section 323 (5) sentence 2 does not apply.”).

5. Summary

The differences in interpretation of the content of the contract, the responsibility of the parties to act in good faith throughout the contractual relationship, the requirements when a contract modification is possible, and differences in the available remedies for a breach of the contracts and/or for when the purpose of the contract is frustrated evidence the risks a party faces when negotiating a contract and when deciding how to manage its risk associated with a contractual relationship. Even commercial parties that have some cross-border trade experience will be first and foremost familiar with their own law. They probably will not even know the law as such but have acquired the experience over time what is possible or not and how to interpret certain behaviour. Parties will negotiate from the basis of that acquired knowledge and “will not know what they don’t know.” Misplaced risk management and frustrations if the bargain does not eventuate as planned are the consequence. The contractual reality will be examined in the next part.

B. Contractual Behavior of MSMEs

1. Introduction

As Fiske already observed in 2004:

Without a neutral, efficient, and fair dispute resolution process that is legally enforceable, many businesses would not contract abroad for fear of foreign litigation.⁸³

Part of a neutral, efficient, and fair dispute resolution process is that the contractual risk is allocated fairly and neutrally should the parties have not stipulated the risk allocation in their contract. The European Commission’s study into intra-EU trade by small and medium sized businesses found that one third of respondents felt that the resolution of cross-border conflicts stifled their cross-border trade.⁸⁴ The World Bank and the International

⁸³ William Fisk, *Should Small and Medium-Size American Businesses “Going Global” Use International Commercial Arbitration?*, 18 *TRANSNAT’L LAW* 455, 459 (2004).

⁸⁴ *Report of the Commission on European Contract Law in Business-to-Business Transactions*, at 6 (2011), https://ec.europa.eu/commfrontoffice/publicopinion/flash/fl_320_en.pdf [hereinafter *Report of the Commission on European Contract Law*].

Finance Corporation in their 2012 co-published study, *Doing Business 2012*, reported that efficiency and transparency in dispute resolution were pivotal in encouraging cross border trade.⁸⁵

SMEs generally lack the knowledge, inclination, resources or bargaining power to incorporate a favourable choice of law clause into their contracts.⁸⁶

The unsatisfactory solution for many SMEs seems to be to “self-hedge,” restricting their cross-border trade, thereby restricting the potential growth and benefits such trade could generate. Alternatively, SMEs potentially expose themselves to the serious risks of cross-border litigation, often resulting in unfair and catastrophic results for small enterprises.

Research on the contractual realities for SMEs is scarce; if not non-existent. In particular, studies have most often relied on quantitative surveys loaded with legal terms which were incomprehensible for many SMEs.⁸⁷ To determine which mechanism to ascertain the applicable law to a cross-border contract is important to support SMEs in trading cross-border. So, how do SMEs actually contract? And what alternatives might exist? A pilot empirical study and survey conducted in New Zealand in 2015 and a broad qualitative study in New Zealand in 2018 confirmed on the one hand the anecdotal evidence of the lack of sophistication in cross border contracting by SMEs; on the other found that the extent and magnitude of the issue is underestimated and/or ignored.⁸⁸ Findings of the 2018 Austrian study supports the findings of the New Zealand study in so far that SMEs avoid recourse to the law and lawyers.⁸⁹

⁸⁵ World Bank Group [WBG] and Int'l Fin. Corp. [IFC], *Doing Business 2012: doing business in a more transparent world* (2012), <https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB12-FullReport.pdf>.

⁸⁶ Haeneke van Oeveren, “It Hurts My Head to Think About It”—SMEs and the Legal Framework for International Commercial Contracts (Aug. 3, 2016) (unpublished L.L.M. thesis, Victoria University Law Faculty) (on file with the Victoria University of Wellington Library).

⁸⁷ See *Report of the Commission on European Contract Law*, *supra* note 84.

⁸⁸ See van Oeveren, *supra* note 86 (The results of the 2018 qualitative empirical study are for the first time incorporated into this Article.).

⁸⁹ Compare with Petra Butler & Christina Geissler, *SMEs and International Dispute Resolution*, Vienna Arbitration Days 2019 (forthcoming Mar. 2019).

2. *The New Zealand Studies*

The New Zealand 2015 pilot study interviewed twelve New Zealand businesses from different areas, from manufacturing to IT, located all around the country.⁹⁰ The 2018 study interviewed 33 SMEs again from manufacturing, to agricultural products, to IT located around the country. The 2018 study also interviewed four large companies from different sectors located in different parts of the country. In addition, in 2018 four Singaporean SMEs were interviewed which allows for an insight into SME contractual behaviour in a very different market from New Zealand.⁹¹ Some findings from the Austrian study which to date has interviewed 15 SMEs will be referred to.

3. *Lack of Single Contract Document*

The New Zealand study found that many SMEs do not have one single contract document.⁹² Contracting is done in a piecemeal fashion frequently through a mixture of emails, phone calls, and even What's App or WeChat.⁹³ Order forms, export documentation, or bill of lading are often the most comprehensive one single document of the contract.⁹⁴ However, the more complex the product, e.g., the product contains intellectual property rights, or involves distribution agreements, the more likely it is that a single all-encompassing contract document exists.⁹⁵ Whether there is a "need" for a

⁹⁰ See van Oeveren, *supra* note 86.

⁹¹ Singapore's economy is distributive with many SMEs are in the import-export business.

⁹² Out of the 48 New Zealand MSMEs interviewed only 12 MSMEs (i.e., 25%) stated with an unqualified "yes" that they used a single contract document. Six MSMEs qualified their answer by either making the extent of the contract document dependent, e.g., on the country they were dealing with, whether it was the service or production side of the business, or the length of the contractual relationship. Two of the Singaporean MSMEs stated that they were using a single contract document.

⁹³ van Oeveren, *supra* note 86; 2018 study: NZ Business 8 (retail)—WeChat when importing from China; NZ Business 20 (retail) no contract document.

⁹⁴ Study 2018: e.g., NZ Business 18 (retail); NZ Business 19 (agriculture); Singapore Business A (automotive industry, buying & selling): "The terms and conditions are stated in the purchase order. Whether it is enforceable, we have never trusted it." For 2 of the Singaporean MSMEs the purchase order was the core contract document. For 4 MSMEs out of the 48 NZ MSMEs a bill of lading, an order form, an export certification were the single contract documents.

⁹⁵ Study 2018: e.g., NZ Business 3 (agriculture-exporting to 23 countries), NZ Business 7 (consumer electronics), NZ Business 24 (marine sector), NZ Business 25 (educational technology). NZ

formal contract document might also depend on in which country the contractual partner is located.⁹⁶

There was a recurring theme of a mistrust of contractual documents. There was some reluctance to require contractual counterparts to sign legalistic-looking documents, perceived as using verbose clauses to contemplate everything that has the potential to go wrong with a particular transaction. The importance of maintaining a relationship between the parties substituted for any contractual document. As one participant emphasized:

Good relationships are important to me; I am not really interested in doing deals just for the sake of a deal I would much rather work on relationships than signing documents and working at a level of distrust.⁹⁷

When asked whether he thought customers read the business' terms and conditions another participant said:

No . . . and I hope that they don't because it can only be damaging for the relationship.⁹⁸

Also instructive is the following statement by NZ Business 29 of the 2018 study:

Some we do, and some we don't. . . . It just depends on who we're dealing with—history and those sorts of things. When you've been paid upfront, it's not always as effectual and it is also depends on the specifications and things which are involved in the transaction. Most of it there is a contract but there is some people we've been dealing with for a long time where there's no actual contract as such, there's just an email back and forth what they want and we sort it out from there.⁹⁹

Interestingly, even one of the large businesses interviewed stated that contract documents (which contained a choice of law and dispute resolution

Business 26 stated: "There are two sectors. There's the product and the service. The service has a massive contract that gets associated with that. The product, there is some basic warranty but [that's all]."

⁹⁶ Study 2018: NZ Business 22 (agriculture) exporting to the U.S. and Canada finding a real need for contract document: ". . . because everything you do with them [U.S., Canada] is very contractual and it's all very organised as well."; NZ Business 12 (retail) exporting to the Pacific Islands ". . . dreaming about contracts, I deal with brutal reality. There is reality to business. The reality is you do the work and you get paid. So you have to get paid, and you have to get paid however you can. But dreaming about having contracts. . . ."

⁹⁷ van Oeveren, *supra* note 86, at 27 n.104.

⁹⁸ *Id.* at 27 n.105.

⁹⁹ *Id.* (The results of the 2018 qualitative empirical study are for the first time incorporated into this Article.)

clause) were just springboards for negotiations and were not really relied upon.¹⁰⁰

Austrian businesses on the other hand seem to value to have their contract negotiations summarised in one contract document more and have reported that they generally have one.¹⁰¹

4. Lack of Awareness of Legal Issue and Lack of Engagement of/with Legal Services

SMEs lack resources to engage legal advice or to deal with the associated processes on top of the day job of trying to sustain and to grow their business.¹⁰² In addition, SMEs generally lack awareness of the complexity of the potential legal issues illustrated by the comment of one of the participants:

If someone comes to us to do business, then I guess my gut feeling would be that whatever law we work in always applies. So if somebody rings me from the U.S. and wants to buy something from me then I assume that they came to us so our law must apply. The moment we call them instead, then U.S. law might apply.¹⁰³

In particular, they are often not aware that in cross border contracting additional issues might arise which is evidenced by the fact that of the 33 NZ MSMEs interviewed in 2018 study 13 MSMEs have gained legal advice regarding their domestic contracts but only 11 of them regarding cross border contracts. Their Austrian colleagues also avoid contact with lawyers on a regular basis. Eight SMEs out of 15 have never contacted a lawyer regarding their domestic contracts and seven never sought legal advice regarding their cross-border contracts. Only one SME stated that it often contacted a lawyer but interestingly regarding its domestic contracts.

¹⁰⁰ Study 2018: Business 35 (import, over 500 employees).

¹⁰¹ Austrian Study 2018/2019: out of 15 interviewed SMEs 11 use a single contract document, 1 sometimes, 1 uses a single contract document but none of the modifications will be recorded in writing or added to the contract document, 1 was unclear, and only 1 SME (viticulture, 2 employees): “No, not really. These are simply orders online, or according to the classic old hand slapping method.”

¹⁰² See van Oeveren, *supra* note 86, at 66; *see also* FED’N OF SMALL BUS., TIED UP: UNRAVELLING THE DISPUTE RESOLUTION PROCESS FOR SMALL FIRMS 6 (2016), <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/tied-up-unravelling-the-dispute-resolution-process-for-small-firms.pdf?sfvrsn=1>.

¹⁰³ van Oeveren, *supra* note 86, at 40 n.157.

Some of the MSMEs take a rather pragmatic view.¹⁰⁴ As one participant stated:

For a layman like myself, even reading a legal document is already something, you have a bit of an idea of what it says, but what it really means you don't really know.¹⁰⁵

Sometimes a “down-to-earth” approach prevails which echoes perceptions maybe gained by watching U.S. legal drama:

No . . . because America you know, don't kid yourself. The Americans are not going to sue me, I could poison and kill an American [with my product] and they wouldn't sue me because the lawyers would not make enough. They could take me to the cleaners, they could take my business, they could take my wife and children and sell them into slavery and they still would make enough to pay their fee.¹⁰⁶

However, even if SMEs seek legal advice the advice they are receiving often does not satisfy their needs. As participant explained

A ten-minute discussion with my solicitor, we sent a machine to the UK which I owned. I had known the dealer for a long time and there was mutual trust but once I sent the machine it was effectively out of my hands, he had it but I owned it. I had a ten minute discussion with my solicitor but he said it was a complicated thing *so I said we will forget it and go with the handshake*.¹⁰⁷

Traditional academic writing on international commercial contracts often assumes the involvement of lawyers in the contract drafting stage.¹⁰⁸ However, in many cases the value of the individual transactions will mean that the involvement of a lawyer is not a commercially viable option.¹⁰⁹ One participant clarified:

For us the amounts are just too small, if we are doing a deal worth 50,000 the profit margin might only be 10%, if we use a lawyer “poof” half the profit is gone.¹¹⁰

¹⁰⁴ “In business, it's always a risk and it's a matter of you determining if that customer is a good customer when it comes to terms of payment” Study 2018: Business 19 (agriculture).

¹⁰⁵ van Oeveren, *supra* note 86, at 27 n.107.

¹⁰⁶ *Id.* at 49 n.203.

¹⁰⁷ *Id.* at 27–28 n.108 (emphasis added).

¹⁰⁸ *Id.* at 30.

¹⁰⁹ See WILLIAM FOX, INTERNATIONAL COMMERCIAL AGREEMENTS AND ELECTRONIC COMMERCE 41 (5th ed. 2013).

¹¹⁰ van Oeveren, *supra* note 86, at 30 n.124.

Furthermore, in relation to international matters, an SME's usual lawyer might not have a broad knowledge of the best practice for key clauses in an international commercial contract. This may be particularly true for smaller firms located in regional areas of New Zealand with lawyers who engage in a broad range of legal services for both private and commercial clients. Many small businesses will customarily refer all their legal queries and issues to the same lawyer.¹¹¹ When asked about the use of drafted documents for international transactions, one participant reported that:¹¹²

I wouldn't have a clue where to start and I also probably would fear that if I went to my usual lawyer.

He wouldn't have a clue either. . . .¹¹³

5. (Perceived) Ingenuity of SMEs

An interesting slightly counter-implication of the multi-tasking SME management is their involvement with, and understanding of the day-to-day performance of contracts, as well as the negotiation thereof. In general, smaller businesses will also have fewer customers and fewer individual transactions than larger firms.¹¹⁴ Where a firm has fewer customers and fewer transactions, it is possible for the management to "hold the reins" and be personally in control and assess the risk of individual transactions.¹¹⁵ Smaller businesses may hereby have an increased ability to be selective in whom they deal with and operate on the basis of relationships rather than formal procedures.¹¹⁶ All 48 participants of the New Zealand studies stressed that "trust" was the essential element of their business relationship.

When asked whether documents for sale to a distributor included anything about dispute resolution or applicable law, one participant said:

No . . . Eventually we will have to go there but at the moment the relationships are really personal and I deal personally with all these people, and when you're sitting across the table face-to-face you work it out. But if we get bigger and employ

¹¹¹ *Id.*

¹¹² *Id.* at 30 n.124.

¹¹³ Elio F. Martinez Jr., *Representing a Small Business*, 26 GPSOLO 28, 29 (2009).

¹¹⁴ van Oeveren, *supra* note 86, at 29.

¹¹⁵ *Id.*

¹¹⁶ *Id.*

salespeople then we need more detail. As I own the business I can see the big picture, but for a salesperson that is much harder to do.¹¹⁷

The comment is illustrative of the (perceived) ability the management of a SME to avoid the need for legal recourse by retaining oversight and by being directly in control of all aspects of their business' involvement in international commercial transactions.

Learning by doing—no legal advice. 'I've read a lot of legal agreements. In an earlier life, I tried to set up a franchise business where we spent \$50,000 on franchisee agreements and supplier agreements and everything else that goes with it and I took it upon myself to learn what all that stuff meant to make sure we had a good contract. I spent a lot of time reading legalese. . . . As long as you take time to understand or think through the implications of it, sometimes an innocent sounding phrase can mean a lot more than it first looks. So, it's important to take time to really think about the implications of what they're saying. It's just logic.'¹¹⁸

Being required to sign a contractual document or requiring the other party to agree to and sign a drafted contract may induce a sentiment of the agreement no longer being a flexible agreement in the hands of the negotiators, but instead being constricted into a paper straightjacket requiring interpretation by lawyers.

The ingenuity of SME management, an illustration of the potential advantages of SMEs but also of their relationship to written formally negotiated contracts is illustrated by one New Zealand SME. An SME that frequently deals with much larger overseas companies, explained

They are dealing with one person—me. I'm dealing with their finance department and their legal department, like 30, 40 or even 50 people . . . so you're dealing with 50 people and they have lawyers on tap that are on payroll and they want to keep those guys busy. And that's why we say, yeah you can go down that track [changing our standard contract] *but you're gonna be paying our legal fees as well.*¹¹⁹

Small businesses find alternative ways to minimise the risk they take on in entering into an international transaction, which reduce the perceived importance of legal recourse.¹²⁰ One of the most obvious, and frequently

¹¹⁷ van Oeveren, *supra* note 86, at 30 n.126.

¹¹⁸ Study 2018: NZ Business 20 (production & retail).

¹¹⁹ van Oeveren, *supra* note 86, at 31 n.129 (emphasis added).

¹²⁰ 2018 NZ Business Study.

recommended, methods to minimize risk for a seller of goods or services is to require full payment before delivery or provision of the services.¹²¹ One participant's response is illustrative:

Well obviously you mitigate it, you approach it differently, but the risk would be that it is much harder, or at least I perceive it to be much harder to enforce any payment. We just don't go there, it is sort of accepted in international transactions that there is a lot more cash on delivery, pay before it leaves.¹²²

This view was echoed by another participant who said:

. . . our credit terms are payment before delivery, so we would never ship without the payment being complete or at the very least a letter of credit. So, no I would not say they are more risky but maybe that is just because we have mitigated against the risks.¹²³

Both participants considered the risk of international transactions, at least to a significant extent, to be mitigated by requiring full payment before delivery.¹²⁴

Since "trust" is the core ingredient of the business relationship, New Zealand and Austrian MSMEs seem to spend a considerable amount of time and energy of finding out about their potential contractual partner, including to travel to meet the potential new contract partner and asking around within the industry whether the potential partner is reliable.¹²⁵ As one participant explains:

There's a number of things we do. We start a dialogue with people. We talk to others who they know in that market about them. We may use [NZTE] to look and see whether they're legitimate or not.¹²⁶

This is echoed by a Singaporean MSME in the whole sale trading business:

¹²¹ U.S. DEP'T OF COM., INT'L TRADE ADMIN., TRADE FINANCE GUIDE: A QUICK REFERENCE FOR EXPORTERS 3 (2008), <https://www.trade.gov/publications/pdfs/tfg2008.pdf>; *see also* 2018 NZ and Singapore Studies (noting that letter of credit is not a payment method that finds any favour with NZ MSMEs as none of the NZ MSMEs interviewed were partial to letters of credit).

¹²² van Oeveren, *supra* note 86, at 16 n.55.

¹²³ *Id.* at 16 n.56.

¹²⁴ *Id.* at 29.

¹²⁵ For example, study 2018: NZ Business 17 (film industry).

¹²⁶ Study 2018: NZ Business 29 (agricultural product).

We do the checks on buyers. We visit them at least once and know them well. [Or we know them through another company]. And then you can also check market information, how are their payments and [for information about the customer]. Even banks, when you put the documents through the banks, the import/export documents, they also conduct a credit report on the buyer and once they get a satisfactory credit report from the other bank, then the transaction takes place.¹²⁷

6. Concluding Observations

The studies so far have revealed that the extent of the SMEs' lack of sophistication and the lack of resources are generally underestimated. Allocation both in time and energy to the various tasks and responsibilities a SME management has to be perform mean that often even awareness of a potential legal issue is not raised neither is information sought, should awareness be present, in regard to even relative simple, let alone complex, legal issues.¹²⁸ The lack of time and the multiple tasks SME management has to fulfil means that no time or money is spent on preventive measures, such as drafting contracts¹²⁹ since time dedicated to contractual drafting is inevitably time that cannot be spent on other tasks or duties.¹³⁰

However, many small businesses, including the majority of those interviewed in the course of the New Zealand research, have been highly successful in their international endeavours, with little concern about risk management of potential disputes. Where current conditions and practices appear to be meeting commercial needs, the sentiment can arise among the businessmen themselves that, "if it ain't broke, why fix it?"

It also has to be noted that SME lobby groups, in New Zealand and Australia, so far have not demanded any change in the legal landscape to date. However, the New Zealand research suggests that at least New Zealand SMEs are so unsophisticated in regard to issues of contracting that "they not

¹²⁷ Study 2018: Singaporean Business C. Note also Singaporean Business D (manufacturing of technical instruments/machinery): "Our customers are very close with us so we visit them quite often, by emails, telephones and visits. So, we know the customers' staff very well. So, when we visit we actually know the procession, their progress, their futures, what they are doing and how the business is going. So, from the how the business is going we know how the customer is performing and what is the risk of the customer."

¹²⁸ See van Oeveren, *supra* note 86, at 28; see also Martinez, *supra* note 113, at 29.

¹²⁹ Martinez, *supra* note 113.

¹³⁰ Wyatt McDowell & Lyle Sussman, *Alternative Dispute Resolution: How Small Businesses Can Avoid the Courts in Resolving Disputes*, 69 SAM ADVANCED MGMT. J. 32, 32 (2004).

even know what they do not know.” That is why quantitative surveys trying to ascertain the preference of SMEs for a particular dispute resolution regime have to be taken with a grain of salt since contrary to large businesses they lack the knowledge and experience to answer the questions asked.¹³¹

7. Conclusion

The New Zealand and Austrian research indicates that SMEs seem to have developed unique coping mechanisms in regard to their internationalisation. The research also strongly suggests that education and sample contracts or choice of law clauses, as can be found on industry websites or in industry publications,¹³² are a nearly futile exercise. SMEs often do not have the awareness that they should include a choice of law clause in their contracts or they do not have the “head space” or the expertise to investigate those offered solutions. The question therefore arises whether there is a solution to safeguard SMEs from potential dispute disasters.

III. THE SOLUTION

The solution for sale of goods contracts which still account world-wide for the majority of cross-border contracts,¹³³ lies in the United Nation Convention on the International Sale of Goods (CISG). The CISG has been ratified by 90 states.¹³⁴ The CISG provides a neutral set of rules, i.e., autonomous from any domestic legal system, for international sale of goods

¹³¹ That was evidenced by a quantitative study the New Zealand Institute for Economic Research conducted at the same time of van Oeveren’s qualitative research. *See* GEORGIA WHEELAN, NZIER, EVALUATING THE PROPOSED BILATERAL ARBITRATION TREATY: NZIER REPORT TO VICTORIA UNIVERSITY OF WELLINGTON LAW FACULTY (2016).

¹³² *E.g.*, INTERNAL CHAMBER OF COMMERCE RESOURCES FOR BUSINESSES, <https://iccwbo.org/resources-for-business/> (last visited Mar. 15, 2019); INSTITUTE OF EXPORT & INTERNATIONAL TRADE, <https://www.export.org.uk/page/Resources>, (last visited Mar. 15, 2019); INTERNATIONAL BUSINESS RESOURCES, <https://fittfortrade.com/fitt-international-business-resources-non-registered> (last visited Mar. 15, 2019).

¹³³ MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT, THE SMALL BUSINESS SECTOR REPORT 8 (New Zealand Gov’t, 2014).

¹³⁴ UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html (last visited Apr. 25, 2019).

transactions.¹³⁵ It encapsulates the modern understanding of the key legal contract principles in regard to international sales and is heralded as a successful amalgamation of common and civil law contract principles.¹³⁶ According to WTO trade statistics, nine of the ten largest export and import nations are CISG contracting states, with the United Kingdom being the exception. Those ten countries account for more than 50% of world trade.¹³⁷ It follows that international sale of goods contracts account for a large majority of international contracts and that therefore the CISG is therefore the most widely accepted uniform international sales law.

The key advantage of the CISG is that it provides a uniform and neutral set of substantive rules specifically drafted for international sale of goods contracts. Importantly, unlike some national contract laws that favor either the buyer or the seller, the CISG balances the rights and obligations of both equally. The CISG provides for the substance of an international sale of goods dispute what international arbitration provides in regard to procedure: a neutral, independent from any domestic law, regulatory framework. Parties who want their international sale of goods disputes decided in a truly international manner should choose the CISG as applicable law if possible. Parties who lack the sophistication to agree on a choice of law clause in their contract and whose business lies in one of the CISG member states are subject by default to a contract law regime that will provide for a business orientated set of rules that takes into the circumstances of the parties.

¹³⁵ Article 7 CISG directs to an autonomous interpretation of the CISG void of any fall back on domestic principles. CISG academic literature is almost unanimous in the conclusion that recourse to any national law, which must be defined according to private international law rules, is an *ultima ratio* solution for gap filling under the CISG and should be avoided as far as possible. SCHWENZER & HACHEM, SCHLECHTRIEM & SCHWENZER COMMENTARY ON THE UN CONVENTION ON THE INTERNATIONAL SALE OF GOODS, art. 7 para. 42, (Oxford 4th ed. 2016). *See also* JOHN HONNOLD & HARRY FLECHTNER, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION 146–48 (Wolters Kluwer 4th ed. 2009). *See also* Ulrich Magnus, in VOL XIV STAUDINGERS KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH (De Gruyter 14th ed. 2011). *See also* PETER SCHLECHTRIEM & PETRA BUTLER, UN LAW ON INTERNATIONAL SALES 50, 51 (Springer, Verlag, Berlin, Heidelberg, 2009). *See also* United Nations Convention on Contracts for the International Sale of Goods, art. 7, Apr. 11, 1980, S. Treaty Doc. No. 98-9 (1983), 19 I.L.M. 668 (1980) [hereinafter CISG].

¹³⁶ Compare PETER SCHLECHTRIEM, DRAFTING CONTRACTS UNDER THE CISG: 25 YEARS OF THE CISG: AN INTERNATIONAL LINGUA FRANCA FOR DRAFTING UNIFORM LAWS, LEGAL PRINCIPLES, DOMESTIC LEGISLATION AND TRANSNATIONAL CONTRACTS 167, 168 (Harry Flechtner et al. eds., Oxford University Press 2008).

¹³⁷ *See* WORLD TRADE ORG., ECONOMIES BY SIZE OF MERCHANDISE TRADE IN 2013, http://www.wto.org/english/ress/statise/its2014e/its14worldmapsmerchandise_e.pdf (last visited Mar. 1, 2019).

How the CISG deals with the four legal issues discussed earlier will serve as an illustration that the CISG provides a sophisticated default contract regime and that, therefore, every effort should be undertaken by the respective business communities to lobby the governments of non-CISG member states to ratify the CISG. On a domestic level Chambers of Commerce, industry organizations, and MSME interest groups need to educate MSME's about the advantage of the CISG and its applicability. Universities have the obligation to teach the CISG to the next generation of lawyers.

However, before briefly outlining the CISG's response to the discussed issues it has to be noted when the CISG is applicable to a sale of goods contract. Regarding the application of the CISG to business-to-business international sale of goods contract by an arbitral tribunal, three scenarios have to be distinguished (Article 1 CISG).¹³⁸ Firstly, and uncontroversially, an arbitral tribunal will generally respect the choice of the CISG by commercial parties as the governing law of their sale of goods contract.¹³⁹ Second, it is also uncontroversial that Article 1(1)(b) CISG can be applied by an international arbitral tribunal.¹⁴⁰ Article 1(1)(b) dictates the application of the CISG when the rules of the private international law of the forum lead to the application of the law of a CISG Member State. Article 1(1)(b) is not a choice of law rule. It gives the CISG domestic law status and prevents any possible renvoi.¹⁴¹ Third, it is controversial, however, whether an arbitral tribunal can apply the CISG by virtue of Article 1(1)(a) CISG, which

¹³⁸ See also SCHWENZER & HACHEM, *supra* note 135, at art. 1-6 para. 12.

¹³⁹ An arbitral tribunal will apply the CISG as the choice of the parties directly if the parties have chosen the law of a member state without any specification since the CISG is part of its domestic law. However, the requirements of Article 1(1) have to be met. In addition, a tribunal will respect the direct choice of the CISG as applicable law if it is either acting as amiable compositeurs or if the lex arbitri permits or even requires the application of rules of law instead of (or in addition to) a particular domestic law. See also SCHWENZER & HACHEM, *supra* note 135, at art. 1-6 para. 12.] Note that issues of the application of mandatory rules or order public in regard to the application of the CISG should only arise in exceptional circumstances (potentially in regard to interest if the seat of the arbitration is in an Islamic state) since the CISG was drafted with the aim to amalgamate the world's legal regimes.

¹⁴⁰ George Petrochilos, *Arbitration Conflict of Laws Rules and the 1980 International Sales Convention*, 52 REVUE HELLENIQUE DE DROIT INT'L 191, 191-218 (1999); Stefan Kröll, *Arbitration and the CISG*, in CURRENT ISSUES IN THE CISG AND ARBITRATION 59 (Ingeborg Schwenzer et al. eds., Eleven International Publishing 2013).

¹⁴¹ See in regard to the application of Article 1(1)(b) ANDRE JANSSEN ET AL., THE APPLICATION OF THE CISG IN THE WORLD OF INTERNATIONAL COMMERCIAL ARBITRATION 139 (Rabels Z., 2013).

stipulates the application of businesses in two CISG Member States. The prevailing view is that Article 1(1)(a) of the CISG does not apply in the context of arbitration.¹⁴² This view is based on the understanding that the CISG is an international treaty and as such binds the states and its organs but only those. In other words, Article 1(1)(a) is a direction to the courts alone and not (international) arbitral tribunals.¹⁴³ According to the SME research conducted to date, most SME contractual disputes will be adjudicated by the courts by default. Courts will apply the CISG in the scenarios just described for arbitration with one difference: parties cannot choose the CISG as the applicable law to the contract. Private international law rules world-wide only allow the choice of a domestic law by the parties. For the CISG to apply SMEs would need to agree on the domestic law of a CISG member state.

A. Interpretation of the Contract

Article 8 CISG states

(1) For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was.

(2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances.

(3) In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.¹⁴⁴

Article 8 takes account of the fast paced business reality. Even though conceptualised at the end of the seventies it is a provision which in today's world of emails, smartphones and What's App has even gained in

¹⁴² See Petrochilos, *supra* note 140, at 191. See also Kröll, *supra* note 140, at 59.

¹⁴³ Kröll, *supra* note 140, at 65; JANSSEN ET AL., *supra* note 141, at 137; see, in regard to the view that arbitral tribunals should have regard to Article 1(1)(a), INTERNATIONAL SALES LAW, Ch. 30 paras. 63–70 (DiMatteo et al. eds., C.H. Beck 2016).

¹⁴⁴ CISG, *supra* note 135, at art. 8.

importance. Given that at least in New Zealand SMEs often only have parts of their bargain submitted to paper Article 8 allows for ascertaining the parties' true intention. As the United States Court of Appeals held in *MCC-Marble*, Article 8(3) of the CISG displaces the parol evidence rule.¹⁴⁵

B. Good Faith

Whether parties owe each other to act in good faith is controversial among CISG scholars.¹⁴⁶ The concept of reasonableness however can be found throughout the CISG.¹⁴⁷ In addition, it is uncontroversial that the aim of the CISG is to keep the relationship between the parties as long as possible.¹⁴⁸ Therefore, even if good faith is not applicable regarding the contractual relationship between the parties, the CISG does expect a reasonable behavior of the commercial parties to allow the contractual relationship to continue as long as possible. Even though the concept of reasonableness is also elusive- unlike good faith—it embodies and can be measured against common business behavior. The CISG with relying on the reasonable business person has found a way to satisfy the common law's need for certainty and the civil law's foundational principle of an overall responsibility of the contracting parties to the contract.

C. Modification of the Contract

The CISG's approach towards consideration is indicated by Article 29(1) CISG, whereby “[a] contract may be modified or terminated by the mere agreement of the parties.” According to the Secretariat Commentary

¹⁴⁵ See *MCC-Marble Ceramic Ctr. Inc. v. Ceramica Nuova D'Agostino S.P.A.*, 114 F.3d 1384 (11th Cir. 1998). See also *Mitchell Aircraft Spares Inc. v. Eur. Aircraft Serv.* AB, 23 F. Supp. 2d 915, 920–21 (N.D. Ill. E.D. 1998).

¹⁴⁶ CISG, *supra* note 135, at art. 7. See also Petra Butler, *The Use of the CISG in Domestic Law*, 3 BELGRADE L. REV. 7, 7–28 (2011). See also DISA SIM, REVIEW OF THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG): THE SCOPE AND APPLICATION OF GOOD FAITH IN THE VIENNA CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS 19–27 (Pace International Law Review ed., Kluwer Law International 2004). See also Peter Schlechtriem, *Good Faith in German Law and in International Uniform Laws*, 24 Centro de studi e ricerche di diritto comparato e straniero, Saggi, Conference e Seminari (1997).

¹⁴⁷ CISG, *supra* note 135, at arts. 8, 16, 18, 25, 77, 85, 86, 88.

¹⁴⁸ This is evidenced, for example, by the high threshold of *fundamental* breach that has to be met to avoid the contract.

Article 29(1) was intended to “eliminate” and “overrule” the common law consideration requirement.¹⁴⁹ The CISG instead requires what both common and civil law have in common—the meeting of the minds regarding a legal consequence. To dispense of the consideration requirement avoids the issues the common law jurisprudence had to deal with over the years to react to the changing business environment of, for example, long term contracts. It also avoids issues what different business cultures regard as consideration. The SME research has undoubtedly shown that the majority of SMEs would not think about consideration when modifying a contract.

D. Remedies

Under the CISG, the “wronged” party can choose either specific performance,¹⁵⁰ price reduction¹⁵¹ or damages¹⁵² as the primary remedy for a breach of the sales contract. Whether adaptation of the contract when a hardship situation arises is controversial. The majority of authors acknowledge that in the case of hardship the party that suffers the hardship should be able to demand adaptation. The authors base the cause of action either on an extended interpretation of Article 79 CISG or acknowledging an existing internal gap in the CISG that has to be filled by an autonomous interpretation. Articles 50 and 77 CISG can be drawn upon together with the international trend in domestic law to allow the remedy of adaptation to base the cause of action and the remedy of adaption within the CISG.

IV. CONCLUSION

Only 29% of the interviewed New Zealand SMEs had any awareness of the United Nation Convention on the International Sale of Goods (CISG), whereas 40% of their Austrian colleagues had heard of it. New Zealand and Austria are both member states of the CISG. SMEs in New Zealand and Austria are fortunate since they already reside in a CISG member state so that the chance that the CISG is applicable to their contract by default is high. New Zealand SMEs, if they trade cross-border, trade mostly with Australian

¹⁴⁹ Secretariat Commentary on Article 27 of the 1978 draft (draft counterpart of Article 29) at [2.3].

¹⁵⁰ CISG, *supra* note 135, at arts. 28, 46.

¹⁵¹ *Id.* art. 50.

¹⁵² *Id.* arts. 45(1)(b), 74.

SMEs. Both Australia and New Zealand are CISG member states and the CISG is applicable by default. Their Austrian counter parts trade generally with other EU states, in particular with Germany. Since nearly all EU member states are also CISG member states, the CISG will apply by default. Since the U.S. is also a CISG member state one might ask where is the problem? As demonstrated earlier in this paper, so far the research in New Zealand and Austria indicates that SMEs do not pay too much attention to a choice of law clause or even a contract. And some evidence suggests that not putting their mind to a choice of law clause and relying on the default, especially if it is the CISG, is better than for SMEs trying to do so. The following example highlights to what innovative, albeit pathological, choice of law rules two businesses agreed: the law of the seller's country was applicable if the seller would sue and the law of the buyer's country was applicable if the buyer would sue.¹⁵³

As long as SMEs trade with a business in another CISG member state the CISG will therefore be applicable to their contractual arrangement via Article 1(1) CISG. However, the UK and India, for example, are both not part of the CISG community but are important trading partners.¹⁵⁴ For SMEs to benefit from the CISG when contracting with an Indian or UK party they will have to insert a choice of law clause into their contract agreeing on a domestic law that has incorporated the CISG. A scenario, as described above, that is very unlikely to eventuate. Hence SMEs that do not have their seat of business in a CISG member state are very unlikely to benefit from the CISG.

In addition, even if the CISG was to be applicable via Article 1(1) CISG the lack of knowledge of the CISG by the legal profession often leads to an involuntary exclusion of the CISG. Anecdotal evidence suggests that most Australian and New Zealand sale of goods contracts are generally subject to either New Zealand or Australian law.

To date, 90 states have ratified the CISG, to allow MSMEs to participate in global trade supported by a modern and neutral contract law regime it is

¹⁵³ Hanneke van Oeveren, conversation, September 2018.

¹⁵⁴ As an indication of their trade competitiveness: the UK is ranked 8th and India 20th in the 2018 world trade competitiveness survey, United Kingdom Competitiveness Rank, TRADING ECONOMICS, <https://tradingeconomics.com/united-kingdom/competitiveness-rank> (last accessed Mar. 16, 2019). See also India Competitiveness Rank, TRADING ECONOMICS, <https://tradingeconomics.com/india/competitiveness-rank>.

important that especially trading nations, such as the UK and India will become CISG member states. Regarding the former, it might be that regarding the CISG, Brexit will be a blessing in disguise; the UK's potential need to form new trade relationships and ease global business for its MSMEs might encourage the UK to become a member state.¹⁵⁵

¹⁵⁵ See generally THE LAW COMMISSION AND THE SCOTTISH LAW COMMISSION, AN OPTIONAL COMMON EUROPEAN SALES LAW: ADVANTAGES AND PROBLEMS—ADVICE TO THE UK GOVERNMENT (2011).