

CHAPTER 3

Resolving International Commercial Disputes

AVOIDING BUSINESS DISPUTES

Long-term business relationships are generally the most profitable ones. Experienced executives and international managers know this, and they work very hard to foster them, at both the personal and organizational levels. Long-term relationships are based on trust. In a world where we do business with people who look, speak, and act differently from ourselves and who live and work oceans away, trust takes on a new and even more important significance. Indeed, it has been said that all international business is based on trust. Any dispute that threatens the bonds of trust can threaten future business opportunities, do irreparable harm to individual and corporate reputations, and permanently damage long-term relationships. Moreover, when disputes become combative, it can be costly, time consuming, and physically and mentally exhausting for all parties. After all, there is the real possibility that one or both of the parties will have to litigate in a protracted and expensive trial in a foreign court, before a foreign judge, and in a foreign language, and have their rights determined under foreign procedural rules and possibly foreign law. Quite often the parties must retain attorneys in more than one country. So, when disagreements break out, amicable settlements are usually the best outcome and offer the best hope of salvaging a business relationship. It is always helpful if the parties have a reservoir of trust and goodwill that they can draw on to settle the dispute in a friendly way. But, of course, this is not always possible, and the prudent international businessperson, in any contract or any venture, will seek good legal advice and always "hope for the best and plan for the worst."

Nowhere is this more important than in negotiating and drafting business contracts. The contract is the basis of any bargain and its importance cannot be

overstated. If and when a dispute arises, the terms of the contract provide the basis for dispute resolution.

Cultural Attitudes toward Disputes

Keep in mind that cultural factors will influence a party's attitude toward how disputes are settled. Americans are notorious litigators, quickly turning to the courts to redress grievances. Their combative stance can result in a "win or lose" mentality. On the other hand, in some Asian cultures, it is a virtue to seek harmony and a vice to seek discord. These differences are evident in the way American and Japanese businesspeople approach contract or business negotiations. It is quite common for Americans to include their attorney or corporate counsel as a member of the negotiating team. Indeed, many Western managers and executives would never dream of it being any other way. But to the Japanese, this may seem a little confrontational, a little unnecessary, and a bad omen or a sign that disagreement is inevitable.

All too often, Americans view the negotiating process as something to be quickly completed so the deal can be closed, the contract signed, and all can go back home. People of many other cultures, from Asia to Latin America, might see the negotiating process as a time to build a relationship and new friendships. Of course, these attitudes differ throughout the world, and from country to country, and no generalizations should be made. But one thing is certain, and that is that the rest of the world views Americans as confrontational and quick to call in the lawyers. Perhaps the words of the English Lord Denning best sum up the foreign view:

As the moth drawn to the light, so is a litigant drawn to the United States. If he can only get his case into their courts, he stands to win a fortune. At no cost to himself; and at no risk of having to pay anything to the other side . . . The lawyers will charge the litigant nothing for their services but instead they will take forty percent of the damages . . . If they lose, the litigant will have nothing to pay to the other side. The courts in the United States have no such cost deterrents as we have. There is

also in the United States a right to trial by jury. These are prone to award fabulous damages. They are notoriously sympathetic and know that the lawyers will take their forty percent before the plaintiff gets anything. All this means that the defendant can be readily forced into a settlement. *Smith Kline and French Laboratories v. Bloch*, [1983] 1 W.L.R. 730, 733-4 (Eng. C.A.).

The resolution of disputes between citizens of different countries, with business transactions that span continents and cultures, raises many complicated legal and tactical problems. Consider a dispute involving an American manufacturer that purchases thousands of meters of cloth from a Chinese supplier. The cloth is shipped to Vietnam where the manufacturer contracted to have it embroidered and sewn into pillow shams. When the finished goods arrive in the United States, it is discovered that they are damaged. Apparently the fabric was shipped from China in a defective condition, but the Vietnamese firm failed to inspect for damage as it normally did. The Chinese company claims that the time for bringing the defective fabric to its attention has long passed. The Vietnamese company says it was not its responsibility. Consider all the questions presented. To whom does the manufacturer look for remuneration? Is the relationship between the parties worth keeping, and is the case capable of being settled or should the manufacturer "take the gloves off?" Was there a contract with either party and did it specify the method of resolution, such as mediation, arbitration, or litigation, and, if so, where and under what law? If the contract does not specify, what legal rules apply to determine where the case should be heard and what law should govern? Finally, if a judgment is obtained through litigation, how will it be enforced across international borders? These are some of the questions we will discuss in this chapter.

Methods of Resolution

This chapter presents several alternatives for dispute resolution, including mediation, arbitration, and litigation. Consider a domestic dispute in which a New York supplier tries to sue a Texas distributor. This situation raises several questions: Should the parties settle, mediate, arbitrate, or litigate? Where should the dispute be heard—in New York or Texas? In federal or state court? Which law applies to the transaction—the law of New York, Texas, or some other jurisdiction? Finally, if a resolution is reached (be it a settlement, a verdict, or a judgment), how will it be enforced?

Changing the parties to an American supplier and a foreign distributor adds several dimensions to the problem. Many of the same questions that are relevant to a domestic dispute are equally relevant to an international dispute, but they become infinitely more complex. This chapter examines these questions as they apply to commercial disputes in international business.

ALTERNATIVE DISPUTE RESOLUTION

Alternative dispute resolution (ADR) usually offers a faster, cheaper, and more efficient alternative to resolving international commercial disputes than litigation. Unlike litigation, ADR requires that the parties voluntarily submit to the resolution process.

Mediation

Mediation is a voluntary, nonbinding, conciliation process. The parties agree on an impartial mediator who helps them reach a solution amicably. The final decision to settle rests with the parties themselves. It is private, and there are no public court records or glaring articles in the local press to influence local opinion about the firms. The parties reserve all legal rights to resort to binding arbitration or litigation.

Arbitration

Arbitration is a more formalized process resulting in a binding award that the courts of law in many countries will enforce. The parties must agree to arbitration, and once they do, they may not withdraw. Arbitration is frequently used in international business because it "levels the playing field" since the case may be heard in a more impartial tribunal. First, arbitration may permit the resolution of the case in a third "neutral" country, rather than in the country of one of the parties. The parties are generally free to choose a location for arbitration that is mutually convenient. For example, a dispute between an American company and a Russian company might be arbitrated in Paris or Stockholm. Disputes between American companies and Chinese companies are often arbitrated in Hong Kong. (Not only is Hong Kong still considered a neutral site, but its awards are enforceable by the courts of both the United States and China.) Secondly, the arbitrator may be chosen by the parties from a roster of impartial industry experts or



distinguished lawyers, who may also be from a third country. Finally, the case may be resolved using the impartial and straightforward rules of the arbitrating organization, rather than the procedures buried in the statutes or rules of a court of the country of one of the parties. **Arbitration rules** are the rules of arbitral tribunals that address issues such as the qualification and appointment of arbitrators, the conduct of proceedings, procedures for finding the facts and applying the law, and the making of awards. These rules are often published in multiple languages.

There are other advantages to arbitration besides neutrality. Pretrial discovery is faster and more limited than that available in the United States, resulting in less expense and delay. The process is private and records of proceedings are not publicly available as are court records. Arbitration and attorney fees are far less than similar fees in a court of law. The rules for evidence admissibility are more flexible than in many national courts. And finally, a party's right to appeal is more limited.

Although parties can always agree to arbitration, a requirement to submit to arbitration is often set out in many international contracts. Contracts for the sale of goods, commodities, or raw materials might include arbitration clauses. International shipping contracts, employment contracts, international construction contracts, financing agreements, and cruise ship tickets, to name a few, as well as in multimillion- or billion-dollar contracts may also use them. Today, arbitration helps to resolve disputes over intellectual property and licensing agreements.

Despite its reputation for being less costly than litigation, arbitration is not cheap. The International Chamber of Commerce (ICC) estimates that for a

\$1 million claim before its International Court of Arbitration in Paris, the average arbitrator's fee is \$39,379, plus \$21,715 in administrative expenses, for a total of \$61,094—or about 6 percent. For a \$100,000 claim, the average arbitrator's fee is \$10,060, plus \$5,365 in administrative expenses, for a total of \$15,424—or about 15 percent.

There are other disadvantages to arbitration in addition to cost:

- The losing party in an arbitration has a limited right to appeal the decision, which is usually reserved for rare cases involving misconduct or fraud by the arbitrator or the arbitrator exceeding his or her authority or refusing to consider material evidence.
- Discovery is limited in arbitration proceedings, and parties may proceed to an arbitration hearing without full awareness of the other side's case or all of the facts.
- Relaxed procedural rules may permit the admission of evidence that would otherwise be excluded from consideration in a court of law.
- As previously mentioned, the widespread use of arbitration clauses in contracts may result in the limitation of the right to initiate litigation for an unwary party who has not carefully read the agreement.
- Less sophisticated parties may also be at a disadvantage in such circumstances due to limited experience in the selection of an arbitrator.
- Finally, there is no precedential value to an arbitrator's decision meaning that it cannot be relied upon in future proceedings to the same extent as judicial opinions.

National Arbitral Laws. Most commercial nations today have laws permitting arbitration and specifying the effect of an arbitral award (see Exhibit 3.1). The *British Arbitration Act* went into effect in 1996. The *Arbitration Law of the People's Republic of China*,

Exhibit 3.1

Some Arbitration Treaties in Force Worldwide

Arab Convention on Commercial Arbitration (1987)

Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention, 1958)

Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (Washington Convention, 1965)

European Convention Providing a Uniform Law on Arbitration (Strasbourg Convention, 1966)

Geneva Protocol on Arbitration Clauses (1923)

Geneva Convention on the Execution of Foreign Arbitral Awards (1927)

Inter-American Convention on International Commercial Arbitration (Organization of American States, Panama Convention, 1975)



which became effective in 1994, provides that arbitrators must have eight years' prior legal experience. The Russian arbitration law, which was enacted in 1993, provides that arbitration may be conducted in Russia in any language agreed upon by the parties. The laws of many countries, such as China, Russia, Mexico, and Canada, were patterned after the 1985 *Model Law on International Commercial Arbitration* of the United Nations' Commission on International Trade Law (UNCITRAL). The U.S. *Federal Arbitration Act* dates back to 1925, but it has been modernized; it applies to both domestic and international arbitration and defers to the specific procedural rules of the arbitral body conducting the arbitration proceedings. Many U.S. states (e.g., California, Connecticut, Illinois, Oregon, and Texas) have enacted statutes on international commercial arbitration, some patterned after the UNCITRAL model.

Arbitration Bodies. Many organizations worldwide provide arbitral services. The choice is up to the parties, and this is often decided in advance and set out in the terms of the contract. Some leading private organizations for arbitration of commercial disputes include the following:

- American Arbitration Association
- Arbitration Institute of the Stockholm Chamber of Commerce
- Cairo Regional Center for International Commercial Arbitration
- China International Economic and Trade Arbitration Commission
- Dubai International Arbitration Center
- Hong Kong International Arbitration Centre
- International Court of Arbitration of the International Chamber of Commerce (ICC)
- Japan Commercial Arbitration Association
- London Court of Arbitration
- St. Petersburg International Commercial Arbitration Court
- Singapore International Arbitration Centre
- World Intellectual Property Organization (WIPO) Arbitration and Mediation Center

Two additional organizations provide dispute resolution between private parties and national governments:

- The *International Centre for the Settlement of Investment Disputes* (ICSID), a part of the World Bank group, provides arbitration for the settlement of disputes between member countries and investors who qualify as nationals of other member countries.
- The *Permanent Court of Arbitration at The Hague* provides arbitral services for commercial disputes to states, private parties, and intergovernmental organizations, including handling

mass claims and environmental disputes where one of the parties is a national government.

Each of these organizations operates under a different set of procedural rules. The ICC uses its own, highly respected rules. Many other arbitral bodies use the widely accepted rules drafted by UNCITRAL, which take into account the various legal systems and countries in which they might be used. The Hong Kong Arbitration Center, WIPO, and other organizations throughout the world, for example, use the UNCITRAL rules.

Arbitration Clauses. Many contracts contain clauses requiring that disputes be submitted for arbitration because doing so removes much of the uncertainty in the event of a breach of contract or other dispute. Here is a typical example:

All disputes or claims arising out of this contract, or breach thereof, shall be resolved by arbitration before [name of arbitral body], and according to the rules of that body. Any award rendered thereby may be entered in any court of competent jurisdiction.

While the validity of these clauses is now generally accepted, that was not always clear. In the following case, *Scherk v. Alberto-Culver*, the U.S. Supreme Court considered an arbitration clause in an international contract calling for arbitration in Paris.

Enforcement of Arbitration Awards. The courts of most nations recognize and enforce arbitral awards. In the United States, for example, an arbitral award will usually be enforced if the following conditions are met:

- The award is enforceable under the local law of the country where the award was made.
- The defendant was properly subject to the jurisdiction of the arbitral tribunal.
- The defendant was given notice of the arbitration proceeding and an opportunity to be heard.
- Enforcement of the award is not contrary to public policy.
- The subject matter of the contract at issue is not unlawful under applicable law.
- The contract at issue is not void for reasons of fraud or the incapacity of one of the parties.

More than 150 nations have signed the 1958 *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, known as the *New York Convention*, further strengthening the ability to enforce



Scherk v. Alberto-Culver

417 U.S. 506 (1974) United States Supreme Court

BACKGROUND AND FACTS

Alberto-Culver Co., a Delaware corporation with its principal office in Illinois, manufactured toiletries and hair products in the United States and abroad. In February 1969, Alberto-Culver signed a contract in Austria to purchase three businesses of Fritz Scherk (a German citizen) that were organized under German and Liechtenstein law, as well as the trademarks to related cosmetics. In the contract, Scherk warranted that he had the sole and unencumbered ownership of these trademarks. The contract also contained a clause that provided that "any controversy or claim [that] shall arise out of this agreement or the breach thereof would be referred to arbitration before the International Chamber of Commerce in Paris, France, and that the laws of Illinois shall govern." One year after the closing, Alberto-Culver discovered that others had claims to Scherk's trademarks. Alberto-Culver tried to rescind the contract; Scherk refused, and Alberto-Culver filed suit in federal court in Illinois claiming that the misrepresentations violated the Securities and Exchange Act, Sec. 10(b), and SEC rule 10b-5. Scherk moved to dismiss or to stay the action pending arbitration. In the U.S. District Court, the motion to dismiss was denied and arbitration was enjoined. The U.S. Court of Appeals affirmed. The U.S. Supreme Court granted certiorari.

JUSTICE STEWART

The *United States Arbitration Act*, now 9 U.S.C. 1 et seq., reversing centuries of judicial hostility to arbitration agreements, was designed to allow parties to avoid "the costliness and delays of litigation," and to place arbitration agreements "upon the same footing as other contracts . . ."

Alberto-Culver's contract to purchase the business entities belonging to Scherk was a truly international agreement. Alberto-Culver is an American corporation with its principal place of business and the vast bulk of its activity in this country, while Scherk is a citizen of Germany whose companies were organized under the laws of Germany and Liechtenstein. The negotiations leading to the signing of the contract in Austria and to the closing in Switzerland took place in the United States, England, and Germany, and involved consultations with legal and trademark experts from each of those countries and from Liechtenstein. Finally, and most significantly, the subject matter of the contract concerned the sale of business enterprises organized under the laws of and primarily situated in European countries, whose activities were largely, if not entirely, directed to European markets.

Such a contract involves considerations and policies significantly different from those found controlling in *Wilko v. Swan* [citation omitted]. In *Wilko*, quite apart from the arbitration provision, there was no question but that the laws of the United States generally, and the federal securities laws in particular, would govern disputes arising out of the stock-purchase agreement. The parties, the negotiations, and the subject matter of the contract were all situated in this country, and no credible claim could have been entertained that any international conflict-of-laws problems would arise. In this case, by contrast, in the absence of the arbitration provision considerable uncertainty existed at the time of the agreement, and still exists, concerning the law applicable to the resolutions of disputes arising out of the contract.

Such uncertainty will almost inevitably exist with respect to any contract touching two or more countries, each with its own substantive laws and conflict-of-laws rules. A contractual provision specifying in advance the forum in which disputes shall be litigated and the law to be applied is, therefore, an almost indispensable precondition to achievement of the orderliness and predictability essential to any international business transaction. Furthermore, such a provision obviates the danger that a dispute under the agreement might be submitted to a forum hostile to the interests of one of the parties or unfamiliar with the problem involved.

A parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate these purposes, but would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages. In the present case, for example, it is not inconceivable that if Scherk had anticipated that Alberto-Culver would be able in this country to enjoin resort to arbitration he might have sought an order in France or some other country enjoining Alberto-Culver from proceeding with its litigation in the United States. Whatever recognition the courts of this country might ultimately have granted to the order of the foreign court, the dicey atmosphere of such a legal no-man's-land would surely damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements . . .

For all these reasons we hold that the agreement of the parties in this case to arbitrate any dispute arising out of their international commercial transaction is

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to be respected and enforced by the federal courts in accord with the explicit provisions of the Arbitration Act.

Decision. Reversed and remanded.

Comment. The Court understood that an arbitration agreement was the ultimate type of forum selection clause. The Court made reference to national legislation that indicated an acceptance of arbitration (the *Arbitration Act*, 9 U.S.C 1 et. seq.). Other countries have similar national legislation or are signatories to the New York Convention and/or the European Convention on International Arbitration.

Case Questions

1. What were the Court's reasons for upholding the arbitration provision?
2. What needs of international businesses were served by the Court's holding? How were these needs addressed?
3. What factors would Alberto-Culver need to have shown in order to have overturned the arbitration provision?

awards in those countries. The *New York Convention* requires that an arbitral award made in one country be honored and enforced by the courts of another country, where both countries are parties to the Convention. The award will be enforced unless one of the defenses listed above exists or if the original award has been set aside or suspended by a court in the country in which it was made.

LITIGATION

Litigation in a court of law is the final alternative for resolving a dispute. It is used more frequently in the United States than in virtually any other country. Many countries have different procedural rules for litigating cases. First, many concepts familiar to American and English students, such as trial by jury and other traditions, may not be used in the civil law countries. While we take jury trials in criminal and civil cases almost for granted in the United States, the same is not true throughout the world. The role of the judge may be very different; in some countries, the judge is an impartial arbiter of fairness and procedure, while in other countries, he or she may examine witnesses and take an active role in the search for the truth. The discovery process, by which the parties attempt to uncover evidence in advance of trial, can also be different. For instance, oral depositions taken under oath outside of court may be routine in the United States, while China and some other countries prohibit their use. There are different rules for compensating lawyers; in the United States, for instance, contingent fees are widely used in tort cases, while in other countries, they are barred. The entire issue of damages is frequently handled differently.

Finally, many countries handle appeals differently, with some, like the United States, limiting appeals to reconsidering issues of law applied by the trial courts. In other countries, appellate courts will consider new or additional evidence.

There can also be many differences in substantive law ("the law of the case"), although this topic is too broad for this chapter. Suffice it to say that almost every body of law—contracts, torts, crimes, property, business regulation, intellectual property, and so forth—can vary from legal system to legal system and country to country. This has a tremendous impact on the outcome of litigation. Certainly, parties to a contract can have some control over the choice of substantive law and procedural rules by incorporating a *choice of law clause* in the contracts. They may also have control over where the litigation takes place by using a *forum selection clause* in the contract. Keep these critical issues in mind as you read on.

Jurisdiction

Jurisdiction, one of the key concepts of jurisprudence, is the power of a court to hear and decide a case. A court that has jurisdiction is said to be a "competent" court. The term has different meanings depending on how it is used. For example, **territorial jurisdiction** refers to the power of criminal courts to hear cases involving crimes committed within their territory.

In rem jurisdiction refers to a court's power over property within its geographical boundaries. **Subject matter jurisdiction** refers to the court's authority to hear a certain type of legal matter, such as tort cases or breach of contract. In the United States, for example, federal courts have subject matter jurisdiction over cases involving federal statutes and federal government



agencies, constitutional issues, and cases arising between citizens of different states or between citizens of the United States and citizens of foreign countries (where the amount in controversy exceeds \$75,000). The latter is known as **diversity jurisdiction**. Thus, we see that there are many different uses for the term “jurisdiction.” But one thing is certain, without it, courts are powerless to act.

In Personam Jurisdiction. In personam jurisdiction or “jurisdiction over the person” refers to the court’s power over a certain individual or corporation. No party can be made to appear before a court unless that court has personal jurisdiction. If there is no personal jurisdiction, the case will be dismissed upon the defendant’s motion. Typically, jurisdiction is obtained by having a summons served on an individual or on the legal agent of a corporation. In certain types of cases, service over those not present in the territory can be done by registered mail or even through publication in the “legal notices” section of approved newspapers. In the United States, the Due Process Clauses of the 5th and 14th Amendments to the U.S. Constitution require obtaining service of process on a defendant in a case, and of having jurisdiction over them. The method used must be authorized by statute and be fundamentally fair. The basic concept is that one should not be “hauled into court” in some distant state or country unless that person has some connection to that place.

Requirement for In Personam Jurisdiction: Minimum Contacts. At one time in U.S. legal history, the U.S. Supreme Court had interpreted the Due Process Clause to limit personal jurisdiction to people physically present in the court’s territory. As the nation grew and as interstate commerce expanded, the concept was broadened to allow jurisdiction over persons who were not present within the court’s geographical territory, but who, for reasons of justice and fairness, should be held to answer a complaint there. A modern example is a state “implied consent” statute, by which one operating a motor vehicle on the highways of a state “impliedly consents” to submitting to the jurisdiction of the courts of that state for all suits arising out of the operation of the vehicle there.

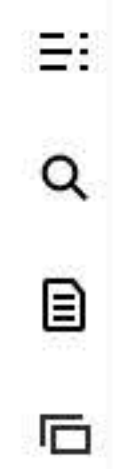
The due process requirements for *in personam* jurisdiction over persons absent from a state or territory have been carefully considered by the courts. In the now famous language of U.S. Supreme Court decisions dealing with both interstate and international

commerce, “due process requires only that in order to subject a defendant to a judgment *in personam*, if he be not present within the territory of the forum, he have certain minimum contacts with it such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice.” *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

Just how much of a connection to a foreign state or country does it take for the courts to require one to defend a case there? The courts answer the question on a case-by-case basis, looking to see whether it would be fair to ask a nonresident to come to their jurisdiction to defend a case. The courts look at many factors, including the extent of the defendant’s presence in the state, what business he or she may have conducted there, the burden on the defendant, fairness to the plaintiff, and the interest of the state in having the case resolved there. Did the defendant have an office, branch location, or salespeople in the territory of the forum? Did any of its employees or agents travel there on business? Did it advertise or otherwise solicit business there? Did it ship goods there? Did it enter into a contract there, or was the contract to be performed there? In *Worldwide Volkswagen Corp. v. Woodson*, 444 U.S. 286 (1980), the U.S. Supreme Court stated that a New York automobile distributor was not required to appear in Oklahoma to defend a product liability suit based on the sale of a vehicle that took place in New York and was later involved in a serious accident in Oklahoma.

Petitioners carry on no activity whatsoever in Oklahoma. They close no sales and perform no services there. They avail themselves of none of the privileges and benefits of Oklahoma law. They solicit no business there either through salespersons or through advertising reasonably calculated to reach the State. Nor does the record show that they regularly sell cars at wholesale or retail to Oklahoma customers or residents or that they indirectly, through others, serve or seek to serve the Oklahoma market. In short, respondents seek to base jurisdiction on one, isolated occurrence and whatever inferences can be drawn therefrom: the fortuitous circumstance that a single Audi automobile, sold in New York to New York residents, happened to suffer an accident while passing through Oklahoma.

A similar concept exists in the international context. The following case, *Asahi Metal Ind. v. Superior Ct. of California*, questions whether a Japanese manufacturing company should be forced to defend a lawsuit in California for an accident that occurred there. As you read, keep in mind that these cases are resolved on a case-by-case basis after a consideration of all the facts.



A decision on jurisdiction may depend on one or more different factors not present in other cases. In other words, it is very difficult for lawyers to counsel whether your actions will or will not subject you to a foreign

court's jurisdiction sometime in the future. In reading this case, think about what factors, if they had been present, might have forced Asahi to appear in court in California.



Asahi Metal Industry Co. v. Superior Court of California, Solano County

480 U.S. 102 (1987) United States Supreme Court

BACKGROUND AND FACTS

Asahi Metal Industry, a Japanese corporation, manufactured valve assemblies in Japan and sold them to tire manufacturers including Cheng Shin (a Taiwanese corporation) from 1978 to 1982. Cheng Shin sold tires all over the world, including in California. On September 23, 1978, in Solano County, California, Gary Zurcher was injured riding his motorcycle. His wife was killed. He filed a product liability action against Cheng Shin, the manufacturer of his motorcycle's tires, alleging that the tires were defective. Cheng Shin filed a cross-complaint seeking indemnification from Asahi. Cheng Shin settled with Zurcher. However, Cheng Shin pressed its action against Asahi. The California Supreme Court held that California state courts possessed personal jurisdiction over Asahi, and Asahi sought review by the U.S. Supreme Court. The case presented the question of whether a dispute between a Taiwanese company and a Japanese company with the above-described relationship to California should be heard by the California courts. In other words, did the California courts have personal jurisdiction over Asahi?

JUSTICE O'CONNOR

The placement of a product into the stream of commerce, without more, is not an act of the defendant purposefully directed toward the forum State. Additional conduct of the defendant may indicate an intent or purpose to serve the market in the forum State, for example, designing the product for the market in the forum State, advertising in the forum State, establishing channels for providing regular advice to customers in the forum State, or marketing the product through a distributor who has agreed to serve as the sales agent in the forum State. But a defendant's awareness that the stream of commerce may or will sweep the product into the forum State does not convert the mere act of placing the product into the stream into an act purposefully directed toward the forum State.

Assuming, *arguendo*, that respondents have established Asahi's awareness that some of the valves sold to Cheng Shin would be incorporated into tire tubes sold in California, respondents have not demonstrated any action by Asahi to purposefully avail itself of the California market. It has no office, agents, employees, or property in California. It does not advertise or

otherwise solicit business in California. It did not create, control, or employ the distribution system that brought its valves to California. There is no evidence that Asahi designed its product in anticipation of sales in California. On the basis of these facts, the exertion of personal jurisdiction over Asahi by the Superior Court of California exceeds the limits of due process.

The strictures of the Due Process Clause forbid a state court from exercising personal jurisdiction over Asahi under circumstances that would offend "traditional notions of fair play and substantial justice." *International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945), quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940).

We have previously explained that the determination of the reasonableness of the exercise of jurisdiction in each case will depend on an evaluation of several factors . . .

Certainly the burden on the defendant in this case is severe. Asahi has been commanded by the Supreme Court of California not only to traverse the distance between Asahi's headquarters in Japan and the Superior Court of California in and for the County of Solano, but also to submit its dispute with Cheng Shin to a foreign nation's judicial system. The unique burdens placed upon one who must defend oneself in a foreign legal system should have significant weight in assessing the reasonableness of stretching the long arm of personal jurisdiction over national borders.

When minimum contacts have been established, often the interests of the plaintiff and the forum in the exercise of jurisdiction will justify even the serious burdens placed on the alien defendant. In the present case, however, the interests of the plaintiff and the forum in California's assertion of jurisdiction over Asahi are slight. All that remains is a claim for indemnification asserted by Cheng Shin, a Taiwanese corporation, against Asahi. The transaction on which the indemnification claim is based took place in Taiwan; Asahi's components were shipped from Japan to Taiwan. Cheng Shin has not demonstrated that it is more convenient for it to litigate its indemnification claim against Asahi in California rather than in Taiwan or Japan.

Because the plaintiff is not a California resident, California's legitimate interests in the dispute have considerably diminished. The Supreme Court

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of California argued that the State had an interest in “protecting its consumers by ensuring that foreign manufacturers comply with the state’s safety standards.” . . . The State Supreme Court’s definition of California’s interest, however, was overly broad. The dispute between Cheng Shin and Asahi is primarily about indemnification rather than safety. Moreover, it is not at all clear at this point that California law should govern the question whether a Japanese corporation should indemnify a Taiwanese corporation on the basis of a sale made in Taiwan and a shipment of goods from Japan to Taiwan.

Considering the international context, the heavy burden on the alien defendant, and the slight interests of the plaintiff and the forum State, the exercise of personal jurisdiction by a California court over Asahi in this instance would be unreasonable and unfair.

Because the facts of this case do not establish minimum contacts such that the exercise of personal jurisdiction is consistent with fair play and substantial justice, the judgment of Supreme Court of California is

reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

Decision. The U.S. Supreme Court reversed the California Supreme Court and found that there was no jurisdiction. This Supreme Court case is significant because it lists several factors that will be taken into account in determining whether a court has personal jurisdiction.

Case Questions

Jurisdiction in the European Union. Jurisdiction in civil and commercial cases between parties domiciled in two or more European Union (EU) countries is determined by EU Council Regulation No. 1215/2012. This law was implemented in 2015 and replaced Regulation No. 44/2001 and the 1968 *Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters*. The general rule is that jurisdiction is determined by the domicile of the defendant, specifically, his or her habitual or ordinary residence. Corporations are domiciled in the Member State (i.e., member country of the EU) where they are incorporated, where they have their primary administrative offices, or where they have their principal place of business.

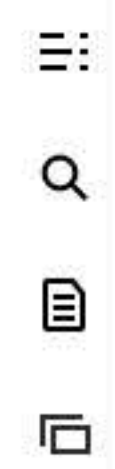
There are several exceptions to this general rule:

1. Cases involving commercial contracts for the sale of goods within the EU will be heard in the country where the goods were or should have been delivered.
2. Cases involving a breach of contract for services (other than insurance or employment) within the EU will be heard where the services were or should have been provided.
3. Tort cases, such as an action arising out of an automobile accident, will be heard before the courts in the country where the wrong occurred.

1. Why did the Court refuse to hold that the California courts had personal jurisdiction over Asahi?
2. In what activities would Asahi need to have engaged in order for the Court to determine that it had purposefully availed itself of California law? Are some of these activities more important than others? If so, which ones?
3. Did the Court give adequate weight to California’s interest in the safety of products distributed in the state? Why or why not?

4. In consumer contract cases, a consumer may bring an action against the other party to the contract either in the country in which that party is domiciled or in the country where the consumer is domiciled. Lawsuits against a consumer to enforce the contract can only be brought in the courts of the consumer’s home country.
5. An employer may sue its employee or former employee only in the employee’s place of domicile. However, an employee may bring a lawsuit against an employer either in the country where the employee is domiciled; where the employer is domiciled, or, if not domiciled in the EU, where a branch or agent is located; or in the country where the employee regularly or last worked.
6. Where at least one of the parties is domiciled in the EU, by an agreement specifying the courts of a certain EU country, provided that the agreement is in written or electronic form, or in international cases, in a form that the parties should have known amounted to a forum selection.

Jurisdiction in China. Chinese courts may not exercise jurisdiction over nonresident defendants who are merely present in China. Rather, the nonresident defendant must have a meaningful connection to China which provides a “sufficient ground” warranting the exercise of the court’s power. The *Civil Procedure Law*



of 1991 grants jurisdiction to Chinese courts based upon a nonresident defendant's conduct or property. For example, courts may exercise jurisdiction if a contract was concluded or performed in China. In such a circumstance, the Chinese court at the place of the contract or performance would possess jurisdiction over the parties. A nonresident defendant may be subject to personal jurisdiction if the subject matter of a claim is located in China, if the defendant has property in China or maintains a representative office in China. An additional "sufficient ground" for exercising personal jurisdiction is if the nonresident defendant committed a tort in China.

Jurisdiction in the Internet Age. As electronic commerce brings the world closer together, there will likely be more disputes between parties in distant countries. How will the courts fashion rules for deciding when a party must defend itself against litigation in foreign courts? Just as the meaning of "minimum contacts" adapted to the rise of interstate commerce in the United States over 70 years ago, it is now adapting to the rise of the Internet age. The following case, *Elayyan v. Sol Melia, SA*, involves personal injury and demonstrates the challenges litigants and courts confront in determining whether and under what circumstances a presence on the Internet subjects a defendant to personal jurisdiction.



Elayyan v. Sol Melia, SA

571 F. Supp.2d 886 (2008) United States District Court (Northern District of Indiana)

BACKGROUND AND FACTS

Plaintiffs Ayah and Rania Elayyan (the Elayyans) are residents of Indiana. Defendant Sol Melia is a Spanish corporation with its principal place of business in Palma de Mallorca, Spain. Sol Melia manages hotels under a variety of brands, all of which are located outside of the United States. The Elayyans filed a lawsuit against Sol Melia as a result of injuries suffered by Ayah Elayyan while in the pool of the Hotel Melia Puerto Vallarta located in Puerto Vallarta, Mexico. Sol Melia filed a motion to dismiss for lack of personal jurisdiction.

Sol Melia maintained a website which permitted users to make reservations directly with Sol-brand hotels. Potential guests were not charged when they made a reservation but rather paid the hotel upon the commencement of their stay. Sol Melia's website was available in nine languages and targeted a worldwide audience. Guests were also able to make reservations with Sol-brand hotels through third-party websites, such as "www.expedia.com" and "www.hotels.com." Sol Melia did not control the content of such websites and did not enter into contracts with guests through these websites.

The Elayyans booked their hotel stay at the Melia Puerto Vallarta through Fantasy Travel, a travel agency located in Gary, Indiana. Sol Melia was not involved in the reservations for or the booking of the Elayyan's vacation package and did not have a contract or agency relationship with Fantasy Travel, nor paid it a commission. The all-inclusive vacation package was offered by Apple Vacations, a vacation-package wholesaler, based in Illinois. Apple Vacations had purchased an allotment of rooms from the owner of the Melia Puerto Vallarta. Sol Melia was not a party to the purchase agreement.

CHERRY, U.S. MAGISTRATE JUDGE

Due Process mandates the dismissal of a case when personal jurisdiction is properly challenged and found to be lacking. See *Int'l Shoe Co. v. Washington*, 326 U.S. 310, 315 (1945). Due Process mandates that a non-resident defendant have "certain minimum contacts with the [forum state] such that the maintenance of the suit does not offend traditional notions of fair play and substantial justice." *Int'l Shoe*, 326 U.S. at 316; see also *Asahi Metal Indus. Co., Ltd. v. Superior Court of California*, 480 U.S. 102, 113 (1987). A court must examine whether a defendant's contacts with the state are such that the defendant "should reasonably anticipate being haled into court [in the forum State]," *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 474 (1985) (quoting *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297 (1980)), because the defendant has "purposefully avail[ed] itself of the privilege of conducting activities within the forum State." *Hanson v. Denckla*, 357 U.S. 235, 253 (1958).

General jurisdiction permits a federal district court to exercise personal jurisdiction over a nonresident defendant regardless of the subject matter of the litigation only when the defendant has "continuous and systematic general business contacts." *Purdue Research Found. v. Sanofi-Synthelabo, S.A.*, 338 F.3d 773, 787 (7th Cir. 2003). The Seventh Circuit has explained that "[t]hese contacts must be so extensive to be tantamount to [the nonresident defendant] being constructively present in [Indiana] to such a degree that it would be fundamentally fair to require it to answer in [an Indiana court] in any litigation arising out of any transaction or occurrence taking place anywhere in the world." "In general,

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the standard for establishing general jurisdiction is a high one." *Wilson v. Humphreys (Cayman) Ltd.*, 916 F.2d 1239, 1245 (7th Cir. 1990).

A court's ability to exercise personal jurisdiction based upon the maintenance of a website is dependent on the level of interactivity between the consumer and the operator. See *Litmer v. PDQUSA.com*, 326 F. Supp. 2d 952, 957 (N.D. Ind. 2004). The mere fact that a state's resident can access a defendant's website does not subject a nonresident defendant to general jurisdiction in that state. "Premising personal jurisdiction on the maintenance of a website, without requiring some level of 'interactivity' . . . would create almost universal personal jurisdiction because of the virtually unlimited accessibility of websites across the country." *Jennings v. AC Hydraulic A/S*, 383 F.3d 546, 550 (7th Cir. 2004). Therefore, "the likelihood that personal jurisdiction can be exercised is directly proportionate to the nature and quality of commercial activity that an entity conducts over the Internet." *Zippo Mfg. Co. v. Zippo Dot Com, Inc.*, 952 F. Supp. 1119, 1124 (W.D. Pa. 1997).

To determine whether personal jurisdiction can be properly exercised, this Court has adopted the three-step sliding scale test established in *Zippo*. At one end of the scale are "passive websites." *Aero Indus., Inc. v. DeMonte Fabricating, Ltd.*, 396 F. Supp. 2d 961, 968 (S.D. Ind. 2005). A passive website is one that only provides "contact information and descriptions of its various product lines, but [does] not enable customers to order products online." *U.S. Sch. of Golf, Inc. v. Biltmore Golf, Inc.*, 2005 U.S. Dist. LEXIS 28235, 2005 WL 3022005, at *6 (S.D. Ind. Nov. 10, 2005). Contacts with the forum state through a passive website are insufficient to establish general jurisdiction. At the other end of the sliding scale are "transactional websites," through which defendants enter into contracts and conduct highly commercial business activities with residents of the forum state. The exercise of personal jurisdiction is proper in such cases. Located in the middle of the sliding scale are "interactive websites," which allow users to exchange information with the operator but do not allow contracts to be entered into by the user and operator of the website. For interactive websites, "the exercise of jurisdiction is determined by examining the level of interactivity and commercial nature of the exchange of information that occurs on the [website]." *Zippo*, 952 F. Supp. at 1124.

Sol Melia operates an interactive website, located in the middle of the sliding scale test. Sol Melia's website does not allow contracts to be formed over the website, but it does allow consumers to place reservations. However, courts have consistently refused to exercise jurisdiction based solely on the fact that reservations can be placed and paid for through a hotel's website. Courts treat hotel websites that allow the placing of reservations similarly to other forms of national

advertising, such as toll-free reservation hotlines, which are themselves insufficient to establish general jurisdiction. Sol Melia's website allows customers to contact Sol Melia to make reservations, which is not qualitatively different from an advertisement in another medium that provides a toll-free number for reservations. Therefore, it is improper to assert general jurisdiction over Sol Melia based solely upon the ability of its website to take reservations.

Furthermore, consumers placing reservations through Sol Melia's website do not pay Sol Melia directly. Payment is completed directly with the hotel. Sol Melia's website simply makes the products and services available to the consumer, which alone is not enough to establish jurisdiction without purposeful targeting. For personal jurisdiction to be established through the maintenance of a website, the defendant must direct its business activities toward consumers in the forum state. * * *

The website is available in nine languages, evidencing Sol Melia's intent to reach a worldwide audience. The website contains no evidence that it is targeted at Indiana. Therefore, the Court cannot exercise general jurisdiction over Sol Melia based solely upon the maintenance of an interactive website.

The Plaintiffs also contend that the Court can exercise jurisdiction over the Defendant based on third-party websites, which allow reservations to be placed at Sol-brand hotels. Sol Melia does pay commissions to third-party websites for reservations placed at Sol-brand hotels. The third-party websites operate as independent sales agents, maintain their own businesses, are paid according to the results they produce, promote products for various companies, and are not under the control or direction of the companies whose products they are promoting. Sol Melia does not have an exclusive contract with or exercise control over the third-party websites. Moreover, Sol Melia pays the third-party websites according to the results they produce. Therefore, the third-party websites operate as independent sales agents.

The Court has already established that sales and sales promotion activities through independent non-exclusive sales representatives are not enough by themselves to subject an out of state company to local jurisdiction in actions unrelated to those activities. Without more, such as direct shipments to customers in the forum state—which is not the case in this matter, general jurisdiction over Sol Melia cannot be based upon the functions of third-party websites.

* * *

Having found that the Court lacks general personal jurisdiction over the Defendant, the Court turns to the issue of specific jurisdiction. An Indiana court may exercise specific jurisdiction only when the nonresident defendant purposefully availed itself of the privilege

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of conducting activities within Indiana and the plaintiff's claims arise out of the defendant's contacts with Indiana.

The only contact Sol Melia has with Indiana that could potentially constitute purposeful availment is the maintenance of its interactive website that is available for use in Indiana. As noted above, a website does not satisfy the purposeful availment test when there is no evidence that the website was specifically targeted at the forum's residents. The website is accessible worldwide and available in nine languages, evidencing its intent to target a worldwide audience, not specifically Indiana. However, because an individual Indiana resident could book a reservation through Sol Melia's website in Indiana, it is conceivable that such a contact may constitute purposeful availment for the purposes of specific jurisdiction if the individual used the website and if the alleged injury then arose out of that individual's use of the website. Neither contingency is present in this case. Here, there is no allegation that Plaintiffs made their reservation through Sol Melia's website; rather, the Complaint alleges that Plaintiffs entered into a contract with Apple Vacations for the vacation at issue. Sol Melia is not a party to any contract with Apple Vacations. Therefore, there is no connection between Sol Melia's contacts with Indiana and Plaintiffs' injuries, and the alleged injuries could not have arisen out of Sol Melia's contacts with Indiana.

There are no allegations in the Complaint related to the booking of the hotel such as breach of contract or that the Plaintiffs' injuries sustained in Mexico occurred as the result of Sol Melia's website or the booking of the reservation. Therefore, even if Plaintiffs had booked their reservation in Indiana through Sol Melia's website, the tort claim occurring in Mexico could not have arisen out of any such reservation. Accordingly, the Court does not have specific personal jurisdiction over Sol Melia.

Decision. The Court dismissed the Elayyan's complaint. The maintenance of the website did not constitute a "continuous and systematic presence" in Indiana or "purposeful availment" to the protections of Indiana law as to support the court's exercise of personal jurisdiction.

Case Questions

1. On what basis did the court hold that Sol Melia had insufficient minimum contacts with Indiana such as to support the exercise of personal jurisdiction?
2. Is the court's focus on the interactivity of Sol Melia's website valid? What factors determine whether a website is passive, interactive or transactional?
3. Is the Internet sufficiently different from non-electronically based businesses to merit different treatment for purposes of jurisdiction? Why or why not?

Obtaining Jurisdiction by Service of Process. As we have learned, a court must have personal jurisdiction over individuals or corporate entities before they can be made to appear and defend a civil case. Personal jurisdiction is obtained through lawful service of process. Without proper service, any judgment that might be taken will not be enforceable. This is especially problematic when attempting to enforce a judgment internationally. To illustrate, imagine that an American plaintiff files suit in a U.S. court against a resident of France on a contract that was performed in the United States. Assume that the plaintiff's attorney is able to obtain service of process upon the defendant in France. The French citizen does not appear in the United States and a default judgment is entered. When the American attempts to enforce the U.S. judgment in the courts of France, the defendant will claim that the method of service of process upon him was unsatisfactory under French law. If the French courts agree, the plaintiff's judgment may be worth nothing if the defendant's only

assets are in France. Thus, international lawyers trying to obtain jurisdiction over a foreign defendant are advised to consult an attorney in the defendant's country and to follow the requirements of both U.S. and French law to the letter.

Service of process upon a foreign defendant is addressed in *The Hague Convention on the Service Abroad of Judicial and Extra-judicial Documents in Civil or Commercial Matters*, in force in more than 60 countries. Authorized methods of service are different even for countries that are members of the Convention. Some countries permit service through the use of registered or certified mail, with a return receipt signed by the defendant being served, although other countries (e.g., Germany, Norway, Egypt, China, and others) do not permit this method. Some countries permit personal service by an agent or attorney of the plaintiff located in the defendant's country who signs an "affidavit of service" at a nearby U.S. embassy affirming that he or she has served the defendant with notice and a copy

of the complaint. Most countries require the complaint to be in the local language as well as in English. Perhaps the safest method, but one that can cause very long delays (up to a year, according to the U.S. State Department), is a formal request for service made through a **letter rogatory** (a "letter of request" sent through diplomatic channels) that results in personal service on the defendant by the courts of the country in which he or she is found. Defendants located in countries not parties to this Convention can also be served with process with a letter rogatory.

Venue

Jurisdiction is often confused with the concept of venue. **Venue** refers to the geographical location of a court of competent jurisdiction where a case can be heard. While the courts of several different states or countries may have proper jurisdiction, the concept of venue helps decide which one of these should actually hear the case. For instance, in some civil lawsuits between citizens of different states, we know that the federal courts may have jurisdiction. But in which federal districts should the suits be tried?

Imagine an automobile accident in which the passengers of one car are residents of Pennsylvania, while the driver of the other vehicle is a resident of North Carolina, and the accident occurs while they are both on vacation in California. We know that jurisdiction is proper in the federal courts (and it may also be proper in some state courts). But we certainly would not expect that the case could be tried in a federal court located in Montana. Federal rules generally permit the case to be heard where all of the plaintiffs reside, where all of the defendants reside, or where the cause of action arose. (In complex transnational litigation, it is not unusual that courts in several countries might attempt to exercise jurisdiction over the matter.) While typically the plaintiff will initially choose where to file its suit, it is not unusual for a defendant to request a change of venue, asking that the case be removed to a location that is more convenient and that has a closer connection to the facts of the particular case.

Forum Non Conveniens

The legal doctrine of **forum non conveniens** (meaning "inconvenient forum") refers to the discretionary power of a court to refuse to hear a case, even though jurisdiction and venue are otherwise proper, because a court in another jurisdiction or location would be more

convenient and justice would be better served. According to this doctrine, whenever a case is properly heard in the courts of more than one jurisdiction, it should be heard in the jurisdiction that is more convenient and has the closer connection to the cause of action that led to the case. In deciding on where to hear a case, the courts will examine both "private factors" (factors affecting the convenience of the parties and their ability to pursue their claims) and "public factors" (factors related to the public interest). For example, it may be more convenient to hear a case where the action arose, where witnesses and evidence are located, where the parties reside, or in the state or country whose law applies to the case.

Imagine an airline disaster in the United States, with many plaintiffs and one airline. Jurisdiction may be proper in any number of locations, including the airline's principal place of business. But would it not be more convenient to hold the trial where the crash occurred? After all, that is where the wreckage is located, and where the controllers and other witnesses live and work. *Forum non conveniens* is applied by courts in the United States, as well as in many other countries. In the United States, it is applied by the federal courts in determining where to hear lawsuits between citizens of different states. It is also used in determining whether an international case should be heard by U.S. courts or by the courts of some other country. It is not unusual for one of the parties to a case to ask a court to transfer the case to another judicial district or location for reasons of convenience. The factors generally considered are described by the U.S. Supreme Court in *Gulf Oil v. Gilbert*, 330 U.S. 501 (1947).

Important considerations are the relative ease of access to sources of proof; availability of compulsory process for attendance of unwilling [witnesses] and the cost of obtaining attendance of willing witnesses; . . . and all other practical problems that make trial of a case easy, expeditious and inexpensive. There may also be questions as to the enforceability of a judgment if one is obtained . . . It is often said that the plaintiff may not, by choice of an inconvenient forum, "vex," "harass," or "oppress" the defendant by inflicting upon him expense or trouble not necessary to his own right to pursue his remedy. But unless the balance is strongly in favor of the defendant, the plaintiff's choice of forum should rarely be disturbed . . . There is a local interest in having localized controversies decided at home. There is an appropriateness, too, in having the trial of a diversity case in a forum that is at home with the state law that must govern the case, rather than having a court in some other forum untangle problems in conflict of laws, and in law foreign to itself.



Forum Non Conveniens in Action: In re Union Carbide Gas Plant Disaster at Bhopal. After a chemical leak at a plant in Bhopal, India, killed more than 3,000, Indian citizens filed suit in the United States against Union Carbide. At one point, almost 145 legal actions on behalf of some 200,000 plaintiffs had been consolidated for trial in federal court in New York. However, the case was subsequently dismissed on the basis of *forum non conveniens* in favor of the case being heard in India. The judge gave many reasons for the decision: the Indian legal system was better able to determine the cause of accident and assign liability; the overwhelming majority of witnesses and evidence were in India; the records of plant design, safety procedures, and training were located in India; most records were not in English and many witnesses did not speak English; the court would be unable to compel witnesses to appear and the cost to transport them to the United States would be prohibitive; visits to the plant might be necessary; there was the likelihood that the U.S. court would have to apply Indian law (the tort law of the jurisdiction where the accident occurred); and the undue burden of this immense litigation would unfairly tax an American tribunal. Also considered was India's substantial interest in the accident and the outcome of the litigation: The Indian government and Indian citizens owned 49 percent of the plant, with Union Carbide owning the rest. As the judge expressed in the opinion:

To retain litigation in this forum would be another example of imperialism, another situation in which an established sovereign inflicted its rules, its standards and values on a developing nation. This Court declines to play such a role. The Union of India is a world power in 1986, and its courts have the proven capacity to mete out fair and equal justice. To deprive the Indian judiciary of this opportunity to stand tall before the world and to pass judgment on behalf of its own people would be to revive a history of subservience and subjugation from which India has emerged. India and its people can and must vindicate their claims before the independent and legitimate judiciary created there since the Independence of 1947. This Court defers to the adequacy and ability of the courts of India. Their interest in the sad events . . . in the City of Bhopal, State of Madhya Pradesh, Union of India, is not subject to question or challenge. *In re Union Carbide Gas Plant Disaster at Bhopal*, 634 F. Supp. 842, 867 (S.D.N.Y. 1986).

The case was settled in India prior to trial in 1989 when Union Carbide agreed to pay \$470 million in compensation. In 2010, an Indian court convicted

several former Union Carbide officers of crimes arising from the accident but none from the United States. In June 2010, the Indian government announced additional compensation of \$22,000 per death and \$4,000 for those persons who developed cancer or renal failure as a result of the accident.

Forum Shopping. It is not unusual that requests to transfer on the basis of *forum non conveniens* are in truth attempts by counsel to “shop around” for a better legal deal. They may be looking for laws that are more favorable to their cases or for juries that might be more sympathetic to their sides. After all, in federal lawsuits between residents of different states, such as in tort cases, the federal courts apply the laws of the states in which they sit.

Although there are procedural rules that discourage “forum shopping,” it still weighs on the minds of most trial lawyers. The same is true, perhaps even more so, in international cases which may involve several considerations. For example, there may be procedural reasons for forum shopping, such as the availability of a jury trial, class action procedures, and liberal discovery rules. The availability of property that may be readily attached may lead some litigants to select specific forums. Forum shopping may occur in order to avoid resolution of a dispute in a country where the judicial system suffers from a perceived lack of integrity. Provisions affecting the compensation of attorneys, such as the availability of contingent fees and awards of attorney's fees, may also encourage forum shopping. A significant motivation for forum shopping is the perception that U.S. courts will be more likely to award larger amounts of damages to injured parties than courts in other countries.

In the following case, *Fallhowe v. Hilton Worldwide, Inc.*, the district court had to decide whether a case for personal injuries should be heard in Colorado or in Mexico. The plaintiffs wanted the case heard in Colorado because, as one would expect, the possibility of winning a large damage award was much greater than in Mexico.

Forum Selection Clauses

Businesspeople and lawyers negotiating international contracts can avoid much of the uncertainty over jurisdiction and venue by including a forum selection clause in their contracts. A **forum selection clause** is a



Fallhowe v. Hilton Worldwide, Inc.

2015 U.S. Dist. LEXIS 114640 (2015) United States District Court (District of Colorado)

BACKGROUND AND FACTS

Plaintiffs Bruce and Renee Fallhowe (the Fallhowes) are residents of Colorado. Hilton Worldwide, Inc. (Hilton) is a Virginia corporation that owns the Hilton Los Cabos in Cabo San Lucas, Mexico. The Fallhowes were guests at the Hilton Los Cabos in November 2013. The Fallhowes sustained serious injuries as a result of exposure to fumigants which had been sprayed in an adjoining employee room.

The Fallhowes filed a lawsuit in Colorado against Hilton asserting claims of negligence and strict liability. Hilton claimed that, given the fact that the injury occurred in Mexico and that all witnesses were located there, the court should dismiss the action on forum non conveniens grounds. The court was required to determine the adequacy of Mexico as a forum for the lawsuit and evaluate the application of public and private interest factors.

BRIMMER, DISTRICT COURT JUDGE

Adequacy does not require that the alternative forum provide the same relief as an American court. See *Gschwind v. Cessna Aircraft Co.*, 161 F.3d 602, 607 (10th Cir. 1998). "Instead, the alternative forum is not inadequate unless its remedy is 'so clearly inadequate that it is no remedy at all.'" *Yavuz v. 61 MM, Ltd.*, 576 F.3d 1166, 1174 (10th Cir. 2009).

Plaintiffs assert two causes of action against defendants: negligence and strict liability. First, plaintiffs argue that Mexican negligence law is not comparable to American law in that Mexican law is much more restrictive. The Court finds plaintiffs' argument unconvincing. Several courts have found that a negligence claim brought in a Mexican forum is analogous to one brought in the United States in terms of like elements and available defenses. . . . Indeed, courts have held that Mexico is an adequate forum for negligence claims despite differences between Mexican and American substantive and procedural tort law. See, e.g., *Gonzalez v. Chrysler Corp.*, 301 F.3d 377, 383 (5th Cir. 2002); *Torreblanca de Aguilar v. Boeing Co.*, 806 F. Supp. 139, 145 (E.D. Tex. 1992).

Second, plaintiffs contend that the possibility they may not be able to bring an "objective liability" action against defendant Hilton proves that Mexico is an inadequate forum. However, the complete absence of a strict liability cause of action does not render a forum inadequate. Moreover, plaintiffs do not establish that an objective liability claim would be foreclosed in a Mexican forum. Plaintiffs' expert states that, "if the defendant who was 'making use' of the dangerous mechanism was doing so in the exercise of his

functions as an employee, Mexican law would allow for the vicarious liability of the employer. . . ."

Third, plaintiffs claim that the maximum size of their potential recovery in Mexico renders the forum inadequate. . . . The Court acknowledges that plaintiffs' potential recovery will be lower in Mexico than it would be in this District given the availability of "pain and suffering" damages under American law. However, while the Court is sympathetic to plaintiffs' position, a lower potential recovery does not render Mexico an inadequate forum. . . . In *Gonzalez*, a wrongful death case, the plaintiff argued that, because Mexican law did not recognize strict liability and capped damages at approximately \$2,500, the Mexican courts were inadequate. The Court held that, because the calculation of tort damages is a legitimate policy choice made by Mexico, Mexico was an appropriate forum despite the limits on damages. Further, the court noted that allowing economic viability to determine the adequacy of an alternative forum. . . .

Since the Court answered both threshold questions in the affirmative, it now weighs the various private and public interests. The private interest factors that a court is to consider are: (1) the relative ease of access to sources of proof; (2) the availability of compulsory process for compelling attendance of witnesses; (3) the cost of obtaining attendance of willing non-party witnesses; (4) the possibility of a view of the premises, if appropriate; and (5) all other practical problems that make trial of the case easy, expeditious, and inexpensive. The public interest factors that a court is to consider include: (1) administrative difficulties of courts with congested dockets which can be caused by cases not being filed at their place of origin; (2) the burden of jury duty on members of a community with no connection to the litigation; (3) the local interest in having localized controversies decided at home; and (4) the appropriateness of having diversity cases tried in a forum that is familiar with the governing law.

Private Interests

* * *

The evidence regarding plaintiffs' negligence claim is overwhelmingly based in Mexico. Both the allegedly negligent act and the injury occurred in Mexico. Defendant states that the Hilton Los Cabos' employees and contractors are in and/or residents of Mexico. . . . Assuming plaintiffs are able to bring forth an objective liability theory, the evidence regarding plaintiffs' second claim is also based largely in Mexico. Defendants argue that information regarding the specific type of chemical

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allegedly used to fumigate the room and the manner in which it was used can only be obtained through individuals and witnesses in Mexico.

As previously stated, most of the potential witnesses in this action and the company responsible for managing the Hilton Los Cabos are domiciled in Mexico. . . . Mexican citizens are beyond the Court's subpoena power. The many difficulties in obtaining testimony and evidence located in foreign jurisdictions—as shown by defendant Hilton—weigh in favor of dismissal on forum non conveniens grounds. . . .

The subject hotel where plaintiffs' claims arose is located in Cabo San Lucas, Mexico. The Court agrees that a view of the premises may be appropriate given plaintiffs' factual allegations, although an investigative firm could provide a report on which any expert opinion could be based. This factor weighs slightly in favor of forum non conveniens dismissal.

Hilton states that it may need to bring contribution claims against Mexican third parties, which will most likely include the subject hotel's management company, Operadora. Hilton states that Operadora is domiciled in Mexico and is not licensed to conduct business in the United States. It is unlikely that the Court has personal jurisdiction over Operadora, so this factor also weighs in favor of forum non conveniens dismissal. Hilton has satisfied its burden as to this factor.

Public Interests

* * *

The Court acknowledges that it is inherently more difficult for an American court to analyze and apply foreign law. However, the fact that many potential witnesses only speak Spanish is not a significant difficulty since many proceedings in this District involve Spanish-speaking parties or witnesses. The Court finds defendant Hilton has not satisfied its burden as to this factor and finds it is neutral.

The only connections claimed by plaintiffs are: (1) the defendants are United States corporations, (2) the plaintiffs are citizens of Colorado, and (3) the Hilton Los Cabos caters to American tourists. As United States citizens, jurors have a connection to this litigation.

However, the connection to the United States, much less Colorado, is minimal at best since Mexican law will govern and the injuries were allegedly caused and arose in Mexico. . . . This factor, therefore, supports forum non conveniens dismissal as defendant Hilton has met its burden.

Colorado has a minimal interest in the present litigation. "Mexico's substantial interest in holding businesses operating in Mexico accountable" and ensuring the safety of foreign tourists favors forum non conveniens dismissal given that the crux of plaintiffs' complaint is that defendants, operating in Mexico, caused them injuries. . . . Mexico has a significant interest in ensuring that foreign resorts comply with Mexican laws in order to protect one of the nation's key industries. The Court finds defendant Hilton has met its burden. This factor supports forum non conveniens dismissal. . . .

For the foregoing reasons, it is ordered that defendant Hilton Worldwide, Inc.'s Motion to Dismiss for Forum Non Conveniens is granted.

Decision. The court dismissed the Fallhowe's complaint on the basis of forum non conveniens. Mexico is an adequate forum for the maintenance of the lawsuit despite substantial differences between U.S. and Mexican tort law. Furthermore, the public and private interest factors weighed in favor of dismissal.

Case Questions

1. What were the court's reasons for applying forum non conveniens to this case and requiring refiling of the litigation in Mexico?
2. Does the court's opinion reward Hilton at the expense of the Fallhowes by requiring them to file their lawsuit in Mexico when both the plaintiffs and defendants are based in the United States?
3. Would the outcome of this case change if the political situation in Mexico became unstable? Should it change under such circumstances? Why or why not?

provision in a contract that fixes in advance the jurisdiction in which any disputes will be arbitrated or litigated. It provides certainty because the parties know where and how a dispute will be resolved in the event of a breach. One of the major advantages of these clauses is that they eliminate the last-minute attempt by lawyers to go "forum shopping" by filing suits in jurisdictions that offer the best law for their cases. The last chance for forum shopping may very well be during contract negotiations. This allows both parties to agree on a forum,

perhaps the courts of a certain country, which they find acceptable. Of course, the reality is that these clauses are often not open for negotiation at all—the party to the contract with the greatest bargaining power will simply include a fine print provision calling for disputes to be resolved in the courts of the country where it is located.

Historically, any attempt by private parties to control jurisdiction was viewed with hostility by the courts as an effort to usurp their authority. However, the realities of the international marketplace and the need to reduce



uncertainty in a dispute have persuaded many courts to accept forum selection clauses. Today, they are generally accepted as valid provided that the forum chosen has some reasonable connection to the transaction. In the following case, *M/S Bremen v. Zapata*, the U.S. Supreme Court upheld a clause calling for disputes to be resolved before the English courts, noting that U.S. courts can no longer remain geocentric in light of modern-day international trade.

CONFLICT OF LAWS

As a general rule, courts apply the law in force in their jurisdictions to the cases before them. In the United States, state courts usually apply their own states' laws. Federal courts hearing **diversity of citizenship** cases, such as breach of contract or tort actions between residents of different states, generally apply the laws of the states in which they sit (unless a federal statute or treaty controls). But these are general rules only, and there are many cases where courts apply the laws of other states, or even of foreign countries. The term **conflict of laws** refers to the rules by which courts determine which jurisdiction's laws apply to a case and how to reconcile differences between laws. In turn, the choice of law ultimately determines whether a court has jurisdiction, the rights and liabilities of the parties, and how to enforce a judgment or monetary award.

The Restatement (Second) of the Conflict of Laws

Conflict of laws rules are some of the most complex in procedural law, with different jurisdictions following

different rules. However, the concepts found in the *Restatement (Second) of the Conflict of Laws*, drafted under the auspices of the American Law Institute in 1971, provide a clear and widely accepted explanation of these rules. As a general rule, courts apply the law of the state, country, or jurisdiction that has the closest relationship to the action before them. The *Restatement (Second)* addresses different types of actions, including actions for breach of contract and for tort.

Contracts. It has been said that deciding which law governs a contract is like finding its "center of gravity." In other words, in the absence of an agreement by the parties, contracts should be governed by the law of the jurisdiction that has the most significant relationship to the transaction and the parties. The *Restatement (Second)* sets out five factors to be considered: (1) the place of contracting (i.e., where the acceptance took place); (2) the place where the contract was negotiated (particularly if the parties met and negotiated at length); (3) the place where the contract will be performed; (4) the location of the subject matter of the contract; and (5) the domicile, residence, nationality, place of incorporation, and place of business of the parties. If the contract was both negotiated and performed in the same jurisdiction, then the law of that jurisdiction will apply (except for contracts involving real estate or life insurance, which have special rules). Of these, the place of negotiation and performance is often the most important factor, especially if both parties are performing within the same jurisdiction. The place of contracting and the domicile of the parties, while not critical by themselves, are important when supporting other factors.



M/S Bremen v. Zapata Off-Shore Co.

407 U.S. 1 (1972) United States Supreme Court

BACKGROUND AND FACTS

In 1967, Zapata, a Houston-based corporation, entered into a contract with Unterweser, a German corporation, to tow Zapata's drilling rig from Louisiana to Ravenna, Italy. The contract the parties signed contained the clause "Any dispute arising must be heard before the London Court of Justice." During a storm, the rig was damaged, and Zapata instructed Unterweser's tug, the *Bremen*, to tow instead to Tampa, Florida, the nearest port. Immediately thereafter, Zapata filed suit in

federal district court in Tampa, Florida, on the basis of admiralty jurisdiction, seeking \$3,500,000 damages *in personam* against Unterweser and *in rem* against the *Bremen*. Unterweser moved to dismiss for lack of personal jurisdiction on the basis of the forum selection clause and *forum non conveniens*. Unterweser sought a stay of action pending resolution in the London Court of Justice.

The U.S. District Court and Court of Appeals denied the motion to stay, thus allowing the case to proceed in

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U.S. court despite the forum selection clause. Unterweser filed a petition of certiorari to the U.S. Supreme Court.

CHIEF JUSTICE BURGER

We hold, with the six dissenting members of the Court of Appeals, that far too little weight and effect were given to the forum clause in resolving this controversy. For at least two decades we have witnessed an expansion of overseas commercial activities by business enterprises based in the United States. The barrier of distance that once tended to confine a business concern to a modest territory no longer does so. Here we see an American company with special expertise contracting with a foreign company to tow a complex machine thousands of miles across seas and oceans. The expansion of American business and industry will hardly be encouraged if, notwithstanding solemn contracts, we insist on a parochial concept that all disputes must be resolved under our laws and in our courts. Absent a contract forum, the considerations relied on by the Court of Appeals would be persuasive reasons for holding an American forum convenient in the traditional sense, but in an era of expanding world trade and commerce, [prior cases that have decided otherwise] have little place and would be a heavy hand indeed on the future development of international commercial dealings by Americans. We cannot have trade and commerce in world markets and international waters exclusively on our terms, governed by our laws, and resolved in our courts.

Forum-selection clauses have historically not been favored by American courts. Many courts, federal and state, have declined to enforce such clauses on the ground that they were "contrary to public policy," or that their effect was to "oust the jurisdiction" of the court. Although this view apparently still has considerable acceptance, other courts are tending to adopt a more hospitable attitude toward forum-selection clauses. This view, advanced in the well-reasoned dissenting opinion in the instant case, is that such clauses are *prima facie* valid and should be enforced unless enforcement is shown by the resisting party to be "unreasonable" under the circumstances. We believe this is the correct doctrine to be followed by federal district courts sitting in admiralty . . .

This approach is substantially what is followed in other common-law countries including England. It is the view advanced by noted scholars and that adopted by the Restatement of the Conflict of Laws. It accords with ancient concepts of freedom of contract and reflects an appreciation of the expanding horizons of American contractors who seek business in all parts of the world . . . The choice of that forum was made in an arm's length negotiation by experienced and sophisticated businessmen, and absent some compelling and

countervailing reason it should be honored by the parties and enforced by the courts.

The elimination of all such uncertainties by agreeing in advance on a forum acceptable to both parties is an indispensable element in international trade, commerce, and contracting. There is strong evidence that the forum clause was a vital part of the agreement, and it would be unrealistic to think that the parties did not conduct their negotiations, including fixing the monetary terms, with the consequences of the forum clause figuring prominently in their calculations.

Thus, in the light of present-day commercial realities and expanding international trade we conclude that the forum clause should control absent a strong showing that it should be set aside. Although their opinions are not altogether explicit, it seems reasonably clear that the District Court and the Court of Appeals placed the burden on Unterweser to show that London would be a more convenient forum than Tampa, although the contract expressly resolved that issue. The correct approach would have been to enforce the forum clause specifically unless Zapata could clearly show that enforcement would be unreasonable and unjust, or that the clause was invalid for such reasons as fraud or overreaching. Accordingly, the case must be remanded for reconsideration.

Decision. Vacated and remanded for proceedings consistent with the opinion.

Comment. The Supreme Court noted the possible reasons that a forum selection clause could be unenforceable, including: (1) if it contravenes strong public policy and (2) if the forum is seriously inconvenient. These reasons still hold true today. Other reasons forum selection clauses may be ignored by the courts are because parties are of unequal bargaining power; counsel was not consulted; the clause was written in a foreign language; the clause violates federal law; or circumstances have changed (where the forum is the site of a revolution hostile to one party's country—for example, a forum selection clause choosing Iran after the Islamic Revolution). Many other countries also support the validity of forum selection clauses, including Austria, the United Kingdom, France, Germany, Italy, and many Latin American and Scandinavian countries.

Case Questions

1. What was the Court's holding with respect to the general enforceability of forum selection clauses?
2. How would you define "public policy reasons" or "serious inconvenience" for purposes of refusing to uphold a forum selection clause? What factors would you take into account in making this determination?



Torts. Traditionally, the law in the United States and in most countries has been that **tort actions**, including personal injuries, product liability, wrongful death, fraud, and business torts, should be governed by the law of the place where the injury or damage occurred (known as *lex loci delicti*). In the United States, many courts are adopting the broader view taken by the *Restatement (Second)* that tort liability should be governed by the law of the jurisdiction that has the most significant relationship to the tort and to the parties. The *Restatement (Second)* lists the following factors to be considered: (1) the place where the injury occurred; (2) the place where the conduct causing the injury occurred; (3) the domicile, residence, nationality, place of incorporation, and place of business of the parties; and (4) the place where the relationship between the parties is centered.

Choice of Law Clauses

Choice of law clauses are contract provisions that stipulate the country or jurisdiction whose law will apply in interpreting the contract or enforcing its terms. Lawyers are quite aware that laws can be very different from state to state or country to country and will consider this in contract negotiations. Indeed, the choice of law may well become a bargaining point in international contract negotiations. As a general rule, the choice of law selection will be upheld as long as there is a reasonable relationship between the transaction and the jurisdiction chosen. For example, imagine a Japanese manufacturer who enters into a contract with a buyer in New York for the shipment of goods to New York. Both parties have offices in California and sign the contract there. A clause making California law applicable to the contract would be valid, because there is a sufficient nexus, or connection, between the contract and the state of California.

Choice of law clauses are often used in conjunction with a forum selection agreement. Such concurrent use ensures that the selected forum is consistent with the selected law. A selected court thus would not be required to speculate on what law may be applicable to the case and the requirements of such law. A recent example includes the passenger tickets of guests upon the *Costa Concordia* cruise ship, which capsized off the Italian coast in January 2012. The accident resulted in

32 fatalities and 64 injured passengers. Despite the fact that the victims hailed from eight different countries, they were all bound by Section 2 of their tickets which provided as follows:

All claims, controversies, disputes, suits and matters of any kind whatsoever arising out of, concerned with or incident to any voyage that does not depart from, return to, or visit a U.S. port . . . shall be instituted only in the courts of Genoa, Italy, to the exclusion of the courts of any other country, state or nation. Italian law shall apply to any such proceedings.

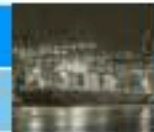
This language will most likely serve to prevent successful lawsuits in the United States and other locations where recoveries may be larger than those available in Italian courts.

The Application of Foreign Law in American Courts

If an American court determines that it should apply foreign law to the case, how does it know what that law is? At one time, foreign law was required to be proven in court as fact. Today, in the federal courts, that has changed. Courts are free to determine as a matter of law what the foreign law is. The federal courts will follow the *Federal Rules of Civil Procedure*. Rule 44.1 states:

A party who intends to raise an issue about a foreign country's law must give notice by a pleading or other writing. In determining foreign law, the court may consider any relevant material or source, including testimony, whether or not submitted by a party or admissible under the Federal Rules of Evidence. The court's determination must be treated as a ruling on a question of law.

Accordingly, judges may conduct their own research on foreign law, they may request briefs provided by the parties' lawyers, or they may rely on the testimony of foreign lawyers in or out of court. The following case, *Finnish Fur Sales Co., Ltd. v. Juliette Shulof Furs, Inc.*, involves a U.S. court in New York that had to decide a case under the laws of Finland. It offers an explanation of how a choice of law clause works and shows how a U.S. court applies the law of a foreign country to resolve a contract dispute. Notice the interplay of federal and state law and the application of Rule 44.1.



Finnish Fur Sales Co., Ltd. v. Juliette Shulof Furs, Inc.

770 F. Supp. 139 (1991) United States District Court (Southern District of New York)

BACKGROUND AND FACTS

Juliette Shulof Furs (JSF) is a New York corporation that has been in the fur-dealing business for fifteen years. George Shulof, an officer of JSF, attended two auctions conducted by Finnish Fur Sales (FFS) in Finland in 1987. He purchased more than \$1.2 million worth of skins at the auctions. Shulof attended each auction and was the actual bidder. The conditions of sale were listed in the auction catalog in English. JSF paid for the majority of the skins purchased, leaving an unpaid balance of \$202,416.85. FFS brought this action to recover the contract price of the skins from Shulof, claiming he was personally liable for payment under Finnish law. Shulof responded that he was acting only as the agent for JSF and that under New York law he was not personally responsible for the contracts of the corporation he represented at the auction.

LEISURE, DISTRICT JUDGE

Section 4 of the *Conditions of Sale* provides:

Any person bidding at the auction shall stand surety as for his own debt until full payment is made for purchased merchandise. If he has made the bid on behalf of another person, he is jointly and severally liable with the person for the purchase.

George Shulof denies any personal liability on the grounds that the provision is unenforceable under both New York and Finnish law.

Section 15 of the *Conditions of Sale* provides that "[t]hese conditions are governed by Finnish law." Choice of law clauses are routinely enforced by the courts of this Circuit, "if there is a reasonable basis for the choice." *Morgan Guaranty Trust Co. v. Republic of Palau*, 693 F. Supp. 1479, 1494 (S.D.N.Y. 1988). New York courts also generally defer to choice of law clauses if the state or country whose law is thus selected has sufficient contacts with the transaction. Under those circumstances, "New York law requires the court to honor the parties' choice insofar as matters of substance are concerned, so long as fundamental policies of New York law are not thereby violated." *Woodling v. Garrett Corp.*, 813 F.2d 543,551 (2d Cir. 1987). Finland's contacts with the transactions at issue are substantial, rendering the choice of law clause enforceable unless a strong public policy of New York is impaired by the application of Finnish law. Plaintiff FFS is a Finnish resident, which held auctions of Finnish-bred furs in Finland. All bids were made in Finnish marks, with payment and delivery to take place in Finland. Mr. Shulof voluntarily traveled to Finland in order to partake in FFS's auctions. Thus, virtually all of the significant events related to these transactions took place in Finland. Finland also has an obvious interest in applying its law to events

taking place within its borders relating to an important local industry, and in applying uniform law to numerous transactions with bidders from foreign countries.

Mr. Shulof argues that the choice of Finnish law provision should be held invalid . . . According to Mr. Shulof, New York has the following interests in this action: it is the place of business and of incorporation of JSF; FFS has a representative with a New York office who communicated with Mr. Shulof about the fur auctions; and that New York is, allegedly, "the economic and design center for the world's fur industry." Mr. Shulof also argues that, under New York law, Section 4 of the *Conditions of Sale* would be invalid as contravening New York's policy against imposing personal liability on corporate officers . . .

Under Federal Rule of Civil Procedure 44.1, a court, "in determining foreign law, may consider any relevant material or source, including testimony." Both parties have submitted affidavits of Finnish attorneys on the issue of Mr. Shulof's liability under Finnish law. FFS's expert, Vesa Majamaa, a Doctor of Law and Professor of the Faculty of Law at the University of Helsinki, gives as his opinion that the provision of Section 4 of the *Conditions of Sale* imposing personal liability upon the bidder, regardless of whether he bids on behalf of another, is valid both as a term of the particular auctions at issue and as a general principle of Finnish and Scandinavian auction law. According to Majamaa, it is "commonly accepted in Scandinavia that a bidder, by making a bid, accepts those conditions which have been announced at the auction." Further, he states: According to the Finnish judicial system, no one may use ignorance of the law as a defense . . . This same principle is also . . . applicable when the matter in question concerns . . . terms of trade . . . If the buyer is not familiar with the terms observed in an auction, he is obliged to familiarize himself with them. In this respect, failure to inquire will result in a loss for the buyer . . . If a businessman who has been and is still active in the fields falls back on his ignorance in a case in which he has been offered an actual opportunity to find out about the terms of the auction, his conduct could be considered to be contrary to equitable business practices [and] the "Principle of Good Faith." . . .

Majamaa also notes that under Danish law, which he maintains would be applied by a Finnish court in the absence of Finnish decisional or legislative law on point, "It is taken for granted that someone who has bid on merchandise on someone else's account is responsible for the transaction, as he would be for his own obligation, together with his superior . . . Hence the auction buyer's responsibility is not secondary, as is, for example, the responsibility of a guarantor." . . .

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Majamaa also opines that the terms of Section 4 are neither unexpected nor harsh because “the liability has been clearly presented in the terms of the auction,” and because the same rule of liability would apply under Finnish law in the absence of any provision.

... [T]he Court concludes that a Finnish court would enforce the provisions of Section 4 and impose personal responsibility upon George Shulof for his auction bids on behalf of JSF.

Moreover, even if a New York court would not enforce such a provision in a transaction to which New York law clearly applied, this Court does not find New York’s interest in protecting one of its residents against personal liability as a corporate officer to constitute so fundamental a policy that New York courts would refuse to enforce a contrary rule of foreign law. Indeed, the New York Court of Appeals has held that “foreign-based rights should be enforced unless the judicial enforcement of such a contract would be the approval of a transaction which is inherently vicious, wicked or immoral, and shocking to the prevailing moral sense.” *Intercontinental Hotels Corp. v. Golden*, 15 N.Y.2d 9, 13, 254 N.Y.S.2d 527, 529, 203 N.E.2d 210 (1964). Given the lack of a clear conflict with either New York law or policy, this Court concludes that a New York court would apply Finnish law to the issue before the Court. The Court also notes that a similar result has often been reached under New York conflict rules even in the absence of a contractual choice of law clause. Thus, Mr. Shulof must be held jointly and severally liable with JSF for any damages owed to FFS for the furs purchased.

Decision. Under conflict of law rules, the U.S. court applied Finnish law to hold Shulof personally liable for the contract debt.

Case Questions

1. What was the court’s holding with respect to the enforceability of the choice of law clause?
2. What factors did the court use in its decision to uphold the choice of law provision?
3. How would you define a “fundamental” public policy that would cause a court to refuse to enforce a choice of law provision?

ENFORCEMENT OF FOREIGN JUDGMENTS

At the close of a judicial proceeding, a winning party might obtain a judgment for damages or some other award. Once a judgment is taken against a defendant, it must be enforced. If necessary, it can be done through a legal process, including the seizure of the losing party’s property. But what if a judgment is won in a state or country where that party has no money or property? This is where some good detective work comes in handy. In the United States, judgments taken against a party by a court of competent jurisdiction in one state will be enforced by all other states under the *Full Faith and Credit Clause* of the U.S. Constitution. This provision requires U.S. states to recognize the public acts, records, and judicial proceedings of their sister states. However, the Full Faith and Credit Clause does not apply to the recognition of judgments from foreign countries. Rather, the issue of whether to recognize a foreign judgment is governed by state law.

Many states have statutes specifically permitting the enforcement of foreign judgments. More than 30 states have adopted either the *Uniform Foreign Money*

Judgments Recognition Act of 1962 or its successor the *Uniform Foreign-Country Money Judgments Recognition Act of 2005*. The remaining states rely on the requirements of comity in determining whether to recognize a foreign judgment. Regardless of the source of recognition, U.S. courts will usually recognize a final and conclusive foreign money judgment based on a full and fair trial on the merits of the case by an impartial tribunal. The foreign court must have had jurisdiction over the subject matter and over the parties or property involved, and the defendant must have been given notice of the action and an opportunity to appear. Judgments may not be enforced where they violate due process or public policy, where they were procured by fraud, where the original proceeding contravened a forum selection clause in a contract, where the foreign court was a seriously inconvenient forum, or where there is serious doubt about the integrity of the foreign court.

Foreign courts often enforce judgments of U.S. court on the basis of reciprocity and comity in countries where the losing party or its property can be found. Foreign courts, including several in Europe, have been known to refuse to honor the judgments of U.S. courts where in the view of the foreign court the amount of money awarded was excessive, or represented punitive



damages, or where in the opinion of the foreign judge the U.S. court extended its net of jurisdiction too widely. To ensure that U.S. judgments will be enforceable in foreign courts, or foreign judgments enforceable in the United States, it is a good idea for the plaintiff's counsel here to coordinate with counsel in the foreign country. That way they can develop some reasonable assurance that the procedures used to obtain the judgment will satisfy the courts of the country in which property is located or it will otherwise be enforced.

Rules regarding recognition of foreign judgments are similar in other jurisdictions. For example, effective December 12, 2012, European Union Regulation 1215/2012 requires mutual recognition of court judgments among EU member countries, without any special procedures. Exceptions to recognition and enforcement include judgments in violation of public policies of the state in which enforcement is sought and lack of adequate service of process and notice.

Foreign judgments may be recognized and enforced in China in accordance with a specific bilateral treaty with the jurisdiction in question or through the application of the principle of reciprocity. China has concluded bilateral recognition and enforcement treaties with 36 states to date. A Chinese court may issue an order of recognition and writ of enforcement unless it determines that the judgment contravenes Chinese law, sovereignty, public security, or public interests. Additional grounds upon which China refuses to recognize foreign judgments include lack of subject matter or personal jurisdiction, lack of notice of the foreign proceeding, and concurrent litigation regarding the same subject matter and issues in China.

The *Code of Civil Procedure*, adopted in 1908 when India was a British colony, governs recognition of some foreign judgments in India. Judgments from the so-called reciprocating territories such as the United Kingdom, Singapore, Malaysia, New Zealand, and Bangladesh may be enforced directly before an Indian court. However, judgments from "nonreciprocating territories" such as the United States may only be enforced by filing a lawsuit in India seeking entry of an Indian judgment based on the non-Indian judgment. The non-Indian judgment has only evidentiary effect. The lawsuit must be filed within three years of the date of entry of the non-Indian judgment.

Uniform Foreign Money Claims Act. As a general rule, courts award money judgments in their own currencies. For many years, U.S. courts were only able to

award judgments in dollars. This rule was rooted in English law dating back several hundred years. However, it created some problems. If an international contract called for payment in the year 2012 in Japanese yen, and a judgment for a breach of the contract is awarded in 2016 in dollars, fluctuations in currency exchange rates may have distorted the value of the judgment relative to the contract terms. One of the parties may be greatly disadvantaged, while the other may receive a windfall profit. The question of whether or not a foreign money judgment can be awarded is, in the United States, a matter of state law, not federal law. In recent years, about half of the states have enacted the *Uniform Foreign Money Claims Act*. This statute gives state courts the authority to issue a judgment in a foreign currency. Some state courts have permitted foreign money awards by judicial decision, acknowledging the need to make the parties whole. Foreign money awards have been available in Great Britain since 1975.

COMMERCIAL DISPUTES WITH NATIONS

This chapter deals with commercial disputes between private parties. Of course, governments, too, are players in commercial transactions because they are the largest purchasers of goods and services in the world. Resolving disputes with nations is quite a different matter. When governments act in their capacity as a sovereign, it is very difficult to bring them to answer in court. When they act in a commercial capacity, it is easier.

Sovereign Immunity

Sovereignty is defined as the supreme and absolute power that governs an independent state or nation. Of course, in reality, sovereignty can have a range of meanings. For example, in the United States, sovereignty can be shared between the federal government, the states, and even Native American tribes. In Europe, some national sovereignty had to be sacrificed by countries that joined the European Union. For our purposes, we should recognize that all independent countries are equal with one another and that each has the exclusive right over its citizens, its territory, all property within that territory, and its internal affairs.

It follows that the doctrine of **sovereign immunity** states that the courts of one country cannot hear cases brought against the government of another country



and that courts cannot involve themselves in the internal affairs of a foreign country. In English law this is derived from the feudal notion that the “king can do no wrong.” This principle was firmly established in the United States in *Schooner Exchange v. McFaddon*, 11 U.S. 116 (1812), in which an American merchant ship was seized by Emperor Napoleon and pressed into service with the French navy. When the ship docked at Philadelphia, its original owners filed suit to have it returned. The U.S. Supreme Court ruled that under sovereign immunity, a warship of a foreign nation was not subject to seizure by U.S. courts. Today, sovereign immunity is recognized by most nations of the world and defined by statute in many.

In the United States, the *Foreign Sovereign Immunities Act of 1976* defines jurisdiction of U.S. courts over foreign nations. This takes a somewhat restrictive view of immunity by creating exceptions courts must consider. These exceptions generally are waiver (by statute or by agreement in a contract); commercial activity; certain violations of international law such as torture, terrorism, and unlawful expropriation of private property without payment of compensation; and lawsuits for money damages for torts committed within the United States. Examples might include a lawsuit by the victim of state-sponsored terrorism or a lawsuit against a foreign government for negligence in the operation of a motor vehicle within the United States.

Commercial Activity Exception. Sovereign immunity protects foreign governments from suit when they are acting as political entities. When foreign governments or their agencies enter the commercial field, engaging in business for profit, as would a private company, or engaging in essentially private functions, they can be sued in the courts of a foreign country. When agencies of government buy and sell goods or services, they become liable for damages for breach of contract. An example is a contract between a private company in the United States and a government-owned company in China for the supply of raw materials. If the Chinese government is acting as a private company in mining, marketing, and selling raw materials, it is liable to suit in the United States (assuming other jurisdictional requirements are met) for delivering materials that do not conform to the contract specifications.

Abstention Doctrines

There are three abstention doctrines worthy of mention which may impact litigation with a foreign sovereign

or relating to an action taken by a foreign sovereign. In each of these circumstances, a U.S. court may refuse to exercise jurisdiction.

Comity. Comity refers to the willingness of one court or department of government to respect the rules or decisions of another or to grant it some privilege or favor. International comity is a judicial doctrine, not an international law, based on the desire for courtesy and reciprocity between countries. It also serves to prevent courts from embroiling themselves in matters of foreign affairs and thereby helps to avoid diplomatic conflicts. Comity allows the courts of one country to recognize the laws and court decrees of another country or to defer hearing a case that is more appropriate for hearing in the courts of another country. Under comity, for example, a court that otherwise might be entitled to hear a case may allow it to be transferred to a court in a foreign country with a greater interest in the case.

Assume, for example, there is a breach of contract for the sale of goods between two parties, the buyer residing in the United States and the seller in Japan. Assume that the contract does not mention where disputes should be resolved and that jurisdiction in the case would be appropriate in the courts of either country. If the seller files suit for payment in the courts of Japan, and subsequently the buyer (not wanting to defend the case in a foreign country) files suit in a U.S. court alleging damages for defective goods, the U.S. court will likely dismiss the case on the basis of comity to avoid a conflict with the courts of Japan. Now assume that the seller wins a money judgment in Japanese courts, but the buyer has no assets there to satisfy the judgment. The seller can take the judgment to U.S. courts for enforcement. (Keep in mind that U.S. courts will only enforce civil judgments from countries that guarantee fair trials and due process. U.S. courts will not enforce foreign tax liens or verdicts in foreign criminal cases.)

Act of State. The **act of state doctrine** is a principle of domestic law (not international law) that prohibits the courts of one country from inquiring into the validity of the legislative or executive acts of another country. It was first announced in the United States in the case of *Underhill v. Hernandez*, 168 U.S. 250 (1897) where it was held that “... [T]he courts of one country will not sit in judgment on the acts of the government of another done within its own territory. Redress of grievances by reason of such acts must be obtained through the means open to be availed of by sovereign powers as between themselves.”



Many of the U.S. cases discussing the Act of State doctrine involve the confiscation of American-owned property by foreign governments without the payment of compensation, such as occurred with Fidel Castro's communist takeover of Cuba in 1959 and with the Islamic revolution in Iran in 1979. As a general rule, the Act of State doctrine prohibits courts from embroiling themselves in such politically charged issues. The doctrine is based on the idea that courts should not intervene in matters of foreign affairs. These matters are best left to the executive branch, which has the benefit of a diplomatic corps, foreign embassies, and the ability to talk directly to foreign governments. There is also the practical reason that it may very well be impossible for domestic courts to enforce their decisions against foreign governments, as it certainly would have been in the case of both Cuba and Iran. In the latter case, a treaty between the United States and Iran led to the creation of an impartial tribunal in the Netherlands to resolve outstanding claims between U.S. citizens and the Iranian government. Courts in the United States, the United Kingdom, Germany, France, Italy, Japan, and many other countries recognize the Act of State doctrine.

Political Question Doctrine. The **political question doctrine** traces its origin to the U.S. Supreme Court's 1803 opinion in *Marbury v. Madison* in which Chief Justice Marshall stated "[q]uestions, in their nature political, or which are, by the constitution or laws submitted

to the executive, can never be made in this court." The modern version of this doctrine requires courts to consider six different factors before dismissing a lawsuit on political question grounds. These factors are: (1) constitutional commitment of the question to the executive or legislative branch; (2) a lack of judicially manageable and discoverable standards for resolving the question; (3) the impossibility of resolving the question without making a policy determination of a kind clearly for nonjudicial determination; (4) the determination of the question will result in the expression of lack of judicial respect for the executive or legislative branches; (5) the need for adherence to a previously made political decision; and (6) the potential for embarrassment of the U.S. government by differing pronouncements of policy by multiple branches of government.

CONCLUSION

When negotiating international transactions, the prudent businessperson or lawyer will hope for the best but always plan for the worst. Planning for disputes in advance is a proper method of minimizing risk in a transaction. This planning includes obtaining expert legal advice in negotiating and drafting business contracts. The importance of the contract cannot be overstated because if and when a dispute arises, the terms of the contract provide the basis for dispute resolution.

Chapter Summary

1. Alternate dispute resolution usually offers a faster, cheaper, and more efficient alternative to litigation. Mediation is a voluntary, nonbinding conciliation process. Arbitration is a more formalized process, resulting in a binding award that courts in many countries will enforce. The parties must agree to arbitration, but once they do, they cannot withdraw. Most commercial nations today have laws permitting arbitration and recognizing arbitral awards.
2. Litigation is the final step in attempting to resolve a dispute. It is in use more frequently in the United States than in virtually any other country. Many litigants from foreign countries seek ways for American courts to hear their cases. American juries are known for giving larger verdicts, and punitive damage awards are possible.
3. Jurisdiction is the power of a court to hear and decide a case. *In personam* jurisdiction, or "jurisdiction over the person," refers to the court's power over a certain individual or corporation. No court can enter a judgment against an individual or corporate defendant unless they have such jurisdiction. When a defendant is not physically present in the state, a court can obtain jurisdiction only if the party has had sufficient minimum contacts with the territory of the forum such that it is fair for the defendant. The Internet is leading to new jurisdictional issues.



4. Jurisdiction is often confused with the concept of venue. Venue refers to the geographical location of a court of competent jurisdiction where a case can be heard.

5. According to the legal doctrine of *forum non conveniens*, whenever a case can be properly heard in the courts of more than one jurisdiction, it should be heard in the jurisdiction that is most convenient.

6. The term *conflict of laws* refers to the rules by which courts determine which state or country's laws will apply to a case and how to reconcile differences between laws. In breach of contract cases, in the absence of an agreement by the parties, the law of the jurisdiction that has the most significant relationship to the transaction and the parties usually governs the contracts. The law of the place where the injury or damage occurred usually governs tort cases, although today many courts are adopting the broader view that the law of the jurisdiction that has the most significant relationship to the tort and to the parties should govern liability.

7. A forum selection clause is a provision in a contract that fixes in advance the jurisdiction in which any
- disputes will be litigated. A choice of law clause is a contract provision that stipulates which country or jurisdiction's law will apply in interpreting the contract or enforcing its terms.

8. As a general rule, U.S. courts honor the judgments of foreign countries when the requirements of comity are satisfied and when the foreign judgment was rendered by an impartial tribunal in a fashion that would not offend American notions of fundamental fairness and due process of law.

9. Foreign courts often enforce judgments of U.S. courts on the basis of reciprocity and comity in countries where the defendant or its property can be found. Some foreign courts have been known to refuse to honor the judgments of U.S. courts where, in the view of the foreign court, the amount of money awarded was excessive.

10. Commercial disputes with foreign sovereigns present many difficulties including barriers to the initiation of litigation. These barriers include sovereign immunity, comity, the act of state doctrine, and the political question doctrine.

Key Terms

alternative dispute resolution (ADR) 58	subject matter jurisdiction 62	conflict of laws 73
mediation 58	diversity jurisdiction 63	tort actions 75
arbitration 58	in personam jurisdiction 63	choice of law clauses 75
arbitration rules 59	letter rogatory 69	Full Faith and Credit Clause 77
litigation 62	venue 69	sovereign immunity 78
jurisdiction 62	forum non conveniens 69	comity 79
territorial jurisdiction 62	forum selection clause 70	act of state doctrine 79
in rem jurisdiction 62	diversity of citizenship 73	political question doctrine 80

Questions and Case Problems

1. Explain the concepts of jurisdiction and minimum contacts. What application do they have in international disputes?

2. Naoko Ohno, a Japanese citizen, obtained a \$1.2 million tort judgment against the Saints of Glory Church, a California corporation, and its pastor Yuko Yasuma, a California resident, in Tokyo District Court. The basis for the
- judgment was a transfer of money by Ohno to the church allegedly as a result of undue pressure. The judgment was affirmed on appeal by the Tokyo High Court. Ohno then initiated an action seeking recognition and enforcement of the judgment under California's *Uniform Foreign-Country Money Judgments Recognition Act*. The church and Yasuma objected to recognition and contended that



the judgment imposed liability for its religious teachings in violation of its constitutional right to free exercise of religion. As a result, the church and Yasuma argued that the Japanese judgment was not entitled to recognition or enforcement under California law as it was repugnant to public policy. The district court granted judgment in Ohno's favor, and the church and Yasuma appealed. How should the court of appeals decide this case? Is recognition of the Japanese judgment "repugnant"? Do judgments resulting from cases concerning religious disputes violate public policy such that the results should not be recognized and enforced? Why or why not? *Ohno v. Yasuma*, 723 F.3d 984 (9th Cir. 2013).

- Two teenagers residing in North Carolina were fatally injured when the bus upon which they were riding overturned on a roadway outside of Paris, France. The parents of the decedents brought a lawsuit in North Carolina state court against Goodyear Tire and Rubber Company and its subsidiaries based in Luxembourg, Turkey and France alleging that the accident was caused by negligent design and production of the bus tires. The subsidiaries moved to dismiss for lack of personal jurisdiction. The plaintiffs alleged that North Carolina courts had personal jurisdiction due to the fact that the subsidiaries placed their tires into the stream of commerce and some of these tires ended up in North Carolina. The subsidiaries alleged that there was no personal jurisdiction as the mere placement of a product in the stream of commerce is an insufficient basis for the assertion of personal jurisdiction especially when the accident had no connection with the forum other than the residence of the decedents. Additionally, the mere placement of tires into the stream of commerce did not constitute a continuous and systematic presence in North Carolina as to subject the subsidiaries to personal jurisdiction. The North Carolina state courts disagreed and exercised personal jurisdiction over the subsidiaries. The subsidiaries appealed to the U.S. Supreme Court. Do the North Carolina courts have personal jurisdiction over Goodyear's foreign subsidiaries arising from the accident in France? *Goodyear Dunlop Tires Operations, S.A. v. Brown*, 131 S. Ct. 2846 (2011).
- Nicastro was severely injured at his workplace in New Jersey by an industrial metal shearing machine manufactured by J. McIntyre Machinery, Ltd., an English company. Nicastro filed a product liability claim against McIntyre in New Jersey state court. McIntyre denied that the New Jersey state courts had personal jurisdiction. The machinery in question was manufactured in England and was not directly sold to Nicastro's employer in New Jersey. McIntyre had no office, did not pay taxes, own property, advertise, or maintain employees in New Jersey. Although McIntyre had a U.S. distributor for its products and sent its employees to the United States to attend trade shows,

its only contact with New Jersey was the presence of the metal shearing machine at Nicastro's workplace. The New Jersey Supreme Court disagreed with McIntyre's contentions and held that state courts could exercise personal jurisdiction with respect to Nicastro's claim. McIntyre appealed this decision to the U.S. Supreme Court. Do the New Jersey courts have personal jurisdiction over McIntyre arising from Nicastro's injuries? *J. McIntyre Machinery, Ltd. v. Nicastro*, 131 S. Ct. 2780 (2011).

- Why do so many litigants, "like moths to a flame," want to litigate in the United States?
- Seung was a passenger on the *M/S Paul Gauguin* cruise ship owned by Regent Seven Seas Cruises. The cruise ship operated exclusively in French Polynesia. Seung's ticket contained a forum selection clause that designated Paris, France, as the sole location for any lawsuit that might be filed arising from passenger injuries on cruises that did not include a U.S. port. Seung was injured on her cruise and filed a lawsuit in the U.S. District Court for the Southern District of Florida. Regent Seven Seas Cruises moved to dismiss the lawsuit on the basis of the forum selection clause. Seung claimed that the clause violated U.S. public policy, was unfair and unreasonable as she was financially and medically unable to bring a lawsuit in Paris, and that Paris was a "remote alien forum" designated for the sole purpose of discouraging passengers from bringing legitimate claims. The district court disagreed with Seung and dismissed her lawsuit. Seung appealed to the U.S. Court of Appeals for the Eleventh Circuit. Is the forum selection clause as drafted enforceable against Seung such as to bar her lawsuit in the United States? Why or why not? *Seung v. Regent Seven Seas Cruises, Inc.*, 2010 U.S. App. LEXIS 17449 (11th Cir. 2010).
- The *Uniform Foreign Money Judgments Recognition Act of 1962* and the *Uniform Foreign-Country Money Judgments Recognition Act of 2005* do not mention any requirement of reciprocity. However, several states will not recognize foreign judgments without assurance that judgments entered in their courts will be enforced overseas. Criticism of such a requirement has focused on the absence of reciprocity in English common law and U.S. statutes and common law, the holding of the interests of private litigants hostage to the government's interest in promoting reciprocity, and the gridlock that results as the United States and foreign states refuse to recognize one another's judgments due to failure to reciprocate. Should recognition of foreign judgments in U.S. state courts be subject to a reciprocity requirement? Why or why not?
- Michael Ghannoum, a resident of Texas, was hired to work as a pilot for Qatar Airways. Qatar Airways is entirely owned by the government of Qatar. Ghannoum's employment was based in Qatar, where he resided under



a Qatari resident permit. Qatar Airways' chief executive officer Akbar Al Baker allegedly terminated Ghannoum without cause and refused to pay Ghannoum for one month's work. Qatar Airways subsequently cancelled Ghannoum's residency permit which prevented him from leaving the country to interview for jobs with other airlines. Ghannoum was subsequently deported from Qatar and was unable to return to the country for two to four years. Ghannoum filed a lawsuit against Qatar Airways for tortious interference with prospective relations, intentional infliction of emotional distress, invasion of privacy, and defamation. Qatar Airways moved to dismiss on the basis of *forum non conveniens*, contending that Qatar was a more convenient forum for the resolution of the claims. Qatar Airways conceded that Qatar would not be an adequate and available forum if Ghannoum was not permitted to reenter Qatar. However, Qatar Airways promised the court that it would do everything within its power to facilitate Ghannoum's reentry into Qatar to allow him to file and pursue his claims there. Under the circumstances, is Qatar an adequate alternative forum? What are the private and public interest factors at stake? How do these factors balance in this case? *Ghannoum v. Qatar Airways*, 2014 WL 4354436 (S.D. Tex. Sept. 2, 2014).

9. Pebble Beach Company (Pebble Beach) is a well-known golf course and resort located in Monterey County, California. The golf resort has used "Pebble Beach" as its trade name since 1956. Pebble Beach operates a website located at www.pebblebeach.com. Caddy ran a three-room bed and breakfast, restaurant, and bar located in southern England. The name of Caddy's operation was "Pebble Beach." Caddy advertised his services, which did not include a golf course, at his website, www.pebblebeach-uk.com. Caddy's website included information about the accommodations he provided, including lodging rates in pounds sterling, a menu, and a wine list. The website did not have a reservation system and did not allow potential guests to book rooms or pay for services online. Visitors to the website who had questions about Caddy's services were required to fill out an online inquiry form. Pebble Beach sued Caddy for infringement of its "Pebble Beach" trademark in federal court in California. Caddy moved to dismiss the complaint for lack of personal jurisdiction. The district court granted Caddy's motion, and Pebble Beach appealed. May Caddy's website serve as the basis for personal jurisdiction in California? How should the appellate court classify Caddy's website? What did the court of appeals decide? *Pebble Beach Co. v. Caddy*, 453 F.3d 1151 (9th Cir. 2006).

Managerial Implications

1. You are CEO of a large publicly traded company. You are negotiating several contracts with foreign governments in Vietnam, India, and Brazil to provide hardware and software to government agencies. Are you interested in including an arbitration clause in the contract? What are the pluses and minuses of such a clause? What alternatives do you have? How does your plan change, if at all, if you are dealing with multiple corporations in the same countries? What if you are dealing with one corporation in the United Kingdom and one in New York? Discuss how these variables may affect your decision.
2. You have started a small high-tech company in New York.
 - a. You are running an informational website. Customers must call your 800 number to place an order. A customer in Alaska is very unhappy with your product. Can he or she successfully sue you in Alaska?
 - b. You decide you want to be clear in all your future dealings, so you insert a forum selection clause in all of your contracts with your customers that stipulates arbitration in New York under the rules of the American Arbitration Association. Would this be enforceable?
 - c. What if the forum selection clause stated that all disputes would be heard in Tibet?
 - d. What ramifications are there to changing your website and making it more interactive so that people can place orders there?
 - e. What if your competitor is using your trade secrets and your patents without your permission or payment? Would you be interested in arbitrating this dispute? Explain.
 - f. What difference would it make if your competitor were a Dutch company?
 - g. The CEO has asked you to outline a comprehensive strategy to deal with customers, suppliers, and citizen groups complaining about a myriad of issues as well as employee complaints (both domestic and foreign). Prepare a short memo addressing key principles, major concerns, and suggested actions.

Ethical Considerations

The Bhopal disaster litigation presented the anomaly of Indian plaintiffs seeking to maintain their lawsuit in the United States on the basis of the inadequacy of the Indian legal system, while a U.S. company sought to have the case heard in India. Union Carbide was ultimately successful in having the U.S. case dismissed in favor of litigation in India. Although the subsequent \$470 million settlement sounds very large, the ultimate breakdown was approximately \$600 for each injured person and \$3,000 for each fatality. Union Carbide's legal strategy of forcing the litigation to proceed in India where it could be settled for much less than a U.S. jury may have awarded was very successful.

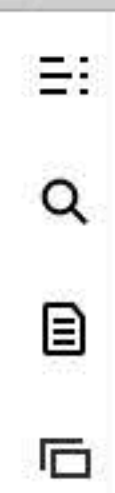
But was it ethical? The answer may depend on the ethical theory one applies to the question. For example, teleological frameworks focusing on the consequences of one's actions lead to mixed results. One such framework, ethical egoism, recognizes that people act in their own self-interest and thus a person should act in a manner that best promotes his or her interests unless the net result will generate negative rather than positive results. Union Carbide clearly acted in its own self-interest in forcing the litigation to India, but the net result was a significant financial undervaluation of the victims' lives. Another theory within the teleological framework is moral relativism, which focuses on determining what is right behavior based on the time and place of the circumstances. Were the terms of the settlement proper given the location of the catastrophe and the financial circumstances of the largely poor and undereducated victims of the gas leak? Finally, utilitarianism focuses on whether an individual's action adds to the overall utility of the community. Ethical conduct is that which is likely to produce the greatest overall good not just for the decider but for all persons who will be affected by the decision. The financial well-being of the victims may have

been enhanced had the litigation been permitted to proceed in the United States, although it is equally possible that this well-being would have been diminished by procedural delays and appeals. However, if one determines that the greater good resides with those interested in the continued financial well-being of Union Carbide, then the outcome was ethically defensible.

By contrast, deontological frameworks focus on duties rather than outcomes. For example, Immanuel Kant's *Categorical Imperative* provides that "[o]ne ought to act such that the principle of one's act could become a universal law of human action in a world in which one would hope to live" and that "[o]ne ought to treat others as having intrinsic value in themselves, and not merely as a means to achieve an end." Would anyone want Union Carbide's conduct in the Bhopal disaster litigation to become an example for companies confronted with similar catastrophes in the future? Was the settlement simply a means of preserving the company's assets and shareholder value at the victims' expense?

The theory of *contractarianism* holds that membership in society is imbued with certain duties and responsibilities and that rational people will always select the course of action that is the fairest and most equitable resolution of a dilemma without regard for personal consequences. Did Union Carbide abide by its duties and responsibilities to the community in Bhopal, especially given the lethal nature of the products it was producing and the large information gap between itself and the people living close to the plant? Did Union Carbide choose the fairest and most equitable resolution of the litigation without regard for consequences? As a profit-driven entity, should it have made such a choice? Is contractarianism unrealistic given that inequality is a fact of life?

What conclusions do you reach and why?



PART 2

International Sales, Credits, and the Commercial Transaction

Early in this book we said that the management of international business is the management of risk. Nowhere is this adage more relevant than in *International Sales, Credits, and the Commercial Transaction*. International business lore is filled with stories about sellers who shipped goods to buyers on the other side of the world, on the basis of a written contract, only to find that the buyer has refused to take delivery or has vanished. The risk is equally as great to the unsuspecting buyer who pays in advance, only to find that the seller has delivered an ocean container filled with worthless merchandise. The risks do not end there. Almost daily, there are reports of cargo being damaged by weather, spoilage, contamination with salt water or chemicals, infestation, inadequate packing, and more. It is not uncommon for cargo vessels to go down in storms or to run aground as a result of errors in navigation. Modern day pirates still plow the high seas and dangerous inland waterways, kidnapping crews, plundering cargo, and seizing entire ships for ransom. These are only a few examples of the transaction risks inherent in an international sale. In this part of the book, we hope to expose readers to the risks of the international sale, and to suggest methods for dealing with such risks. In doing so, we explore traditional business law topics: contracts, sales, commercial law, bank collections, letters of credit, aviation and maritime law, and marine insurance.

In this area, the law is derived from both national and international law. This includes many international conventions, national statutes, and the decisions of national courts. The court decisions appearing in this section are composed of both "landmark" cases that explain longstanding and widely accepted legal principles and those that illustrate common problems faced in international business. Some of the landmark decisions are rooted in the English *law merchant* of hundreds of years ago, or early maritime law, although none in this text is so old.

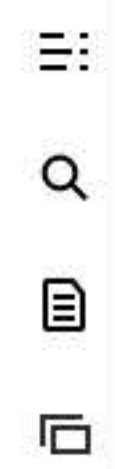
In Chapter 4, *The Formation and Performance of Contracts for the Sale of Goods*, we will study basic principles of international sales law under the *Convention on Contracts for the International Sale of Goods*. This is the first widely accepted body of international sales law, in force

in over 80 nations, governing two-thirds of world trade in goods. The chapter discusses the validity and formation of contracts, their interpretation and performance, remedies for breach, and whether or not events beyond the control of the parties (e.g., a fire, storm, or terrorist act) will excuse performance.

In Chapter 5, *The Documentary Sale and Terms of Trade*, we cover two important transaction risks facing the buyer and seller in an international sale—the seller's credit risk and the buyer's delivery risk. We examine the use of the documentary sale as a secure payment method and the role of the bill of lading and other negotiable transport documents in facilitating the exchange of goods and money across international borders. We will also look at the importance of trade terms in the contract as a means of allocating, as between buyer and seller, the responsibility for arranging the international transportation of goods, as well as for allocating the risk of loss or damage to the goods while in transit. We will also see the crucial role that ocean carriers and international banks play in facilitating the international sale.

Chapter 6, *Legal Issues in International Transportation*, deals with important areas of aviation and maritime law. The first portion of the chapter covers the liability of air carriers for damage or loss to cargo and for baggage claims and bodily injuries to passengers. Next, the chapter covers the liability of ocean carriers for damage or loss to cargo at sea, as well as important legal issues affecting marine insurance policies. No area of international business engenders as much litigation in the courts as the carriage of goods. This is a fascinating and important area of study.

In Chapter 7, *Bank Collections, Trade Finance, and Letters of Credit*, we build on the material presented in Chapter 5. The chapter gives an overview of the law of negotiable instruments in the context of international trade and discusses issues related to trade finance. Although the bank letter of credit is in wide use in international trade, it is not well understood by most businesspeople. Therefore, we devote considerable time to following a typical letter of credit transaction and to understanding both the law and practice of documentary letters of credit.



CHAPTER 4

The Formation and Performance of Contracts for the Sale of Goods

INTRODUCTION TO CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS

The sales contract is universally recognized as the legal mechanism for conducting trade in goods. The contract for purchase and sale embodies the agreement of the parties, the buyer and seller. It expresses their intention to be bound by the contract's terms, commits them to perform their part of the bargain, and makes them responsible for breach of contract if they do not. The sales contract is essential because it sets out rights and liabilities that may extend well into the future. Any agreement to buy and sell goods, especially an international one, usually takes some time to perform. If buyer and seller could do all that was required at the moment the agreement was reached, or if every seller handed over the goods at the moment the purchase price was paid, there would be far less need for a detailed sales contract. In the real world, however, the risks are usually too great to begin performance without first reaching an agreement on all essential terms, especially when the contract extends well into the future.

The contract allows buyer and seller to agree on all essential terms in advance, and to begin performance, knowing there is an understanding of their rights and obligations. It might call for shipment at a future date, or for several shipments to be made over many years. The seller might need time to secure raw materials, or to gear up for the engineering and design phase, and for manufacturing. The buyer may want to arrange advance financing for the purchase, to plan future deliveries to meet production schedules, do advance marketing, or plan the introduction of new products. Whatever the case, both buyer and seller can proceed with some confidence, knowing their contract is sealed.

During the negotiating process the parties can tend to the details of the contract, air their concerns, and negotiate an agreement on all the terms important to them. After all, there are more details to consider besides quantity and price. There are payment terms, shipping and insurance arrangements, specifications and warranties, remedies on default, and more. There is the question of who will bear the risk of loss if the goods are destroyed in transit. Hopefully, everything will go well and neither party will ever have to pull out the document and read its fine print. Yet if performance breaks down, and a dispute arises, that is the first thing the parties and their attorneys will do. If the case proceeds to litigation and a court or arbitrator must resolve their dispute, they will look to the governing law of sales to interpret and enforce the contract.

CULTURAL INFLUENCES ON CONTRACT NEGOTIATIONS

An important factor to keep in mind throughout this chapter is the influence of culture upon contract negotiations. Americans tend to approach contract negotiations in an aggressive, adversarial manner and often view negotiations as a win-lose proposition. Similarly, U.S. lawyers, who are accustomed to practicing in a highly litigious society, press for every legal advantage. They draft their contracts in calculated, technical, and detailed language, setting forth exactly how the parties are to perform and what their legal rights are if the deal falls apart.

Negotiating Contracts in Japan

By contrast, contract negotiations in many countries take a much different form. Japan presents perhaps the best example. Three aspects of Japanese culture and ancient Confucian thinking tremendously influence



the role of a contract in Japanese society. First, every person must strive to maintain harmony and accord in society. Second, the maintenance of harmony and the importance placed on personal dignity stress the importance of not causing others to “lose face” or become embarrassed. Third, Japanese culture attaches the utmost importance to the social group to which one belongs, particularly to one’s school or company. Thus, group loyalty and the desire for group harmony and consensus may characterize Japanese businesspeople.

These attributes affect the Japanese view of contractual relationships. A contract is a relationship, and as much a social one as a business one. Instead of the combative approach of U.S. lawyers, Japanese negotiators view the contract as an expression of a common goal and of a desire for a long-lasting business relationship.

These cultural and societal influences affect the manner in which contracts are negotiated and drafted. Japanese firms normally prefer that lawyers not be involved in negotiating, because they feel that lawyers interfere with the parties’ concentration on their mutual business interests. Western negotiators also must remember that they must never put the other parties in a situation in which losing face is the only outcome such as making demands without offering something in exchange.

In addition, a Western company must be prepared to carry out negotiations for an extended period. In many cases, the Japanese firm will require a long time to reach a group consensus before a decision can be made. The U.S. managers may not realize that, while they have the authority to bind their firm to the agreement, the foreign negotiator may require approval from superiors or from a working group. When doing business in Asia, the watchwords are not only “trust” and “respect” but “patience” as well.

When the contract is finally put into writing, it is typically short and written in little detail. This is considered necessary because a long-term relationship requires a flexible agreement, and one that the parties can easily modify in the future.

These attitudes also affect the manner in which contract disputes are resolved. Japanese contracts might state that, in the event of a dispute, “the parties will resolve their disagreement harmoniously and in mutual consultation with each other.” If a dispute arises, it is

more likely to be settled through private conciliation. Litigation is to be avoided if at all possible.

THE LAW OF SALES

The Origin of Modern Sales Law

Sales law, or the **law of sales**, is generally that body of law which governs contracts for the present or future sale of goods. In most countries, the term **sale** means a transfer of the ownership and possession of tangible goods (sometimes referred to simply as “things which are movable” or “tangible personal property”) from seller to buyer in return for a price or monetary payment. The “law of sales” does not apply to contracts for the sale of real estate or intangibles, such as stocks, bonds, patents, copyrights, and trademarks. It does not apply to contracts of employment, of insurance, or to the provision of services. The reason for the distinction, as we will see, is that sales law developed out of the practices of merchants and traders who dealt in goods. Generally speaking, courts look to the governing sales law to determine whether a valid and enforceable agreement exists, how to interpret contractual provisions, what remedies are available in the event of a breach, and what damages can be awarded. Sales law is a subcategory of both contract law and commercial law. Today, the sales law of most nations can be found in modern statutes, or codes, supplemented by extensive case decisions. Surprisingly, many countries, particularly developing countries, have newly enacted sales codes that have only recently replaced outdated codes from the nineteenth and early twentieth centuries. Examples include several Latin American countries and China.

The Law Merchant and English Sales Law. In the twelfth century, medieval Europe experienced a renaissance of trade and commerce. Merchants met at trade fairs and city markets to exchange goods such as wool, salted fish, cotton cloth, wine, fruit, and oils. Trade routes to the East were opening, with access to silk and spices. Rudimentary banking systems were founded so that money could be used as payment in long-distance transactions. Over time, the merchants developed a set of customs for exchanging goods for money—an unwritten code that protected their words, gave them the benefit of their bargains, and helped foster



commerce and trade. These customs became known as the *lex mercatoria* or *law merchant*, and they were “enforced” by the merchants themselves.

In the centuries to follow, the local courts in both England and continental Europe recognized the *law merchant* and used juries made up of other merchants to decide cases. As trade spanned greater distances, merchants took on greater risks, and transactions required more complex legal rules. In England, by the eighteenth century, the *law merchant* became a part of the common law when noted English jurist Lord Mansfield ruled that it was up to the English courts to say what the *law merchant* was and not merely what merchants thought it to be. In continental Europe, the *law merchant* gave way early on to more formal legal codes enacted by legislatures in the nineteenth century, based on legal concepts dating to the Roman period.

More than a hundred years after the merger of the *law merchant* with the common law, England enacted the *English Sale of Goods Act of 1894*, which codified many customary rules and adapted the common law to business needs of the time. The 1894 act and subsequent legislation were consolidated into the *United Kingdom Sale of Goods Act of 1979*. English sales law was transplanted to most of England’s colonies and remains a strong influence around the world to this day. Virtually all common law nations today have modern commercial codes and extensive case law governing the sale of goods. Canadian sales law, for example, borrows principles from both the English common law and from the U.S. *Uniform Commercial Code* (UCC).

The U.S. Uniform Commercial Code. In the United States, the law of sales was originally drawn from the English common law of contracts and the *law merchant*. In 1906, the *Uniform Sales Act*, codifying the law of sales, was passed in many U.S. states. (It is no longer in effect.) As the business world became more complex, and with the dawn of air travel and worldwide communications, there was a need for a clearer set of modern rules. This led to the creation of the UCC in 1951, which has become the primary body of commercial law for domestic transactions in the United States. The UCC has been adopted (with some minor differences) in each of the 50 states plus the District of Columbia. Louisiana has not adopted UCC Article 2 on the sale of goods, preferring to follow the rules in its French-influenced civil code. The UCC covers many areas of

commercial law, including bank deposits and negotiable instruments as well as the sale of goods, and makes the law uniform throughout the United States. Common law controls contracts not governed by the UCC, such as contracts for employment, insurance, and services, the transfer of intellectual property rights, and sales of real property.

National Differences in Sales Law. In an international contract for the sale of goods, at least one party is likely to have its rights decided under the law of a foreign country. In Chapter 3, we learned that “conflict of laws” rules determine the country in which a breach of contract case will be heard, and under which country’s law will the case be decided. In the absence of a “choice of law” provision in a contract, a court must determine which law will govern—and that could be the law of the country where the contract was made, where it was to be performed, where the goods were to be delivered, where the subject matter is located, where either party resides or has its principal place of business, or in some other country with a close connection to the contract. This could lead to some surprising results. Different countries, even with modern codes, often have different rules for interpreting contracts, for remedies and awarding damages, or even for determining if a contract exists at all. This is especially true when buyer and seller come from countries with different legal systems—common law, civil law, or Islamic law. No international businessperson or attorney can possibly know all the laws of every country in which they do business. Attorneys may feel uncertain about negotiating and drafting contracts for their clients that would be governed by foreign codes that are unfamiliar or that are available only in a foreign language. If they do not have foreign legal experience, have not read the foreign case law, and do not have the advice of foreign counsel, then it becomes very difficult for them to advise their clients on the legal ramifications of a contract. Of course, the parties are free to negotiate and agree on their choice of national law. However, while it may seem like a freely bargained agreement, the choice is usually that of the party with the greatest bargaining power. It is this unpredictability of foreign law that is the unknown factor in contracting, and that can lead to a tremendous uncertainty in buying and selling goods across national borders.

The ability to predict what will happen in the event of a breach of contract is essential to commerce. For centuries, legal scholars and lawmakers everywhere



have realized that no nation can be open for business with the rest of the world without a stable and predictable body of sales law. No nation can expect to attract foreign traders and firms without a modern body of governing law to protect the contract rights of both its own citizens and foreigners alike.

The Unification of Sales Law. The history of legal development in many nations has often coincided with its history of opening to the world through foreign trade. As trade expanded, and as foreign merchants came to trade, so did nations require a more universally accepted set of laws. English common law spread through the early British Empire, including the American colonies. Civil law and Napoleonic codes spread through Europe, Latin America, Japan, and even China. This gradual process certainly unified laws, one country at a time. However, as the twentieth century brought the world closer together, there were calls for more organized efforts at unifying the sales laws of diverse countries around the world.

The process of making national laws more uniform is known as the **unification of law**. The unification of modern sales law has been ongoing since the early part of the last century. Early efforts were made by the League of Nations, and by private organizations and law societies, although those largely turned out to be unsuccessful. In 1966, the United Nations created a new organization responsible for unifying trade law, the *United Nations Commission on International Trade Law*, or UNCITRAL. UNCITRAL's work led to a very successful effort in unifying the law applicable to the international sale of goods and the adoption in 1980 of the *United Nations Convention on Contracts for the International Sale of Goods*, or CISG. The CISG now forms the basis for a widely accepted body of international sales law, now implemented into the national codes and statutes of more than 80 nations, including the United States and its largest trading partners—Canada, Mexico, China, and most of Europe. The great feat of UNCITRAL in creating the CISG was that it was able to bring together legal scholars from all regions of the world, representing diverse legal systems. It was able to develop a code acceptable to the common law countries and civil law countries, including both developed and developing countries as well as the socialist countries of the time. The CISG is the primary subject of this chapter. We will look at contract formation, interpretation, warranties, rights and remedies on default, excuses for nonperformance, and more.

THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG)

Throughout most of the twentieth century, international legal scholars envisioned a near-universally accepted, uniform law of sales. In 1980, that work came to fruition in the form of the CISG. It was drafted by representatives from many different countries at meetings that took place over many years around the world.

The CISG is now in effect in over 80 countries that account for more than two-thirds of all world trade. It was ratified by the U.S. Senate and became effective in the United States in 1988. The CISG is effective for trade within North America, as it has also been ratified by Canada and Mexico. It has also displaced the Chinese law of contracts for international sales. Interestingly, the United Kingdom, which is so firmly rooted in common law traditions, has not adopted the CISG. As of 2016, it has been adopted by the countries shown in Exhibit 4.1. Translations are available in the official languages of the United Nations (Arabic, Chinese, English, French, Russian, and Spanish) and in many others. An edited copy of the CISG appears in the appendix of this book, and you are encouraged to refer to it often while reading this chapter.

This chapter examines the following aspects of the CISG: (1) its applicability to international sales; (2) rules of contract formation, validity, and interpretation; (3) performance and nonperformance by the parties; (4) remedies and damages for breach of contract; and (5) excuses for nonperformance of a contract.

Applicability of the CISG to International Sales

The CISG applies if the following conditions are met:

1. The contract is for the commercial sale of goods (the CISG does not define the term "goods").
2. It is between parties whose places of business are in different countries (nationality or citizenship of individuals is not a determining factor).
3. The parties' places of business are located in countries that have ratified the Convention.

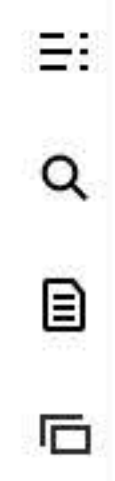


Exhibit 4.1

Countries that Have Ratified or Acceded to the CISG	
Albania	Kyrgyzstan
Argentina	Latvia
Armenia	Lebanon
Australia	Lesotho
Austria	Liberia
Bahrain	Lithuania
Belarus	Luxembourg
Belgium	Macedonia
Benin	Madagascar
Bosnia and Herzegovina	Mauritania
Brazil	Mexico
Bulgaria	Moldova
Burundi	Mongolia
Canada	Montenegro
Chile	Netherlands
China	New Zealand
Colombia	Norway
Croatia	Paraguay
Cuba	Peru
Cyprus	Poland
Czech Republic	Republic of Congo
Denmark	Republic of Korea
Dominican Republic	Romania
Ecuador	Russian Federation
Egypt	St. Vincent-Grenadines
El Salvador	San Marino
Estonia	Serbia
Finland	Singapore
France	Slovakia
Gabon	Slovenia
Georgia	Spain
Germany	Sweden
Greece	Switzerland
Guinea	Syria
Guyana	Turkey
Honduras	Uganda
Hungary	Ukraine
Iceland	United States
Iraq	Uruguay
Israel	Uzbekistan
Italy	Zambia
Japan	

Assume that a dispute arises over a contract between a buyer whose business is located in the United States and a seller whose business is located in France. Regardless of who initiates the lawsuit or whether it is brought in the United States or France, if no choice of law provision specifies otherwise, their rights will be determined by the CISG—not by the UCC or the French Civil Code. Similarly, if the same dispute arises between a U.S. buyer and an English seller whose business is located in the United Kingdom, and there is no choice of law provision in the contract, the applicable law is likely to be that of the country with the closest connection to the contract. Here, one of the parties is not located in a country that has ratified the Convention—the United Kingdom. Now take another, perhaps more important, example. Assume that American and Chinese firms are in the process of negotiating a contract, but that neither will agree to have a dispute heard under the other's law (assume they disagree on the forum as well). There is no arbitration provision. The CISG provides a solution: The contract can be drafted to call for any dispute to be brought before the courts of Hong Kong and to be decided according to the CISG, thus providing a neutral forum and a neutral law.

In the United States, the UCC will continue to apply to purely domestic sales and to sales between firms located in the United States and countries that have not ratified the CISG.

Place of Business Requirement. In the case of buyers or sellers with places of business in more than one country, such as multinational corporations, “place of business” would be considered to be the country that has the closest relation to the contract and where it will be performed. This could mean, at least theoretically, that if two American companies negotiated a contract entirely within the United States, but one of them had a place of business outside of the United States and the contract was to be performed outside the United States (e.g., the contract called for delivery of the goods to a point outside the United States), then the CISG might govern the transaction.

Choice of Law Provisions. Despite the widespread acceptance of the CISG, many attorneys recommend that their clients negotiate a choice of law provision calling for the resolution of disputes according to their own national laws. Many U.S. lawyers prefer to have the more familiar UCC govern their clients' contracts. Article 6 of the CISG allows parties to “exclude the application of



this Convention . . . or vary from any of its provisions.” This is often called the “opting out” provisions of the CISG. Any attempt to “opt out” must be stated in clear and unequivocal language and should only be done by attorneys experienced with the CISG.

The following case, *It's Intoxicating, Inc. v. Maritim Hotelgesellschaft, mbH*, discusses two important points: the ability of the parties to “opt out” of the CISG by using a choice of law clause and the effect of the CISG on international contracts.



It's Intoxicating, Inc. v. Maritim Hotelgesellschaft mbH

2013 U.S. Dist. LEXIS 107149 (2013) (U.S. District Court, Middle District of Pennsylvania)

BACKGROUND AND FACTS

Plaintiff It's Intoxicating Inc. is a Pennsylvania corporation that manufactures and distributes cosmetic products to various retailers. Defendant Maritim Hotelgesellschaft is a German company which owns hotels throughout Germany. Zimmer is an individual living in Berlin, Germany, and is an employee of Maritim who was delegated the authority to purchase beauty products on behalf of Maritim.

In October 2007, Zimmer informed It's Intoxicating that Maritim wished to buy its products for use in 38 of its hotels. It's Intoxicating sent via e-mail a document titled “Conditions of Sale,” a proposed agreement purporting to govern various collateral aspects of the parties’ developing relationship. That document stated:

This agreement will be governed by and construed in accordance with the laws of the state of Pennsylvania, United States of America. The parties hereto hereby consent to the exclusive jurisdiction and venue of the United States District Court for Luzerne County for any action that may be brought in connection with this agreement and/or from the use of the Aromapro software and/or from the use of the Aromapothecary products.

Maritim subsequently sent purchase orders to It's Intoxicating in January 2008. It's Intoxicating shipped 441 cartons of beauty products to Maritim's hotel in Dusseldorf, Germany, which were accepted by Maritim. The purchase price was \$181,547.80 of which Maritim paid \$73,724.85. However, in May 2008, Maritim began to run into problems selling It's Intoxicating's beauty products. By April 2009, It's Intoxicating still had not received the balance due and filed suit against Maritim. Maritim filed a motion to dismiss contending that the parties had never created a binding contract.

MANNION, DISTRICT COURT JUDGE

As a preliminary matter, because Maritim is a foreign corporation and Zimmer is a resident of a foreign country, the court must consider whether the United Nations Convention on Contracts for the International Sale of Goods applies to the contract in this case, thereby preempting Pennsylvania law.

The CISG is a “self-executing treaty with the preemptive force of federal law,” which “applies to contracts for the sale of goods between parties whose places of business are in different States . . . when the States are contracting States.” *American Mint LLC v. GOSoftware, Inc.*, 05-CV-650, 2005 U.S. Dist. LEXIS 45003 (M.D.Pa. 2005). The parties to a contract may agree to apply a signatory's domestic law, but only by affirmatively opting-out of the CISG. Therefore, a choice of law provision, to be effective, must not only select the law that will apply but affirmatively state that the CISG will not apply to the contract.

Here, defendants’ place of business is Germany and plaintiff's is the United States, both countries that are signatories of the CISG. Furthermore, because of the parties extensive communications prior to Defendant's first product order and because the alleged contract contained a shipping agreement, it appears that the parties were aware that they were dealing with foreign entities either before or at the time a contract was formed. Therefore, on its face, it appears that the CISG governs this contract dispute. Nevertheless, the parties point out that the agreement contained a choice of law clause which states in part, “[t]his agreement will be governed by and construed in accordance with the laws of the state of Pennsylvania.”

A choice of law provision is not effective unless it expressly rejects the application of the CISG. Here, the parties did not affirmatively state that the CISG does not apply to this contract, so international law applies.

To plead a contract under the CISG, a party must allege an offer and an acceptance of the essential terms of a sale, including the goods, quantity, and price. An offer must be sufficiently definite and indicate the intention of the offeror to be bound in case of acceptance. Acceptance can be made by any statement or conduct indicating assent to an offer. The CISG provides that the offeree may indicate assent by performing an act, such as one relating to the dispatch of the goods or payment of the price, without notice to the offeror, and the acceptance is effective at the moment the act is performed. As such, while silence or inactivity cannot constitute an acceptance under Article 18, an affirmative action that “indicat[es] assent to an offer” will suffice. Finally, the

continues



continued

CISG contains no statute of frauds requirement, so “a contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form.”

Defendant Maritim seeks dismissal of Plaintiff’s breach of contract claim on statute of frauds grounds, arguing, “an oral contract for the sale of goods in excess of \$500 cannot be enforced unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought.” This argument is easily repudiated as the court has determined that the CISG applies to the contract dispute in this case. Because the CISG contains no statute of frauds requirement, Defendant’s argument fails.

Maritim next argues that Plaintiff has failed to adequately plead the essential elements of a contract action. It is true that a party must plead the essential terms of a contract, but Maritim fails to cite any case law indicating that Plaintiff has omitted an essential term from its pleadings. The CISG speaks very briefly to the issue, indicating that the necessary terms (for pleading purposes) are the goods, their quantity, and the price. Here, Plaintiff does not quote the language of the contract but claims that Zimmer made an order on behalf of Maritim, in response to which Plaintiff shipped 441 cartons of beauty products on eight skids. Plaintiff also sent an invoice for \$181,547.80 and, when

the products and invoice arrived, Defendant “accepted” them. These facts are sufficient to raise a plausible inference that the parties had a contract for 441 cartons of beauty products priced at \$181,547.80. While there may be a question as to some of the terms of the agreement or the date on which the offer and acceptance were effectuated, these are issues of fact for trial.

The allegations as a whole allow the court to make the plausible inference that the parties entered into a binding contract under the CISG. Therefore, Maritim’s motion to dismiss Plaintiff’s breach of contract claim will be denied.

Decision. The CISG was applicable to this transaction, and the absence of a definitive writing stating the contract terms was insufficient to merit dismissal of the plaintiff’s claims.

Case Questions

1. On what basis did the court conclude that the parties had not sufficiently evidenced an intent to opt out of the CISG? What language would you have included in the purchase and confirmation orders to clearly evidence such an intent?
2. What was the effect of the application of the CISG to the contract rather than Pennsylvania state law?

Sales Excluded from the CISG. The following types of sales have been specifically excluded from the Convention:

1. Consumer goods sold for personal, family, or household use
2. Goods bought at auction
3. Stocks, securities, negotiable instruments, or money
4. Ships, vessels, or aircraft
5. Electricity
6. Assembly contracts for the supply of goods to be manufactured or produced wherein the buyer provides a “substantial part of the materials necessary for such manufacture or production”
7. Contracts that are in “preponderant part” for the supply of labor or other services
8. Contracts imposing liability on the seller for death or personal injury caused by the goods
9. Contracts where the parties specifically agree to “opt out” of the Convention or where they choose to be bound by some other law

In the United States, Article 2 of the UCC applies to both consumer and domestic commercial transactions. Consumer sales were excluded from the CISG because consumer protection laws are so specific to every country that it would have been very difficult to harmonize them. Further, consumer sales are usually domestic in nature.

VALIDITY AND FORMATION OF INTERNATIONAL SALES CONTRACTS

Although readers who have studied contract law may be acquainted with the general concepts of contract validity and formation, they may find that many of the specific rules applicable to international contracts are different from what they learned. The following sections discuss the requirements for a valid contract, including the intention of the parties to be bound, mutual assent (offer and acceptance), and other rules.



General Requirements for a Valid Contract

Under the common law, a **valid contract** is an agreement that contains all of the essential elements and meets all the requirements of a binding contract, including:

1. It is an agreement between parties entered into by mutual assent and resulting from their words or from conduct that indicates their intention to be bound.
2. It must be supported by consideration (the bargained-for exchange of a legal benefit or incurring of a legal detriment).
3. The parties must have legal capacity (they may not be minors, legally incompetent, or under the influence of drugs or alcohol).
4. The contract must not be for illegal purposes or contrary to public policy.

If an agreement is missing any one of these essential elements, the courts will not enforce it under the common law.

The CISG only governs the formation of a contract and the rights and obligations of the seller and buyer. The Convention does not provide rules for determining whether a contract is valid, whether a party to a contract is legally competent, or whether a party is guilty of fraud or misrepresentation. These rules are left to individual state or national laws. Consideration is not mentioned, and Article 29 seems to state that consideration is not required in order to modify or terminate a contract under the CISG, although in *Geneva Pharmaceuticals Technology Corp. v. Barr Laboratories Inc.*, 201 F. Supp. 2d 236 (S.D. N.Y. 2002), a U.S. federal court stated that issues of validity, including consideration, were a matter of state law and not governed by the CISG. Other federal courts have reached similar conclusions.

The Effect of Illegality

A generally recognized principle of contract law is that, in all legal systems, agreements that violate the laws of a state or nation are void. A void agreement is of no legal effect and will not be enforced by a court.

The Writing Requirement

The laws of many nations differ as to whether contracts for the sale of goods must be in writing. Under the UCC, American law requires that contracts for the sale

of goods of \$500 or more be in writing. Writing requirements in common law countries date back to an act of the English Parliament in 1677. In 1954, however, the United Kingdom repealed its law.

As we saw in the *It's Intoxicating* case and as provided in Article 11 of the CISG, a contract for the international sale of goods "need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means, including witnesses." This is in keeping with a basic concept found in the CISG: that the parties should have flexibility in contracting and as much freedom of contract as possible.

Several countries, including Argentina, Chile, Hungary, Russia, and a few others, have elected to omit Article 11 from their version of the CISG. In those countries, foreign sales contracts governed by the CISG must still be in writing. In China, one provision of the 1999 *Contract Law for the People's Republic of China* prevails over CISG Article 11, even for international sales otherwise governed by the CISG. This permits foreign sales contracts to be either written or oral, unless some other statute or administrative regulation requires that they be in writing. That requires knowledge of many different administrative regulations. By practice, almost all foreign trade contracts involving Chinese firms are in writing.

Digital Signatures in Electronic Commerce. The United States, Japan, China, and members of the European Union have enacted laws recognizing the validity of electronic or digital signatures on contracts and legal documents. The U.S. law, the *Electronic Signatures in Global and National Commerce Act*, makes an electronic signature on a contract as legally binding as a handwritten one on a paper document.

Problems of Contract Interpretation

Due to the great distances involved in international business, negotiations are often conducted through a series of conversations, meetings, and communications by mail, package delivery, telephone, fax, e-mail, and sharing of digital files. The parties may make reference to ancillary materials, such as spec sheets and price lists. Samples, models, and prototypes may be exchanged. The negotiations may take place in more than one country and more than one language. The buyer may visit the seller's factory to see the seller's capabilities firsthand. Discussions might take place through "delegations" or



negotiating teams of salespeople, technical specialists, agents, and attorneys. Technical discussions are often left to engineers or other experts. Negotiations may be heavily influenced by language barriers and cultural differences, and terminology peculiar to the industry will be used. The parties may have thought that they were close to agreement many times, only to reach an impasse, resuming negotiations at a later time. In the end, the final agreement may be recorded in one written document.

On the other hand, it is not unusual for the parties to fail to put their agreement into a complete and final written document. This can happen out of ignorance, a history of past dealings with one another, time constraints, or other reasons. And as we saw, in most countries, a contract for the international sale of goods does not have to be in writing to be enforceable under the CISG. In the event that a dispute ends in court, it might be possible for the court to look at the chain of negotiations and to piece together the intentions of the parties on the basis of the testimony and other evidence. But this can be expensive and lead to an uncertain result. More experienced firms, at the close of negotiations, would be careful to put their complete agreement in writing. If the complete and final agreement has been put into writing, we say that the contract has become “integrated.” An **integrated contract** is a written document or documents that evidence the final and complete agreement of the parties. Mere informal notes of one of the parties, or an unsigned document marked “draft,” would not be a fully integrated contract.

The Parol Evidence Rule and the Common Law. The common law **parol evidence rule** states that a court may not consider in evidence any written or oral statements that were made by the parties prior to or at the time of concluding a fully integrated written contract if the statements are offered to contradict, vary, or add to the terms of the written contract. The court may not look to prior negotiations, correspondence, or verbal statements offered by one of the parties at trial for the purpose of denying or contradicting the written contract. Parol evidence may be introduced to clarify an ambiguity (but not to contradict the “plain meaning” of a term); to prove fraud, undue influence, or lack of capacity; or to prove the existence of a later agreement that modified or terminated an earlier contract. The parol evidence rule is a common law rule, applicable to all contracts, not just sales contracts. It prevents extrinsic evidence from reaching the ears of a jury and lessens

the chance of perjury and unreliable testimony. The civil law systems, which generally do not use jury trials in these cases, do not have the same strict rule against the admissibility of parol evidence in most breach of contract cases.

Parol Evidence and the CISG. The parol evidence rule has not been incorporated into the CISG. Article 8 of the CISG allows a court, when considering the intent of the parties to a contract, to consider “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.”

In *MCC-Marble Ceramic Center, Inc. v. Ceramica Nuova D’Agostino, S.P.A.*, 144 F.3d 1384 (11th Cir. 1998), a U.S. citizen signed a contract for the purchase of Italian ceramic tile while at a trade fair in Bologna. The document consisted of the seller’s order form and included preprinted terms on the front and reverse sides. The terms stated that if the goods did not conform to the contract, notice had to be given to the seller within ten days. When the tile arrived, the buyer believed it was inferior, but never gave notice of this fact to the seller. There was uncontradicted evidence that, at the time of signing the contract, all parties had a verbal understanding that the preprinted terms would not be applicable. Applying the CISG, the court ruled that parol evidence could be considered to contradict the written terms of the contract. In other words, the trial court could consider the subjective intent of the parties, as well as their verbal understanding at the time of signing the contract, in order to invalidate the preprinted terms. With no preprinted terms, the buyer would be permitted to withhold payment because the goods did not conform to the contract specifications.

The Role of Customs, Practices, and Trade Usages. It is usually not possible, in an international transaction, for the parties to expressly state or write every single detail into their contract. There are bound to be gaps in most contracts. Firms that have done business in a certain way for many years often expect, and are justified in expecting, that they will continue the same practice. A buyer who has always ordered products and materials of specified quality may not recite that in every order placed with his or her supplier. They may assume that their past dealings will become a part of their future dealings, unless specified. Another issue is that in many industries, it is common to use language



and terminology specific to that industry. For example, in purchasing silk from China, a silk buyer in the United States may order “hand-pulled mulberry silk” or “habotai” or “tussah” or “10-momme weight.” These are terms that may have very special meanings to merchants but mean nothing to the rest of us.

To fill in these gaps, or to interpret specific contract provisions, the courts of the United States and most other common law countries will look to **trade usages** for guidance. Trade usages are rules derived from the widespread customs of an industry, the practices of merchants in their past dealings, and the usages of trade terminology and language. Examples are use of specific descriptive terms, guarantees that the goods “will be of average and acceptable quality for the kind and type of goods sold in the trade,” and inclusion of trade terms to refer to which party is responsible for shipping expenses and the risk of damage or loss of goods during shipment.

Trade Usages and the CISG. The CISG provisions of Article 9 resemble how U.S. law handles trade usages. The only trade usages that can be used to interpret or fill in the gaps in a contract are (1) those to which the parties have agreed or that they have established between themselves and (2) those of which the parties knew or ought to have known, and that are widely known in international trade (or at least in those countries in which both buyer and seller are located) and regularly observed in the industry or trade involved.

Mutual Assent: The Offer

The contract laws of all countries require that the parties reach a mutual agreement and understanding about the essential terms of a contract. This is known as **mutual assent**. The agreement is reached through the bargaining process between offeror and offeree. The offeror, by making the offer, creates in the offeree the power of acceptance, or the power to form a contract. A contract arises upon acceptance by the offeree.

The Intention to Be Bound. Under Article 14 of the CISG, a communication between the parties is considered an offer when (1) it is a proposal for concluding a contract and (2) it is “sufficiently definite and indicates the intention of the offeror to be bound.” An offer is considered sufficiently definite if it (1) indicates or describes the goods, (2) expressly or implicitly specifies the quantity, and (3) expressly or implicitly specifies the price for the goods. However, one should not think

that just because an item of communication includes a description of the goods, the quantity, and the price, that it always indicates an offer to conclude a contract. In many international contracts involving a great deal of money, no firm would make a commitment without reaching an agreement on many other terms, such as methods of payment, delivery dates, allocation of shipping costs, quality standards, installation and training, warranties, and responsibility for duties or taxes. In cases where the court does find that the parties had the intention to be bound, it can supply many of the missing terms by looking to their past dealings and to the customs in the trade or industry, or by referring to the applicable provisions of the CISG.

Public Offers. If an offer must express the offeror’s intention to be bound, how does the law treat advertisements, brochures, catalogs, and websites? Are they offers, inviting acceptance, or are they mere **invitations to deal**—invitations to the public to make an offer? The laws of some nations hold that an offer must be addressed to one or more specific persons. In those countries, an advertisement will not create the power of acceptance in a member of the public who reads the ad. Other countries, while treating most advertisements as mere invitations to deal, do recognize that specific advertisements that describe the goods, their quantity, and price may be considered an offer.

The CISG takes a middle position by creating a presumption that an advertisement, catalog, price list, or website is not an offer. Article 14 states, “A proposal other than one addressed to one or more specific persons is to be considered merely as an invitation to make offers, unless the contrary is clearly indicated by the person making the proposal.” Consequently, to be on the safe side, many attorneys recommend that a seller include in all of its price sheets and literature, and on its website, a notice that the content does not constitute an offer.

Open Price Terms. In international transactions between companies familiar with their industry or market, it is not unusual that a contract can be concluded without any mention of price. It is not that it was overlooked; it may just have been that they were relying on some external market factor or prior course of dealings to determine price. A contract may even refer to a market price on a date that is months or even years away. If the price is left “open,” is the parties’ understanding sufficiently definite to constitute a valid contract? In the



United States, most state UCC laws provide that if price is not specified, a “reasonable price” will be presumed. Other countries take different approaches that may not favor open price terms.

Although some conflict stems from the language of the CISG regarding open price terms (see Articles 14 and 55), the CISG provisions seem similar to those of U.S. state law. Article 55 states that where price is not fixed, the price will be that charged “for such goods sold under comparable circumstances in the trade concerned.” Accordingly, if the buyer and seller fail to specify the price of the goods, a court might look to the trade or to the market price of comparable goods to make its own determination of price, and the contract and all its other provisions will remain in effect.

Firm Offers. As a general rule, an offer may be revoked at any time prior to acceptance. Under the UCC, as between merchants, an offer may not be revoked if it is made in a signed writing that gives assurance that it will remain open for a stated period of time, not to exceed three months. Under the CISG, firm offers are valid even if they are not in writing. Moreover, an offer may not be revoked if the offeree reasonably relies on the offer as being irrevocable and the offeree has acted in reliance on the offer. Some civil law countries, such as Germany, France, Italy, and Japan, prohibit revocation during the period of time normally needed for the offeree’s acceptance to arrive.

The Pro Forma Invoice. One very common method of offering goods for sale to a foreign buyer is through the pro forma invoice (Exhibit 4.2). The *pro forma invoice* is a formal document addressed to a specified buyer to sell the products described according to certain terms and conditions. Most pro forma invoices are specific and definite enough to meet the requirements of an offer. The pro forma invoice sets out the price for the goods in the currency stated, plus any additional charges payable by the buyer’s account, including the cost of packing and crating; the cost of inland freight; the cost of ocean or air freight, freight forwarder’s fees, and pier delivery charges; wharfage and warehouse charges; and insurance. The *pro forma* invoice specifies the mode of shipment, the method of payment, the length of time for which the quoted terms will be valid, and any and all other terms required by the seller as a condition of sale. Sellers usually require the buyer to accept the offer by signing it and returning it to them before shipment. In other cases, a buyer might accept

an offer by sending its own purchase order form. The *pro forma* invoice should not be confused with the commercial invoice, which is the final bill for the goods that accompanies the request for payment.

Mutual Assent: The Acceptance

A contract is not formed until the offer is accepted by the offeree. The acceptance is the offeree’s manifestation of the intention to be bound to the terms of the offer. Modern legal rules applicable to the sale of goods give great flexibility to the offeree as to the manner and method of accepting—certainly greater flexibility than under the common law. Under the CISG, an acceptance may take the form of a statement or conduct by the offeree that indicates the offeree’s intention to be bound to the contract. CISG Article 18 states that “a statement made by or other conduct of the offeree indicating assent to an offer is an acceptance.” (UCC 2-206 states that “an offer to make a contract shall be construed as inviting acceptance in any manner and by any medium reasonable in the circumstances.”) This rule has day-to-day applicability. It is very common for a prospective buyer to place an order to purchase goods, with the seller responding not with a verbal or written confirmation, or not by initialing the order and returning it to the buyer, but simply by shipping the goods called for. For instance, the seller may be shipping urgently needed replacement parts for a stopped assembly line. Similarly, it is not uncommon for a buyer to accept the delivery of goods by simply remitting payment (as in the case where the seller ships blue widgets instead of the red ones ordered; if the buyer pays for the nonconforming red ones, there is a contract). Both the UCC and the CISG cover these situations. CISG Article 18 states that an offeree may accept by “dispatching the goods or payment of the price, without notice to the offeror” provided that the parties have established this as a practice or it is routinely accepted in the trade, and if the act is performed within the time for acceptance fixed by the offeror or within a reasonable time.

Silence Not an Acceptance. The general rule in most countries is that the offeree’s silence or inactivity alone should not be interpreted as an acceptance. If you unexpectedly receive goods that you did not order, you should not have to pay for them (although in most legal systems, you might have to safeguard them until the sender retrieves them). Moreover, it would be unfair if a seller could force you to take goods simply

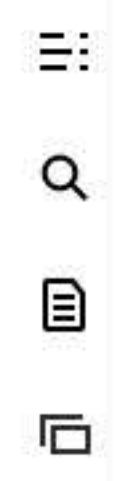


Exhibit 4.2

Pro Forma Invoice				
DownPillow International, Inc. Pro Forma Invoice Boone, North Carolina, U.S.A.				
Invoice to:	Japanese Retailer Osaka, Japan	Date of pro forma invoice:	Oct. 12, 2015	
Ship/Consign to:	as per buyer's instructions	This pro forma no.	000044372	
Shipment via:	U.S. port to destination Kobe	Terms of Payment	Cash against documents,	
Notify Party:	Buyer to advise	irrevocable LC payable in	U.S. dollars	
Country-of-Origin:	U.S.A.	Shipment Date	45 days after receipt of LC	
Total weight (est.):	9405 lbs/4266 kg.			
Shipping volume (est.):	3000 cu.ft./85 cu.m.			
Quantity	Item Code	Description	Price	Amount
5,000	5WGD-1	Bed pillows of white goose down total fill weight 26 oz./0.74 kg, contents sterilized shell: 100% cotton, with piping size 26 × 26", 66 cm × 66 cm"	\$32.00	\$160,000
		PRICE Ex Works, Domestic packing		\$160,000
		Export packing/vacuum pack charges		850
		Cartage/Inland freight charge		1,250
		Pier delivery charge		150
		Freight forwarder's fees		200
		PRICE F.A.S. NC PORT		\$162,450
		Ocean freight charges port to port		\$3,355
		Container rental charge		450
		Marine insurance charges		640
		PRICE C.I.F. Port of KOBE, Japan		\$166,895
DownPillow International, Inc.				
by, Export Sales Manager		Authorized buyer's signature		
All terms of sale interpreted by Incoterms 2010. This quotation is valid for a period of sixty days from above date. Any changes in the actual cost of shipping, handling, packaging, insurance, or other charges not a part of the actual cost of the goods are buyer's responsibility.				
SEE OTHER SIDE FOR ADDITIONAL TERMS AND CONDITIONS				



by stating, "If I don't hear from you, I assume you will keep them and pay for them." On the other hand, there are situations where the parties can agree that silence is an acceptance. If seller makes an offer to you, and you reply, "If you do not hear from me by 5:00 p.m., ship the goods," then you have made your silence an acceptance.

Another exception occurs when the parties' previous dealings oblige them to speak up and not remain silent. Consider this case: For the past five years, DownPillow, Inc., has regularly ordered quantities of white goose down from Federhaus GmbH for shipment within three months. At first, Federhaus confirmed all orders. Soon, Federhaus stopped sending written confirmations of orders and just shipped.

This time, DownPillow placed the order and Federhaus never shipped. DownPillow suffered damages when it unexpectedly ran out of feathers. It can sue Federhaus for breach of contract on the basis that the established practice of the parties presumed Federhaus's acceptance of DownPillow's order.

When an Acceptance Is Effective. Under the common law, and in virtually all legal systems, the offeree may accept at any time until the offer is revoked by the offeror, until the offer expires due to the passage of time, until the original offer is rejected by the offeree, until the offeree makes a counteroffer in return, or until the offer terminates (such as through the death of one of the parties or destruction of the subject matter). Thus, it is often important to know when an acceptance becomes effective because it cuts off the offeror's ability to revoke the offer, and it is at that point in time when contractual rights and obligations arise. Time constraints can be even more critical in international transactions between buyers and sellers located in different time zones and using several different means of communications—next-day letters, e-mail, telephone, and facsimile transmissions.

Under the common law, a contract is formed when the acceptance is dispatched by the offeree. In the case of an acceptance by letter or written document, the time of dispatch is the time the letter is put into the hands of the postal authorities, courier service, or other carrier. This is commonly called the **mailbox rule**. The rule assumes that the correct mode of transmission is used (i.e., one that the offeror specifies or, if none, one that is reasonable under the circumstances) and that it is properly addressed. This assumption makes commercial sense, for if a fax arrives offering to sell fresh roses sitting on the hot tarmac in Colombia, one does not accept by

letter and expect a contract to be formed on dispatch. Hence, if a buyer submits an order to a seller, a contract is formed upon the dispatch of the seller's acceptance. The buyer's power to withdraw the offer to purchase ended at the time the contract was formed. While the mailbox rule was developed long before the existence of electronic communications, and while it has lost some of its significance in the age of fax machines and e-mail, it is still relevant and applicable.

The CISG follows a somewhat different approach. Under Article 18, an acceptance is not effective upon dispatch, but is effective when it reaches the offeror (or in the case of electronic transmission, appears on the offeror's fax machine or in his or her e-mail inbox). Article 16 protects the offeree by stating that the dispatch of an acceptance cuts off the offeror's right to revoke the offer. Thus, an acceptance may possibly be withdrawn if the withdrawal reaches the offeror before or at the same time as the acceptance does (Article 22). Recall that under the common law, the offeree would not have had the same right because the contract would have been formed at the moment of dispatch. This CISG rule follows the basic rules in effect in China and civil law countries. The following case, *Solae, LLC v. Hershey Canada, Inc.*, discusses the formation of a contract and one party's futile attempt to modify it.

The Mirror Image Rule. Students of the common law of contracts are very familiar with the **mirror image rule**. The rule requires that an offeree respond to an offer with an acceptance that is definite and unconditional and that matches the terms of the offer exactly and unequivocally. Under the mirror image rule, a purported acceptance that contains different or additional terms, no matter how minor, is considered a counteroffer and, thus, a rejection of the original offer. The principle that an acceptance must be definite and unconditional is found in the civil law countries and in the CISG. Article 19(1) states, "A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counteroffer." Thus, if the buyer places an order for a quantity of goods of a certain description, for shipment by air no later than "next Tuesday," and the seller replies by promising shipment no later than "next Wednesday morning," there is no contract. For many contracts this rule works fine, because it prevents contracts from arising when there was actually no mutual assent. It lessens the possibility of contract disputes. However, there are a few situations



where strict adherence to the mirror image rule is not commercially practical. One of these situations is where the offeror and offeree, the buyer and seller, are

communicating through an exchange of standard business forms, each of which contains extensive “fine print” provisions.



Solae, LLC v. Hershey Canada, Inc.

557 F. Supp. 2d 452 (2008) (United States District Court, District of Delaware)

BACKGROUND AND FACTS

Solae, a U.S. limited liability company with its principal place of business in St. Louis, Missouri, had sold soy lecithin to Hershey Canada, Inc., a Canadian corporation with its primary place of business in Mississauga, Ontario (Canada), since 2003. The soy lecithin was incorporated into Hershey’s products sold throughout Canada. Solae and Hershey negotiated contracts at the end of each calendar year for Hershey’s orders of soy lecithin in the upcoming year. In January 2006, the parties reached an agreement whereby Hershey would order up to 250,000 pounds of soy lecithin from Solae in 2006 at a price of U.S. \$1.2565 per pound.

In June 2006, Hershey faxed a purchase order to Solae for 40,000 pounds of soy lecithin to be delivered to Hershey’s manufacturing plant in Smith Falls, Ontario, in September 2006. Solae sent an order confirmation to Hershey in June 2006. The order confirmation did not contain Solae’s standard conditions of sale nor did it contain a forum selection clause. In September 2006, Solae shipped 40,000 pounds of soy lecithin to Hershey. An invoice sent to Hershey concurrent with the shipment contained the conditions of sale, including a forum selection clause providing that “the courts of Delaware shall have exclusive jurisdiction over any disputes or issues arising under this Agreement.”

In October 2006, Hershey discovered that the soy lecithin was contaminated with salmonella. The contamination was discovered after Hershey had incorporated the contaminated soy lecithin into over two million units of product shipped throughout Canada. The contamination resulted in a large-scale recall of Hershey’s chocolate products, the temporary closure of the Smith Falls plant, and an extensive investigation by the Canadian government. Hershey notified Solae of the contaminated soy lecithin, informed Solae that it would hold Solae responsible for damages incurred as a result of the incident, and refused to accept delivery or pay for any additional lots of soy lecithin, including a lot for which an order had been placed in October 2006.

Solae filed a lawsuit in March 2007 seeking a determination of the parties’ rights with respect to the June and October 2006 orders. Hershey moved to dismiss Solae’s complaint for lack of personal jurisdiction. The issue before the court was whether the forum selection clause contained within Solae’s conditions of sale were part of the parties’ contract such that the court could exercise personal jurisdiction over Hershey.

FARNAN, DISTRICT JUDGE

The parties dispute the relevant contract governing this dispute. If the relevant contract contains a forum-selection clause, Hershey Canada’s contentions regarding personal jurisdiction are largely irrelevant. Accordingly, the Court must determine whether Hershey Canada is bound by a forum selection clause.

The parties agree that the *United Nations Convention of Contracts for the International Sale of Goods* (“CISG”) governs contract formation here. Under the terms of the *CISG*, “a contract is concluded at the moment when an acceptance of an offer becomes effective in accordance with the provisions of this Convention.” *CISG*, Art. 23. An offer must be “sufficiently definite,” and “demonstrate an intention by the offeror to be bound if the proposal is accepted.” *Id.* Art. 14. An offer is accepted, and a contract is formed when the offeree makes a statement or other conduct, “indicating assent to an offer.” *Id.* Art. 18. The *CISG* does not contain a statute of frauds, stating that “a contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form.” *Id.* Art. 11. Courts have held that a binding contract exists when the parties sufficiently agree to the goods, the quantity and the price. See, e.g., *Chateau Des Charmes Wines, Ltd. v. Sabate U.S.A., Ltd.* [citation omitted].

Having reviewed the record in light of the applicable legal standard, the Court is not persuaded by Solae’s contention that its Conditions of Sale control the disputed transaction. . . . The record is clear that [the parties] reached agreement as to the amount of soy lecithin Solae was obligated to sell Hershey Canada during the calendar year 2006, and the price at which Solae was obligated to sell. Under this agreement, Hershey Canada was obligated to purchase a substantial quantity of soy lecithin from Solae at the price agreed upon. The Court concludes that this is sufficient to create a complete and binding contract under the *CISG* (the “2006 Contract”).

Because the 2006 Contract did not include a forum-selection clause, the Court must now determine if the forum-selection clause contained in the Conditions of Sale subsequently became part of the 2006 Contract under the *CISG*. As Hershey Canada points out, this issue was addressed by the Ninth Circuit in *Chateau Des Charmes Wines Ltd.*, 328 F.3d 528:

continues



continued

Under the Convention, a “contract may be modified or terminated by the mere agreement of the parties.” [CISG], art. 29(1). However, the Convention clearly states that “[a]dditional or different terms relating, among other things, to . . . the settlement of disputes are considered to alter the terms of the offer materially.” *Id.* Art 19(3). There is no indication that [the buyer] conducted itself in a manner that evidenced any affirmative assent to the forum selection clauses in the invoices. Rather, [the buyer] merely performed its obligations under the oral contracts. Nothing in the Convention suggests that the failure to object to a party’s unilateral attempt to alter materially the terms of an otherwise valid agreement is an “agreement” within the terms of Article 29.

Id. at 531. Here, as in *Chateau*, Solae has set forth no substantive evidence indicating that Hershey Canada agreed to a modification of the terms of the 2006 Contract, beyond Hershey Canada’s receipt of the Conditions of Sale. Solae has not set forth evidence refuting statements that Hershey Canada’s material analyst at the Smith Falls plant was not authorized to negotiate contractual terms or to commit Hershey Canada to Solae’s Conditions of Sale, and the Court does not agree with Solae’s contention that because multiple invoices and pre-shipment confirmations containing these Conditions of Sale were sent to Hershey Canada over “years of sales and dozens of transactions,” these terms necessarily became part of the 2006 Contract. “[A] parties’ multiple attempts to alter an agreement unilaterally do not so effect.” *Chateau*, 328 F.3d at 531. In sum, the Court concludes that Hershey Canada’s continued performance of its duties under the 2006 Contract

did not demonstrate its acceptance of the terms contained in the Condition of Sales, and the Court further concludes that Solae’s Conditions of Sale did not modify the 2006 Contract to add a forum-selection clause.

Decision. The parties’ January 2006 contract for the sale and purchase of soy lecithin in 2006 was valid and binding. The forum selection clause contained in Solae’s conditions of sale and incorporated in later sales documents was not a part of this contract. The buyer did not assent to the forum selection agreement simply by receiving and paying for the goods. The seller’s complaint was thus dismissed for lack of personal jurisdiction.

Comment. In addition to its holding on new and additional terms, this case is instructive in its determination of the minimum requirements to form a contract pursuant to the CISG and its disregard of terms apparently incorporated into the sales documents between the parties for three years prior to this lawsuit.

Case Questions

1. What was the court’s holding with respect to the inclusion of the forum selection clause in the parties’ contract?
2. What are the requirements for the formation of a contract pursuant to the CISG?
3. Did the court improperly excuse Hershey’s failure to object to the forum selection clause given the parties’ extended dealings (which included conditions of sale containing a forum selection clause)? Why or why not?

Standard Business Forms and Contract Modifications

Buyers and sellers often use standard business forms for quoting prices, placing orders, and acknowledging receipt of those orders. Two of the most common that we will discuss are the purchase order and the order confirmation. Business buyers commonly use a **purchase order** for placing orders for goods from their vendors. A purchase order is a document issued by a commercial buyer to a commercial seller indicating the buyer’s desire to purchase goods from the seller. Typically, it includes the description and quantity of the goods ordered, a delivery address, and authorized buyer’s signature. It may also recite the prices that the buyer believes to be accurate and current for the goods, a desired shipping date, and any other contractual

requirements the buyer may have. The **order confirmation** (also called a “sales acknowledgment”) is the seller’s formal confirmation of the buyer’s order, either accepting the order, rejecting it, or modifying its terms. Typically, these forms leave room on the front so the parties may insert important contract terms—those that they “bargained for,” such as price, quality, or ship date. The reverse side often contains detailed “fine print” provisions or standard clauses, often called terms and conditions or general conditions of sale (Exhibit 4.3).

An attorney often drafts these **terms and conditions** to limit his or her client’s liability by placing greater responsibility on the other party. The parties may not even be aware of the legal significance of these seldom-read fine print provisions. For the most part, a seller would only read the most crucial provisions on the front page of a buyer’s purchase order to see what



Exhibit 4.3

Seller's Terms and Conditions of Sale

(Seller's Order Confirmation—Reverse Side)
Pro Forma Invoice or

TERMS AND CONDITIONS OF SALE

1. Acceptance

This constitutes acceptance by Seller of Buyer's purchase order. This acceptance is expressly made conditional upon Buyer's assent, express or implied, to the terms and conditions set forth herein without modification or addition. Buyer's acceptance of these terms and conditions shall be indicated by any part of the following, whichever first occurs: (a) Buyer's written acknowledgment hereof; (b) Buyer's acceptance of shipment of the goods herein described; (c) Buyer's failure to acknowledge or reject these terms and conditions in writing within five business days after delivery; or (d) any other act or expression of acceptance by the Buyer. Seller's silence or failure to respond to any such subsequent term, condition, or proposal shall not be deemed to be Seller's acceptance or approval thereof.

2. Price and Delivery

The quoted price for the goods may be varied by additions upwards by the Seller according to market conditions at the date of shipment and the Buyer shall pay such additions in addition to the quoted price, including but not limited to increases in the cost of labor, material, operations, and/or transport. Delivery and payment terms shall be made according to this order confirmation. Trade formulas used herein (e.g., CIF, CPT, FAS, or FOB) shall be interpreted according to *Incoterms* 2010. Payment in the currency and at the conditions of this confirmation.

3. Force Majeure

Seller shall not be liable for loss or damage due to delay in manufacture, shipment, or delivery resulting from any cause beyond Seller's direct control or due to compliance with any regulations, orders, acts, instructions, or priority requests of any government authority, acts of God, acts or omissions of the purchaser, fires, floods, epidemics, weather, strikes, factory shutdowns, embargoes, wars, riots, delays in transportation, delay in receiving materials from Seller's usual sources, and any delay resulting from any such cause shall extend shipment or delivery date to the extent caused thereby, and Seller shall be reimbursed its additional expenses resulting from such delay. In the case of delay lasting more than eight weeks, Seller has the right to cancel the contract. Receipt of merchandise by the Buyer shall constitute a waiver of any claims for delay.

4. Warranties

The Seller makes no representations or warranties with respect to the goods herein. Seller hereby disclaims warranties, express or implied, as to the products, including but not limited to, any implied warranty of quality or merchantability or fitness for any particular purpose, and the Buyer takes the goods on the Buyer's own judgment. Seller is not liable for any damage or loss for a breach of warranty.

5. Limitation of Liability

Seller is not liable for any special, consequential, or incidental damages arising out of this agreement or the goods sold hereunder, including but not limited to damages for lost profits, loss of use, or any damages or sums paid by Buyer to third parties, even if Seller has been advised of the possibility of such damages.

6. Governing Law

In respect of any standard, test, mode of inspection, measurement, or weight, the practice governing the same adopted for use in United States shall prevail. This agreement shall be governed by the Laws of North Carolina and in the event of any dispute arising, whether touching on the interpretation hereof or otherwise, the same shall be resolved before the General Court of Justice of the State of North Carolina.

- was ordered. A buyer may only glance at the key provisions of the seller's confirmation to see when the goods will be shipped. The preprinted terms on these forms may differ, sometimes in significant ways.
- Here are several examples of how they might differ:
- Buyer's purchase order allows the buyer to bring suit for consequential damages if the seller breaches the contract.
 - Seller's confirmation specifically excludes consequential damages.
 - Buyer's purchase order calls for disputes to be resolved in the buyer's country. Seller's confirmation calls for disputes to be heard in the courts of the seller's country.
 - Buyer's purchase order requires shipment by a certain date named in the order. Seller's confirmation allows a grace period for late shipping or provides for excuses for late shipment.



- Buyer's purchase order is silent about whether the buyer has to notify the seller in the event of problems with the merchandise. Seller's confirmation requires buyer to notify the seller of any problems in the order within seven days.

The potential for conflict is almost endless. When this occurs, lawyers call it a **battle of the forms**.

The "Battle of the Forms" under the Common Law and Civil Law. If a seller sends a confirmation in response to a buyer's purchase order and the seller's form contains differing or additional terms, no matter how minor, then no contract exists. The mirror image rule has been violated. Each form or correspondence between them is considered a counteroffer, canceling the previous one. If the parties do not perform, then no contract is formed. If the parties do perform—the seller ships the goods—then that action is an acceptance of the terms on the other party's last form. The result usually is that the form sent last in time will prevail as the contract. The rule is, however, different in the United States.

The "Battle of the Forms" under the UCC. In the United States, the mirror image rule has been modified by statute to deal with modern business practices and to avoid the problems in the preceding examples. Under subsections 1 and 2 of UCC 2-207:

1. A written confirmation that is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those in the purchase order, unless the confirmation "is expressly made conditional on assent to the additional or different terms."
2. If both parties are merchants, any additional terms contained in the seller's confirmation automatically become a part of the contract *unless*:
 - a. The buyer's purchase order "expressly limits acceptance" to the terms in that order;
 - b. The additional terms in the confirmation *materially alter* the terms of the order; or
 - c. The buyer notifies the seller of an objection to the additional terms within a reasonable time after receiving the confirmation containing the new terms.

A careful reading of UCC 2-207 shows that the UCC attempts to uphold the intentions of the parties by keeping the contract in existence where there are only *minor differences* between the forms used by the parties. The UCC states that, between merchants, an acceptance by a

confirmation that contains additional terms that reflect only minor changes from the buyer's order will be effective to produce a contract, and the minor terms become a part of it (unless the buyer notifies the seller of an objection to the new term). A minor term might be one that is in usual and customary usage in the trade. Adding a provision that calls for an interest penalty for late payment is an example of a minor term (only because such penalties are common in sales contracts).

The situation is different in the case of new terms in the acceptance that attempt to *materially alter* the offer. A material term is generally considered to be one that is not commonly accepted in the trade and that would result in surprise hardship to one party if unilaterally included in the contract by the party. Such new terms do not become a part of the contract unless accepted by the other party. Sellers who wish for assurance that their order confirmation will comprise the entire agreement should request that the buyer show its acceptance of the new terms by signing the confirmation and returning the completed contract to them.

The Battle of the Forms under the CISG. The CISG rules fall somewhere between the rules set out by the common and civil law and the UCC. In an international sales transaction governed by the CISG, an acceptance containing new terms that do not materially alter the terms of the offer becomes a part of the contract, unless the offeror promptly objects to the change. However, a purported acceptance that contains additional or different terms that materially alter the terms of the offer would constitute a rejection of the offer and a counteroffer. No contract would arise at all unless the offeror in return accepted all of the terms of the counteroffer. Under the CISG, an acceptance of the counteroffer may arise by assent or *by performance*. In other words, if the original offeror takes some steps toward performing the contract after having received a counteroffer, the offeror will be deemed to have accepted the counteroffer and a contract will be created on the new terms.

Unlike the UCC, the CISG states those key elements of a contract that will materially alter a contract: price, payment, quality and quantity of goods, place and time of delivery, extent of one party's liability to the other, and settlement of disputes. This list is so broad that almost any term could conceivably be interpreted as "material." Thus, under the CISG, almost any new or different term in the acceptance could constitute a counteroffer. The effect is that many businesspeople may believe that they are "under contract" when they really are not.



The Validity of Standard Contract Terms: A Comparison. Today, there is wide use of so-called fine print or standard terms in contracts. They offer many advantages to businesses by eliminating the need to negotiate all the details of a contract every time goods are sold. In the United States, standard terms are generally permitted in business-to-business contracts unless in violation of a statute or struck down by the courts for other reasons. However, in some civil law countries, such as China or Germany, to take two examples, the statutes are quite specific about the kinds of standard contract terms that are permissible.

China takes a clear legal approach to the validity of standardized terms. Chinese law requires standardized terms to be fair in limiting the rights and liabilities of the parties. The terms must be brought to the attention of the other party, and they must be explained if requested. Caution should be used when using standardized terms in China because, if they are not fairly negotiated between both parties, they might be declared invalid. Grounds for invalidation include fraud, duress, illegality, harm to the public interest or the interest of the state, and exclusion of one party's liability for personal injury or property loss caused by intentional misconduct or gross negligence.

The German Civil Code has more detailed provisions dealing with standard contract terms. Standard business terms are defined as "contract terms preformulated for more than two contracts which one party to the contract presents to the other party upon the entering into of the contract." The form of the contract, typeface, font, or physical separation of terms in different documents is irrelevant to this determination. Individually negotiated terms take precedence over standard business terms. Parties may agree in advance to the application of particular standard business terms. In the absence of such advance agreement, standard business terms are incorporated into a contract only if the user expressly draws the other party's attention to them, gives the other party a reasonable opportunity to gain knowledge of their content, and the other party is agreeable to their application. Standard terms that unreasonably disadvantage a party are ineffective. Examples include terms providing for unreasonably long periods of time for acceptance or performance and unilateral reservation of the rights to revoke or modify the contract. If all or some standard business terms do not become part of the contract or are invalidated, the remainder of the contract continues to be valid unless its performance would be

an unreasonable hardship for one party. In the event of doubt, standard business terms are to be interpreted against the user.

PERFORMANCE OF CONTRACTS

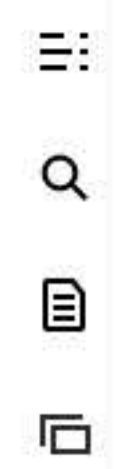
The primary responsibility of the buyer (Articles 53–60) is to pay the price for the goods and take delivery at the time and in the manner promised. The primary responsibility of the seller (Articles 30–35) in performing a contract for the sale of goods is to deliver conforming goods in the manner specified and within the time called for in the contract.

Performance of Seller

One of the primary responsibilities of the seller is to deliver conforming goods. CISG Article 35 states, "The seller must deliver goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract." Goods that do not conform to the requirements of the contract are said to be nonconforming. This includes all express descriptions, specifications, representations, and warranties set out in the contract. They must also comply with representations implied in the contract by law.

Implied Warranties. In the United States, the UCC creates certain implied warranties on goods that become a part of the contract by law (Exhibit 4.4). This includes the warranty of merchantability (drawn from the English common law), the warranty of fitness for a particular purpose in which the buyer relies on the skill and expertise of the seller, and the warranty of title. The CISG has similar provisions. Under CISG Article 35, unless otherwise agreed by the parties, the seller must deliver goods that are of the quantity, quality, and description required by the contract and that

1. Are fit for the purposes for which goods of the same description would ordinarily be used (unless at the time of contracting, the buyer knew or could not have been unaware that the goods were unfit; the seller's knowledge in this case is not relevant). This corresponds to the warranty of merchantability under the common law and the UCC and to the implied representation that goods be of "average quality" under European civil law.



- 2. Are fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgment.
- 3. Possess the qualities of goods that the seller has held out to the buyer as a sample or model.
- 4. Are contained or packaged in the manner usual for such goods or, where there is no such manner, in a manner adequate to preserve and protect the goods (unless at the time of contracting, the buyer knew or could not have been unaware that the goods were not properly packaged).

The CISG does not prevent parties from waiving these representations. The drafters of the CISG wanted to give the parties as much freedom of contract as possible, in part because the Convention does not apply to consumer sales.

Conformance to Laws and Regulation in Buyer's Country. Technical regulations setting standards for product design and performance can vary widely from country to country. This might include safety standards for foods, pharmaceuticals, automobiles, toys, and consumer goods; flammability standards for children's clothing; fire and electrical codes; health codes; environmental standards; and rules for packaging or labeling products. Obviously, these issues are more important in international trade, where the standards are far less uniform, than in domestic commerce. Does Article 35 require the seller to supply goods that conform to the national laws of the buyer's country? The cases seem to depend on the factual situations. The issue often turns on whether the seller knew the uses to which the goods would be put, whether it knew of the regulations in the buyer's country affecting that use, and whether the buyer had relied on the seller's knowledge and expertise. It is usually only then that a court would hold that goods are nonconforming if they do not meet the regulations for sale in the buyer's country.

This issue was addressed by the Federal Supreme Court of Germany in 1995, in the *Case of New Zealand Mussels*. (Translations available online from the Pace Law School Institute of International Commercial Law or from UNCITRAL.) This case dealt with a shipment of mussels from New Zealand to Germany that contained concentrations of cadmium exceeding those recommended by German health authorities. Generally, foodstuffs must be sold in a condition "fit for human consumption." However, the court held that since the mussels were still edible (they are generally not dangerous unless eaten in large quantities) they had conformed to the contract. The court held that the seller was not responsible for complying with the German standards unless it had known of the standards and was aware that this was essential to the buyer, or if similar standards had existed in the exporting country. It did not seem to matter to the German court whether the food safety standards were binding rules or simply "recommended" limits. This should send a warning to international buyers.

UCC Implied Warranties, Merchantability, and Usage of Trade	
§2-314(2)	Goods to be merchantable must be at least such as (a). pass without objection in the trade under the contract description; and (b). in the case of fungible goods, are of fair average quality within the description; and (c). are fit for the ordinary purposes for which such goods are used; and (d). run, within the variations permitted by the agreement, of even kind, quality, and quantity within each unit and among all units involved; and (e). are adequately contained, packaged, and labeled as the agreement may require; and (f). conform to the promises or affirmations of fact made on the container or label if any.
§2-314(3)	(a). Unless excluded or modified other implied warranties may arise from course of dealing or usage of trade.



If it is important that foreign goods meet local standards or regulations, this requirement should be clearly set out in the contract.

Performance of Buyer

We said that the buyer’s main responsibility is to pay the price for the goods and take delivery of them as required (Article 53). In addition, the buyer has an obligation to inspect the goods and notify the seller of any nonconformity.

Inspection and Notice of Nonconformity. The buyer must inspect the goods within “as short a period as is practicable in the circumstances” after they have arrived at their destination (Article 38). Obviously, foodstuffs and perishables require inspection more quickly than durable goods like machinery. The buyer must then give notice of any defect or nonconformity in the goods within a reasonable time after it is discovered or ought to have been discovered. If the defect can be discovered only upon use, the buyer has a reasonable period from that time to notify the seller. Some defects or other nonconformities may be latent, or hidden, and may take longer to detect. There is no set time limit on discovering these, although the time within which notice must be given to the seller of the nonconformity begins to run at the time that the seller “ought to have discovered”

the hidden defect (Article 39). In any event, notice must be given within two years from the date on which the goods were “handed over” to the buyer. If the buyer fails to give timely and proper notice, the buyer loses the right to assert the breach against the seller. The parties are free to agree on other inspection and notice requirements and frequently do so in international business.

The notice of nonconformity should specifically, and in necessary detail, state how the goods are nonconforming. This is necessary so a breaching party can send substitute goods or otherwise correct the problem. In one German case, a German fashion retailer purchased clothing from an Italian manufacturer. The buyer refused to pay and notified the seller that the clothes were of “poor workmanship and improper fitting.” The German court, applying the CISG, ruled that the buyer had lost his breach of warranty claim because the notice did not precisely say why the goods were defective or nonconforming. Another German case refused to excuse a German purchaser of chrysanthemums and hydrangeas from payment in full to an Italian seller on that the plants were of “poor quality” and were “miserable.” An American example of the buyer’s inspection and notification obligations pursuant to the CISG is set forth in the court’s opinion in *Chicago Prime Packers, Inc. v. Northam Food Trading Co.*



Chicago Prime Packers, Inc. v. Northam Food Trading Co.

320 F. Supp. 2d 702 (2004) (United States District Court, Northern District of Illinois)

BACKGROUND AND FACTS

Chicago Prime Packers, Inc., was a Colorado corporation with its principal place of business in Avon, Colorado. Northam Food Trading Company was a Canadian corporation with its principal place of business in Montreal, Quebec, Canada. Chicago Prime and Northam were wholesalers of meat products. In March 2001, Chicago Prime contracted with Northam to sell 1,350 boxes of government inspected fresh, blast frozen pork back ribs, which Chicago Prime purchased from Brookfield Farms, a meat processor. The agreed on price for the ribs was \$178,200.00, and payment was required within seven days from the date of shipment. The ribs were stored at three different locations en route to Northam’s customer Beacon Premium Meats but at all times were stored at or below acceptable temperatures. However, the ribs ultimately proved to be spoiled and were condemned by the U.S. Department

of Agriculture. Nevertheless, Chicago Prime continued to demand payment from Northam. Chicago Prime sued Northam for breach of contract because it refused to pay for the ribs.

MEMORANDUM OPINION AND ORDER

In this case, it is undisputed that the parties entered into a valid and enforceable contract for the sale and purchase of pork loin ribs, Chicago Prime transferred a shipment of pork loin ribs to a trucking company hired by Northam, Northam has not paid Chicago Prime for the ribs pursuant to the contract, and Chicago Prime has suffered damages in the amount of the contract price. Therefore, Chicago Prime has established the essential elements for a breach of contract claim. Northam asserts, however, that the ribs were spoiled at the time of transfer and, as a result, it is relieved of its duty to pay under the contract. The burden is on Northam to

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continued

establish non-conformity. The evidence is evaluated in light of that burden.

1. Northam has failed to prove that the ribs were non-conforming at the time of transfer. . . .

Chicago Prime produced evidence . . . that the ribs delivered by Brookfield were processed and stored in acceptable conditions and temperatures from the time they were processed until they were transferred to Northam on April 24, 2001 . . . The ribs were appropriately processed and maintained in acceptable temperatures while at Brookfield; and no other meat products that were processed and stored at the same time and under the same conditions as the ribs were found to be spoiled or objectionable. . . .

Northam argues that Chicago Prime has “utterly failed to establish that the ribs were damaged while at Beacon.” That argument ignores the fact that Northam carries the burden of proving that the ribs were nonconforming at the time of receipt.

2. Northam failed to prove that it examined the ribs, or caused them to be examined, within as short a period as is practicable under the circumstances.

Northam is correct that “there were no contractual [terms] requiring inspection upon delivery.” . . . When an issue is not addressed by the contract, the provisions of the CISG govern. Because the contract at issue did not contain an inspection provision, the requirement under the CISG that the buyer examine the goods, or cause them to be examined, “within as short a period as is practicable in the circumstances” is controlling. *CISG*, Art. 38(1). Decisions under the CISG indicate that the buyer bears the burden of proving that the goods were inspected within a reasonable time. See, e.g., *Fallini Stefano & Co. s.n.c. v. Foodic BV*, [citation omitted] . . . The determination of what period of time is “practicable” is a factual one and depends on the circumstances of the case. . . .

Section 3 of Article 38 of the CISG provides that “if the goods are redirected in transit or redispached by the buyer without a reasonable opportunity for examination by him and at the time of the conclusion of the contract the seller knew or ought to have known of the possibility of such redirection or redispach, examination may be deferred until after the goods have arrived at the new destination.” *CISG*, Art. 38(3). In this case, Chicago Prime knew, or ought to have known, that the ribs would be redirected or redispached after receipt because Chicago Prime knew that Northam was only a “trading company,” which is defined as a company that buys and sells meat, but does not own any facilities, brick and mortar, or trucks. Thus, under the CISG, examination of the ribs could have been deferred until after they arrived at Beacon.

It is notable, however, that Northam did not present any testimony or evidence as to why the ribs or a

portion of the ribs were not and could not have been examined by Northam, Beacon, or someone acting on their behalf when the shipment was delivered to Beacon or within a few days thereafter . . . Northam points out that the ribs were wrapped and shipped in sealed non-transparent cartons or packages that are either white or brown. However . . . nothing would have precluded a Beacon representative from opening and inspecting the boxes of ribs . . . Northam simply did not present any evidence indicating why the boxes or at least enough of the boxes to constitute a reasonable inspection could not have been opened and examined when they arrived at Beacon or shortly after arrival . . . Accordingly, Northam has failed to demonstrate that it examined the ribs, or caused them to be examined within as short a period as is practicable under the circumstances.

3. Northam also failed to prove that it gave notice to Chicago Prime of the alleged lack of conformity within a reasonable time after it ought to have discovered the alleged lack of conformity.

Article 39 of the CISG states that “[a] buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it.” *CISG*, Art. 39. A buyer bears the burden of showing that notice of nonconformity has been given within a reasonable time. The evidence shows that, shortly after Beacon discovered the ribs were “off condition” and did not “look good,” both Northam and Chicago Prime were notified of a potential problem. Chicago Prime therefore received notice within a reasonable time after Northam discovered the problem; however, the question here is whether Chicago Prime was notified within a reasonable time after Northam should have discovered the problem.

A court in Italy found that the reasonableness of the time for a notice of nonconformity provided in Article 39 is strictly related to the duty to examine the goods within as short a period as is practicable in the circumstances set forth in Article 38. See *Sport D’Hiver di Genevieve Culet v. Ets Louys et Fils*, [citation omitted]. The court further noted that when defects are easy to discover by a prompt examination of the goods, the time of notice must be reduced. The putrid condition of the meat was apparent even in its frozen state. . . .

Because this court has found that Northam failed to examine the shipment of ribs in as short a period of time as is practicable, it follows that Northam also failed to give notice within a reasonable time after it should have discovered the alleged non-conformity.

In summary, the object of the CISG in requiring inspection in as short a period of time as is practicable, and notice promptly thereafter, is to avoid controversies

continues



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such as this—where, because of the passage of time, the condition of the goods at the time of transfer cannot be reliably established. When that happens, the burden falls on the buyer, who had the opportunity to inspect the goods, but failed to do so.

Decision. The district court concluded that the buyer failed to satisfy its obligations with respect to the inspection of the goods and notification of the seller of nonconformities within a reasonable time. As a result, the court entered judgment in favor of the seller in the amount of \$178,200.00 plus \$27,242.63 in interest for a total payment of \$205,442.63.

Comment. This case is interesting not only with respect to ascertaining the buyer's duties of inspection and notification but also for its discussion of sources

for interpretation of the CISG. The court cited Dutch and Italian case law in reaching its conclusion and additionally noted that the CISG must be interpreted in a manner consistent with its international character and the need to promote uniformity and good faith in international trade.

Case Questions

1. What was the court's decision with respect to Chicago Prime Packers' claim for breach of contract?
2. What should Northam have done in order to avoid the result in this case?
3. Is the court's opinion overly harsh given that Northam was only a trading company and not the end user of the product? Why or why not?

REMEDIES FOR BREACH OF CONTRACT

In the event of a breach of contract, the remedies available to a buyer or seller are set out in the CISG. In principle, these remedies are drawn from both the common law and civil law systems. They are intended to give the parties the benefit of their bargain and to put the parties into the economic position they would have been in had the breach not occurred. The remedies outlined in the CISG include (1) avoidance (cancellation) of the contract; (2) the right to remedy or cure; (3) the setting of an additional time, or extension, for performance; (4) price reduction; (5) money damages; and (6) specific performance. The right to a remedy depends on whether or not the failure of performance amounted to a fundamental breach.

The Requirement of Fundamental Breach

The CISG distinguishes between a serious or fundamental breach of the contract and one that is minor or less than fundamental. Article 25 defines a **fundamental breach** as a breach of contract committed by one of the parties that "results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result." Examples of fundamental breaches include shipment of less than the full quantity

of goods ordered by the buyer, the seller's shipment of seriously defective goods that cannot be repaired or replaced on time, or that have no value to the buyer under the contract and, of course, the seller's failure or refusal to ship at all. Late shipments are more problematic, because this is so common in international shipping. Most late shipments are not a fundamental breach, and under the CISG sellers are usually given additional time to perform even when they are late. A partial shipment may also amount to a fundamental breach if it presents a serious problem for the buyer and one that cannot quickly be remedied. A buyer may also be in fundamental breach of a contract. This usually results from the buyer's refusal or inability to live up to its two primary responsibilities—to take delivery and to pay for the goods.

Seller's Right to Cure

The CISG attempts to encourage the parties to stay in their contract rather than to repudiate it in the event of a dispute. It does this by giving the seller (and the buyer) additional time to perform.

Both the UCC and the CISG allow the seller to remedy, or cure, a nonconforming shipment if it can be done within the time for performance called for in the contract. So, if the contract calls for the seller to deliver goods to the buyer by October 1, but defective goods arrive on September 15, then the seller may "cure" by delivering a second shipment of conforming goods by October 1.

Nachfrist Period. Unlike the UCC, civil law systems traditionally grant an extension of time, beyond the date called for in the contract, within which the parties may perform. French civil law often refers to this grace period as *mise en demeure*, while German law calls it **nachfrist**, meaning “the period after.” The CISG adopts this civil law rule in Articles 47–49. In the event that the seller has failed to deliver the goods, or has already delivered nonconforming goods, and the time for their shipment or delivery has passed, the seller may request the buyer to grant a reasonable extension of time to perform (or to “cure” the problem), at the seller’s own expense, if it can be done without causing the buyer unreasonable inconvenience or the uncertainty of reimbursement of expenses incurred during the extension. If the breach is fundamental and, a “cure” seems impossible, the buyer need not grant the extension. In the case of the delivery of nonconforming goods resulting in a breach that is not fundamental, or in the case of a nondelivery that can be cured by the seller within a reasonable time, the buyer may not unreasonably refuse the extension. If the buyer does not respond to the seller’s request within a reasonable time, the seller is entitled to the requested extension. If the seller still does not perform within the extension of time, the buyer is then released from the contract whether or not the breach was fundamental.

Buyer’s Right to Avoidance. When one party fails to perform, the contract does not automatically end. The contract, or certain provisions of it, must be declared to be at an end, or “avoided” by one of the parties. A buyer may declare a contract avoided where the seller’s failure to perform any obligation amounts to a fundamental breach (Article 49). If the seller requests additional time to cure a fundamental breach, the buyer need not grant it. If the buyer takes delivery of goods and learns they are so seriously defective as to amount to a fundamental breach, the buyer must declare avoidance within a reasonable time after he or she became aware, or should have become aware, of the breach. The buyer need not pay for the goods or find a substitute buyer to take them. After notifying the seller of the avoidance, the buyer may simply return them for a full refund of money paid or institute an action for breach of contract. When the goods can rapidly deteriorate or decay, such as with certain foods, the buyer may notify the seller and then take steps to sell them. These rights are especially important to a buyer in an international transaction because of the hardships associated with having to accept delivery and then reselling or disposing of imported goods in a foreign (i.e., the buyer’s) market.

In the case of nondelivery, the buyer may avoid the contract only at the end of the *nachfrist* period—at the end of additional time that the seller was given to perform. The buyer may bring an action for damages against the seller at that time.

Seller’s Right to Avoidance. The seller also may avoid a contract. A seller may avoid a contract if a buyer fails to either take delivery or pay the purchase price or otherwise commits a fundamental breach (Article 64). The effect of avoidance is that the seller is released from the contract, need not deliver the goods still in the seller’s possession, and may claim their return if they have already been delivered. The seller also may bring a legal action for damages.

Price Reduction

One solution for the buyer in the event that the seller ships defective or nonconforming goods is that of **price reduction** (CISG Article 50). A buyer who would like to retain the goods, even though they are perhaps not the quality or specifications called for, may adjust the amount paid by withholding a part of the purchase price in order to offset the reduced value of the nonconforming goods. If the buyer can repair the goods or bring them up to contract specifications, the buyer may adjust the price paid accordingly. If the goods have already been paid for, the buyer may ask that the seller return a portion of the amount paid. The buyer may use the remedy of price reduction whether or not the seller’s breach has been fundamental.

Money Damages

In breach of contract cases, the usual remedy granted by common law courts is the awarding of money damages. Damages for breach of contract are addressed in Articles 74–77. The CISG provides that a breaching party, whether buyer or seller, shall be liable for damages in an amount sufficient to make the injured party whole in the event of a breach. Article 74 states that damages to an injured party shall consist of a “sum equal to the loss.”

Compensatory Damages. In the event of a breach of contract by either buyer or seller, and the nonbreaching party has exercised their right to avoidance of the contract, the method of measuring money damages depends on whether the nonbreaching party has been able to enter into a substitute transaction. For example,



if the seller fails to deliver or delivers nonconforming or worthless goods, and the buyer has been able to purchase substitute goods, the buyer may claim damages if the substitute goods cost more than the contract price. If the buyer has not purchased substitute goods, damages are measured by the difference between the contract price and the current market price or the price of a reasonable substitute. Similarly, if the buyer refuses delivery or fails to pay and the seller has avoided the contract and resold the goods, the seller may recover damages in the amount by which the contract price exceeded the price received in the substitute transaction.

Consequential Damages. The CISG also permits recovery of **consequential damages**. Consequential damages are those special or indirect damages arising as a “reasonably foreseeable” consequence of the breach. They normally result from some special circumstances involving one of the parties to the contract, where those special circumstances were made known, or should have been known, by the other party. For example, assume that the buyer is purchasing the goods in order to resell them at a higher price under a separate contract to a third party. That fact is made known to the seller. If the seller breaches, it may be liable for the

buyer’s **lost profits** as well as other consequential damages resulting from the buyer’s breach to the third party. Consequential damages are limited under Article 74 to those that the parties “foresaw or ought to have foreseen at the time of the conclusion of the contract.” To compare the provisions for consequential damages in the CISG and the UCC, see Exhibit 4.5.

Liquidated Damages. **Liquidated damages** are monetary awards set forth and agreed to by the parties within the express terms of a breached agreement. The CISG does not expressly address liquidated damages as a measure of damages. Rather, it indirectly addresses liquidated damages in several provisions. CISG Article 6 allows for the incorporation of agreed sums into a contract for the sale of goods through its recognition of the principle of freedom of contract. Articles 46 and 62 recognize the principle of *pacta sunt servanda*, specifically, that contractual obligations must be kept. Finally, Article 74 recognizes the necessity of providing full compensation for injured parties in the event of breach of contract. In *American Mint LLC v. GOSoftware, Inc.*, a U.S. district court held that these provisions would not preclude enforcement of a liquidated damages clause pursuant to the CISG.

Exhibit 4.5

Comparison of Consequential Damage Provisions of the CISG and the UCC

CISG Article 74

Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.

UCC 2-715

Buyer’s Incidental and Consequential Damages

- Incidental damages resulting from the seller’s breach include expenses reasonably incurred in inspection, receipt, transportation, and care and custody of goods rightfully rejected, and commercially reasonable charges, expenses, or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.
- Consequential damages resulting from the seller’s breach include
 - any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
 - injury to person or property proximately resulting from any breach of warranty.

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Specific Performance

The usual legal remedy in contract cases in common law countries is an award for money damages. The usual remedy in civil law countries, on the other hand, is that of **specific performance**. Specific performance is used when a court requires a party to the contract to perform, or carry out its part of the bargain. To be sure, courts in the United States and other common law countries hesitate to require parties to specifically perform. It is considered a harsh remedy for use only where money damages cannot be calculated or are inadequate, which may occur when the subject matter of the contract is unique.

Specific Performance under the CISG. The CISG draws strongly on the civil law's acceptance of specific performance as a remedy in contract cases. Under Article 46, a court may grant specific performance only if all of the following conditions are met: (1) the buyer has not resorted to another remedy; (2) the seller failed to deliver or, in the case of nonconforming goods, the nonconformity was so serious that it constituted a fundamental breach; (3) the buyer gave timely notice to the seller that the goods were nonconforming; and (4) the buyer made a timely request that the seller provide substitute goods. The court may grant specific performance without regard to whether money damages are inadequate.

The provisions of the CISG probably will not have much effect on the law in common law countries. Article 28 places a limit on the buyer's right to specific performance by providing that a court need not grant specific performance unless "it would do so under its own law." Thus, the CISG will have little effect on the use of specific performance in the United States.

Anticipatory Breach

Anticipatory breach occurs when one party clearly sees that the other party to the contract either will not perform a substantial part of its obligations or will commit a fundamental breach. The breach may occur as a result of one party repudiating the contract and notifying the other that it will not perform, or it may be determined from the conduct of the breaching party.

Right to Suspend Performance. Either party may **suspend performance** under a contract if one party realizes that the other party will not perform a "substantial

part" of its obligations. A buyer may suspend payment when aware of evidence that the seller cannot or will not ship. A seller may suspend shipment when the buyer obviously cannot pay or take delivery of the goods. A seller who has already shipped may stop the goods in transit. The right to suspend performance ends when the other party provides adequate assurance that it will perform. If adequate assurance becomes impossible, the other party may then avoid the contract entirely.

Right to Avoid Performance for Anticipatory Breach. If prior to the date of performance it becomes clear that one of the parties is likely to commit a fundamental breach in the future, the other party may avoid the contract. This is similar to the common law concept of "anticipatory breach." In contrast to the right to suspend, avoidance for anticipatory breach is allowed where one party will *never* be able to perform. For instance, if the seller's plant burns down, or if an embargo in the seller's country makes it legally impossible to ship the contracted goods, then the buyer may avoid the contract.

Avoidance of Installment Contracts. When a contract calls for the delivery of goods by installments, the rules of avoidance apply to each individual delivery. Therefore, a buyer may refuse a single nonconforming shipment if the seller has committed a fundamental breach. Where the breach of one installment indicates strong grounds that a party will breach future installments, the nonbreaching party may declare the contract avoided if done within a reasonable time. So, if a buyer refuses to pay for one or two installments, the seller may avoid the remainder of the contract.

EXCUSES FOR NONPERFORMANCE

Occasionally, a party will find that circumstances make carrying out its part of the contract difficult, unprofitable, or even impossible. As a defense to an action for breach of contract, it may claim that it has been excused because intervening events beyond its control have made performance impossible or financially impracticable. Whether an intervening event will cause a party to be excused and discharged from its contractual promise depends on the reasoning the court uses. Some courts reason that a party's performance is excused if (1) performance of the contract has been rendered



physically or legally impossible, (2) the underlying purposes of the contract no longer exist, or (3) a change in circumstances has rendered the contract commercially or financially impracticable.

Impossibility of Performance

Under English law, a court may excuse a party's nonperformance where it becomes objectively impossible for it to perform. **Objective impossibility** means that it must be impossible for anyone to perform, not just this particular party, and that the parties did not expressly assume such a risk. Examples of objective impossibility include death of one of the parties, the destruction of the specific subject matter of the contract, or when performance of the contract has been rendered illegal or made impossible due to the fault of the other party. The inability to pay money is not usually an acceptable excuse.

Supervening Illegality. A contract becomes impossible to perform and the parties excused when performance becomes illegal or prohibited by supervening government regulation. For instance, suppose that a U.S. company is under contract to ship computers to Syria. As a result of the ongoing Syrian civil war, the U.S. government declared that such sales were illegal. Because the contract has been rendered illegal, nonperformance is excused.

Frustration of Purpose

Under the English common law, a party's performance could be excused if some unforeseen event occurred that frustrated the purposes of the contract. This event, called **frustration of purpose**, would have to totally destroy the value of the contract to the party relying on the excuse. Moreover, both parties must have known the purposes of the contract. To understand, one might ask the question, "Had this event existed at the time of the contract, would the parties have gone through with it?" Today, the United States does not widely recognize frustration of purpose.

Commercial Impracticability

A party to a contract that is prevented from performing may attempt to be excused under the doctrine of **commercial impracticability**. The United States uses this modern doctrine today. It dates back to 1916 when the California Supreme Court stated in *Mineral Park Land Co. v. Howard*, 156 P. 458 that "[a] thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can be done only at an excessive and unreasonable cost." Today, impracticability in the United States has been codified in the UCC (Exhibit 4.6) and in Article 79 of the CISG. Remember, courts hesitate to excuse parties from contracts.

Exhibit 4.6

Excuse by Failure of Presupposed Conditions

Uniform Commercial Code

2-615. Except so far as a seller may have assumed a greater obligation and subject to the preceding section on substituted performance:

a. Delay in delivery or nondelivery (performance or nonperformance, 2003 amendments) in whole or in part by a seller who complies with paragraphs (b) and (c) is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the nonoccurrence of which was a basic assumption on which the contract was made or by compliance in good faith with any applicable foreign or domestic governmental regulation or order whether or not it later proves to be invalid.

b. Where the causes mentioned in paragraph (a) affect only a part of the seller's capacity to perform, the seller must allocate production and deliveries among its customers but may at its option include regular customers not then under contract as well as its own requirements for further manufacture. The seller may so allocate in any manner which is fair and reasonable.

c. The seller must notify the buyer reasonably that there will be delay or nondelivery and, when allocation is required under paragraph (b), of the estimated quota thus made available for the buyer.

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Accordingly, the breaching party will be excused only if performance would result in extreme hardship, difficulty, or unreasonable expense as a result of an unforeseen event.

Extreme Hardship, Difficulty, or an Unreasonable Expense. The courts have experienced some difficulty in determining what is a “hardship” and how much additional cost is “unreasonable.” If the cost of performing the contract becomes so excessive that performance is rendered unrealistic and senseless and threatens the viability of the business itself, performance may be excused. Of course, what is a lot of money to one company may be a drop in the bucket to another. Thus, if a large multinational corporation contracts to deliver goods at a contract price and discovers that wage increases or an increase in the price of raw materials will cause it to lose millions of dollars on the deal, the courts still may not release the company from its obligation.

Unforeseen Events. Courts also look to see whether the party claiming the excuse should have foreseen the likelihood of its occurrence. If the event was foreseeable, the nonperforming party will not be released from its obligations. This does not mean that the parties had to foresee the specific event that actually occurred. Rather, the parties *should have* foreseen that an event *of this kind* could occur. Thus, if a party is a sophisticated business, experienced and familiar with the risks of entering into this kind of contract, they might have difficulty in proving that they should not have foreseen a particular risk. The courts generally feel that if a particular risk was foreseeable, then the parties would have provided in their contract that performance would be excused if it occurred. If they did not provide for the excuse in the contract, then they must have intended to bear this risk. For the most part, parties to a contract can anticipate shortages, inflation, and even dramatic fluctuations in market prices.

The CISG Exemption for Impediments Beyond Control

CISG Article 79 provides that a party is not liable for a failure to perform any obligations if (1) it was due to an *impediment beyond control*, (2) the impediment was not reasonably foreseeable at the time the contract was concluded, (3) the impediment was unavoidable and

could not be overcome, and (4) notice was given to the other party of the impediment and of its effect on the contract. Unless an impediment renders performance permanently impossible, it does not entirely excuse performance, but merely suspends it during the time that the impediment exists.

Avoiding Performance Disputes: Force Majeure Clauses

Courts do not like to release parties from a contract on the basis of an excuse. As a result, lawyers frequently advise their clients to incorporate a *force majeure* clause into their contracts.

The term **force majeure** means “superior force.” It is a clause in a contract that excuses a party from failing to perform on the occurrence of one or more specified events. These clauses usually list with specificity those events that will excuse nonperformance. These events might include war, blockades, fire, acts of governments, inability to obtain export licenses, acts of God, acts of public enemies, failure of transportation, quarantine restrictions, and strikes. Of course, such a clause assumes the party claiming the *force majeure* did not cause the event and could not control it. In practice, most *force majeure* clauses do not excuse a party’s nonperformance entirely, but only suspend it for the duration of the *force majeure*. For an example of a *force majeure* clause, see the *Terms and Conditions of Sale*, Exhibit 4.3. The *Tandrin Aviation Holdings Ltd. v. Aero Toy Store, LLC* case illustrates limitations upon the operation of a *force majeure* clause and how such clauses are interpreted by courts in the United Kingdom.

CONCLUSION

All commerce and trade require a stable and predictable legal environment in which to prosper. In recent years, the international community has agreed on a common body of international sales law, the *UN Convention on Contracts for the International Sale of Goods* (CISG). The CISG is important not only because it governs transactions for the trade in goods between parties in those nations that have adopted it but also because it represents internationally accepted legal principles of sales law. One of its key doctrines is that business parties should have the greatest freedom to contract possible.

The CISG was drafted under the aegis of the United Nations by representatives from countries





Tandrin Aviation Holdings Ltd. v. Aero Toy Store, LLC

[2010] EWHC 40 (United Kingdom, High Court of Justice, Queen's Bench Division, Commercial Court)

BACKGROUND AND FACTS

Plaintiff Tandrin Aviation Holdings Ltd. (Tandrin) agreed to sell a Bombardier executive jet aircraft to Aero Toy Store, L.L.C. (ATS) for U.S. \$31.75 million. ATS paid a U.S. \$3 million deposit to an escrow agent. Both the deposit and the balance of the purchase price were due to be paid to Tandrin on delivery of the aircraft. Tandrin subsequently purchased the aircraft from a third-party vendor for U.S. \$26.5 million. However, ATS failed to accept Tandrin's tendered delivery of the aircraft in January 2009 or pay the balance of the purchase price. Tandrin terminated the agreement in February 2009 the consequence of which was (according to the agreement) that the deposit became payable to Tandrin as liquidated damages. However, ATS failed to instruct the escrow agent to pay the deposit to Tandrin. Tandrin subsequently sold the aircraft for U.S. \$24 million.

Tandrin filed a lawsuit against ATS for breach of contract. ATS claimed that its contractual obligations were excused by a force majeure clause contained within the agreement. The clause read as follows:

7.17 Force Majeure. Neither party shall be liable to the other as a result of any failure of, or delay in the performance of, its obligations hereunder, for the period that such failure or delay is due to: Acts of God or the public enemy; war, insurrection or riots; fires; governmental actions; strikes or labor disputes; inability to obtain aircraft materials, accessories, equipment or parts from vendors; or any other cause beyond Seller's reasonable control. Upon the occurrence of any such event, the time required for performance by such party of its obligations arising under this Agreement, shall be extended by a period equal to the duration of such event.

ATS claimed that the "unanticipated, unforeseeable and cataclysmic downward spiral of the world's financial markets" triggered the force majeure clause, thereby postponing the time for ATS to complete the purchase and potentially affecting the price at which ATS should be entitled to purchase the aircraft.

HAMBLÉN, JUSTICE

It is well established under English law that a change in economic/market circumstances, affecting the profitability of a contract or the ease with which the parties' obligations can be performed, is not regarded as being a force majeure event. Thus a failure of performance due to the provision of insufficient financial resources has been held not to amount to force majeure—see *The Concolorado* [1916] AC 2 AC 199; and likewise a rise in cost or expense—see *Brauer & Co. (GB) Ltd. v. James Clark (Brush Materials) Ltd.* [1952] 2 All ER 497.

A recent judicial statement disapproving the notion that economic circumstances can generally found a claim for force majeure or frustration appears in *Thames Valley Power Ltd. v. Total Gas & Power Ltd.* [2006] 1 Lloyd's Rep. 441, where Christopher Clarke J. said this:

... It does not at all follow that the supplier is entitled to rely upon an increase in the market price in comparison to the contract price as a force majeure circumstance. ... This conclusion is consistent with a line of cases, both on force majeure clauses and on frustration, ..., to the effect that the fact that a contract has become expensive to perform, even dramatically more expensive, is not a ground to relieve a party on the grounds of force majeure or frustration. I take as an example *Tennants (Lancashire) Ltd v CS Wilson & Co Ltd* [1917] AC 495, a force majeure case where Lord Loreburn observed at page 510:

The argument that a man can be excused from performance of his contract when it becomes "commercially impossible" seems to me to be a dangerous contention which ought not to be admitted unless the parties plainly contracted to that effect.

Whether a force majeure clause in a contract is triggered depends on the proper construction of the wording of that clause; "force majeure" is not a term of art. Here, there are a number of hurdles in the way of clause 7.17 being construed in such a way as to permit ATS to rely on market conditions as a force majeure event.

The phrase "any other cause beyond the Seller's reasonable control" should be read in the context of the entire clause. The specific instances of force majeure in the preceding words are as follows: "act of God or the public enemy; war; insurrection or riots; fires; governmental actions; strikes or labour disputes; inability to obtain the aircraft materials, accessories, equipment or parts from the vendors." Whilst there is no requirement to construe the phrase "any other cause beyond the Seller's reasonable control" ejusdem generis with those earlier specific examples, it is telling that there is nothing in any of those specific examples of force majeure in clause 7.17 which is even remotely connected with economic downturn, market circumstances or the financing of the deal.

Further, it is striking that the clause does not refer to "any other cause beyond the Purchaser's reasonable control" or "any other cause beyond either party's reasonable control" but only to "any other cause beyond the Seller's reasonable control." The natural and ordinary

continues



continued

meaning of such a provision is that it is addressing the position of the seller rather than the purchaser and is a force majeure circumstance that only the seller can rely upon. There would be nothing particularly surprising if this part of the force majeure clause was limited in this way since it is the seller who has the principal performance obligations under the Agreement. The purchaser's essential performance obligation is to pay the price and accept delivery, obligations that are far less likely to be affected by force majeure circumstances.

The expression "any other cause beyond the Seller's reasonable control" cannot sensibly be construed to include matters with which the seller was never expected to be concerned. For instance, the seller would never have been expected to be concerned with, still less to have any control or influence over, the purchaser's financing arrangements; or any back-to-back sale by the purchaser to a third party which would have provided the purchase monies.

Instead, the expression "any other cause beyond the seller's reasonable control" should be construed to comprise only those matters which have some connection with the seller's obligations under the Agreement and/or with which the seller would have been expected to be concerned. For instance, matters relevant to the delivery of the aircraft (which is the obligation of the seller and a matter principally under the seller's control) would be caught by that clause, such as the seller being unable to deliver the aircraft on time due to a pandemic causing a dearth of delivery pilots.

To construe the clause as if it were worded "any other cause beyond the purchaser's control," or "any other cause beyond either party's control," would be wrong because it would give no meaning to the words "the seller's" [and] would fundamentally change the meaning of the phrase.

If the clause were to be construed as ATS contends, i.e. as if it applied to matters over which the seller could never be expected to have any influence, it would have an unacceptably wide ambit.

If, as ATS contends, it is entitled to rely on force majeure events beyond the seller's rather than ATS's control, it would mean that it could rely on force majeure events which were not beyond its control, which would be an absurdity.

Under English law, just as the burden of proof is on the party seeking to rely upon a force majeure clause to prove the facts bringing the case within the clause, so the burden of proof is on ATS to show that this force majeure clause is capable of being construed so as to include any funding difficulties it is encountering. For the reasons above, I accept Tandrin's submission that ATS cannot show this.

For all these reasons, I accept and hold that ATS has not shown that as a matter of principle extreme economic circumstances can arguably give rise to force majeure in the context of a clause such as clause 7.17. I hold that ATS has no real prospect of establishing either that clause 7.17 should be construed as ATS asserts or that as a matter of law it is arguable that the circumstances contended for by ATS can give rise to force majeure under clause 7.17.

I therefore conclude that there is no triable argument that ATS can rely on the force majeure clause to excuse its non-performance.

Decision. The court refused to excuse ATS' failure to perform on the basis of the force majeure clause. English law does not recognize that a change in economic circumstances excuses contractual performance. The court also disagreed with ATS' interpretation of the agreement to include instances beyond the seller and purchaser's control.

Case Questions

1. On what basis did the court refuse to enforce the *force majeure* clause to excuse ATS' failure to perform?
2. Should economic or market circumstances ever serve as a basis for failure to perform contractual duties? Why or why not? Under what circumstances should such circumstances excuse performance?
3. If you were ATS' attorney, how would you have drafted the *force majeure* clause to excuse performance in the event your client could not obtain financing?

with diverse political, economic, and legal systems. Thus it draws on common law, civil law, and even socialist law principles. It has already been adopted by countries whose trade volume represents two-thirds of world trade.

This chapter does not purport to cover all aspects of international sales law. For example, later we will

discuss the actual mechanics of the transaction—how parties carry out contracts.

The next two chapters look at how companies ship goods and exchange money and what happens if the goods are lost at sea. These chapters also examine the responsibility of carriers for transporting the goods and carriers' relationships to buyers and sellers.



Chapter Summary

1. The *UN Convention on Contracts for the International Sale of Goods* (CISG) was ratified by the United States in 1988 and applies to commercial contracts for the sale of goods between buyers and sellers located in different countries, both of which have ratified the CISG. The CISG is not applicable to consumer contracts, liability for injury or death caused by defective products, or the sale of services.

2. Under the CISG, contracts for the sale of goods need not be in writing, although most international business transactions are.

3. Evidence as to trade usages is admissible to interpret or fill in the gaps in a contract. It may include those usages derived from past dealings or those that the parties knew of, should have known of, or are regularly observed in their countries in their type of business.

4. An acceptance may take the form of a statement or conduct by the offeree that indicates the offeree's intention to be bound to the contract. An offeree may accept by "dispatching the goods or payment of the price, without notice to the offeror," provided that the parties have established this as a practice or it is routinely accepted in the trade.

5. In an international sales transaction governed by the CISG, a confirmation or other acceptance containing new terms that do not materially alter the terms of the offer becomes a part of the contract, unless the offeror promptly objects to the change. However, a purported acceptance that contains additional or different terms that do materially alter the terms of the offer would constitute a rejection of the offer and a counteroffer.

6. Unless otherwise agreed by the parties, the seller must deliver goods that are fit for the purposes for which goods of the same description would
- ordinarily be used and fit for any particular purpose expressly or impliedly made known to the seller.

7. Generally, a seller is not responsible for delivering goods that fail to conform to technical regulations and standards in the buyer's country. However, the seller would be responsible if it knew the uses to which the goods would be put, if it knew of regulations in the buyer's country affecting that use and if the buyer had relied on the seller's knowledge and expertise.

8. Unless otherwise agreed in the contract, a buyer must inspect the goods within as short a period as is practicable under the circumstances after the goods have arrived at their destination and notify the seller of any nonconformity within a reasonable time after it is discovered. In no case may the notice be made more than two years from the date the goods were handed over.

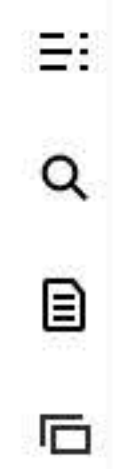
9. The remedies outlined in the CISG include (1) avoidance (cancellation) of the contract; (2) the right to remedy or cure; (3) the setting of an additional time, or extension, for performance; (4) price reduction; (5) money damages; and (6) specific performance. The right to a remedy depends on whether or not the failure of performance amounted to a fundamental breach.

10. A fundamental breach is one that the seller knew or should have known would result in such detriment to the buyer as substantially deprive him of what he is entitled to under the contract.

11. Performance may be suspended or excused for an impediment beyond the control of the parties that was unavoidable and not reasonably foreseeable at the time the contract was concluded, provided notice was given to the other party. A *force majeure* clause excuses a party from failing to perform on the occurrence of a specified event, such as plant closings or natural disasters.

Key Terms

sales law (law of sales) 87	unification of law 89	parol evidence rule 94
sale 87	valid contract 93	trade usages 95
<i>lex mercatoria</i> (law merchant) 88	integrated contract 94	mutual assent 95



invitations to deal 95	battle of the forms 102	specific performance 110
pro forma invoice 96	fundamental breach 107	anticipatory breach 110
mailbox rule 98	nachfrist 108	suspend performance 110
mirror image rule 98	price reduction 108	objective impossibility 111
purchase order 100	consequential damages 109	frustration of purpose 111
order confirmation 100	lost profits 109	commercial impracticability 111
terms and conditions 100	liquidated damages 109	force majeure 112

Questions and Case Problems

1. Lucent Technologies International, Inc., subcontracted with a Saudi Arabian company, National Group, for work that Lucent was doing as part of a \$4 billion telecommunications project for the Saudi government. National Group sued Lucent for damages for terminating the contract. The damages included an amount for lost profits. The contract contained no choice of law provision and Saudi law applied. The U.S. court had to decide if recovery of lost profits was prohibited as *gharar*. After all, *gharar* prohibits gambling, or the sale of the “calf while still in the womb” or of “fish in the sea.” What is *gharar*, and how does this Islamic law principle affect the calculation of damages for breach of contract under Islamic law? Would this decision have been different under the CISG? *National Group for Communications and Computers, Ltd. v. Lucent Technologies International, Inc.*, 331 F. Supp. 2d 290 (D.N.J.2004).
2. Bende had a contract to sell boots to the government of Ghana for \$158,500. Bende promised to deliver the boots “as soon as possible.” Bende then contracted with Kiffe, who agreed to make the boots in Korea and to deliver them in Ghana within 60 to 90 days at a price of \$95,000. The contract contained no *force majeure* clause. Kiffe knew that Bende was going to resell the boots. Kiffe failed to deliver the boots on the agreed date because a train carrying the boots had derailed in Nebraska. Bende brought this action against Kiffe for breach of contract. *Bende and Sons, Inc. v. Crown Recreation and Kiffe Products*, 548 F. Supp. 1018 (E.D.N.Y. 1982).
- a. Kiffe claimed that the contract had been rendered commercially impracticable and that performance was excused. Do you agree? Why or why not? Was the train wreck foreseeable or unforeseeable?

b. What could Kiffe have done in negotiating the contract to protect itself from this contingency?

c. If Bende would have incurred an additional \$18,815 in freight charges and miscellaneous costs had the breach not occurred, what would be its measure of damages? Is Bende entitled to lost profits? How are damages measured in a case such as this?

d. In this case, the risk of damage or loss to the boots while in transit remained with the seller, Kiffe. How would the case differ if the parties had agreed that Kiffe would merely ship (not deliver) the goods by a certain date and that Kiffe would not bear the risk of loss during transit? (You may have to wait until the next chapter to answer this question.)
3. Shantou Real Lingerie Manufacturing Company (Shantou) is incorporated in China. Shantou manufactures and exports garments to the United States. Native Group International, Inc. (Native), is a corporation organized under the laws of New York engaged in the business of selling intimate wear to the wholesale and retail market. Between May and November 2013, Native placed dozens of orders with Shantou for lingerie. Following each order, Shantou issued a sales confirmation to Native, which referenced the cost, quantity, and type of goods ordered. These confirmations were signed by a representative of Native. Thereafter, Shantou manufactured the goods in accordance with the requested specifications. Between October 2013 and February 2014, Shantou delivered the goods specified in the confirmations to Native through five separate shipments. Shantou also included in each of the five shipments an invoice, indicating the total balance due, as well as the price, quantity, and type of products shipped. Native accepted each shipment, retained the goods delivered, and never claimed a set-off or credit. The total amount invoiced for the five shipments was \$437,562.20. Native made payments totaling \$165,522.80, leaving an unpaid balance of \$272,040.40. The communications between Shantou and Native were silent with respect to the governing law. Native claimed that there was no written contract between the parties when Shantou subsequently filed a lawsuit against Native for the unpaid balance. What law should govern the terms of the parties’ arrangement? Is a written agreement necessary in this case? What are the terms of the parties’ agreement if any? *Shantou Real Lingerie Manufacturing Co. v. Native Group International, Ltd.*, 2016 WL 4532911 (S.D.N.Y. Aug.23, 2016).



4. In May 2009, Hanwha submitted a bid for the purchase of 1,000 metric tons of the petrochemical Toluene at \$640 per metric ton. Cedar accepted the bid and followed up its acceptance by sending Hanwha, via e-mail, a signed contract sheet and a document setting forth Cedar's standard terms and conditions. Cedar provided that New York law, the UCC, and Incoterms 2000 would govern the contract. Hanwha modified the provision providing for governing law, crossing out New York law and the UCC, leaving only the provision that Incoterms 2000 was to govern the contract. Hanwha also provided a new set of "standard" terms and conditions; in relevant part, Hanwha's new set of conditions provided that Singapore law would govern the contract, rather than New York law. Hanwha further provided that no contract would enter into force unless Cedar countersigned Hanwha's proposed version of the contract documents. Cedar refused to accept Hanwha's terms, and sent Hanwha an e-mail explaining that the contract would be finalized only if Hanwha accepted Cedar's original terms. The e-mail asked Hanwha to sign and return an unaltered version of the contract documents. In June 2009, Cedar advised Hanwha that because of its failure to sign the version of the contract tendered by Cedar, there was no contract between the parties, and Cedar had the right to sell the Toluene to another party. The price of Toluene as of that date had risen from \$640 per metric ton to \$790.50. In November 2009, Hanwha sued Cedar for breach of contract. The court was faced with the questions of applicable law and whether the parties' attempt to form a contract succeeded. What law should apply to this transaction? Did the parties succeed in creating an enforceable contract? Why or why not? *Hanwha Corp. v. Cedar Petrochemical, Inc.*, 760 F.Supp.2d 426 (S.D.N.Y. 2011).
5. Mrs. Clark's Foods (Clark's) was an Iowa corporation engaged in the business of labeling and distributing juices. Clark's purchased apple juice concentrate in April 2011 from International Suntrade, Inc. (Suntrade), and Miller & Smith Foods, Inc. (Miller & Smith), which are Canadian-based food brokers and distributors. In November 2011, Clark's found out the concentrate contained isomaltose, rendering it adulterated and subject to recall. Clark's provided notice of the nonconformity to Suntrade and Miller & Smith in December 2011. Clark's subsequently sued Suntrade and Miller & Smith for breach of contract, breach of warranty, negligence, and fraud. Suntrade and Miller & Smith alleged that the seven-month delay in subjecting the concentrate to authenticity testing was unreasonable under Article 38 of the CISG as Mrs. Clark did not examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances. Suntrade and Miller & Smith contended that timely inspection in the case of perishable or durable goods should be no more than three to four days. Mrs. Clark responded that reasonableness is a fact-specific inquiry and the CISG sets an outer limit of two years in recognition that there may be long period of time before nonconformity is discovered with some products. The concentrate in this case had a shelf life up to two years. Was Mrs. Clark's inspection performed in a timely manner as required by the CISG? What is a "short a period as is practicable" pursuant to the CISG? *MCF Liquidation, LLC v. International Suntrade, Inc.* 2015 WL 12670169 (S.D. Iowa Nov. 16, 2015).
6. A U.S. software manufacturer sold software for processing credit card charges to a U.S. limited liability company that was a wholly owned subsidiary of a German corporation. The software did not function properly and generated erroneous reports of charges. The U.S. buyer and its German parent sued the software manufacturer for breach of contract. The plaintiffs asserted that the CISG was applicable to the transaction as the head of the German parent company signed the purchase and sales contract. The software manufacturer alleged that the CISG was inapplicable as the contract was addressed to the U.S. limited liability company, and the purchase price was paid with a check tendered by the U.S. purchaser. Is the CISG applicable to this transaction? Why or why not? *American Mint LLC v. GOSoftware, Inc.*, 2006 U.S. Dist. LEXIS 1569 (M.D. Pa. 2006).
7. A Canadian seller sued a U.S. purchaser for the purchaser's refusal to pay for concrete light poles utilized in a construction project in Florida. The purchaser counterclaimed that it had sustained damages because the poles had not been delivered on time. The seller admitted that it had problems with production and was unable to ship a truck load of poles every two weeks as it had done in the past. Nevertheless, the purchaser accepted the poles that had been shipped. Applying the CISG, the court interpreted Article 39 to encompass not only nonconforming goods but also goods that were not shipped in a timely manner pursuant to the contract. Thus, the light poles could be deemed nonconforming based not on their performance but rather on their untimely delivery. As the purchaser had given notice of the untimely delivery of the light poles within two years from their delivery, it was free to pursue its counterclaim. Do you agree with this result? Is the court's interpretation of Article 39 too expansive? Was Article 39 intended to include untimely delivery as well as nonconforming goods? *Sky Cast, Inc. v. Global Direct Distribution, LLC*, 2008 U.S. Dist. LEXIS 21121 (E.D. Ky. 2008).
8. A U.S. purchaser sued a German limited partnership alleging that the partnership breached a contract to deliver 15,000–18,000 metric tons of used Russian railroad rail to the U.S. company for recycling into other products. The rail was to be shipped from the port in St. Petersburg, Russia, travel by sea for four weeks, and



be delivered to the purchaser at its factory in Illinois by December 31, 2002. The seller failed to meet this deadline allegedly due to the unexpected early freezing of the St. Petersburg port on approximately December 1, 2002. The seller thus alleged that its performance was subject to *force majeure*. In denying the purchaser's motion for summary judgment, the court acknowledged that the contract was governed by the CISG and, specifically, Article 79 relating to *force majeure*. It also noted the absence of U.S. case law interpreting Article 79. However, instead of applying foreign case law or scholarly commentary to the interpretation of Article 79, the court simply applied similar provisions contained within §2-615 of the UCC. Applying the UCC, the court concluded that the freezing of the port rendered the seller's performance

impracticable, and the premature freezing was unforeseeable. The court's opinion has been condemned as "the worst CISG decision in twenty-five years" due to its disregard of the international character of the CISG and the need for uniformity in international trade. It has also been cited as an example of the "homeward trend" in improperly utilizing analogous domestic law to interpret the CISG. What is meant by "homeward trend"? Do you agree with the application of this trend and result in this case? Compare the opinion with that in *Chicago Prime Packers Inc.* issued by the same court in the same year. What are the possible explanations for the divergence in sources utilized to interpret the CISG? *Raw Materials, Inc. v. Manfred Forberich GMBH & Co.*, 2004 U.S. Dist. LEXIS 12510 (N.D. Ill. 2004).

Managerial Implications

You are the vice president of sales for DownPillow International, Inc., a U.S. manufacturer of bed pillows. The raw materials needed for making pillows are all sourced from suppliers overseas. Your firm purchases feathers from exporters in China who maintain large flocks of geese and ducks for breeding and cotton ticking and other textiles from mills in Germany. Every year you show your products at the International Bed Show in New York. This year, a delegation of Japanese buyers, representing several well-known Tokyo stores, showed interest in your best quality pillows. The president of your firm expressed interest in these contacts because although Americans use the same pillow for long periods of time, the Japanese are fastidious about their bedding. You followed up with samples, product, and pricing information. After several discussions and months of correspondence, you now expect to receive your first overseas orders.

You are to meet with legal counsel next week to discuss this opportunity. What questions might you want to ask about entering a sales contract with a Japanese buyer? If a buyer shows interest in purchasing large quantities, should you consider a visit to the buyer's Tokyo office? What would you accomplish? Should your attorney conduct negotiations there for you? If you and your buyer agree to put your agreement in writing, what terms might the document contain? Your customers want assurances that their pillows will be made of the finest white goose down, with less than 10 percent feathers. What assurance will you be able to give them regarding product quality and specifications? What factors might influence the selection of a choice of law clause? Do you think your lawyer will insist on a *force*

majeure clause? Can you suggest some of the things DownPillow might want in its clause?

If you anticipate having several accounts in Japan, and each of them will be sending in purchase orders for each order, will you need a confirmation form? Will your attorney recommend that you develop a standard form to use for confirming all export orders? How will this form differ from the form you use for domestic shipments? What kind of provisions should it have?

How might negotiating your supply contracts with the Chinese differ from dealing with German textile mills? You have some concern about making sure that the quality of the down from China remains consistent. What will assure you that you will receive goose down and not duck down? What other precautions should you take? The German mill wants you to mail in or fax your orders. Your lawyer recommends that certain terms be put into your purchase order form. What might they be? Your purchase order states that the seller is liable for consequential damages for late shipment. The mill's confirmation states that "the liability of the seller is limited to the replacement of returned goods." In the event of a dispute, which will prevail under U.S. law? Under German law? Under the CISG?

Your contract with the Japanese buyer specifies that the CISG is to govern the transaction. Your pillows arrive in Japan and the buyer discovers that they contain only 13 ounces of down instead of the full 16 ounces of down as promised. You admit the error and want to resolve the problem. However, the buyer has just been offered the same quality pillow at considerably lower prices from a firm in Taiwan and wants to cancel the contract. Discuss the rights of each of the parties under the CISG.



Ethical Considerations

Most commentators agree that nonpecuniary injuries resulting from breach of a sales contract (such as reputational harm, injury to goodwill, pain and suffering, and emotional distress) cannot be compensated under the damages provision of the CISG. However, other efforts to unify or harmonize contract law on an international or regional level have considered allowing monetary compensation for nonpecuniary injuries. This has caused a minority of commentators to advocate a similar interpretation of the CISG on the basis that some breaches of contract cannot be adequately addressed if only economic losses can be awarded as damages. Such a circumstance may arise in cases involving “ethically tainted” goods, such as those which are the product of child or forced labor or are produced under circumstances that pose grave health hazards to workers.

In an article published in the *Pace International Law Review* in 2007, noted scholar Peter Schlechtriem denounces any such interpretation of the CISG on several grounds. Schlechtriem contends that the CISG was not the proper instrument to promote moral convictions. Rather, adequate remedies addressing such convictions may exist in other areas of international law as well as in domestic law (such as causes

of action for fraud and misrepresentation and mandatory production and manufacturing standards). Parties could also establish standards with respect to the goods for which they have contracted in their agreements, the violation of which gives rise to a cause of action for breach of contract. Second, there are few if any shared ethical values across and within populations. Similar problems exist with respect to product lines. For example, one may object to the animal testing in the development of cosmetics but not in the development of life-saving pharmaceuticals. Third, any ethics-based damages award pursuant to the CISG would circumvent the burden of proof for pecuniary losses “by reverting to the ‘penal’ sanction of nonpecuniary damages, which could result in extremely diverging awards around the globe and, in some instances, in ‘hometown justice.’ ” Finally, any such interpretation could impose one party’s social, religious, and ideological beliefs on other parties. The consequence of such interpretation would be irreparable harm to the CISG’s neutrality, objectivity, and uniformity on which its worldwide acceptance rests.

Do you agree with Schlechtriem? Is the CISG “ethically challenged”? Is the CISG the proper tool by which to address trade in “ethically tainted” goods? Why or why not?