

CISG – A Tool for Globalization (1): American and Japanese Perspectives

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INTRODUCTION

When the United Nations Commissions on International Trade Law (UNCITRAL) was created in 1966, it undertook to review and consolidate the existing two conventions dealing with substantive laws applicable to international sales contracts.¹⁾ This effort produced a draft of *the United Nations Convention on Contracts for the International Sale of Goods* (the **CISG** or the **Convention**) adopted by UNICITRAL. Subsequently, on April 11, 1980, the draft was approved and adopted by a diplomatic conference convened by the United Nations in Vienna attended by representatives of sixty-two countries. The CISG came into force on January 1, 1988, and, at this writing, has been ratified by 77 countries.

PART ONE

APPLICABILITY: JURISDICTIONAL BASIS

§1:1 Parties Diversity: General Rule for the Applicability of CISG

In general, the CISG applies to contracts entered into either between (a) parties doing business in different contracting States (CISG Art. 1(1)(a)), or (b) parties doing business in different States if the contracts are governed by the law of a contracting State (CISG Art. 1(1)(b)). This general rule, however, is subject to several reservations and exclusions.

§1:2 Article 95 Reservation to and Power to Exclude CISG's Applicability

To better understand the issue of the applicability of the CISG to contracts for the sale

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1) The two conventions were (1) the Convention Relating to Uniform Law on the International Sale of Goods ("ULIS") and (2) the Convention Relating to Uniform Law on the Formation of Contracts for the International Sale of Goods ("UFL"). Those conventions were drafted by the International Institute for the Unification of Private Law ("UNIDROIT") and adopted in 1964 at a conference at the Hague convened by UNIDROIT member states.

of goods, a review of the significance of adopting the Convention subject to a reservation under Article 95 as well as the power to exclude the application of the CISG is in order.

§1:2.1 Article 95 Reservations

Contracting States can join the Convention subject to a reservation under Article 95 not to be bound by Article 1(1)(b) (countries making such reservation, hereinafter **Article 95 Reserving States**, and the remaining signatories **Article 95 Non-Reserving States**). In other words, the intent of the reservation is not to bestow CISG jurisdiction to “contracts of sale of goods between parties whose places of business are in different States” merely because “the rules of private international law lead to the application of the law of Contracting State.” (*See* CISG Art. 1(1)(b))

On first reading of Article 95 of the CISG, it would appear that contracts entered into by (a) a party doing business in a country that entered the CISG under Article 95 reservation and (b) a party doing business in a non-contracting State would be outside the applicability of the Convention even if the governing law resulting from the application of the applicable conflict of laws rules was the law of one of the contracting States. For example, if a party doing business in the United States (Article 95 Reserving State) contracted with a party doing business in England (a non-contracting State) (or pre-adhesion Japan), their contract would not be governed by the CISG even if the laws of California were the governing law of the contract, because the United States is not bound by Article 1(1)(b) of the CISG. While most commentators agree, this interpretation does leave some room for argument and is not completely unassailable.

§1:2.2 Contracting Parties' Power to Exclude the Application of CISG (Opting Out)

Even if the CISG would be applicable solely by virtue of Section 1(a) or 1(b) of Article 1 of the CISG, the parties may expressly exclude its applicability or derogate from or change the effect of any of its provisions. (CISG Art. 6) However, the requirement of writing mandated by the adoption of the reservation under Article 96 of the CISG, which trumps the otherwise relaxed methods of concluding, evidencing, modifying or terminating contracts, or indicating the parties' intentions, cannot be derogated in case where the contracting State has adopted such reservation. (CISG Arts. 11, 12, 13, 29, 96)

By granting the power to opt out, derogate or change to the contracting parties, the drafters gave expression to the principle of parties' autonomy in conducting international commerce. The exclusion of the applicability of the provisions of the Convention may be either express or implied. The CISG will clearly not apply if the parties properly agree to exclude its applicability in their agreement. The parties may also exclude the applicability of the Convention by implication, typically by choosing the governing law of a non-contracting State. Moreover, an implied exclusion could be effected where the terms of the agreement are so steeped with the concepts of a particular State's domestic law that such intention can be

readily inferred.²⁾

COMPARATIVE ANALYSIS

UCC: The liberal policy of allowing parties to exclude, derogate from or vary the provisions of the Convention is shared by the Uniform Commercial Code (the **UCC** or the **Code**), which, in general, allows parties to vary the effect of its provisions. (UCC §1-302(a) & (b))³⁾ Whereas the UCC mandates that only the obligations of good faith, diligence, reasonableness and care are beyond the parties' power to derogate from, the CISG is silent on whether the parties can exclude any such concepts and the matter awaits future adjudication.

JAPANESE LAW: While the Japanese Civil Code does not directly deal with this issue, based on the principle of "freedom of contract," a party can freely conclude a contract as long as it does not contradict the *ordre public* (public policy) or provisions of law that are either compulsory or mandatory.

§1:2.3 Contracting States' Exclusions and Reservations

As mentioned above, a contracting State may, at any time, declare under Article 96 of the CISG that it is not bound by the provisions discarding the writing requirement for making, terminating or modifying a contract or making any indication of intention which are contained either in Article 11, Article 29, or Part III of the Convention (*Sales of Goods*) in cases where one of the parties is doing business in such contracting State. The Article 96 declaration is available to States whose legislation requires that contracts of sale be concluded or evidenced in writing. (CISG Art. 96)

In addition to the exclusions effected through the reservations under Articles 95 and 96 of the CISG, China has elected not be bound by Article 11, which (a) allows conclusion or proof of contract not only by writing, (b) does not subject a contract to any prescribed form, and (c) allows a proof of contract to be made by witnesses and any other means.

Finally, a contracting State may, in connection with joining the Convention, declare, pursuant to Article 92(1), not to be bound by Part II (*Formation of the Contract*, concerning contract formation issues), or Part III of the Convention (*Sale of Goods*, containing sections on the parties' obligations and remedies under the contract).

2) See Franco Ferrari, "CISG Rules on Exclusion and Derogation: Article 6" in *The Draft UNCITRAL Digest and Beyond*, 128-129 (Franco Ferrari, Harry Flechtner, Ronald A. Brand eds., 2004) ("Ferrari, Article 6").

3) Article 2 of the UCC (Sales) which was first adopted in 1952 underwent major revisions in 2003. Unless otherwise indicated, UCC citations refer to pre-2003 official text. References to the proposed (i.e., amended) 2003 version of Article 2 are indicated as "proposed" or "2003" UCC version. It should be pointed up, however, that, at this writing, **no state of United States has adopted the proposed UCC Article 2.**

§1:3 Parties with “Places of Business” in Different States

For the CISG to apply, it is of no significance under what jurisdiction a party to a contract is organized. The parties’ commercial or non-commercial character is also irrelevant. (CISG Art. 1(3)) Similarly, concepts such as parties’ “nationality” or “citizenship,” while significant for other reasons, such as taxation, are irrelevant under the CISG. As long as the parties do not expressly exclude the CISG, it may also be irrelevant whether the parties expressly incorporate the CISG into their agreement. What matters is that the parties’ places of business are in different States. (CISG Art. 1(1)(a)) Such “place of business” is (a) for a party with multiple places of business, understood to be the place bearing the “closest relationship to the contract and its performance” (CISG Art. 10(a)), and (b) for a party with no place of business, taken to mean that party’s “habitual residence.” (CISG Art. 10(b)) In the event that the place of contracting and performance are different, the place of performance is likely to be more influential in determining the party’s place of business. (CISG Art. 10(a))

For most businesses, the definition of the “place of business” has nothing to do with such business’s place of incorporation, seat, principal office or headquarters. Rather, the relevant “place of business” is a place that bears a close relationship to the contract and its performance. The CISG is not applicable if parties were not aware of the different places of business and the contract is silent in this regard. (CISG Art. 1(2)) This issue may, for example, arise in the context of agents contracting on behalf of undisclosed principals located in different States.

The following discussion illustrates the applicability of the CISG in more detail.

§1:3.1 Both States Are Contracting States

When both parties to a contract are doing business in different contracting States, the applicability of the CISG is *not automatic*. While this may sound counterintuitive, the governing law of the agreement may or may not play a decisive role with respect to this issue.

As a starting proposition, the CISG should apply when the parties have chosen their contract to be governed by the laws of one of the contracting States, for the simple reason that the CISG is part and parcel of the contracting State’s domestic laws.

A more problematic situation arises where a contract between parties doing business in different contracting States (e.g., Japan and China) is governed by the law of a non-contracting State (e.g., the laws of England). Should such contract be still governed by the CISG by virtue of the mandate of Article 1(1) of the CISG, which makes the CISG applicable to contracts between parties doing business in different contracting States?

(a) Non-Contracting State’s Law *Not Expressly* Chosen: If the reviewing court is located in a contracting State, the court should apply the CISG in situations where the applicability of the law of a non-contracting State came about by way of the conflict of

laws rules of the State of the reviewing court;⁴⁾

(b) Non-Contracting State's Law Expressly Chosen: On the other hand, in cases where the parties expressly stipulate to the applicability of the law of a non-contracting State, a strong argument can be mounted that the parties intended to exclude the CISG.⁵⁾ Nevertheless, even in such a case, it is not entirely clear how the adjudicative tribunal might rule on the issue.⁶⁾

§1:3.2 Contracts Governed by Law of Contracting State Entered into between a Party Doing Business in Article 95 Reserving State and a Party from a Non-Contracting State

In this situation, the CISG should not apply because the reason for the reservation is to apply the Convention only when all parties are doing business in a Contracting State.⁷⁾ Another reason is that the reserving State presumably made the reservation to promote its own domestic law.⁸⁾

§1:3.3 Contracts Between Parties Doing Business in Non-Contracting States Governed by Laws of Contracting States

A simple reading of Article 1(1)(b) of the CISG suggests that the CISG will apply to contracts entered into by parties doing business in different States (even if they are non-contracting States), if the governing law is the law of a contracting State. Such governing law may be expressly stipulated by the contracting parties or may be determined by the application of the conflict of laws rules. For example, a contract governed by the laws of Japan between a business in Oman (a non-contracting State) for a sale of goods to a business in Portugal (a non-contracting State) would be governed by the CISG by the straightforward application of Article 1(1)(b) of the CISG.

However, when we introduce into the equation various permutations of forum States and governing laws based on whether they are Article 95 Reserving or Non-Reserving States, we encounter potential complications and often controversial outcomes.

(a) Governing Law of an Article 95 Non-Reserving State

The application of the CSIG in such cases appears to be beyond controversy, regardless of whether the forum state is located in a contracting or non-contracting State. As pointed out by commentators, courts located in Article 95 Reserving States are not obligated to “disapply” Article 1(1)(b) and should not do so when, through their own conflict of laws rule, the

4) E.g., John O. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention*, 80 (3d ed. 1999) (“*Uniform Law for Int’l Sales*”).

5) Ferrari, Article 6 at 123 (cited in note 2).

6) See Roy Goode, *Goode on Commercial Law* at 1019 (Ewan McKendrick ed, Penguin Books 4th ed. 2010).

7) Franco Ferrari, “*The CISG’s Sphere of Application: Article 1-3 and 10*” in “*The Draft UNCITRAL Digest and Beyond*,” 49-50 (Franco Ferrari, Harry Flechtner, Ronald A. Brand eds., 2004).

8) *Id.* at 50.

applicable law is that of a CISG-espousing Article 95 Non-Reserving State.⁹⁾

(b) Governing Law of an Article 95 Reserving State

In such cases, the applicability of the CISG to contracts governed by the laws of an Article 95 Reserving State may depend on the location of the forum State. It is unclear whether a State (whose laws are to govern the contract) that makes an Article 95 reservation is to be considered as a contracting State for the purpose of analysis under Article 1(1)(a). If such a State is to be considered to be a non-contracting State, then the CISG may not (or, should not) be applicable if adjudicated therein. This view has been embraced in Germany and by many scholars. Others argue that courts located in Article 95 Non-Reserving States should be bound to apply the Convention regardless of whether the law as determined by the rules of private international law is that of an Article 95 Reserving or Non-Reserving State.¹⁰⁾

Fig. 1 Applicability of the CISG to contracts between parties doing business in non-contracting States governed by the laws of contracting States.

		FORUM LOCATION		
		ARTICLE 95 RESERVING STATE	ARTICLE 95 NON-RESERVING STATE	NON-CONTRACTING STATE
GOVERNING LAW	ARTICLE 95 RESERVING STATE	CISG Should Not Apply Although the Position is Not Without Controversy	CISG Applicability Is controversial; whereas CISG would not apply in Germany and is supported by a number of scholars, others disagree	CISG Applicability Is Controversial; however scholars' view appears to support applicability
	ARTICLE 95 NON-RESERVING STATE	CISG Should Apply	CISG Should Apply	CISG Should Apply
	NON-CONTRACTING STATE	CISG Should Not Apply	CISG Should Not Apply	CISG Not Applicable

9) See *id* at 50-51.

10) See *Goode on Commercial Law* at 1020 (cited in note 6).

§1:3.4 Opting In

Whether doing business in contracting or non-contracting States, as a general proposition, parties to a contract for the sale of goods are free to elect to be governed by the CISG. They can do so by expressly stating that the CISG will apply to their agreement or by choosing a governing law of a country that has ratified the CISG. However, as mentioned earlier in Section 1:3.3, above, relying on the implied incorporation of the CISG merely by choosing the law of one of the Contracting States is fraught with hazards and uncertainties.

Whether the parties' autonomy to make their own contracts extends to their right to opt into the CISG in case where the CISG would not otherwise apply, either because the parties are not in different contracting States, the governing law is that of a non-contracting State or the type of goods are excluded by the Convention, is debatable.

§1:3.5 Agreements among Multiple Parties

The applicability of the CISG to contracts entered into by multiple parties remains a vexing problem if the requirements of Article 1(1) of the CISG are not met in their entirety and the parties did not opt-in to be governed by the Convention.

§1:3.6 CISG Applicability to Third Parties' Claims Derived from the Contract

On its face, the CISG governs only the rights and the obligations between buyers and sellers. Does the CISG also apply to parties who are not in privity of contract, whether such parties are subsequent buyers, sellers or otherwise? The issue of privity of contract is never discussed in the Convention. Inasmuch as the old strictures of privity have been significantly relaxed in the legal systems all over the world, the issue becomes important in the context of contracts governed by the CISG. Indeed, despite some existing caselaw to the contrary, some commentators argue that claims by remote buyers of goods derived from the original contract to which the CISG applied should be governed by the CISG.¹¹⁾

(a) Assignment of Rights

An assignment is a present transfer of a party's rights under a contract. Upon assignment, the assignor's rights under such contract are extinguished in respect of the assigned rights, and only the assignee can enforce the assigned rights.

Let us assume that the original contract was subject to the CISG, based on the parties' diversity (doing business in different States) and not through the parties' express stipulation of the governing law. What happens if the assignee destroys the diversity? Should the assignee's rights be subject to the CISG? Inasmuch as the assignee becomes a party to the contract, would it be reasonable to assume that he or she can no longer rely on the availability of the Convention? And, how could such outcome be justified vis-à-vis the other party to the contract who may have fully expected that the CISG would govern?

11) See Ingeborg Schwenzer, Mareike Schmidt, *Extending the CISG to Non-Privity Party*, 13 *Vindobona J. of Int'L Com. L. & Arb.* at 109-122 (2009), <http://www.cisg.law.pace.edu/cisg/biblio/schwenzer-schmidt.html> (visited Aug. 31, 2011).

Conversely, let us assume that the original contract was not within the reach of the CISG but became potentially subject to it by virtue of the place of business of the assignee. Should the assignee be able to avail himself of the applicability of the Convention in such a case? Inasmuch as the assignee becomes a party to the contract, the logical answer appears to be yes. Inasmuch as the other party's original expectation might be unjustifiably foiled, the answer may be otherwise.

(b) Delegation of Contractual Duties

A party to a CISG-governed contract may delegate his duties to a third party. Unlike in the case of an assignment, upon delegation of contractual duties, the delegatee is not solely responsible for the performance and the delegator's obligations are not extinguished. If the delegatee fails to perform, the delegator remains liable under the contract. Nevertheless, if the delegatee fails in its performance, should claims by the delegator or the original obligee (i.e., the party to the original contract with the delegator) who may have claims based on a third-party beneficiary status, be subject to the CISG?

(c) Third-Party Beneficiaries

The foregoing analysis is directly relevant to the issue of whether the Convention should apply to the rights of third-party beneficiaries in respect of contracts governed by the CISG. While the validity of such rights is a matter of domestic law, once their standing is ascertained, it would appear that their claims should be governed by the CISG just like the underlying contract regardless of whether their entry upon the contractual stage might accidentally destroy the required Article 1 diversity.¹²⁾

COMPARATIVE NOTE

UCC: Except for limited references to third-party rights with respect to warranties (UCC §2:318 (*Third Party Beneficiaries of Warranties Express or Implied*)), the UCC does not expressly deal with the issue of third-party beneficiaries. Instead, it allows the applicable Common law to govern those rights. With respect to warranties, the Code offers three alternative solutions for dealing with claims by "non-privity" plaintiffs, i.e., plaintiffs who did not contract directly with the defendant.¹³⁾ Accordingly, the Code would extend sellers' warranties, whether express or implied to the following class of third-party beneficiaries:

A. Under Alternative A (adopted by most states), to:

"any natural person who is in the family or household of his buyer or who is a

12) See Schlechtriem & Schwenger, *Commentary on the UN Convention on the International Sale of Goods* Art. 21, para. 14 at 83-4 (Ingeborg Schwenger ed., Oxford 2010) ("Schlechtriem & Schwenger").

13) The parties to a contract, such as a seller and a buyer, are said to be "in privity."

guest in his home if it is reasonable to expect that such person may use, consume or be affected by the goods and who is injured in person by breach of the warranty (UCC §2-318 Alternative A);

B. Under Alternative B (adopted by eight states), to:

Any natural person who may reasonably be expected to use, consume or be affected by the goods and who is injured in person by breach of the warranty (UCC §2-318 Alternative B); and

C. Under Alternative C (adopted by at least eight states), to:

Any person who may reasonably be expected to use or be affected by the goods and who is injured by breach of the warranty (UCC §2-318 Alternative C).

In addition, some states have adopted their own more expansive versions of Section 2-318, while California has chosen not to enact Section 2-318 at all.

Once any of the foregoing Alternatives is adopted, sellers may not limit or exclude the operation of such Alternative. (UCC §2-318; all Alternatives)

JAPANESE LAW: The Civil Code recognizes “contracts for the benefit of third parties” in which parties to such contracts promise to tender certain performance to third parties. (Civ. C. Art. 537(1)) The rights of the third party accrue when such party expresses to the obligor the intention to enjoy the benefits of the contract. (Civ. C. Art. 537 (2)) Once the third party’s rights have come into existence, the parties to the contract may not modify or extinguish those rights. (Civ. C. Art. 538) However, the obligor under the contract may raise a defense based on such contract against a third party who is to enjoy the benefit. (Civ. C. Art. 539)

PART TWO

APPLICABILITY BASED ON SUBJECT MATTER

The CISG applies to contracts for the sale of goods, with the term “sale of goods” understood as a transfer of property interests in movable tangible property for a price. (CISG Arts. 2, 30, 53)

§2:1 Goods

§2:1.1 Goods Falling Within the Scope of CISG

Even though a uniform definition of goods does not exist in the framework of the Convention, it is evident from scholarly writings and reports of adjudicated disputes that only movable and tangible goods are properly classified as “goods.”¹⁴⁾ This can be deduced largely by examining the expressly mentioned things and situations to which the CISG

14) See, e.g., Franco Ferrari, *Brief Remarks on Electronic Contracting and the United Nations Convention on Contracts for the International Sale of Goods (CISG)*, 6 *Vindobona J. of Int’l Com. L. & Arb.* at 289-304 (2002), <http://www.cisg.law.pace.edu/cisg/biblio/ferrari12.html> (visited Aug. 31, 2011).

does not apply. The CISG sets forth such negative definition of goods by excluding from such definition certain things based on their nature, their intended use, and nature of the underlying transactions. (CISG Arts. 2, 3, 30, 53)

COMPARATIVE NOTE

UCC: Unlike the CISG, the UCC is more particular in delineating what things will fall within the applicability of Article 2 of the UCC, by listing things that both do and do not enter into the definition of goods. Thus, the goods with which Article 2 of the UCC is concerned are “all things (including specially manufactured good) which are movable at the time of identification to the contract for sale,” including (a) “the unborn animals and growing crops and other indented things attached to realty” (UCC §2-105(1)), and (b) “minerals or the like (including oil and gas) or a structure or its materials to be removed from realty” as long as they are to be severed by the seller” (UCC §2-107(1)). On the other hand, similar to the approach taken by the CISG, the Code specifically excludes from the definition of goods “money in which the price is to be paid, investment securities and things in action.” (*Id.*) The exclusion of money, however applies only when money serves as medium of payment and not when it is treated as a commodity under the contract. (UCC §2-105 Comment 1) Furthermore, Article 2 of the UCC does not concern itself with contracts of sales intended to serve solely as security transactions. (UCC §2-102)

JAPANESE LAW: Under the Civil Code, a sales contract becomes effective when one of the parties promises to transfer “certain real rights” to the other party and the other party promises to pay the purchase price. (Civ. C. Art. 555) The “certain real rights” referred to here are the rights to derive ownership interests and benefits with respect to the subject matter of the sale (proprietary nature), including real rights, claims, and other intangible property rights (intellectual property rights). Contracts for the sale of electricity are also sales subject to the Civil Code according to the caselaw. (*Daisin-in Judgment*, Showa 12.6.29; 16 Minshuu 1014) Things not yet in existence as well as property rights arising in the future are also legitimate subject matters of contracts of sale. (*Daisin-in Criminal Judgment Taisho 2.1.23; 19 Keiroku 23*) Moreover, rights of third parties are also acceptable subject matters of sales. (Civ. C. Art. 560)

§2:1.2 Things and Items Whose Sales Are Excluded from the Applicability of CISG

(a) Proposed Use of Goods Does Matter

The CISG does not apply to sales of goods intended for “personal, family or household use.” (CISG Art. 2(a)) However, the Convention will apply if the seller did not know or should not have known that the goods were bought for such purpose at the time of contracting. (*Id.*) On the other hand, the applicability of the Convention does not, on its face,

discriminate on the basis of the party's characterization as a consumer, merchant or otherwise. (CISG Art. 1(3))

COMPARATIVE NOTE

UCC: Unlike the CISG, the UCC applies to sales of goods sold for personal, family or household use. Thus, the UCC applies fully to transactions entered into with “consumers,” defined as “individual[s] who enter[] into a transaction primarily for personal, family, or household purposes.” (UCC §1-201(11)) However, while the UCC is not intended as a consumer protection statute, some of its provisions afford consumers special protection, including special treatment with respect to firm offers under Section 2-205 (which by its terms applies only to offers made by merchants), or rendering limitations on consequential damages for injury to a person in cases of consumer goods *prima facie* unconscionable under Section 2-719(3).

JAPANESE LAW: There are no direct provisions regarding things excluded from the applicability of sales under the Civil Code. Article 555 of the Civil Code applies equally to sales involving consumers as well as sales between merchants; the only difference is that sales between merchants are additionally regulated under the Commercial Law.

(b) Types of Excluded Things

Sales of stocks, shares, investment securities, negotiable instruments, money, ships, vessels, hovercraft, aircraft as well as sales of electricity are not governed by the Convention. (CISG Art. 2(d), (e) and (f)) Moreover, sales of immovables (real property) are excluded. The reason advanced by some commentators for the inapplicability of the CISG to things such as ships, vessels or aircraft is that those objects (which typically used to or continue to be identifiable by serial numbers and registration) were often treated as “immovables” under the applicable civil law systems.¹⁵⁾ Yet, the caselaw appears to dismiss as irrelevant the concept of registrability by holding that sales of parts of aircrafts are covered by the CISG, even though they are also identifiable by serial numbers or registration.

Furthermore, sales of industrial property rights, such as trademarks, patents or copyrights, are generally excluded. On the other hand, as elaborated in the following section, transfers of proprietary rights in respect of information are within a zone of significant legal controversy as to whether the CISG should apply.

COMPARATIVE NOTE

UCC: See discussion under Comparative Note under Section 2:1.1 (Goods Falling Within the

15) Ralph H. Folsom et al., *International Business Transactions* at 16 (2d ed. 2001).

Scope of CISG), above.

JAPANESE LAW: Under Japanese Civil Code anything of proprietary nature, including real rights, claims, or intellectual property, can be the subject matter of a contract of sale.

§2:1.3 Goods in a Grey Zone

Sales of information remain in the controversial grey zone of the CISG applicability. In particular, sales of software have attracted numerous scholarly comments offering pro and con arguments for their inclusion and exclusion. Some argue that software embedded in tangible things, such as computers, cameras or automobiles, should be included within the CISG definition of goods. Some courts appear to be sympathetic to this view. Whatever the case may be, only sales of software for indefinite term of use appear to be potentially within the reach of the Convention.¹⁶⁾ Others argue for a more liberal interpretation of the definition of goods.¹⁷⁾

COMPARATIVE NOTE

UCC: Sales of intangibles under the CISG and the UCC appear to have received more or less similar treatment. However, while sales of electricity are expressly excluded under the Convention, the caselaw under the UCC is mixed on this point, with some courts applying the UCC and some rejecting its applicability.¹⁸⁾ The applicability of the UCC to software licensing is still uncertain, with the courts struggling to sort out relevant issues. While the 2003 amendment to the UCC excludes by its terms sales of information from the definition of goods (proposed UCC §2-103(1)(k)), no state of the United States has chosen to adopt that amendment, and the commonly held view is that the amendment will never be enacted.¹⁹⁾ As a consequence, the status within the UCC framework of rights in information, including sales and licenses of software, continues to be uncertain, with the issues resting for the time being within the province of the judiciary.

JAPANESE LAW: Contracts regarding software can be divided into contracts for the development of software and contracts for the license of software. Thus, a contract that purports to document a “sale of software” is likely to be essentially a contract for the license of the software. Indeed, a “sale of software” in the strict meaning of the term amounts to an assignment of copyright to the software by the copyright holder to the other party.

16) See Camilla Baasch Anderson et al., *A Practitioner's Guide to the CISG* at 35 (JurisNet, LLC 2010) (“*A Practitioner's Guide*”).

17) Joseph Lookofsky, *The 1980 United Nations Convention on Contracts for the International Sale of Goods* 37 (2000), <http://www.cisg.law.pace.edu/cisg/biblio/loo1.html> (visited Feb. 16, 2012).

18) See James J. White and Robert S. Summers, *Uniform Commercial Code* §10-2(d) at 452 (West 6th ed. 2010) (“White & Summers”).

19) *Id.* at §2-1 at 27.

§2:2 Applicable Contracts

§2:2.1 Transactions Within the Scope of CISG

(a) Contract for the Sale of Goods

Not every contract *dealing* with goods falls within the sphere of CISG applicability. For the CISG to apply, the contract must be for the *sale* of goods. (See CISG Art. 1(1)) Other dealings in goods will automatically fall outside the reach of the Convention. The term “sale of goods” appears to entail *a delivery of movable goods coupled with a transfer of property rights in them for a price*. (See CISG Arts. 30, 53) Without a transfer of “property in the goods” a transaction in respect of the goods would not presumably rise to the level of a CISG sale transaction. (See CISG Art. 30) Presumably, transactions that do not contemplate transfers of title to the goods do not meet the applicability test.²⁰⁾

COMPARATIVE NOTE

UCC: The UCC deals broadly with “transactions in goods,” with “sales of goods” representing merely one component. (See UCC §2-102) Other UCC “transactions in goods” may include, for example, rentals, leases or gifts of goods. Nonetheless, most provisions of Article 2 of the UCC are made applicable solely in respect of sales of goods. The UCC definition of “sales of goods” is almost identical to that under the CISG. According to the UCC, a contract for the sale of goods is a present or future passing of title to the goods from the seller to the buyer for a price. (See UCC §2-106)

JAPANESE LAW: Under the Civil Code, a sales contract becomes effective when one of the parties promises to transfer “certain real rights” to the other party and the other party promises to pay the purchase money for it. (Civ. C. Art. 555) Accordingly, a contract for the purchase and sale of goods under the Civil Code is a consensual, bilateral contract for value under which the present or future title to the goods passes from the seller to the buyer for a price.

(b) Contracts for Goods to Be Manufactured: Substantiality Test

Sales of goods to be specially manufactured or produced by the seller are within the scope of applicable sales under the CISG as long as the part of materials provided by the purchaser for the manufacture or the production of the goods is not substantial. (CISG Art. 3(1)) As interpreted by commentators, the test of what amount or quantity of goods will meet this criterion is both quantitative and qualitative. In other words, in addition to a comparison of quantities of buyer-provided materials to those supplied by the seller or a third

20) See *Drafting Contracts under the CISG* at 198 (Harry M. Flechtner et al. eds., Oxford University Press 2008) (“*Drafting Contracts*”).

party, the test contemplates a comparison of the value of such materials.

COMPARATIVE NOTE

UCC: The UCC specifically governs sales of specially manufactured goods without making any distinctions based on whether the purchaser or any other person provides some or all of the materials for manufacture or production. (*See* UCC §2-105(1)) Consequently, some sales that would otherwise fall outside the CISG because the buyer supplied a substantial portion of the required materials would be governed by the UCC.

JAPANESE LAW: A contract for the supply and manufacture of goods is a type of contract not affiliated with the 13 typical contract patterns specifically listed in the Civil Code, namely, gifts, sales, exchanges, loans for consumption, loans for use, leases, employment contracts, contracts for work, mandates, deposits, partnership, annuities, and settlements. The contents of such supply and manufacture contract usually provide for (a) a party to produce goods or other things by using its own material pursuant to the ordering party's order, and supply them to ordering party, and (b) the payment. In general, the supplier/ manufacturer in such a contract is a manufacturer who itself produces the ordered products by using either its own materials for the manufacture or production, or materials (or part of them) provided by the ordering party. Therefore, it is understood that a contract for the supply and manufacture of goods is a mixture of a contract of sale of goods and a contract to perform work or services.

(c) Contracts for Sale of Goods and Services: Preponderance Test

Mixed contracts for the sale of goods coupled with the provision of services by the seller are within the scope of the CISG as long the seller's obligations to supply labor or other services are not "preponderant." (CISG Art. 3(2)) In this test, a service element in a transaction constitutes a "preponderant" part of the whole when more than 50% of the purchase price is allocable to labor or other services. (Compare the "substantial part" requirement under Article 3(1) of the CISG, under which the purchaser does not need to provide any particular percentage of materials necessary for the manufacture or production of goods for the contract to be excluded from or included within the CISG's reach.) Assuming that a mixed contract falls within the CISG's reach because the sale of goods element is preponderant, both the sale of goods and supply of services are governed by the CISG, provided that they do not form severable contracts under the applicable domestic legal rules.

The apparent simplicity of Article 3(2) of the CISG is based on the concept that each part of the mixed transaction forms a fragment of a single unitary contract, whereby such contract is either entirely within the CISG or is entirely excluded by the application of Article 3(2). However, because the CISG is not meant to be an exclusive body of law applicable to any sales of goods transaction, the insistence on the all or nothing approach

to mixed contracts may not be the most appropriate solution except in case of unified (not divisible) contracts. Indeed, commentators have attempted to resolve the applicability of the CISG to mixed contracts by analyzing whether given contracts are “separate” or “unified.” On the other hand, it is not entirely clear whether that question itself should be resolved solely under the Convention or pursuant to the domestic law rules.²¹⁾

COMPARATIVE NOTE

UCC: A “hybrid transaction” involving sales of both goods and services is typically within the scope of the UCC as long the sale of goods aspect “predominates” in the whole transaction.²²⁾ Otherwise, the UCC does not apply. This “predominant factor” test appears to parallel exactly the CISG approach. While the CISG approach may, at least in theory, allow for the applicability of the Convention only to the sale-of-goods aspect of a transaction and not to the supply-of-services part, the majority of the UCC caselaw appears to have adopted an all-or-nothing approach.²³⁾

JAPANESE LAW: Many contracts do not fit nicely into the several categories of typical contracts designated under the Civil Code (also referred to as “named contracts” or “nominated contracts”). Such “non-typical” (“non-named”) contracts include (among many others) medical contracts, transportation agreements (contracts for carriage), book deals, maintenance contracts, security agreements, joint venture agreements, and business collaboration agreements. A contract containing two or more types of contract may be referred to as a “mixed contract.” For example, a manufacture/ supply contract, which provides for the production followed by the supply of goods to the buyer, has the elements of both a contract for the provision of work and a contract of sale.

§2:2.2 Transactions Outside the Scope of CISG

(a) Inapplicable Manner of Sales

Contracts for the sale of goods fall outside the ambit of the CISG if the sales are accomplished through auctions or are executed by authority of law. (CISG Art. 2(b) and (c)). This exception applies to auctions, whether conducted privately or by the authority of law as well as forced sales carried out by government officials. On the other hand, the exception does not apply to sales of goods at commodity exchanges.²⁴⁾

21) See *Drafting Contracts* at 205 (cited in note 20).

22) See, e.g., *Bonebrake v. Cox*, 499 F.2d 951, (8th Cir. 1974), cited in White & Summers §10-2 at 448 (cited in note 18).

23) See White & Summers §10-2 at 448 (cited in note 18).

24) *UNCITRAL Digest of Case Law on the United Nations Convention on the International Sale of Goods* for art. 2, ¶ 5 (Other Exclusions) at 13 (United Nations 2008) (“*UNCITRAL Digest*”), http://www.uncitral.org/pdf/english/clout/08-51939_Ebook.pdf (visited Feb. 16, 2012).

COMPARATIVE NOTE

UCC: Sales by auction that would fall outside the reach of the CISG would likely be governed by the UCC. Thus, the Code provides for “offers without reserve” which are considered irrevocable offers to sell to the highest bidder at an auction, and “offers with reserve,” which can be withdrawn by the auctioneer prior to letting the hammer fall. (UCC §2-328(3))

JAPANESE LAW: Both an auction and tender involve methods used by competing potential buyers to offer to buy goods from a vendor and are typically concluded by a contract formed between the vendor and the buyer who offered the most advantageous conditions (price) for the goods. The case where the competing potential buyers are aware of the conditions of each others’ bids for the goods is called an auction. The case where they submit conditions of their bids without knowing their competitors’ conditions is called a tender. Although no Civil Code provision deals directly with either auction or tender, the Civil Execution Act deals with auctions under compulsory executions of claims for payment of money and executions for exercise of security interests.

(b) Service Contracts

Contracts entered purely for services are beyond the CISG application. (CISG Art. 3(2)) However, as mentioned earlier, where the service aspect is not preponderant in the transaction, the CISG will apply. (CISG Art. 3(2))

COMPARATIVE NOTE

UCC: Similar to the treatment received under the CISG, contracts predominantly for the sale of goods, with labor (or services) part being incidental, are governed by the UCC, and contracts purely for services are excluded.

JAPANESE LAW: The term “service contract” is not mentioned in the Civil Code. However, the concept of a service contract can be found in the provisions of Article 2 of the Act on Specified Commercial Transactions dealing with “offers of designated services.” Furthermore, in business practice, there is a kind of “contract to request others to do certain acts or provide certain services,” and it is generally accepted to refer to such contract as “service contract,” “business trust agreement,” “contract for consignment of business activities,” or “operating agreement.” Actually, the legal character of such contract corresponds to either a “mandate contract” or “contract for work”; alternatively, it shares the characteristics of both (a mixed contract).

(c) Leases

Commentators appear to agree that leases of goods fall outside the applicability of

the Convention, either because they are not in the nature of sales, or because the financing arrangements often form a preponderant consideration.²⁵⁾

COMPARATIVE NOTE

UCC: Like the CISG, Article 2 of the UCC does not generally apply to leases. However, a separate UCC chapter 2A has been devoted to govern those transactions.

JAPANESE LAW: A “lease,” as defined in Article 601 of the Civil Code, “becomes effective when one of the parties promises to make a certain thing available for using and taking profits by the other party and the other party promises to pay rent for it.” However, a “financial lease,” which is often used in business, differs greatly from the “lease” as understood in the above-quoted Article of the Civil Code. The financial lease, while having substantially a financial character, also bears resemblance to other contracts, such as a lease contract, “use rights setting contract,” and “property rights reservation installment payment sales.” As such, a financial lease is probably one of the “non-typical contracts” (non-named contracts) under the Civil Code.

(d) Assignments, Liens, Pledges and Other Security Arrangements

The CISG applies only to transactions in the nature of sales of goods. Consequently, ordinary security arrangements in goods, including assignments, liens or pledges, are excluded. This is not to say that sales of goods arrangements that contemplate allocation of security interest in the goods lie beyond the CISG applicability. What it means is that the security aspects of the transactions will not be governed by the Convention.

Several vexing problems emerge from the foregoing discussion. For example, does the CISG apply to a sale of goods intended purely as a security arrangement? While the issue may have yet eluded formal adjudication, a prudent approach might be (short of dealing with the issue of CISG applicability expressly by providing for it in the agreement) to assume that the CISG is applicable, thus avoiding unnecessary surprises. For example, the issue may be relevant in determining whether the CISG will apply to a typical *joto tanpo* form of assignment under Japanese law (a mortgage, sometimes also referred to as a “title-transfer security interest” or “security assignment”). After all, the whole concept of this form of assignment relies on a transfer of title.

COMPARATIVE NOTE

UCC: A sale of goods coupled with security interests is certainly governed by the CISG, presumably even if the transaction is intended solely as a security arrangement. Under the

25) See *A Practitioner's Guide* at 37 (cited in note 16).

UCC, a sale of goods involving taking or allocating of security interests should also be governed by the UCC, although the security concerns may be governed by the UCC Article 9. However, Article 2 of the UCC will not apply in case where a contract for the sales of goods, even if unconditional in nature, “is intended to operate only as a security transaction.” (UCC §2-102) Hence, under the UCC, a *joto tanpo* arrangement would probably lie outside the applicability of Article 2.

JAPANESE LAW: *Joto tanpo* is a form of a mortgage arrangement by which the creditor (the holder of *joto tanpo*) acquires title to collateral from the debtor to secure a debt obligation. Under this arrangement, the possessory right to the goods (collateral) remains with the debtor, and, following the transfer of title, the debtor has the right to use the goods at no charge. Inasmuch as *joto tanpo* is not specified in the Civil Code, it is one of the non-named (atypical) forms of security interests. However its legitimacy has been sanctioned by judicial precedent.

(e) Preliminary Contracts

In general, preliminary contracts between parties fall outside the scope of the CISG. However, this general rule does not prevent subsequent contracts for the sale of goods to be governed by the Convention. To that extent, provisions set forth in preliminary agreements may be relevant, once subsequent sales under the CISG do materialize. For example, preliminary agreements establishing confidentiality or exclusivity obligations may very well extend into future sales of goods between the parties and consequently may be considered to form an integral part of CISG sales transactions. In fact, the applicability of the CISG to such preliminary agreements appears to be without question. Apart from those cases, typical memorandums of understanding, heads of agreement, letters of intent and similar understandings are not covered by the Convention.

Similarly, typical distributorship agreements, joint venture agreements, marketing contracts or franchising contracts are normally looked upon as preliminary agreements to the sales of goods transactions. As such, they fall outside the CISG sphere of applicability, except as they may be relevant to subsequent sales transactions governed by the Convention. However, some distributorship agreements will often set out virtually all obligations with respect to the subsequent sales of goods, with parties proceeding directly to engage in such sales transactions. Obviously, despite being referred to as “distributorship agreements,” such contracts may meet all of the CISG applicability criteria and therefore should be properly governed by it. In fact, some of those agreements appear to constitute sales of goods accomplished by installments, which are expressly within the scope of the CISG by virtue of CISG Article 73. In the same vein, while franchise agreements (whether they contemplate sales of goods or not) generally fall outside the applicability of the Convention, “a single sale of goods pursuant to . . . franchise contract would be governed by the CISG.”²⁶⁾

26) CLOUT Case No. 192, No. 11 95 123/357 (Obergericht des Kantons Luzern (Switzerland Jan. 8, 1997).

COMPARATIVE NOTE

UCC: The reason why most preliminary agreements, including distributorship agreements, may not be covered by the CISG is that they are only preliminary agreements to any potential future sales, and the CISG applies only to “contracts of sale of goods.” In contrast, since the UCC embraces all “*transactions* in goods,” typical distributorship agreements may well be within the UCC sphere of applicability. (See UCC §2-102) Indeed, the gap-filling Section 2-309(2), giving validity to contracts for “successive performances” but of indefinite duration, appears to confirm this point.²⁷⁾ Moreover, courts do not shy away from transplanting provisions of Article 2 of the UCC beyond the “transactions in goods.” Commentators echo the same sentiments. Even the original comment to Section 1-102 cited with approval cases that apply the UCC by analogy, commending those courts for “[having recognized] the policies embodied in an act as applicable in reason to subject-matter which was not expressly included in the language of the act.” (Original (pre-2001) UCC §1-102) For example, courts have embraced the applicability of Article 2 of the UCC in the analysis of parties’ rights and obligations under franchise agreements even though the sale of goods “was, in a commercial sense, a minor aspect of the entire relationship.”²⁸⁾

JAPANESE LAW: Agreements for the sales of goods in the future, such as distributorship agreements, basic sales agreements or franchising contracts, are deemed to constitute preliminary agreements entered with respect to individual future sales contracts. Those agreements are non-typical agreements which are not specifically designated under the Civil Code.

(f) Consignment-Like Arrangements

Inasmuch as the requirements of a CISG “sale” entail a transfer of property rights in the goods, typical consignment-like arrangements in which the consignor retains title are not captured by the CISG.²⁹⁾

COMPARATIVE NOTE

UCC: The UCC applies broadly to “transactions in goods.” (UCC §2-102) Accordingly, the UCC is not overly concerned with the issue of where the title resides in a particular transaction as a condition of its applicability, and many consignment-like arrangements are expressly dealt with by the Code. Although a UCC “sale of goods” requires that the title pass

27) See, e.g., *Gruppo Essenziero Italiano, S.P.A. v. Aromi D'Italia, Inc.*, No. CCB-08-65 (D. Md. July 27, 2011), <http://cisgw3.law.pace.edu/cases/110727u1.html> (visited Feb. 16, 2012).

28) *Zapatha v. Dairy Mart, Inc.*, 381 Mass 284, 290 (Mass 1980) (applying principles of UCC “not by subjecting the franchise relationship to the provisions of the sales article but rather by applying the stated principles by analogy”).

29) See *Drafting Contracts* at 198 (cited in note 20) and the list of concurring authorities therein.

for a price, the UCC deals with many non-sale transactions. (*See* UCC §2-106(1))

For example, Article 9 of the UCC would capture a “consignment,” defined as a “transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale” (UCC §9-102(20)) However, the scope of such an assignment is limited insofar as (a) the value of each delivery must not be less than \$1,000, (b) the goods are not consumer goods, and (c) the transaction does not create a security interest for an obligation. (*Id.*) Filling in some of those definitional gaps, the Code separately deals with consignments of consumer goods regardless of their value under UCC Section 2-326 as “sale on approval” transactions. In those consignments, the title to the goods (as well as the risk of loss) remains with the consignor (the seller) until the buyer accepts them. (*See* UCC 2-326 Comment 1 and UCC §2-327(1)(a))

Furthermore, the UCC has created a separate category of a “sale or return” transaction, where the “seller” delivers goods to a “buyer” primarily for resale, and the buyer contractually secures the right to undo such “sale” at his own option. (UCC §2-326 and Comment thereto) It is not entirely clear whether it is necessary to actually surrender title to the goods to the “buyer” in order to qualify as a “sale or return” transaction. Nevertheless, since the transaction is considered to be a “present sale of goods” from seller to buyer, it probably presupposes a transfer of title. (*See id.*) More importantly, “in a sale or return the risk remains throughout on the buyer.” (UCC §2-327 Comment 3) In any event, because it is debatable whether a “sale or return” transaction would fall within the ambit of the CISG, a prudent approach may be to be prepared for either possibility.

JAPANESE LAW: Selling goods on a consignment basis involves entrusting the goods by a consignor to a consignee for execution of a sale of those goods with a third party. This form of sale is suitable for sales to customers in remote locations where the consignors do not have their own presence or sufficient distribution networks. Because the consignees are either unwilling or not in the position to purchase the consigned goods for their own inventory, a consignment can offer a mutually satisfactory solution. Although the title to the goods remains with the consignor, the consignee can sell the goods in his own name. Profits and losses on the sales belong to the consignor and typically a commission is paid to the consignee by the consignor upon execution of the sale.

While there are no specific regulations concerning sales on a consignment basis in the Civil Code, such sales are regulated as “wholesale business” pursuant to the second volume of Chapter 6 of the Commercial Code. In the context of mandates regarding commercial activities, also known as entrustments of commercial activities, “the parties entrusted with commercial activities can engage in activities of such entrustment within a scope not contrary to the tenor of such entrustment,” although such activities are not specifically mentioned. (Comm. C. Art. 505)

In the publishing industry, there are particular types of sale subject to return which look similar to consignment sales. In those transactions, publishers (or book agents) sell

books (or magazines or other publication) to bookstores which reserve the right to return unsold books to the publisher under certain conditions. The book return policy is typically decided upon when such sales contracts are executed. At the time when publishers sell their books to bookstores, the publishers transfer ownership to the books to the bookstores, and the bookstores pay the price of such books to the publishers. Here the publishers can often utilize a sales on account method of payment. The bookstores are then trying to sell the books. However, according to the negotiated return policy, if the bookstores are not able sell all or some of the books within a specified time, they have the right to sell back (return) the unsold books to the publishers.

§2:2.3 Transactions to which CISG Applicability is Uncertain

The standard interpretation limits the applicability of the Convention to sales of goods for which the buyer pays a “*price*.” (See CISG Art. 53) Article 53 of the CISG merely obligates the purchaser to “pay the price for the goods,” without specifying the form such price. If “price” equals money, as indeed such reading could be deduced from the “payment” requirement, then, typical barter transactions where parties exchange goods for goods or other non-monetary consideration would fall outside the CISG. However, the concept of “payment” is often used in a broader sense, and nothing in the Convention appears to give the definition of “price” or “payment” such a restrictive meaning. Indeed, some commentators support the inclusion of barter transactions in goods within the scope of the Convention’s applicability while the caselaw is unsettled.³⁰⁾

COMPARATIVE NOTE

UCC: The applicability of the CISG to barter transactions is uncertain because some courts and commentators have adopted a narrow view that the requirement to “pay the price” necessitates payment of money. The UCC, on the other hand, while also containing the requirement of an exchange for a price (UCC §2-106), expressly provides that “[t]he price can be made payable in money or otherwise,” thus sanctioning the applicability of the UCC to barter-type exchanges. (UCC §2-304(1))

JAPANESE LAW: Article 586 of the Civil Code deals with exchange transactions other than transfers of “ownership of money.” In other words, Article 586 provides for transactions in the nature of barter. Otherwise, if an exchange of money is introduced into the transaction, provisions dealing with sale transactions come into effect. (Civ. C. Art. 586(2))

30) See, e.g., John O. Honnold, *Uniform Law for Int’l Sales* §56.1 (cited in note 4).

PART THREE

LIMITED SCOPE OF ISSUES DEALT WITH BY THE CONVENTION

§3:1 Issues Covered by CISG

§3:1.1 Contract Formation, Parties' Rights and Obligations and Burden of Proof

The Convention concerns itself only with issues of formation of contracts for the sale of goods (excluding issues of validity), and the rights and obligations of contracting parties. Furthermore, it is evident from the text of the CISG that issues of burden of proof are also within the Convention's domain. As interpreted by the courts and commentators, the burden of proof typically rests with the party asserting a position or a claim or desiring to derive a benefit based thereon.³¹⁾

Within the scope of governed issues, the Convention embraces matters that are not readily discernible as issues of contract formation or the parties' rights and obligations. For example, the CISG governs matters of interpretation of the parties' statements and other conducts (CISG Art. 8), the incorporation of standard terms into the contract (generally requiring making such terms "available" or "apparent" to the other party),³²⁾ usage, customs and practice between the parties (CISG Art. 9), and termination and modification of contracts (CISG Art. 29).

§3:1.2 Non-Exhaustive Nature of CISG Legal Regime

The limitations placed on matters to which the CISG applies imply that contracts for the sales of goods cannot be governed exclusively by the Convention and necessitate the applicability of other governing laws. While the CISG provides gap-filling mechanisms, those are limited to the main issues to which the Convention applies.

Indeed, the CISG is not and should not be thought of as an exhaustive system of law, which it is not. The weight of tradition requiring that every contract be grounded in the legal system emanating from a sovereign country is heavy indeed with national courts (as distinguished from arbitral bodies) showing no signs of letting go of the notion that a "*contrat sans loi*" (where *loi* refers to a national legal system) is not only impossible but sheer absurdity.³³⁾

§3:2 Issues Not Covered by CISG

With the CISG being concerned only with issues pertaining to contract formation and the parties' rights and obligations, a plethora of related issues is beyond its reach.

31) Anna L. Linne, *Burden of Proof under Article 35 CISG*, 20 Pace Int'l L. Rev. 31, 32-33 (2008), <http://digitalcommons.pace.edu/pilr/vol20/iss1/2> (visited Feb. 16, 2012) (citations omitted); see also *UNCITRAL Digest* for art. 4, ¶¶ 4-7 (Issues Dealt with by the Convention) at 17 (cited in note 24).

32) See, e.g., Peter Huber, Alastair Mullis, *The CISG – A New Textbook for Students and Practitioners* 30-33 (Sellier 2007) ("A New Textbook").

33) See, e.g., *Drafting Contracts* ch. 8 (cited in note 20); Peter Nygh, *Autonomy in International Contracts* at 172 (1999).

UCC: The limited ambit of applicability of the CISG pales in comparison with the breadth of issues to which UCC Article 2 applies. For example, the CISG is silent on such issues dealt with by the UCC as delegation of performance and assignment of rights under the contract (UCC §2-210), seller's creditors' rights in the goods sold (UCC §2-402), entrusting possession of goods to merchants (UCC §2-403), set-off rights in respect of claims under the same contract³⁴⁾ (UCC §2-717); unconscionability (UCC §2-302); or limitation of actions (other than limitation on the purchaser's notice with respect to nonconformity of goods under CISG Article 39) (UCC §2-725). Furthermore, while the CISG is silent with respect to F.O.B, C.I.F. and other shipping terms, the UCC deals with those matters directly. (UCC §§2-319, 2-320, 2-321, 2-322 & 2-323) Nevertheless, some courts and commentators are of the opinion (while others disagree) that the Convention has incorporated the Incoterms through Article 9(2). Note, however, that the 2003 Amendment to the UCC repeals Sections 2-319 through 2-324 (provisions dealing with shipping terms), as being "inconsistent with modern commercial practices." Under the 2003 proposed Article 2, in the absence of the parties' express agreement, the meaning of FOB, CIF, and similar terms "must be interpreted in light of any applicable usage of trade and any course of performance or course of dealing between the parties." (UCC §2-319 Comment)

JAPANESE LAW: The following matters which are treated under the Civil Code or the Commercial Code of Japan are not provided for in the CISG: public policy (Civ. C. Art. 90); acts of agents (Civ. C. Art. 99(1)); methods of agency (Comm. C. Art. 504); self-contracts and representation of both parties (Civ. C. Art. 108); mistake (Civ. C. Art. 95); fraud and duress (Civ. C. Art. 96(1)); attribution of right of choice in cases of alternative obligations (Civ. C. Art. 406); designation of obligations to be performed (Civ. C. Art. 488(1)); assignability of claims (Civ. C. Art. 466(1)); novation by substitution of obligor (Civ. C. Art. 514); performance by third parties (Civ. C. Art. 474(1)); obligee's subrogation right (Civ. C. Art. 423(1)); obligee's right to demand rescission of fraudulent acts (Civ. C. Art. 424(1)); requests for performance (Civ. C. Art. 432); requirements for set-offs (Civ. C. Art. 505(1)); novation (Civ. C. Art. 513(1)); and methods of compensation for damages (Civ. C. Art. 417)).

§3:2.1 Issues Related to Contract Validity (unless Otherwise Expressly Provided in CISG)

Issues concerning validity of a contract or any of the CISG provisions or "of any usage" have been relegated to the treatment by domestic legal rules and are outside the province of the CISG, unless otherwise stipulated in the Convention. Note that the usages themselves are not outside the sphere of the Convention's applicability – only the issue of their validity is. Note further that the general rule of Article 11 of the CISG, itself dealing with validity issues, which allows parties to conclude or evidence their contract without any requirement of

34) However, some courts would allow the purchasers' set-off claims under the CISG; *see, e.g.*, CLOUT Case No. 273 (Oberlandesgericht München, Germany July 8, 1997), CLOUT Case No. 541 (Oberster Gerichtshof Austria, Jan. 14 2002) (allowing the buyer to set off the damages against the full amount of the contractual price).

writing or particular form, is subject to an exception in case when a party's place of business is located in a contracting States that has made a reservation under Article 96 of the CISG. (CISG Arts. 11, 12, 96)

The concept of validity under the CISG is typically understood to include rules by whose application the contract could be rendered "void, voidable, or unenforceable."³⁵⁾ Nevertheless, because the Convention leaves open the definition of "validity" itself, it is largely in the hands of the adjudicators to determine which issues that concept will embrace. But, a potentially open-ended license to embrace within the concept any important or mandatory issues of domestic law would certainly undermine the original premise of the CISG to create a uniform body of international laws to govern international sales contracts. Therefore, commentators point out that it is vital for adjudicators to exercise prudence in applying the interpretative rules of the Convention and balance parochial domestic interests against the desire to promote the international unification of laws.³⁶⁾

For the sake of illustration, the CISG validity exclusion applies to such matters and issues (all of which are left to the treatment under national laws) as:

(a) Capacity to Contract and Agency Authority

Even though the issue of parties' capacity to contract is indisputably outside the CISG's concern, the issue is not likely to occur in the context of international sales of goods. More pertinent issues that might require judicial intervention and which are excluded in the name of "validity" concern the existence or the lack of agents' authority to enter into a contract. In the near future, these issues may be addressed by the UNIDROIT Convention on Agency in the International Sale of Goods, a treaty which is currently awaiting the minimum number of ratifications before coming into force.

COMPARATIVE NOTE

UCC: Like the CISG, the UCC does not, for the most part, deal with these issues. Nevertheless, the Code deals, albeit indirectly, with the effect on third-party good faith purchasers contracting with sellers with a voidable title to the goods. (UCC §2-403(1)) Such voidable title can be a result of transacting with "infants" whose capacity to contract is limited, or with persons who acquired goods by fraud in a prior "transaction of purchase."³⁷⁾ (UCC §2-403) Under the Common law, infants could void their contracts even if third parties

35) Helen Elizabeth Hartnell, *Rousing the Sleeping Dog: The Validity Exception to the Convention on Contracts for the International Sale of Goods*, 18 Yale J. Int'l L. 1, 44 (1993) (citations omitted), <http://cisgw3.law.pace.edu/cisg/biblio/hartnell.html> (visited Feb. 16, 2012).

36) *Id.* at 7-8.

37) The "voidable" title with which Section 2-403 of the UCC is concerned must be distinguished from "void" titles. Thus, since a thief can get only a void title to the stolen goods, he cannot pass good title even to good faith purchasers. (See White & Summers §4-12 at 201 (cited in note 18)).

subsequently acquired rights derived from such contracts even without knowledge that the goods were originally sold by infants. For example, a minor who sold goods to the first buyer could disaffirm the contract and reclaim the goods even vis-à-vis a second buyer who purchased the goods from the first buyer. The UCC is less sympathetic to the infants and favors “good faith purchasers for value,” who do indeed acquire good title to the goods. (UCC §2-403(1)) However, to obtain good title, the “good faith” purchasers must be unaware of the sellers’ limited capacity to contract. Yet, there is some comfort to our infants, as they might still be able to claim damages from the original purchasers of goods if the goods could not be returned.

JAPANESE LAW: The capacity to contract is based on the capacity to act (Civ. C. Arts. 4-21). For instance, a person who has not reached the age of 20 must obtain consent of his statutory agent to perform any juristic act. (Civ. C. Art. 5) A juridical person (a corporation) has rights and can assume duties to the extent of the purposes set forth in the applicable articles of incorporation or act of endowment subject to the applicable provisions of the laws and regulations. (Civ. C. Art. 43) A foreign juridical person established outside of Japan and approved pursuant to Article 36 (1) of the Civil Code possesses the same private rights as similar juridical persons which can be formed in Japan. (Civ. C. Art. 36(2)) Nevertheless, juridical persons are not strictly limited by the purposes expressly listed in their articles and can perform any acts necessary to accomplish the stated purposes.

(b) Enforceability of Standard Terms

While it is generally accepted that the Convention will determine whether the parties’ standard terms and conditions have been incorporated into their contract, the enforceability of such terms and conditions is left to the determination under national laws. In other words, issues of validity of the content of the terms and conditions based on a standard of fairness, often referred to as “material validity,” are analyzed by applicable local laws. Yet, even standard terms that might be valid under national laws may not derogate from the fundamental principles on which the CISG is based.³⁸⁾

COMPARATIVE NOTE

UCC: The validity of standard terms incorporated into a CISG contract governed by the laws of a state of the United States would be determined by such state’s laws, presumably including the UCC.

JAPANESE LAW: Terms and conditions prepared with the intention to apply them when dealing with many unspecified users are referred to as "Ordinary Standard Terms and Conditions (Covenants) for Transactions." In general, the courts recognize their validity. (*E.g.*,

38) CLOUT Case No. 428 (Oberlandesgericht Braunschweig, Germany Oct. 28, 1999) (terms contrary to the basic policy of the CISG are to be disregarded).

Daisinninn Taisho 4. 12.24, 21 Minroku 2182) In addition, according to the commercial practice theory, in the presence of a custom or practice whereby the parties conduct their commercial dealings based on standard terms and conditions, such custom and practice will be recognized by the courts within the sphere of their applicability either as the customary commercial practice under Article 1 of the Commercial Code or the custom under Article 92 of the Civil Code.

(c) Consideration

The question of whether a contract will fail for lack of consideration has been held by the courts to be a question of validity governed by the applicable domestic law.³⁹⁾ However, some commentators protest, arguing that the issue is not one of validity at all. In support of the assertion that “domestic consideration requirement should not be applied to contracts underlying the CISG,” they argue that, because “both the formation rules (CISG Art. 14 *et seq.*) and the rules on form (CISG Art. 11 *et seq.*, Art. 29) demonstrate that consideration is not required for either formation or variation under the CISG[,] [i]t would therefore not be correct to treat the consideration requirement as a ‘validity’ issue and submit it to the domestic law according to Art. 4(a) CISG.”⁴⁰⁾

COMPARATIVE NOTE

UCC: In contrast to the CISG, the UCC largely preserves the Common law requirement of consideration to form a binding contract. It does so first, by incorporating the requirement by reference (UCC §1-103(b)), and second, by making payment for the goods an indispensable element of the buyer’s contractual obligations (UCC §2-301). In essence, this requirement calls for a “bargained-for exchange” to form a valid contract. To evidence such bargained-for exchange, the parties will often exchange promises, performance, derive benefit, or suffer detriment.

The sacrosanct Common law requirement of consideration to form a valid contract is perfectly applicable to contracts for the sale of goods under the UCC and has been codified by reference to supplement the UCC by UCC Section 1-103(b), except as this requirement of consideration has been specifically displaced by UCC provisions dealing with (a) firm offers (UCC §2-205), (b) modifications of contracts (UCC § 2-209(1)), (c) renunciation of claims or rights stemming from alleged breaches (UCC §1-306), and (d) output and requirement contracts (UCC §2-306 Comment 2).

JAPANESE LAW: There is no concept of consideration under Japanese law.

39) See, e.g., *Geneva Pharmaceuticals Tech. Corp. v. Barr Labs. Inc.*, 201 F.Supp.2d 236, 283 (S.D.N.Y. May 10, 2002), <http://www.unilex.info/case.cfm?id=739> and <http://cisgw3.law.pace.edu/cases/020510u1.html> (visited Feb. 16, 2012).

40) *A New Textbook* at 24 (cited in note 32).

(d) Conflict of Laws

To analyze legal issues under contracts that are silent on what the governing law is, the governing law must still be determined, even if the CISG is applicable by virtue of CISG Article 1(a). After all, the scope of applicability of the CISG is limited, and even within it there are gaps which could only be filled by resorting to national laws. Furthermore, the applicability of the CISG under Article 1(b) is predicated on the applicability of a contracting State's law as determined by the conflict of law provisions, or, as the Convention puts it, "the rules of private international law." (CISG Art. 1(b)) Because the CISG does not offer its own conflict of law rules, they need to originate out of national legal frameworks pursuant to Article 7(2) of the Convention.

COMPARATIVE NOTE

UCC: The UCC provides that, in the absence of the parties' agreement on the governing law, their rights and obligations are subject to the U.C.C. regime as adopted in the forum state, provided that the transaction bears an "*appropriate relation*" to that state. (UCC §1-301(b)) However, with respect to transactions with consumers, the Code imposes certain restrictions. (See UCC §1-301(c)) It should be noted that even though the foregoing rule reflects the 2008 amendment to the official text of the UCC, it is fairly representative among the states of the American Union. In fact, the supplanted version that was official from 2003 (2003 UCC §1-301)⁴¹⁾ was mostly rejected by the states, most of which continue to adhere to the pre-2003 version. (See Pre-2003 UCC §1-105)⁴²⁾ However, that pre-2003 version bore a very close resemblance to the current official version. In addition, the courts are also likely to look to their own conflict of laws rules, and apply the law of the place of (a) the most significant relationship to the transaction and the parties (Rest. 2^d Contracts §188), (b) agreed upon delivery of the goods (Rest. 2^d Contracts §191); (c) the "center of gravity" of the contract or similar conceptual approaches, or (e) contracting.

JAPANESE LAW: When places relevant to a contract, such as the contracting parties' addresses and the place of the conclusion and performance of a contract, are all in Japan, Japanese laws will govern unless the parties have chosen a different law. In Japan, the parties are generally free to select any governing law (including laws of non-Japanese jurisdictions) to govern their agreement, except in certain instances involving consumer contracts or employment agreements in order to ensure that special treatment under Japanese law is afforded to consumers and employees. (See Act on General Rules for the Application of

41) The 2003 version of Section 1-301 required that "[i]n the absence of an agreement . . . , the rights and obligations of the parties are determined by the law that would be selected by application of this State's conflict of laws principles."

42) The pre-2003 Section 1-105 was amended and codified as Section 1-301 in the official 2003 version. Under subsequent amendment, the Section continues as Section 1-301.

Laws Arts. 11 and 12) Except in those cases, the parties' choice of law will be respected to the extent that the application of such law is not contrary to the public policy of Japan.

(e) Unconscionability

As a matter of validity, the unconscionability of a contractual provision is within the province of national laws.

COMPARATIVE NOTE

UCC: As codified in the UCC, the principle of unconscionability abhors depriving a party of any remedy or taking away remedies in an unscrupulous manner.⁴³⁾ (UCC §2-302) The question to ask is “whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.” (UCC §2-302 Comment 1) For example, any unreasonable limitations on remedies such as liquidated or consequential damages will fail or be limited. (UCC §§2-718(1), 2-719(3)) Moreover, the UCC’s remedies will govern if the parties’ limitations or exclusions thereof fail of their essential purpose. (UCC §2-2-719(2)) The courts will frequently analyze the issue in terms of (a) procedural and (b) substantive unconscionability. Under procedural unconscionability, the courts will consider issues such as contract of adhesion where one party lacks any meaningful choice to enter a contract, sharp bargaining practices, or use of “fine print and convoluted language,” and, under substantive unconscionability, the courts will examine such matters as particularly one-sided terms unreasonably favoring one party.⁴⁴⁾ Although the courts tend to deny remedies when faced with procedural unconscionability alone, the prevailing trend for finding unconscionability is to take a balancing approach requiring some elements of both types.⁴⁵⁾

JAPANESE LAW: There are no direct statutory provisions dealing with unconscionable behavior in the context of contract formation or performance, except for the provisions dealing with fraud and mistake. Instead, unconscionable behavior may be captured as being against the public policy (Civ. C. Art. 90), the doctrine of good faith (Civ. C. Art. 1(2)), the doctrine of abuse of rights (Civ. C. Art. 1(3)), or as constituting an independent tort (Civ. C. Art. 709).

43) Under the UCC, “it is of the very essence of a sales contract that at least minimum adequate remedies be available” to the parties, and parties should provide “at least a fair quantum of remedy for breach of the obligations or duties” of the parties. (UCC §2-719 Comment 1)

44) E. Allan Farnsworth, *Contracts* §4.28 at 301 (4th ed. 2004) (“Farnsworth”).

45) *See White & Summers* §5-7 at 234 (cited in note 18).

(f) Fraud and Misrepresentation

For the most part, the CISG relegates issues of fraud to the domestic treatment. Thus, a buyer's allegations of fraudulent inducement to purchase a machine have been adjudicated under *lex fori*.⁴⁶⁾ However, in cases where instances of fraud relate more directly to the CISG substantive rules, the courts can limit the right of the defrauding parties to avail themselves of particular remedies under the Convention. Thus, one court deprived a fraudulent seller of the right to rely on the remedies listed in Article 40 of the CISG. That Article expressly takes away that right from sellers who "know or could not have been unaware" of the lack of conformities and failed to disclose them to the buyer. (CISG Art. 40) According to the court, even a negligent buyer is entitled to more protection under the CISG than a fraudulent seller.⁴⁷⁾

COMPARATIVE NOTE

UCC: Even though under the UCC scheme the elements of fraud are supplied by other "principles of law and equity" pursuant to its Section 1-103, the UCC will not leave the victim of fraud without remedies available under the Code. (UCC §2-721) In this way, the Code puts the victim of fraud on parity with claimants injured by warranty breaches who might otherwise be entitled to wider scope of remedies. (UCC §2-721 Comment) At the same time, the victim of fraud or material misrepresentation in case where the seller knowingly misrepresents the quality of goods may, in general, resort to all available damages under other applicable state laws, such as rescission of contract. The UCC makes it clear that, in such cases, neither rescission of contract nor rejection or return of goods by the defrauded party will bar such party from recovery of other damages available under the UCC for non-fraudulent breach. (UCC §2-721 and Comment thereto) Because most fraudulent behavior is presumably more egregious than plain vanilla unconscionable acts, remedies based on UCC Section 2-302 for unconscionability may also be applicable.

JAPANESE LAW: In general, a manifestation of intention induced by fraud may be rescinded by the defrauded person. (*See* Civ. C. Art. 96(1)) However, if a third party commits fraud in inducing a party to make manifestation of intention to another party, such manifestation of intention may be rescinded by the party who made the manifestation of intention only if that other party (i.e., the party to whom the manifestation of intention was made) was aware of the fraud (Civ. C. Art. 96(2)). Nevertheless, a rescission of manifestation of intention induced by fraud as set forth above may not be asserted against a bona fide third party who had no knowledge of the fraud. (Civ. C. Art. 96(3)).

46) *Miami Valley Paper, LLC v. Lebbing Engineering & Consulting*, No. 1:05-CV-00702 (S. D. Ohio Mar. 26, 2009), <http://cisgw3.law.pace.edu/cases/090326u1.html#cd> (visited Feb. 16, 2012)

47) *See* CLOUT Case No. 168 (Oberlandesgericht Köln May 21, 1996).

(g) Illegality or Violation of Public Policy

The CISG does not concern itself with issues of public policy or illegality of transactions.

COMPARATIVE NOTE

UCC: Some contracts for the sale of goods may be unenforceable (in whole or in part, or their enforceability may be limited) on the grounds of public policy due, for example, to illegality. Concerns of illegality in the context of contracts for the sale of goods enter into the UCC framework through the supplementary rules of law and equity. (UCC §1-103(b)) Not all contracts that contravene public policy are unenforceable by virtue of illegality of their subject matter. In other words, contracts that are unenforceable based on public policy do not necessarily involve criminal behavior. Public policies can be either the product of judicially developed doctrines or legislative enactments. Public policy matters that may face concerns of illegality include gambling contracts, contracts to procure illegal businesses, covenants not to compete, commercial bribery, usurious contracts, clauses indemnifying the perpetrator of intentional torts against liability, or contracts for services by a party without holding required permits or licenses. Additional policies that may affect sales of goods in particular include policy against restraint of trade, policy against encouraging litigation and policy discouraging improper use of goods (for example selling goods to be used in criminal activity).⁴⁸⁾

Contrasted with contracts whose performance is prohibited by law from their inception (in which case neither party is required to perform) are contracts that became illegal or violative of public policy subsequent to their making. Such “supervening illegality” falls directly under scope of Section 615(a) of the UCC, which (among other things) excuses a seller from making timely performance if it becomes commercially impracticable due to “any applicable foreign or domestic governmental regulations or order whether or not it later proves to be invalid.” (UCC §2-615(a)) In other words, faced with a “supervening illegality,” a seller who neither “collude[d] in inducing the governmental action preventing his performance,” nor assumed the risk of such illegality will not be in breach for the resulting delay in delivery or non-delivery and he will be usually discharged from further performance.⁴⁹⁾ (UCC §2-615 Comment 10)

JAPANESE LAW: Under the principles of private autonomy and freedom of contract, parties are free to shape the contents of their agreement. Nevertheless, this freedom is not entirely boundless for it sanctions only agreements that do not (a) offend the public order and morals (Civ. C. Art. 90), or (b) contradict the “strong law.” (Civ. C. Art. 91) For, if they do, such agreements are invalid.

48) See generally Farnsworth ch. 5 at 311-341 (cited in note 44).

49) See Farnsworth §9.9 at 638 (cited in note 44)

(h) Mistake

In general, issues concerning mistakes are matters of validity relegated to the domestic law treatment pursuant to Article 4 of the CISG. However, it has been pointed out that validity issues that are specifically embraced by the Convention should be governed by the CISG. Accordingly, mistakes with respect to the quality or characteristics of the goods should not be treated as “validity issues,” and buyers in those cases should resort to remedies available under the CISG, including those under its Article 45.⁵⁰⁾

COMPARATIVE NOTE

UCC: While the CISG largely defers (except as mentioned above) to national legal regimes with respect to issues concerning mistake, the UCC defers to the applicable principles of Common law and equity. (UCC §1-103(b)) According to those Common law doctrines, once the required elements of mistake are met, the contract can be either avoided (coupled with restitution or payment of damages when appropriate), or adjusted. Mistake can be either mutual or unilateral, each with different legal requirements for obtaining relief. In order to be awarded a remedy for unilateral mistake, those requirements are much stricter. Importantly, the “mistake” under discussion here involves a mistaken belief concerning facts existing at the time of contracting and not some future predictions. In the latter case, the proper analysis would call for an examination of whether the doctrines of impracticability or frustration of purpose might afford a remedy.⁵¹⁾

JAPANESE LAW: A manifestation of intention is of no effect (and the contract is null and void) when there is a mistake with respect to any essential portion or element of a contract, except that a person who made the manifestation of intention was grossly negligent may not assert nullity of the contract. (Civ. C. Art. 95)

(i) Warranty Disclaimers (Exculpatory Clauses)

Contractual exculpatory clauses, or “disclaimers” of warranty, may have a critical effect on the parties’ exposure to liability. These clauses, sometimes tagged on to the parties’ standard terms and conditions, seek to disclaim, limit, or modify express or implied warranties or available remedies. There is little doubt that the validity and the enforceability of such disclaimers are governed by domestic laws. However, the resulting necessity to conform warranty disclaimers to applicable domestic laws poses a particular challenge for the parties inasmuch as those laws tend to display a considerable variety in the scope of their requirements.

50) See *A New Textbook* at 22-24 (cited in note 32).

51) See Farnsworth §9.2 at 598 (cited in note 44).

COMPARATIVE NOTE

UCC: Under the UCC, disclaiming or modifying warranties set forth in the UCC is subject not only to the requirements pertaining to form of such disclaimers or modifications but also to the policing doctrine of unconscionability. For example, with respect to (a) disclaimers of implied warranties of merchantability or fitness, the parties might have to deal with the requirement that such disclaimers be “conspicuous” (UCC §§2-316(2) and 1-201(10)); and (b) limitations of remedies, the courts would inquire whether they are not unreasonable or whether they do not fail of their “essential purpose” (UCC §§2-718(1) and 1-719(2)). While negotiating warranty disclaimers to which UCC standards may apply, the parties should also bear in mind a general judicial hostility to give them recognition.⁵²⁾

JAPANESE LAW: The seller’s refusal to provide any warranty or guarantee concerning goods by taking advantage of its dominant bargaining position may potentially qualify as an offence against public order.

(j) Penalty Provisions

The CISG appears to relegate the issue of punitive and liquidated damages to the national laws’ treatment as a matter of validity. It should be noted that the 2004 UNIDROIT Principles of International Contracts (**UNIDROIT Principles**) provide for a reduction of liquidated damages “to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances.” (UNIDROIT Principles Art. 7.4.13(2)) Whereas adjudicating bodies are not likely at this time to look *sua sponte* into the UNIDROIT Principles as a gap-filling mechanism in the context of the CISG-governed contracts, the parties themselves may consider incorporating those Principles into their contracts to the extent they do not conflict with the provisions and general principles of the Convention.⁵³⁾

COMPARATIVE NOTE

UCC: The fundamental policy dealing with contract breaches and corresponding damages under the Common law aims at compensating the aggrieved party for the other party’s breaches *and not* at attempting to enforce performance by setting up *in terrorem* levels of penalties.⁵⁴⁾ This policy is reflected in the general prohibition against providing for damages that deviate from such policy. Hence, courts will not enforce any provisions that amount to assessing penalties on the promissors. In the words of the UCC, while remedies “must be liberally administered,” no “penal damages may be had except as specifically provided in [the

52) See, e.g., White & Summers §13-1 at 570 (cited in note 18).

53) See *Drafting Contracts* at 79-83 (cited in note 20).

54) See, e.g., Farnsworth §12.18 at 807 (cited in note 44).

UCC] or by other rule of law.” (UCC §1-305(a)) (In other words, since punitive damages are not available in actions sounding in contract, there is a possibility of assessing punitive damage awards through “other rules of law” *via* Section 1-103(b) of the UCC.) Likewise, liquidated damages provisions could be stricken down for the foregoing reasons. Mindful of the prohibition on exemplary damages, the UCC allows parties to stipulate to liquidated damages “but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy.” If that condition is not met, “[a] term fixing unreasonably large liquidated damages is void as a penalty.” (UCC §2-718(1))

JAPANESE LAW: The parties may agree on the amount of liquidated damages with respect to the failure to perform obligations under their contract. Faced with such agreed upon measure of damages, the court may not increase or decrease the amount thereof. (Civ. C. Art. 420(1)) In addition to liquidated damages, a non-defaulting party can demand performance or exercise the cancellation right. (Civ. C. Art. 420(2)) Any penalty under the contract is presumed to constitute liquidated damages. (Civ. C. Art. 420(3)) However, sometimes the damages agreed upon may be treated partly as a penalty and partly as liquidated damages. For example, the parties may agree on a penalty for a breach of contract solely as a punishment for such breach and not as compensation for damages, in which case the non-breaching party could also claim compensation for damages in addition to the claim of the penalty. Nevertheless, in case where the amount of liquidated damages is excessively large or in contracts of adhesion or made under duress, provisions allowing such damages might be found invalid as offending public order, or limited by special laws relating to interest limitation or consumer contracts. In addition, an award of punitive damages pursuant to a foreign law may be unenforceable on public policy grounds in light of the general policy against availability of punitive damages under Japanese Civil Code.

(k) Settlement Agreements

The validity of settlements of claims by the parties must be reviewed under domestic laws and is outside the scope of the CISG.

COMPARATIVE NOTE

UCC: The traditional Common law approach would generally require consideration for settlements of claims for lesser amounts based on the “*pre-existing duty*” doctrine. Furthermore, modifications of contracts in consideration of a pre-existing duty would fail for lack of consideration. For example, settling a debt for a smaller amount would not be binding (the so-called “*Foakes v. Beer*” rule). While punctured by several exceptions, this rule is still in force in many states of the United States. This is despite the overall policy of the contract

law favoring settlements among the parties.⁵⁵⁾ However, the *pre-existing duty* rule has been completely abolished under the UCC. Under the UCC, no consideration at all is required for any modification of a contract, provided that (a) any writing requirement provided by the parties or under the UCC statute of frauds has been satisfied (UCC §2-209(1), (2) & (3)); and (b) the party who has waived any portion of his rights under an executory contract may retract such waiver unless the retraction would cause injustice due to the other party's reliance on the waiver (UCC §2-209(5)).

JAPANESE LAW: Parties will often seek to settle a legal dispute through reciprocal concessions by entering into a settlement agreement. Such an agreement can be characterized as a consensual bilateral contract for value. When settlements are reached within the context of judicial proceedings, they are referred to as “judicial settlements.” When settlements are reached under private law, as provided for in Article 695 of the Civil Code, they are referred to as “extra-judicial settlements.”

There is another type an out-of-court, private amicable arrangement to resolve disputes, called “*jidan*,” which is not provided for under written laws. A *jidan* often resembles an Article 695 settlement but not always. An Article 695 settlement (or “*wakai*”) becomes effective when parties to a dispute promise to settle their dispute through reciprocal concessions. On the other hand, under *jidan*, one party can completely concede its rights without the other party's making any concession.

(l) Assignment of Contracts in General

The issue of validity of assignments of rights under an international contract for the sale of goods is beyond the scope of the CISG.

COMPARATIVE NOTE

UCC: Under the UCC, parties can, in general, freely assign their contractual rights and transfer their performance obligations to third parties, unless the contract says otherwise. (UCC §2-210) As a present transfer of rights under the contract, an assignment does not require consideration. The UCC expressly deals with assignments of rights and delegations of duties under the contract. (UCC §2-210)

Assignments: A party can assign his rights unless the assignment would (a) “materially change the duty of the other party; (b) “increase materially the burden or risk” allocated to the other party; or (c) “impair materially” the other party's risk of receiving return performance. (UCC §2-210) While anti-assignment clauses will generally be respected under the UCC, some rights can be assigned *irrespective of the parties' agreement*, including:

- (a) Assignments of the right to damages for breach of the entire contract (UCC §2-

55) See, e.g., Farnsworth §2.12 at 71 (cited in note 44).

210(2));

- (b) Assignments of rights arising out of the assignor's fulfillment of all his obligations (UCC §2-210(2)); and
- (c) Assignments of rights to payment under certain contracts under UCC Article 9 (UCC §9-406(d)).

Delegations: A party can delegate his duties unless the other party has "substantial interest" in having the original party perform. (UCC §2-210(1))

JAPANESE LAW: Not only specific claims but also various rights and obligations that adhere to a contract can be subject to an assignment. Indeed, as a transfer of such individual rights and obligations might often be quite complex, a contracting party can transfer to a third party his entire status (position) as a contracting party in a lump-sum like assignment of all related rights and obligations under the contract. Such a transfer is typically referred to as a "*transfer of the position in the contract*." (See, e.g., Daisinninn Taisho 14.12.15, Minshu 4-710) Under a "*transfer of the position in the contract*," the transferee is entitled not only to receive performance under the contract but also to all other accompanying rights of the transferor, such as the right to cancel (annulment), the right to rescind, and the right to defend (beneficial excuse). Importantly, however, for most contracts, an agreement or approval of the other party to the contract is necessary to effect the transfer of the transferor's position in the contract to the transferee.

(m) Assignment of Receivables

Issues concerning assignments of the right to payment under CISG-governed contracts are not within the scope of the CISG; they are the subject of applicable domestic laws.

COMPARATIVE NOTE

UCC: Rights to payment under a contract can be the subject of assignments. When such assignments are effected, they give rise to a "security interest" under Article 9 of the UCC. Under the UCC, assignments of "accounts or payment intangibles" are perfected automatically when they attach, provided that they do not, "[by themselves] or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles." (UCC §9-309(2)) However, certain types of assignments are excluded from the application of UCC Article 9. (UCC §9-109(d)) In addition, the UCC grants automatic perfection to some sales of "payment intangibles," i.e., sales by a debtor (e.g., a seller of goods) of general intangibles with respect to monetary obligations of the account debtors (e.g., the buyers of goods owing payment obligations to the seller).⁵⁶⁾ (UCC §9-309(3))

56) However, sales of "accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose" are excluded from the application of UCC Article 9. (UCC §9-109(d)(4))

The party assigning his rights to payment under a contract for the sale of goods governed by Article 9 of the CISG cannot be prevented from doing so by the other party to the contract (i.e., the “account debtor” in the UCC terminology), and any clause prohibiting assignment is ineffective to the extent it (a) “prohibits, restricts, or requires the consent of the account debtor . . . to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest” in the payment intangible (UCC §9-406(d)(1)); or (b) states that any such assignment or the “creation, attachment, perfection, or enforcement” would result in a default, breach, termination or give certain other rights or remedies to the account debtor (UCC §9-406(d)(2)).

JAPANESE LAW: Article 466 of the Civil Code allows a party to a contract to assign his contractual claims unless their nature does not permit an assignment. However, in respect of nominative claims (i.e., claims where the creditor is specified), in order for the assignee to assert such claims, either the assignor must give notice of the assignment to the obligor, or the obligor must have acknowledged the assignment (Civ. C. Art. 467(1)), provided further that in order to assert such assigned claims against third parties, the said notice or acknowledgement must be made by an instrument bearing a fixed date (Civ. C. Art. 467(2)).

An assignment of a claim under a contract is often used as a security mechanism (“*mortgage by transfer*”) by which the assignor transfers his property/ ownership rights in the property to a creditor as a form of a security interest. Examples of using real estate and goods for such purposes are well known. Another security interest can be achieved by a “*mortgage by assignment of claims*,” under which the mortgagor assigns his claims against a third party to the mortgagee. A single claim or any number of claims can be so mortgaged. Moreover, both existing claims and claims to be generated in the future are subject to such mortgage. This type of security interest can be registered in accordance with the “Act on Special Provisions, etc. of the Civil Code Concerning the Perfection Requirements for the Assignment of Movables and Claims.”

(n) Statutes of Limitation

Issues of whether actions for the enforcement of rights flowing from the Convention may be barred by the passage of time are examined by reference to the applicable domestic law, or, if applicable, *the Convention on the Limitation Period in the International Sale of Goods* (the “1974 Limitation Convention”), concluded in New York on June, 14, 1974, together with the amending Protocol thereto (“Protocol”), concluded at Vienna on 11 April 1980. Both of these instruments entered into force (among the adopting states) on August 1, 1988. The basic limitation period under 1974 Limitation Convention is four years, which period, in certain circumstances, can be (a) extended to a maximum of ten years, (b) shortened, or (c) extended. As of this writing, Japan has not acceded to the 1974 Limitation Convention.

COMPARATIVE NOTE

UCC: Under the UCC, in most cases, the claimant must bring an action for breach of contract within the later of (a) four years from the time the cause of action has accrued,⁵⁷⁾ or (b) one year after the breach was or should have been discovered. (*But see* UCC §2-725 for additional details) Other than in consumer contracts, the parties are free to reduce the prescribed time limitations on actions to no less than one year. However, an extension of the UCC statute of limitation in contracts for sale of goods is not permitted. (UCC §2-725(1))

JAPANESE LAW: There is no “statute of limitations” in Japan as the term is understood in the American jurisprudence. Accordingly, the creditor can bring a lawsuit at any time. However, in case the creditor asserts a claim in a lawsuit after expiration of the applicable prescription period, the debtor can invoke prescription to bar the suit by pleading that the claim has already been extinguished as it was not exercised for ten years. In general, a claim will be extinguished if not exercised for ten years (Civ. C. Art. 167 (1)), except that (a) a claim pertaining to the price of any product or goods sold by a manufacturer, wholesale merchant, or retail merchant will be extinguished if not exercised within two years; (b) claims arising out of commercial transactions will be extinguished after five years; and (c) where other laws provide for shorter prescription periods, such shorter periods will control. (Comm. C. Art. 522) The foregoing rules fixing the periods after which the defense of prescription could be exercised are not absolute as the right to assert such defense is subject to considerations of good faith and fair dealing.

(o) Effect of Contract on Third Parties

With the exception of rights of third party beneficiaries, as discussed above under Section §1:3.6(c), rights of third parties to a CISG contract are not governed by the Convention and cannot be overridden by it.⁵⁸⁾

COMPARATIVE NOTE

UCC: The UCC’s reach extends to many aspects surrounding contracts for the sale of goods, including matters affecting third parties to such contracts. To illustrate, parties to a contract

57) Following exemplifies situations when a cause of action will accrue: (a) when the breach of contract occurs, (b) in case of a breach by repudiation, at the earlier of when the aggrieved party elects to treat the repudiation as a breach, or when reasonable time for awaiting performance has expired, (c) in case of a breach of a remedial promise, when such promise is not performed, (d) in case of breaches of warranty, generally at the time of tender of delivery, or with respect to breaches of warranties that extend to future performance of the goods, generally when such breaches were or should have been discovered. (UCC §2-725(2) and (3))

58) *See, e.g.*, CLOUT Case No. 613 (*Usinor Industeel v. Leeco Steel Prods., Inc.*, 209 F.Supp.2d 880, 886 (N.D. Ill. 2002)), <http://www.cisg.law.pace.edu/cases/020328u1.html> (visited Feb. 16, 2012).

for the sale of goods may have a valid cause of action for damages caused to the goods by a third party. Such third party may then be sued, for example, by seller with a reservation of title (*see* UCC 2-401(1)), the buyer who has an “insurable interest in the goods” (*see* UCC §2-501), or the holder of the title to the goods (*see* UCC §2-401). (*See also* UCC §2-722 (*Who Can Sue Third Parties for Injury to Goods*) for more details.) On the other hand, the Code provides that the seller’s unsecured creditors will in general be subject to the buyer’s right to recover the goods in some cases, except in cases of fraud. (*See* UCC §2-402 for details and exceptions.)

JAPANESE LAW: Under the Civil Code, an infringement upon the rights of a third party (other than a debtor’s claims) constitutes a tort. (*See* Civ. C. Art. 709) Thus, a third party causing or contributing to a party’s breach of contract is liable for damages caused to the non-breaching party based on tort. That would be the case, for example, when a party that owes an obligation of feaseance (performance) under a contract was prevented from rendering such feaseance or such rendition was frustrated by a third party. Furthermore, a party’s (obligor’s) performance of an obligation to a holder of the claim (e.g., a person with an authorization to receive performance) will be effective but only to the extent that the obligor acted in good faith (“without knowledge”) and was free from negligence. (Civ. C. Art. 478)

§3:2.2 Issues Related to Property Rights in Goods

The CISG does not concern itself with “the effect which the contract may have on the property in the goods sold,” except as otherwise expressly provided therein.⁵⁹⁾ (CISG Art. 4(b)) At first blush, that provision seems to suggest that matters involving title to and ownership in the goods are left to the applicable domestic laws. This, however, is not the whole truth. For one thing, the CISG expressly places on the seller the obligation to furnish good title free of any third party claims to the buyer on two separate occasions. (*See* CISG Arts. 41 and 42) For another thing, in the context of contract avoidance, the CISG expressly gives the seller who has performed in whole or in part the right to get back from the buyer whatever it had supplied to him – a matter clearly concerning property rights in the goods. (CISG Art. 81(2)) Rather, the restriction of Article 4(b) of the CISG, while recognizing that the seller must deliver free and clear title to the buyer, instructs that (a) the rights between the seller or the buyer and **third parties**, (b) the parties’ rights to the goods in case of nonpayment by the buyer or in case of the buyer’s insolvency, and well as (c) the effect of the seller’s retention of title, are governed by domestic laws.⁶⁰⁾

COMPARATIVE NOTE

UCC: The CISG protects the buyer of goods by requiring the seller to provide a good title.

59) Note, however, that the CISG gives ample treatment to the issue of passing of risk in the goods.

60) *See* Schlechtriem & Schwenzler Art. 4, paras 46-47 at 94 (cited in note 12).

As between the seller and the buyer, the CISG also gives the seller the right of restitution if the seller is able to declare the contract avoided. (CISG Art. 81(2)) This idyllic picture from the seller's point of view, however, becomes a little cloudy by the appearance onto the scene of third parties potentially having also rights or claims with respect to the goods. Moreover, the CISG's abdication of control over matters of title retention and other property rights with respect to the goods in favor of domestic laws, could, to the dismay of unsuspected sellers, deprive them of their expectations.

Under the UCC, on the other hand, the standing of the seller is straightforward. While the concept of title does matter, it has been pushed back to secondary importance. Most of legal consequences under the UCC are determined without considering where the title resides.

With the foregoing considerations in the background, the UCC has a set of rules to determine the moment when the title changes hands. Although the parties, as between themselves, have the power to control the way and timing of the passing of title (UCC §2-401(2)), from the perspective of a third party, those issues are immaterial. Thus, the purchaser of goods "[a]cquires all title which his transferor had or had power to transfer except that a purchaser of limited interest acquires rights only to the extent of the interest purchased." (UCC §2-403(1)) Accordingly, even an express reservation of title by the seller results only in a retention of a security interest in the goods.

JAPANESE LAW: A holder of a statutory lien has the right to have his own claim satisfied prior to other creditors out of the relevant assets as provided under the Civil Code and other laws. (Civ. C. Art. 303) In general, a statutory lien may be exercised not only against tangible things but also against monies the obligor is to receive as a result of a sale, lease or loss of, or damage to, the subject matter of the statutory lien. (Civ. C. Art. 303) However, a statutory lien may not be exercised with respect to the movable property after the obligor has delivered it to a third-party acquirer. (Civ. C. Art. 333) When such third party is a person who has a *joto tanpo* form of assignment (a mortgage, sometimes also referred to as "title-transfer security interest" or "security assignment") with respect to that property, the problem of priority between the a statutory lien and *joto tanpo* comes into existence.

§3:2.3 Seller's Liability for Death and Personal Injury Caused by the Goods

Unlike contractual claims with respect to property damage, matters concerning claims and recoveries for personal injury "to any person" caused by the goods, including death as well as mental distress and emotional suffering, are outside the scope of the Convention.⁶¹⁾ (CISG Art. 5) Those matters, including issues ranging from concurrent applicability of domestic laws governing such recoveries, whether in the nature of torts or otherwise, to recoveries of concurrent damages under the CISG, are governed by national laws.⁶²⁾

61) See Schlechtriem & Schwenzler Art. 5, para. 4 at 97 (cited in note 12).

62) See, e.g., Peter Schlechtriem, Petra Butler, *UN Law on International Sales – The UN Convention on the International Sale of Goods* 38 -40 (2009).

COMPARATIVE NOTE

UCC: In comparison to the CISG whose Article 5 squarely removes claims for death and personal injury from its application (except perhaps for claims with respect to personal injuries sustained by third parties), the UCC specifically allows for such damages by allowing buyers to recover consequential damages for “injury to person . . . resulting from any breach of warranty.” (UCC §2-715(2)(b))

JAPANESE LAW: If an obligor fails to perform consistent with his undertaken obligations, the obligee is entitled to damages arising from such failure. (Civ. C. Art. 415) The scope of available damages aims to compensate the obligee not only for damages ordinarily arising from such failure but also for damages arising from any special circumstances as long as the obligor foresaw or should have foreseen such circumstances. Moreover, recoverable damages include damages for loss of life, bodily injury, mental suffering and other noneconomic damages.

§3:2.4 Non-Contractual Claims

In principle, claims that do not sound in contract are not governed by the CISG. Such claims may, for example, sound in tort, including negligence, products liability or intentional wrongs. The big question, however, is whether the claimant can either bring both contractual claims under the CISG concurrently with his tortious claims or selectively exercise choice of preferred mode of recovery. Wading through judicial and arbitral decisions and scholarly commentary, it is difficult to detect any consensus on this issue. The matter is further muddled by often inconsistent demarcation lines between contract and tort claims across the jurisdictional spectrum.

COMPARATIVE NOTE

UCC: Dealing with UCC-governed contracts, plaintiffs may often exercise an election to sue either in contract or in tort. In fact, claims stemming from warranty breaches often span over and overlap the two bodies of law. Depending on various jurisdictional approaches, claimants may even be allowed to sue concurrently under both theories. Hence, although the availability of tort damages based on breaches of warranty is still largely in flux, the approach taken under both the UCC and the CISG do not appear to be so much different – especially considering that the matters of tort claims will usually be analyzed under domestic laws anyway. Dealing with claims arising from warranty breaches under the UCC, perhaps partly in an effort to stem the rush of plaintiffs seeking tort liabilities (often allowing for more handsome recoveries) and partly to distinguish between remedies under contract and tort laws, courts have begun increasingly to utilize the so-called “economic loss doctrine,” preventing plaintiffs suing for property damage from recovering “economic damages,” such as

lost profits, or loss of good will.⁶³⁾ As plaintiffs often try to bring claims under both tort and contract theories (even though the claimant may often make his own election which theory of recovery to pursue), in determining whether recovery under tort theories is available, courts could ask: (a) whether the claim concerns contractual misfeasance (affirmative act causing harm) or nonfeasance (taking no action), with courts tending not to award tort damages in cases of nonfeasance except in cases of misrepresentation when the party had no intention to perform when making a promise, and (b) what the “gravamen” of the complaint is, i.e., whether the tort or contract theory forms the gist of the complaint. Especially in the context of commercial transactions, courts may look askance at plaintiffs who—“having negotiated an elaborate contract or having signed a form when they wish they had not – claim to have a right in tort whether the tort theory is negligent misrepresentation, strict tort, or negligence.”⁶⁴⁾ Accordingly, injuries to property are likely to be characterized as “economic,” for which recovery in tort may thus be precluded.⁶⁵⁾

JAPANESE LAW: Apart from contract liability, under Japanese law, a person is liable in tort for damages resulting from intentional or negligent infringement on legally protected rights or interests of others. (*See* Civ. C. Art. 709) Faced with a breach of contract, the non-breaching party will often be able to exercise a choice of suing based on the tort law regime of “unlawful responsibility,” or the contract law regime of responsibility for breach. The two regimes are based on different legal concepts. On a more practical level, assuming that choice is available, plaintiffs should bear in mind divergent rules governing the burden of proof under each regime. Thus, when a plaintiff chooses to sue in contract for damages based on a breach of contract, the party allegedly in breach will have the burden of proof with respect to the existence default or the extent or lack of his responsibility. On the other hand, suing on a tort theory, the alleged victim carries the burden of proving the other party’s negligence or fault.

63) White & Summers §11-5 at 538-541 (cited in note 18) (“One way the courts have attempted to draw a line between tort and warranty is to bar recovery in tort for ‘economic loss.’”).

64) *Id.* §11-5 at 541.

65) *Id.* §11-5 at 539.

