

2011

Comparative Efficiency in International Sales Law

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Recommended Citation

Larry A. DiMatteo & Daniel Ostas, *Comparative Efficiency in International Sales Law*, 26 Am. U. Int'l L. Rev. 371 (2011), available at <http://scholarship.law.ufl.edu/facultypub/525>

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COMPARATIVE EFFICIENCY IN INTERNATIONAL SALES LAW

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INTRODUCTION

This article uses economic criteria to assess the efficiency of select provisions of the United Nations Convention on Contracts for the International Sale of Goods (“CISG”).¹ Signed in Vienna in 1980 and ratified by more than seventy countries, the CISG “applies to contracts of sale of goods between parties whose places of business are in different [Contracting] States.”² Reflecting diverse legal traditions, the CISG provides an interesting mix of civil and common law rules.³ When civil and common law rules coincide, the CISG typically adopts the convergent view.⁴ When they differ, the CISG sometimes adopts one approach and sometimes the other. In certain instances, the CISG creates alternative rules assumed to be the result of negotiation and compromise among the drafting nations.⁵ In other

1. United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, 1489 U.N.T.S. 3 [hereinafter CISG].

2. *Id.* art. 1. Additionally, CISG jurisdiction applies if relevant private international or conflict of law rules “lead to the application of the law of a Contracting State,” thereby allowing for the application of CISG rules even if only one party has its place of business in a Contracting State. *Id.* art. 1(1)(b). However, some countries, most notably the United States, availed themselves of Article 95, which allows states to declare, upon ratification, acceptance, approval, or accession to the CISG, that they will not be bound by Article 1(1)(b). *Id.* art. 95; Status of the United Nations Convention on Contracts for the International Sale of Goods, UNITED NATIONS TREATY COLLECTION, http://treaties.un.org/Pages/ViewDetails.aspx?src=UNTSOnline&tabid=2&mtdsg_no=X-10&chapter=10&lang=en (last visited Feb. 1, 2011).

3. See generally Alejandro M. Garro, *Reconciliation of Legal Traditions in the U.N. Convention on Contracts for the International Sale of Goods*, 23 INT’L LAW. 443 (1989).

4. See *id.* at 453 (“[T]he Convention reflects more a blending of the two legal traditions rather than the prevalence of one over the other.”).

5. See *id.* at 450 (recounting that the drafters of the CISG engaged in dynamic debates that ultimately led to compromises over the integration of concepts from different legal systems).

instances, the drafting nations failed to reach consensus resulting in gaps in the CISG that expressly exclude specific areas of law⁶ or amount to implicit delegation.⁷

The goal of this article is to analyze whether the most efficient rules were selected from among the civil and common law alternatives or whether other considerations resulted in the election of a non-efficient alternative. Selection of an inefficient CISG rule takes one of two forms—either (1) a compromise away from a more efficient national rule⁸ or (2) a bargaining impasse leading to the abdication of efficient selection.⁹ The Chicago School's normative goal of wealth maximization provides a useful benchmark with which to compare the efficiency of alternative contract law rules.¹⁰

6. See CISG, *supra* note 1, arts. 4-5 (stating that CISG is not concerned with property rights or products liability).

7. See *id.* arts. 28, 78 (delegating to the states issues such as specific performance (Article 28) and the process of selling rejected goods (Article 88)).

8. See, e.g., *infra* Part II.B.1 (discussing how the United States compromised away from a more efficient national rule when it agreed not to have a writing requirement in the CISG—so as to better mirror civil law rules and promote conformity, notwithstanding the fact that its Uniform Commercial Code (“U.C.C.”) contains such a requirement). By electing not to opt out of the no writing requirement, the United States created divergent rules for its legal systems—one for domestic sales and one for international sales. Whatever one's opinion of the efficiency of the statute of frauds, it is clear that applying different rules in similar situations is inefficient because it raises the level of uncertainty and increases transactions costs. See George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65, 67 (1977) (explaining that inefficient rules impose higher costs than efficient rules because they result in the inefficient assignment of liability and greater avoidance costs).

9. See Carlo H. Mastellone, *Sales-Related Issues Not Covered by the CISG: Assignment, Set-off, Statute of Limitations, Etc., Under Italian Law*, 5 VINDOBONA J. INT'L COM. L. & ARB. 143, 147 (2001) (identifying a variety of issues within the scope of sales law that are not covered by the CISG as identified by foreign and Italian courts). A bargaining impasse can lead to a less comprehensive code or convention. In such cases, relevant issues may be excluded due to non-agreement. See *infra* Part II.A. (discussing the inefficiency of non-selectivity, with particular reference to the enforceability of penalty clauses).

10. See RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 4 (7th ed. 2007) (defining efficiency in terms of wealth maximization). A rule that results in greater wealth maximization is more efficient than a rule that results in less wealth maximization. The wealth maximization principle asserts that distributional consequences should be irrelevant in the enforcement of contract rules since the key goal is an *overall* net gain in utility. See Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 544 (2003) (suggesting that contract law should encourage efforts of contracting parties to

To understand the efficiency implications of impasse, one needs to compare the wealth maximization implications of a centralized rule with the wealth implications of a decentralized and heterogeneous legal regime.

The analysis proceeds in four parts followed by a conclusion. Part I begins with a brief history of the CISG, identifying the choices involved in the drafting process. It then discusses the central tenets of the economic analysis of law (“EAL”). Part II uses these tenets to assess the efficiency of specific CISG rules, including rules addressing liquidated damages, evidentiary rules governing the statute of frauds, such as the use of parol evidence, and rules addressing contract interpretation and formation. Part III discusses the implications of these CISG choices for best business practices. Part IV assesses the value of comparative EAL as a means of understanding and critiquing legal reforms.

Taken collectively, the analysis illuminates the structure and choices incumbent in the CISG. It also illustrates the usefulness of EAL as a means of advancing comparative contract law. Over the last thirty years, EAL has emerged as a leading jurisprudential view, especially in the United States, that informs judicial decision-making, legal education, and scholarly analysis. The present analysis demonstrates its usefulness in a comparative law context.

I. CISG AND ECONOMIC ANALYSIS

A. DRAFTING THE CISG

The CISG reflects a culmination of a century old process of failed attempts to achieve an international sales law.¹¹ Given the differences in the legal systems involved—civil, socialist, and common law—the drafting process involved intense negotiation and compromise.¹² Compromise at times took the avenue of abdication. In areas such as

maximize “contractual surplus”).

11. See PETER HUBER & ALASTAIR MULLIS, *THE CISG: A NEW TEXTBOOK FOR STUDENTS AND PRACTITIONERS* 2-3 (2007) (explaining that the development of the CISG can be traced back to the creation of the International Institute for the Unification of Private Law (“UNIDROIT”) and the United Nations Commission on International Trade Law (“UNCITRAL”).

12. See generally JOHN O. HONNOLD, *DOCUMENTARY HISTORY OF THE UNIFORM LAW FOR INTERNATIONAL SALES* (1989).

specific performance,¹³ validity,¹⁴ and pre-contractual liability,¹⁵ the CISG designates national law as the source of relevant rules. In this way, the CISG is less comprehensive than it potentially could have been as some areas of coverage are left to the inefficiency of the private international law system that the CISG was attempting to replace. Notwithstanding this and other limitations, the CISG embodies a major advance in international law.

Generally speaking, one of the most important functions of any system of contract law is to offer to the parties a set of ready-made “default rules” that do not require bargaining.¹⁶ This function is undermined by a less comprehensive code, which does not offer the necessary mix of optimal defaults for the parties. Hence, in drafting the CISG, member states needed to agree on which default rules to embrace. Failure to agree threatened the overall efficiency of the system.¹⁷

The drafters of the CISG had to select a core methodology in order to build an international sales law. They employed both the “common core” and “better rule” approaches.¹⁸ The common core

13. See CISG, *supra* note 1, art. 28 (providing that “a court is not bound to enter a judgment for specific performance unless the court would do so under its own law”).

14. See *id.* art. 4(a) (stating that the CISG is “not concerned with . . . the validity of the contract or of any of its provisions”).

15. See *id.* art. 4 (noting that the CISG “governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer”).

16. See, e.g., Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 822-23 (1992) (acknowledging that default rules apply only if the parties’ agreement fails to provide a necessary term). This is the gap-filling function of contract law. Like the U.C.C., the CISG is largely made up of default rules. Stated in the alternative, parties are free to derogate from most of the rules supplied by the U.C.C. or CISG. There is a deep literature discussing the notion of default rules. See, e.g., *id.* at 825-26 (arguing that by failing to provide a necessary term, contracting parties are consenting to the default rules; therefore, default rules are not the product of regulation but rather consent and private autonomy); see also Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 MICH. L. REV. 489, 490 (1989) (examining default rules in the context of the philosophy of promising and the implications thereto).

17. See generally HONNOLD, *supra* note 12.

18. See Ole Lando, *The Common Core of European Private Law and the Principles of European Contract Law*, 21 HASTINGS INT’L & COMP. L. REV. 809, 809 (1998) (explaining that the “common core” approach is a comparative research method that is used to determine if there is a common core among differing legal

approach was used whenever the civil law and common law rules were essentially similar and there was little difference in national interpretations of those rules.¹⁹ The fact that the negotiators possessed expertise in both civil and common law framed the discussions. Given that background, the CISG reflects the common core of the major principles found in the civil and common law legal traditions. The common core approach is essentially a descriptive enterprise that provides a better understanding of the similar rules and principles found in most legal systems.²⁰

The better rule approach, by contrast, was needed whenever common law and civil law conflicted, or whenever national interpretations of facially similar rules varied.²¹ Implicit in this choice is the normative determination of whether alternative rules or interpretations are better. An extended analysis would ask whether fabrication of an alternative rule would prove even better in advancing the normative goals of an international sales law.

1. Types of Rules

Employing the common core and better rules approaches resulted in an interesting amalgam of common and civil law rules. The CISG consists of rules that can be characterized as: (1) rules consistent with both common and civil law legal traditions, (2) rules that recognize the superiority of a given common or civil law rule—at

systems); *see also* Mauro Bussani & Ugo Mattei, *The Common Core Approach to European Private Law*, 3 COLUM. J. EUR. L. 339, 347 (1998) (noting that the goal of the “common core” approach is “to provide with the highest degree of precision a map of the relevant elements of different legal systems”).

19. *See* Bussani & Mattei, *supra* note 18, at 340 (explaining that the purpose behind the common core approach is to unearth what European’s private law has in common with civil law, common law, and other western legal traditions).

20. *See id.* at 347 (“The fundamental characteristic of the common core research is that it analyzes the existing situation without trying in any way to force uniform solutions.”).

21. *See* Disa Sim, *The Scope and Application of Good Faith in the Vienna Convention on Contracts for the International Sale of Goods*, in *REVIEW OF THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS* 19, 63 (Michael Maggi ed., 2004) (citing M.J. BONELL, *AN INTERNATIONAL RESTATEMENT OF CONTRACT LAW: THE UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS* 65 (2d ed., 1997) (characterizing the better rule approach as having the purpose of adopting rules that are the most persuasive and well-suited for cross-border transactions, regardless of how many countries have adopted them for domestic use).

least for the sake of transborder transactions, (3) rules that are fabricated to be national system-neutral, (4) rules that abdicate to national law by expressly refusing to cover certain topics, and (5) rules that fit in one of the first three categories but are subject to modification by the CISG's preference for original or autonomous interpretation of its rules.²²

The first category of rules has the closest affinity to a common core approach. The evolution of similar rules in different legal traditions may suggest that these rules reflect the needs of commerce and are inherently efficient,²³ but this will not always be the case. There is no guarantee that the "common rules" found in both legal traditions are the "better rules." Common rules possess value, however, because they tend to provide stability and to avoid misunderstandings between contracting parties.

The second category of rules—the primary focus of the analysis in Part II—represents instances where there was a selection between opposing civil and common law rules. Consider, for example, the CISG's rejection of the United States Uniform Commercial Code's ("U.C.C.") perfect tender rule²⁴ in favor of a fundamental breach

22. See, e.g., CISG, *supra* note 1, art. 7(1) (stating that in interpreting the CISG "regard is to be had to its international character and to the need to promote uniformity in its application"). It has generally been argued that regard to those goals implies original or autonomous interpretation of its Articles—that is, an interpretation not framed by the national law of the court (homeward trend bias). See Frank Diedrich, *Maintaining Uniformity in International Uniform Law via Autonomous Interpretation: Software Contracts and the CISG*, 8 PACE INT'L L. REV. 303, 312 (1996) (defining "autonomous interpretation" as "a supranational synthesis combining single methods that form a new canon of interpretation"); see also LARRY A. DIMATTEO ET AL., *INTERNATIONAL SALES LAW: A CRITICAL ANALYSIS OF CISG JURISPRUDENCE* 6, 12 (2005) (urging that the "international character [of the CISG] calls for a non-domestic, autonomous interpretation . . . divorced from the idiosyncrasies of domestic jurisprudence"); Angela Maria Romito & Charles Sant 'Elia, Comment, *CISG: Italian Court and Homeward Trend*, 14 PACE INT'L L. REV. 179, 185-86 (2002) (providing an example of the tendency to interpret the CISG through the prism of national law instead of a newly developed international legal methodology).

23. See Priest, *supra* note 8, at 72 (observing how legal rules tend to become more efficient as time passes because "efficient rules 'survive' in an evolutionary sense because they are less likely to be relegated and thus less likely to be changed" while "inefficient rules 'perish' because they are more likely to be reviewed and review implies the chance of change").

24. See U.C.C. § 2-601 (1977) (allowing a buyer to reject the seller's goods if they "fail in any respect to conform to the contract").

rule.²⁵ Given the distribution system and readily available secondary markets in the United States, the U.C.C. provides a right to the buyer to reject non-conforming goods for any reason.²⁶ The reselling and reshipping of goods within domestic markets is manageable, and thus a pro-buyer rule is reasonable in such a context.²⁷ In contrast, this rule in the international context proves problematic. The higher costs of reselling or reshipping the goods are likely to lead to waste. Due to such costs and a lack of a readily available secondary market, the seller may simply elect not to retrieve the goods. In order to discourage such waste, the CISG limits the buyer's right to reject.²⁸ This reflects the more efficient choice because the buyer is in a better position to make use of or resell the nonconforming goods. The CISG protects the buyer by providing a price reduction remedy, not found in the common law, which allows the buyer to unilaterally reduce the contract price to reflect the diminishment of value caused by the nonconformity.²⁹ In the end, the seller avoids the costs of retrieving the goods and the buyer is made whole through a price reduction.³⁰

25. See CISG, *supra* note 1, arts. 25, 49 (permitting the buyer to avoid the contract if the seller commits a "fundamental breach," which is defined as a breach that detracts the buyer to the extent that it "substantially" deprives him of "what he is entitled to expect under the contract").

26. U.C.C. § 2-601(a) (1977).

27. Cf. David Charny, *Nonlegal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 373, 375 (1990) (urging that non-contract sanctions such as relationship-destroying and reputational costs likely curtail the use of the rule as a bad faith means to terminate a contract). See generally Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963). This does not however solve the moral hazard problem where the buyer uses the perfect tender rule in order to avoid the contract in a market with falling prices. The solution is the seller negotiating a modification to the rule in the contract. See William H. Lawrence, *The Revision of Article 2 of the Uniform Commercial Code: Appropriate Standards of a Buyer's Refusal to Keep Goods Tendered by a Seller*, 35 WM. & MARY L. REV. 1635, 1650-51 (1994) (indicating further the possibility to counter this potential problem by adding a requirement of good faith on the part of the buyer).

28. See CISG, *supra* note 1, arts. 25, 49 (requiring the breach to be "fundamental"—or that the buyer is substantially deprived of contract expectations).

29. See *id.* art. 50 (permitting a reduction to contract price at time of delivery regardless of whether the contract price was already paid to the seller).

30. The buyer is also able to collect any other damages that it incurred due to the delivery of nonconforming goods. See, e.g., *Delchi Carter, SpA v. Rotorex Corp.*, No. 88-CV-1078, 1994 WL 495787, at *5 (N.D.N.Y. Sept. 9, 1994)

Despite the general similarities of the sales law of the representative countries, there remained a significant number of differences in which a choice between civil and common law had to be made. Examples include: (1) the adoption of the civil law's receipt rule³¹ for the effectiveness of acceptances over the common law's dispatch or mailbox rule;³² (2) the selection of the civil law's material breach rule for rejection or avoidance of contracts over the American U.C.C.'s perfect tender rule;³³ (3) the selection of the civil law's enforcement of purely oral sales agreements over the U.C.C.'s statute of frauds;³⁴ and (4) the rejection of the common law's parol evidence rule in favor of the free admissibility of extrinsic evidence.³⁵

The third category of rules recognizes that the CISG drafters, in rare instances, fabricated new rules instead of adopting existing (common or competing) national rules. Unfortunately, from an efficiency perspective this does not always result in the adoption of better rules. For example, the no-writing/writing hybrid rule embodied by Articles 11 and 12³⁶ was an inefficient political compromise resulting from an attempt to incorporate opposing rules into a unified law.³⁷

(awarding the buyer compensatory damages for the buyer's attempts to remedy the nonconformity of seller's goods because the damages were foreseeable as a result of the seller's breach).

31. See CISG, *supra* note 1, art. 18 ("An acceptance of an offer becomes effective at the moment the indication of assent reaches the offeror.").

32. See U.C.C. § 2-206 (1977) (inviting acceptance of an offer by "any manner and by any [reasonable] medium"); see also *infra* Part II.D.1 (discussing the mailbox rule).

33. See *supra* notes 24-26 and accompanying text.

34. See *infra* Part II.B.1 (discussing the writing requirement). Compare U.C.C. § 2-201 (imposing a writing requirement), with CISG, *supra* note 1, art. 11 ("A contract of sale need not be concluded in or evidenced by writing . . .").

35. See *infra* Part III.B.2 (discussing the parol evidence rule). Compare U.C.C. § 2-202 (1977) ("Terms . . . set forth in a writing intended by the parties as a final expression of their agreement . . . may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement . . ."), with CISG, *supra* note 1, art. 8 (casting a wide net for all evidence relevant to the interpretation of contract terms—including prior conduct and negotiation history).

36. See CISG, *supra* note 1, arts. 11-12 (indicating that contracts for sale need not be in writing per Article 11, unless one of the parties resides in a Contracting State which has made an Article 96 declaration under the CISG per Article 12).

37. See *infra* Part II.B.1 (commenting on the inherent inefficiency of such a system).

The fourth category involves nonselective inefficiency—or the failure to provide any rules or coverage. There are numerous places where the CISG fails to provide rules in areas that a more comprehensive international code would cover. For example, the negotiating parties failed to agree on a legal regime in areas such as product liability and specific performance.³⁸ Hence, the CISG is less comprehensive than it could be and, as a consequence, is less efficient than it should be since it fails to harmonize international sales law in these (and other) areas.³⁹ Generally, rules from different legal systems competed for recognition, and in most cases one of the competitors was selected.⁴⁰ Where the negotiators were unable to agree on the better rule, compromise often resulted in abdication or removal of coverage.⁴¹

The fifth and final category of rules involves issues of interpretation. These rules reflect the temporal nature of fixed rules. The evolution of rule application and adjustment, obtained by studying the resulting jurisprudence, has led to a voluminous CISG

38. See CISG, *supra* note 1, arts. 5, 28 (expressly excluding coverage over products liability for personal injury and implicitly delegating the issue of specific performance to states).

39. See Sim, *supra* note 21, at 61 (reasoning that due to a lack of coherence in the CISG's good faith concept and no explanation of the concept's meaning given by any delegate of the convention, the predictability and efficiency of good faith in international sales will be undermined as domestic decision makers interpret the concept in varying ways).

40. See Avery W. Katz, *Remedies for Breach of Contract under the CISG*, 25 INT. REV. L. ECON. 378, 378, 384 (2006) (offering examples where the drafters preferred one legal tradition over another, such as the CISG's selection of the civil law's specific relief rules rather the common law's preference for monetary damages). Selections like this are sometimes obscured by the CISG's usage of terms not readily found in any national legal system. This phenomenon ostensibly advances the notion of neutrality and encourages autonomous interpretation of the rules. Thus, words like "avoidance," "fundamental breach," and "non-conformity" are utilized instead of the common law's "rejection," "material breach," and "defect." CISG, *supra* note 1, arts. 25, 35, 81; see Vikki M. Rogers & Albert H. Kritzer, *A Uniform International Sales Law Terminology*, in Festschrift für Peter Schlechtriem zum 70. Geburtstag 223, 237 (Ingeborg Schwenzer & Günter Hager eds., 2003), available at <http://cisgw3.law.pace.edu/cisg/biblio/rogers2.html> (stating that in legal research using domestic terminology, such as "rescission of the contract," a lawyer would not find CISG cases that typically use the phrase "avoidance of the contract").

41. See, e.g., CISG, *supra* note 1, art. 4 (declaring that the CISG is concerned with the formation of contracts rather than the validity of contracts).

literature.⁴² The important point here is that even where the drafters chose between competing national rules, the CISG expressly rejects the use of any corresponding national jurisprudence⁴³ and instead espouses original interpretation of its rules.⁴⁴ CISG interpretive methodology requires the interpretation of CISG rules based upon the general principles underlying the CISG, not by concepts found in a domestic legal system.⁴⁵ This approach aims to foster a “better jurisprudence” in the future interpretation of CISG rules. The judicial or arbitral interpreter is mandated to interpret CISG rules with regard to the CISG’s “international character and to the need to promote uniformity in its application.”⁴⁶ This requires the search for original interpretations⁴⁷ and rejects “homeward trend” bias⁴⁸ in which national rules and jurisprudence are used to fill in interpretive gaps. The fact that the drafters often selected national, system-neutral terminology—such as avoidance, non-conformity, and fundamental breach—indicates their desire for the development of original, uniform, and more efficient interpretations of CISG rules.⁴⁹

42. See *Bibliography*, PACE L. SCH. INST. INT’L COM. L., <http://www.cisg.law.pace.edu/cisg/biblio/biblio.html> (last visited Feb. 1, 2010) (containing a bibliography with 9,069 citations to works on the CISG).

43. See CISG, *supra* note 1, art. 7 (“In the interpretation of this Convention, regard is to be had to its international character”); Franco Ferrari, *Uniform Interpretation of the 1980 Uniform Sales Law*, 24 GA. J. INT’L & COMP. L. 183, 200-01 (1994) (urging that an interpreter of the CISG “should not read the Convention through the lenses of domestic law, but should project the interpretive problems against an international background”).

44. See Ferrari, *supra* note 43, at 198-201 (describing the interpretation of the CISG as independent and not reliant on any specific legal system).

45. See CISG, *supra* note 1, art. 7(1).

46. *Id.*

47. See, e.g., Franco Ferrari, *Gap-Filling and Interpretation of the CISG: Overview of International Case Law*, 7 VINDOBONA J. INT’L COM. L. & ARB. 63, 65 (2003) (indicating that CISG should be interpreted autonomously even though once it is in full force, it is integrated into domestic law).

48. See, e.g., Timoth N. Tuggey, Note, *The 1980 United Nations Convention on the International Sale of Goods: Will a Homeward Trend Emerge?*, 21 TEX. INT’L L.J. 540, 554 (1986) (warning that a homeward trend bias would undermine the goal of the CISG to promote uniformity).

49. See U.N. Comm. on Int’l Trade Law [UNCITRAL], *Introduction to the Digest of Case Law on the United Nations Sales Convention*, Note by the Secretariat, ¶ 4, U.N. Doc. A/CN.9/562 (June 9, 2004) (“The drafters of the Convention took special care in avoiding the use of legal concepts typical of a given legal tradition, concepts often accompanied by a wealth of well-established case law and related literature that would not be easy to transplant in different legal

2. Summary

The drafters of the CISG faced a number of dilemmas in negotiating a convention to supersede the legal rules of both civil and common law countries. The first was selecting among inherently conflictive rules. Examples include the writing requirement (statute of frauds) and the parol evidence rule. Generally, these two doctrines are prominent in common law systems⁵⁰ but not as pervasive or formalized in civil law countries.⁵¹ Other examples include the perfect tender rule found in the U.C.C. versus the fundamental or material breach rule in the civil law,⁵² and the civil law's receipt rule versus the common law's dispatch rule in the area of effectiveness of acceptance.⁵³

The second dilemma when drafting the CISG was whether to incorporate or ignore legal concepts that exist in one system but are foreign to the other system. Examples of incorporation include the adoption of the price reduction remedy⁵⁴ and *Nachfrist* notice,⁵⁵ both

cultures.”); C.M BIANCA & M.J. BONELL, COMMENTARY ON THE INTERNATIONAL SALES LAW: THE 1980 VIENNA SALES CONVENTION 74 (1987) (“When drafting the single provisions these experts had to find sufficiently neutral language on which they could reach a common understanding.”).

50. See, e.g., Louis F. Del Duca, *Implementation of Contract Formation Statute of Frauds, Parol Evidence, and Battle of Forms CISG Provisions in Common Law Countries*, 25 J.L. & COM. 133, 134 (2005) (making the point that Article 11 of the CISG was initially misapplied in the United States, a common law country, because the U.S. has a statute of fraud provision for the sale of goods); see also *id.* at 142-43 (discussing MCC-Marble Ceramic Ctr., Inc. v. Ceramica Nuova D'Agostino, S.P.A., 144 F.3d 1384, 1392-93 (11th Cir. 1998), where the court held that the U.S. parol evidence rule did not apply in cases implicating the CISG).

51. Cf. Joshua D. H. Karton & Lorraine de Germiny, *Has the CSIG Advisory Council Come of Age?*, 27 BERKELEY J. INT'L L. 448, 470 (“Civil law has no rules analogous to these doctrines . . .”).

52. See Jürgen Basedow, *Towards a Universal Doctrine of Breach of Contract: The Impact of the CISG*, 25 INT'L REV. L. & ECON. 487, 493 (2005) (concluding that the concept of breach as found in CISG Article 46 is indicative of the common law but also “introduces a new category of non-conformity into civil law jurisdictions”).

53. See, e.g., Marwan Al Ibrahim, Ala'eldin Ababneh & Hisham Tahat, *The Postal Acceptance Rule in the Digital Age*, 2 J. INT'L COM. L. & TECH. 47, 47 (2007) (explaining the common law's dispatch or mail box rule as constituting acceptance upon mailing or posting).

54. CISG, *supra* note 1, art. 50; see Eric E. Bergsten & Anthony J. Miller, *The Remedy of Reduction of Price*, 27 AM. J. COMP. L. 255, 255, 265, 271 (1979) (detailing the drafting history of the price reduction remedy and evaluating its

of which are foreign to common law systems. A vague and potentially crippling abdication of coverage is found in the deference of Article 4 to national law on issues pertaining to validity. This abdication was largely due to countries' desire to protect the operation of their consumer protection laws.⁵⁶ Unfortunately, the CISG fails to provide a definition of "validity," which may allow Article 4 to be used to invalidate contract terms intended to be covered by the CISG. The use of Article 4 to adopt nation-specific rules undermines the CISG's unifying goal and diminishes its overall efficiency.⁵⁷

B. ECONOMIC ANALYSIS OF CONTRACT LAW

The EAL movement in the United States traces its modern roots to the 1960s,⁵⁸ but the milestone event is the 1973 publication of Judge

implications).

55. CISG, *supra* note 1, arts. 47, 48, 63; see Ericson P. Kimbel, *Nachfrist Notice and Avoidance under the CISG*, 18 J.L. & COM. 301, 302, 305-07 (1999) (explaining that *Nachfrist* notice "is the Convention's only route to avoidance without an initial fundamental breach" as it provides a notice procedure through which, upon a failed delivery, the buyer gives notice to the seller that he has a reasonable time period to fully perform and upon expiration of such time, if the seller has not performed, then the buyer may declare avoidance per CISG Article 26).

56. See PETER SCHLECHTRIEM, *UNIFORM SALES LAW: THE UN-CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS* 32 (1986) ("Economic regulations such as export or import controls or consumer-protection laws which prohibit certain formulations may void contracts falling under the Convention").

57. See 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, 4-5 (1993) (asserting that the CISG's abdication in this area "raises difficult questions, such as how a tribunal is to ascertain which issues are validity issues and to what extent applying non-uniform domestic rules of validity . . . seriously handicaps the CISG's potential for achieving its goals").

58. See generally Ronald H. Coase, *Law and Economics at Chicago*, 36 J.L. & ECON. 239 (1993) (discussing the origins of EAL at the University of Chicago); Daniel A. Farber, *Economic Efficiency and the Ex Ante Perspective*, in *THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW* 54, 56-64 (Jody S. Kraus & Steven D. Walt eds., 2000) (discussing the intellectual history of the debate on law and economics). Three influential works in the area of EAL are Becker on crimes and punishment, Calabresi on torts, and Coase on property. See generally Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968); Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499 (1961); Ronald H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960).

Richard Posner's *Economic Analysis of Law*.⁵⁹ Posner's approach is part of the Chicago School of EAL, asserting that common law rules evolve efficiently.⁶⁰ The idea of EAL also developed in Europe and led to the establishment of the European Association of Law and Economics ("EALE").⁶¹

EAL scholarship developed into a major school of legal thought in American law schools,⁶² despite the reluctant reception and outright opposition of the late seventies and early eighties.⁶³ Additionally, EAL is now a major force in American legal theory and exerts a dominant influence on contract law in particular.⁶⁴ Today, it is very difficult to find an American contract law monograph or law review article not discussing EAL arguments.⁶⁵ EAL scholars have produced

59. See POSNER, *supra* note 10. Posner's 1973 text entered its seventh edition in 2007.

60. See ANTHONY T. KRONMAN & RICHARD A. POSNER, *THE ECONOMICS OF CONTRACT LAW* 6 (1979) (indicating that inefficient rules "will be progressively ignored and eventually forgotten" over time while the efficient rules remain); Priest, *supra* note 8, at 65 (urging that the "tendency toward efficiency is a characteristic of the common law process"); Paul H. Rubin, *Why is the Common Law Efficient?*, 6 J. LEGAL STUD. 51, 51 (1977) (discussing Posner's persuasive argument regarding the relationship between the common law and economic efficiency).

61. See, e.g., Roberto Pardolesi & Giuseppe Bellantuono, *Law and Economics in Italy*, FINDLAW.COM, 244, 245 (1999), <http://encyclo.findlaw.com/0345book.pdf> (asserting that EAL can be traced in Europe back to the 1961 work of Pietro Trimarchi on strict liability, written around the same time Coase and Calabresi were writing their respective articles). EALE "is the institutional response to the increasing importance of the economic analysis of law in Europe[.] EALE was founded in 1984 with the purpose of providing assistance to law and economics scholars and bringing their scholarship to a wider audience, including policy makers, legislators and judges." *Mission Statement*, EUR. ASS'N L. & ECON., <http://law.haifa.ac.il/eale/site/> (last visited Feb. 1, 2011).

62. See Symposium, *The Place of Economics in Legal Education*, 33 J. LEGAL ED. 183 (1983) (documenting the early influence of Chicago-style EAL in U.S. law schools).

63. See generally Richard A. Posner, *A Reply to Some Recent Criticisms of the Efficiency Theory of the Common Law*, 9 HOFSTRA L. REV. 775 (1981); Daniel T. Ostas, *Postmodern Economic Analysis of Law: Extending the Pragmatic Visions of Richard A. Posner*, 36 AM. BUS. L.J. 193 (1998).

64. See Ronald J. Scalise Jr., *Why No "Efficient Breach" in the Civil Law?: A Comparative Assessment of the Doctrine of Efficient Breach of Contract*, 55 AM. J. COMP. L. 721, 722 ("Law and economics scholarship dominates much of the work in antitrust, contracts, and torts, just to name a few areas.")

65. See Eric A. Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 829 (2003) ("[M]any scholars

a depth of literature analyzing EAL in contract law areas such as breach, remedies, impossibility, and commercial impracticability.⁶⁶

On the other hand, EAL historically was not a major theoretical force in Europe, but recently has become more widely studied in European and comparative law literature.⁶⁷ Some of the conclusions of EAL theory were more readily accepted while others failed to gain widespread acceptance. For example, the theory of efficient breach⁶⁸—broadly embraced by EAL scholars in the United States—was largely rejected in Europe.⁶⁹ Professor Mattei offers an explanation for this:

On policy grounds, moreover, it is not clear that efficient breaches should be encouraged by a legal system, since in the long run the certainty of property rights may be undermined. This is the reason why most legal systems of the civil law tradition tend to resist efficient breaches (at least in theory), and why they have traditionally assigned a more central role to specific performance than has common law.⁷⁰

would agree [that EAL] has become the dominant academic style of contract theory.”).

66. For a survey of EAL for contract law, see generally *ENCYCLOPEDIA OF LAW AND ECONOMICS* (Boudewijn Bouckaert & Gerrit De Gees eds., 2000); *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* (Peter Newman ed., 1998).

67. See, e.g., Viktor Winkler, *Some Realism About Rationalism: Economic Analysis of Law in Germany*, 6 *GERM. L. J.* 1033, 1033-34 (2005) (discussing the publication in Germany of American EAL classics, which introduced German legal scholars to the EAL debate). For a review of the uneven reception of EAL in Europe and elsewhere in the late 1980s, see generally Christian Kirchner, *The Difficult Reception of Law and Economics in Germany*, 11 *INT’L REV. L. & ECON.* 277 (1991); Lionel Montagné, *Law and Economics in France*, in *ENCYCLOPEDIA OF LAW AND ECONOMICS*, *supra* note 66, at 150; Shozo Ota, *Law and Economics in Japan: Hatching Stage*, 11 *INT’L REV. L. & ECON.* 301 (1991); Santos Pastor, *Law and Economics in Spain*, 11 *INT’L REV. L. & ECON.* 309 (1991).

68. See Posner, *supra* note 65, at 834-36 (discussing the evolution of academic writings regarding efficient breach—the notion that sometimes breach of contract is the most efficient result). This article returns to the issue of remedies, *infra* Part II.A (addressing liquidated damages).

69. See Scalise, *supra* note 64, at 723 (“Encouraging breach of contract is immoral, and civilian contract theory, which is pervaded with a concept of good faith, properly refuses to recognize efficient breach.”). Efficient breach theory has also been criticized in the United States. See generally Daniel Friedmann, *The Efficient Breach Fallacy*, 18 *J. LEGAL STUD.* 1 (1989); Ian R. Macneil, *Efficient Breach of Contract: Circles in the Sky*, 68 *VA. L. REV.* 947 (1982).

70. Ugo Mattei, *The Comparative Law and Economics of Penalty Clauses in*

This view of efficient breach is consistent with those offered by the critics of EAL in the United States.⁷¹ Thus, European rejection of the efficient breach theory is not itself evidence that economic reasoning plays no role in civil law. Rather, the rejection suggests that in civil law systems the comparative efficiency of specific performance as an ordinary remedy—or any other contract rule for that matter—can be assessed only on a rule by rule basis.⁷²

Notwithstanding objections from abroad, EAL provides a means of both understanding and critiquing the structure and content of the CISG. In comparing alternative academic theories of contract law, Eric Posner concludes that “[o]nly economic analysis seems to be on solid footing.”⁷³ He recognizes the highly nuanced nature of EAL theory and the difficulty of empirically testing many of its assertions, but he nonetheless finds value in its approach. He writes, “[e]ven if economic analysis cannot determine the magnitude of [economic] costs and benefits, and the extent to which they offset or interact with each other, the judge who knows about them is more likely to make a wise decision than a judge who does not.”⁷⁴

This article organizes the economic logic of contract law with reference to three central tenets of EAL: deferring to individual autonomy, reducing transactions costs, and providing stability in transactions. Although alternate schemes are possible, these tenets provide a means of keeping the discussion tractable. Taken collectively, they provide a basis for the comparative EAL analysis of the CISG that follows.

Contracts, 43 AM. J. COMP. L. 427, 429 (1995). Mattei further notes that the insertion of penalty clauses and the shifting of risk increases the contract price and does not discourage efficient breach. *Id.*

71. The normative argument against the theory is that breaches (efficient or not) should not be aided by contract law given the moral basis of promise-keeping. See generally CHARLES FRIED, *CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION* (1981).

72. See, e.g., Macneil, *supra* note 69, at 953 (analyzing the legitimacy of the simple-efficient-breach conclusion that the specific performance rule is inefficient).

73. See Posner, *supra* note 65, at 829-30 (comparing EAL with theories of contract based on doctrine, philosophy, and cognitive psychology).

74. *Id.* at 854-55.

1. *Deferring to Individual Autonomy*

Economic reasoning begins with the proposition that individuals are in a better position to understand what is in their own best interests than courts or governments.⁷⁵ Individual preferences are highly idiosyncratic and, presumably, individuals do not agree to an exchange unless they feel that the agreement will advance their own interests.⁷⁶ Based on this assumption, a voluntary exchange, duly consummated, puts both parties in a better situation.⁷⁷ This pareto-superior perspective of private exchange has been the primary tenet of economic theory since Adam Smith.⁷⁸ For Smith, the relative wealth of nations depends on their degree of specialization.⁷⁹ Specialization, in turn, depends on the establishment of free markets. An efficient market facilitates private exchange, enables specialization, and promotes economic growth.⁸⁰

75. See Jeffrey L. Harrison, *Egoism, Altruism, And Market Illusions: The Limits Of Law And Economics*, 33 UCLA L. REV. 1309, 1309-10 (1986) (citing Norman Frolich et al., *Beyond Economic Man: Altruism, Egalitarianism and Difference Maximizing*, 28 J. CONFLICT RESOL. 3 (1984)) (describing EAL's foundational tenet that "man is a 'rational maximizer of self-interest'"). The view of individual autonomy that motivates EAL is far from obvious. Many cognitive scientists and postmodern philosophers insist that human preferences cannot be separated from a cultural context. In other words, culture precedes the individual. See generally JEFFREY REIMAN, *JUSTICE AND MODERN MORAL PHILOSOPHY* (1990) (identifying the notion of autonomy with a "radical theory" of human agency). Like neoclassical economics generally, EAL asserts the primacy of the individual. See Anthony Ogus, *What Legal Scholars Can Learn from Law and Economics*, 79 CHI.-KENT L. REV. 383, 400 (2004) (discussing how EAL rests on the basic assumption of individual autonomy).

76. See GARY S. BECKER, *ACCOUNTING FOR TASTES* 3-4 (1996) (defining "individual preferences" broadly so as to include habits, addictions, and even the influence of parents, peers, and advertising).

77. See JAMES M. BUCHANAN, *ECONOMICS: BETWEEN PREDICTIVE SCIENCE AND MORAL PHILOSOPHY* 26-29 (1987) (asserting that the potential for gains from trade provides virtually the only lesson of economic theory).

78. See JOSEPH SCHUMPETER, *HISTORY OF ECONOMIC ANALYSIS* 187 (7th ed. 1968) (noting that for Adam Smith, specialization fostered by the gains of trade was practically the sole determinant of economic progress).

79. See *id.* at 187 (describing Adam Smith's belief that division of labor alone "accounts 'for the superior affluence and abundance commonly possessed even by [the] lowest and most despised member of Civilized society'"). See generally ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* (Edwin Cannan ed., Univ. Chi. Press 1976) (1776) (providing the seminal statement of classical economics).

80. See generally SMITH, *supra* note 79 (addressing the relationship between

The private laws of property, tort, and contract provide the legal foundations of market transactions.⁸¹ Property law identifies alienable entitlements; tort law protects such entitlements; and contract law enables the exchange of those entitlements. Due deference to individual autonomy not only respects the rights of individuals but also promotes economic ends.⁸² In contract law, this translates to a regime of free contracting.

No one has been more articulate in explaining the economics of free contracting than the Austrian economist, Friedrich Hayek.⁸³ To Hayek, markets provide a means of coping with the dispersal of information in society.⁸⁴ Market actors carry idiosyncratic knowledge as to how resources can best be used in society. Much of this knowledge is difficult, if not impossible, to communicate. Hayek saw two alternatives: central planning and free markets.⁸⁵ He concluded that central planning does not work. The government simply does not hold sufficient information to direct the workings of a modern economy.⁸⁶

Free markets, according to Hayek, provide a means of addressing information problems.⁸⁷ Two contract principles underscore free markets—freedom *to* contract and freedom *from* contract.⁸⁸ Freedom to contract means that individuals should be allowed to exchange

efficient markets, division of labor, and economic growth).

81. See generally JOHN R. COMMONS, *LEGAL FOUNDATIONS OF CAPITALISM* (1924).

82. See Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293, 293-95 (1975) (distinguishing between libertarian and utilitarian justifications for the principle of deferring to individual autonomy).

83. See generally FRIEDRICH A. HAYEK, *INDIVIDUALISM AND ECONOMIC ORDER* 107-18 (1948) (articulating the seminal argument in defense of decentralized markets).

84. See Friedrich A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519, 519-20 (1945) (lamenting that the issue with rational economic order is that knowledge "never exists in concentrated or integrated form").

85. See *id.* at 520-21 (commenting that free markets still involve planning, but that it is here divided among individuals).

86. See *id.* at 524 (urging that "communicating all . . . knowledge to a central board which, after integrating all knowledge, issues its orders" is not effective).

87. See *id.* (indicating that decentralization of economic order ensures that the information will be timely used).

88. See generally Richard E. Speidel, *The New Spirit of Contract*, 2 J.L. & COM. 193 (1982).

their entitlements free from government restrictions.⁸⁹ Freedom from contract means that the government should not force individuals to transfer entitlements without their consent.⁹⁰ By insisting that each party secure the consent of the other, a regime of free contracting enables each party to signal their idiosyncratic preferences and communicate private information. Free contracting enables meaningful prices to emerge, which in turn can direct the workings of a decentralized economy.

In short, the first economic tenet provides a presumption against governmental intervention into the substance of private agreements. Both forced transfers (required contract terms) and prohibited transfers (contract terms that are prohibited by public policy) frustrate the price system and erode efficiency.⁹¹ Alternatively stated, contract terms that reflect the subjective agreement of the parties should be readily and strictly enforced.

2. *Reducing Transaction Costs*

Whereas deference to private autonomy provides an overarching goal, tone, and orientation to EAL, the second tenet, reducing transactions costs, provides the details. Market activities are promoted by providing contract rules that reduce the costs of private exchanges, including the costs of negotiation, performance, and enforcement.⁹² In a seminal work articulating the economic logic of contract law, Richard Posner and Anthony Kronman identify three ways contract law can reduce transaction costs: (1) by providing a remedy for breach, contract law encourages performance of mutually agreed upon terms; (2) by offering standard terms, the law reduces the need to negotiate; and (3) by punishing fraud and other

89. *Id.* at 195.

90. *Id.* at 196.

91. *See id.* at 195-96 (implying that the classical contract system, which, among other things, requires mutual assent and promotes economic efficiency, is the key to economic growth).

92. *See* David K. Lutz, *The Law and Economics of Securities Fraud: Section 29(A) and the Non-Reliance Clause*, 29 CHI.-KENT L. REV. 803, 818-19 (2004) (suggesting that efficient rules would not only assist parties in codifying the appropriate rights and obligations in a contract but also help predict the interpretation of such terms, particularly in light of the fact that the conflicting economic interests of contracting parties often encourage them to leave gaps in the contract's scope).

improprieties during contract negotiations, the law deters misleading conduct.⁹³

The first economic function of contract law is to determine which transfers will be enforced and which will not. Deference to autonomy suggests that the court should enforce every transfer subjectively agreed to by the affected parties and withhold enforcement of any transfer not subjectively understood.⁹⁴ As a practical matter, however, it is difficult to resolve or prove subjective claims of intent. Hence, courts must look for objective manifestations as a surrogate for subjective intent.⁹⁵

Most contract rules address this evidentiary function. For example, rules that require specificity in contracts, require a writing, demand conformity with offer and acceptance rules, or inquire into the presence of fraud all provide objective evidence of subjective intent. The inevitable slippage—the divergence between subjective and objective intent produced by the fact that objective evidence is second best or indirect evidence of subjective intent—in these evidentiary surrogates results in both over-enforcement and under-enforcement of contractual language.⁹⁶ Over-enforcement occurs when courts enforce transfers not reflective of any subjective agreement. Under-enforcement results when courts refuse to enforce agreements *ex post* that were subjectively understood *ex ante*. The second tenet of EAL suggests that rules should minimize the sum of over-enforcement and under-enforcement costs.⁹⁷

93. KRONMAN & POSNER, *supra* note 60, at 4-5.

94. *But cf. id.* at 5 (indicating, however, that enforcement of a contract even when the terms may not be agreed upon by both parties discourages carelessness in the contractual process).

95. See Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 272 (1986) (“It has long been recognized that a system of contractual enforcement would be unworkable if it adhered to a will theory requiring a subjective inquiry into the putative promisor’s intent.”). See generally LARRY A. DiMATTEO, *CONTRACT THEORY: THE EVOLUTION OF CONTRACTUAL INTENT* (1998) (providing an historical analysis of the evolution and fabrication of the reasonable person standard).

96. See generally Larry A. DiMatteo, *The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment*, 48 S.C. L. REV. 293 (1997) (examining the divergence of the objective theory of contract and the subjectivity involved in its application).

97. See KRONMAN & POSNER, *supra* note 60, at 5 (observing that “only a contract that involves a meeting of the minds satisfies an economist’s definition of

Contract rules also reduce transaction costs by providing default terms that help fill the gaps in contractual language. It is not cost effective, or even possible, for parties to account for all contractual contingencies *ex ante*. Contractual activity, like life, is simply too complex and multifaceted. Contract law responds with standard terms.⁹⁸ EAL suggests that these terms should reflect customary expectations so as to facilitate subjective agreement.⁹⁹ Difficulties arise when the parties do not share similar customs. In such situations, EAL supports a preference for industry customs, so as to provide an incentive for all parties to learn the language and usages of the particular trade.¹⁰⁰

EAL also generates insights into the substantive content of default terms. Most contract or default terms allocate risk between the contracting parties. Both parties benefit if these costs are allocated to the party who can best absorb them at a lower cost.¹⁰¹ Such an allocation generates an exchange surplus that the parties can divide. EAL suggests that default rules reflect this cost reduction logic.¹⁰² For example, an implied warranty of merchantability assigns the risk of a faulty product to the merchant seller, the party best able to take precautions and to insure against non-conforming products. Similarly, liability for damage to goods in shipment typically rests with the common carrier, the party best able to take efficient precautions and insure against loss.

Finally, contract law reduces transaction costs by deterring fraud and other negotiation improprieties. To this end, the law must

a value-maximizing exchange”). Kronman and Posner note, however, that EAL allows for “rules designed to prevent people from misleading others into thinking that they have a contract with them; hence both the subjective and objective theories have a place in contract law.” *Id.*

98. See Barnett, *supra* note 16, at 823-25 (providing analysis of the gap filling function of contract law, which reads into a contract default terms where the contract is otherwise silent).

99. Ostas, *supra* note 63, at 232.

100. *Id.*

101. See Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83, 89 (1977) (characterizing the economic efficiency of contracting in terms of maximizing of the aggregate value of an exchange).

102. See Ostas, *supra* note 63, at 232 (stating that, in general, EAL looks to use the law to lessen transaction costs).

balance two forms of welfare-diminishing opportunism.¹⁰³ On one hand, one party could mislead the other into agreeing to a transfer the latter party did not fully understand. On the other hand, the party asserting the fraud may be trying to avoid a bad bargain. Both types of opportunism generate costs. An efficient contract law system minimizes the sum of these costs. Such calculations inform the laws of fraud, misrepresentation, undue influence, duress, mutual mistake, and unconscionability.¹⁰⁴

In sum, the logic of cost reduction provides a powerful heuristic. Although the logic can be complex and multi-faceted, EAL benefits from sharpness of focus. Virtually every contract rule impacts transaction costs, thus providing a useful benchmark for comparative efficiency analysis.

3. *Providing Stability*

For contract rules to accomplish desired instrumental effects, the content of the rules needs to be effectively communicated to the affected parties. EAL “views law as an incentive structure” that directs business conduct.¹⁰⁵ The importance of predictability and stability in the law is particularly important in the international context of the CISG. Transacting parties need to be alerted to gaps in the CISG and to interpretations developed by CISG tribunals.

The third tenet of EAL emphasizes the need for legal predictability and stability in international transactions. In a number of areas, the CISG failed to select a stable rule simply by not covering certain areas of contract law within its jurisdictional scope.¹⁰⁶ One area of non-selective inefficiency is the duty to negotiate in good faith. The duty of good faith in pre-contractual negotiations is unknown to the common law.¹⁰⁷ One efficiency argument in favor of the duty of good

103. Daniel T. Ostas, *Predicting Unconscionability Decisions: An Economic Model and an Empirical Test*, 29 AM. BUS. L.J. 535, 551-52 (1992).

104. *See id.* (charting the factors and implications in evaluating the negotiation process of contracts).

105. Ostas, *supra* note 63, at 213.

106. *See* Carlo H. Mastellone, *Sales-Related Issues Not Covered by the CISG: Assignment, Set-off, Statute of Limitations, Etc., Under Italian Law*, 5 VINDOBONA J. INT'L COM. L. & ARB. 143, 147-52 (2001) (presenting an aggregate analysis based on Italian, German, Argentine, and other states parties' case law).

107. *See* Duncan Kennedy, *From the Will Theory to the Principle of Private Autonomy: Lon Fuller's "Consideration and Form"*, 100 COLUM. L. REV. 94, 143-

faith in negotiation is that the ability to negotiate in bad faith creates incentives for opportunism and moral hazard as well as results in adverse selection effects. Additionally, the increase in transaction costs leads to a suboptimal number of concluded contracts. However, the CISG does not recognize such a requirement even though it adopts the duty of good faith in the interpretation of CISG rules.¹⁰⁸

The fact that the CISG contains numerous gaps in the scope of its coverage causes a number of problems. One commentator states, “[b]ecause uniform rules are lacking, similarly situated parties sometimes receive vastly different results; the disparities undermine the purpose of the CISG.”¹⁰⁹ The abdication of authority over areas clearly within the body of sales law makes the CISG less comprehensive and more inefficient than a law drafted with fewer intended gaps. That being said, this article is primarily focused on determining the relative efficiency of the rules found in the CISG. The relative or comparative efficiency analysis is accomplished by comparing the rule options available to the drafters with the rule that was actually incorporated into the CISG. The options available can be described as those provided by competing civil and common law rules, a compromised or modified version of one of those rules, or the creation of a new, system-neutral rule. Ultimately, the comparative efficiency analysis is based on whether the chosen rule

44 (2000) (indicating that the civil law’s good faith doctrine tends to bind parties to contracts in situations where the common law would not recognize an enforceable agreement). The civil law also assesses contractual damages for bad faith, allowing plaintiffs to recover reliance damages under the tort doctrine of *culpa en contrahendo*. *Id.* Even though the common law rejects a duty to negotiate in good faith, more and more courts have allowed the recovery of reliance damages when negotiations include a “preliminary agreement.” Professors Schwartz and Scott have argued that such recovery is economically efficient. They argue that preliminary agreements allow for “the realization of a socially efficient opportunity.” Alan Schwartz & Robert E. Scott, *Precontractual Liability and Preliminary Agreements*, 120 HARV. L. REV. 661, 662 (2007). Therefore, they conclude that “contract law should encourage relation-specific investments in preliminary agreements by awarding the promisee his verifiable reliance if the promisor has strategically delayed investment.” *Id.*

108. See CISG, *supra* note 1, art. 7 (providing that in the interpretation of the CISG, “regard is to be given to . . . the observance of good faith in international trade”).

109. John Y. Gotanda, *Using the UNIDROIT Principles to Fill Gaps in the CISG 2* (Villanova University School of Law, Public Law and Legal Theory Working Article No. 2007-18), available at <http://ssrn.com/abstract=1019277>.

provides a stable or predictable outcome when applied to similarly situated circumstances or fact patterns.

II. ASSESSING THE EFFICIENCY OF CISG RULES

EAL provides a powerful heuristic with which to assess the CISG. Part II of this article begins with an assessment of the CISG treatment of liquidated damages. The CISG failed to take a stand on liquidated damages—and the enforceability of penalties—leaving this issue to national legal systems.¹¹⁰ This is an example of non-selective inefficiency. Part II then turns to the evidentiary rules embodied in the statute of frauds and the parol evidence rule. In this area, the CISG chose to follow the civil law.¹¹¹ Part II concludes with a discussion of CISG rules pertaining to contract interpretation and contract formation—areas in which the CISG drafters tended to fabricate compromise positions.

A. LIQUIDATED DAMAGES

The voiding of all penalty clauses in the common law¹¹² produced a significant amount of EAL literature.¹¹³ Commentators are split

110. Katz, *supra* note 40, at 387.

111. See Peter L. Fitzgerald, *The International Contracting Practices Survey Project: An Empirical Study of the Value and Utility of the United Nations Convention on the International Sale of Goods (CISG) and the Unidroit Principles of International Commercial Contracts to Practitioners, Jurists, and Legal Academics in the United States*, 27 J.L. & COM. 1, 22 (2008) (indicating the CISG's lack of a writing requirement in Article 11 or a parol evidence rule in Article 8); Anthony J. McMahon, Note, *Differentiating Between Internal and External Gaps in the U.N. Convention on Contracts for the International Sale of Goods: A Proposed Method for Determining "Governed By" in the Context of Article 7(2)*, 44 COLUM. J. TRANSNAT'L L. 992, 1027 (2006) ("[T]he parol evidence rule and the statute of frauds, though well entrenched in many common law countries, do not exist and are likely not to be understood in civil law countries.").

112. See U.C.C. § 2-718 (1) (1977) ("A term fixing unreasonably large liquidated damages is void as a penalty."); see also RESTATEMENT (SECOND) OF CONTRACTS § 356(1) (1981) ("A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty.").

113. See, e.g., Aristides N. Hatzis, *Civil Contract Law and Economic Reasoning—An Unlikely Pair?*, in THE ARCHITECTURE OF EUROPEAN CODES AND CONTRACT LAW 181 (Stefan Grundmann & Martin Schauer eds., 2006) (arguing that the common law's lack of penalty clauses is inefficient); Aristides N. Hatzis, *Having the Cake and Eating It Too: Efficient Penalty Clauses in Common and Civil Contract Law*, 22 INT'L REV. L. & ECON. 381, 381-82 (2003) [hereinafter *Efficient Penalty Clauses*] (discussing the civil law versus common law with

between: (1) those who see the non-enforcement of penalty clauses as a facilitation of efficient breach and prevention of moral hazard problems, (2) those who argue that not enforcing such clauses undermines contracts as an allocation of risk mechanism, creates barriers to entry, and is antithetical to general economic theory,¹¹⁴ and (3) those who would like to see a bifurcation of the concept of penalties into efficient and inefficient penalties.¹¹⁵ The common law has long seen penalties as a coercive means of ensuring performance—either perform or be punished. Under this rationale, the penalty violates the principle of compensatory damages that underlay common law remedies.

The second approach noted above asserts that the common law needs to change and allow for the enforcement of penalties. This view argues that common law damages are under-compensatory, allowing the breaching party to obtain more than its fair share of the subsequent surplus.¹¹⁶ In addition, general economic theory holds that rational contracting parties will negotiate efficient contract terms. Therefore, the insertion of a penalty clause will likely be offset by a price adjustment. It also allows a contracting party to be more competitive by using the penalty clause as a signal of its reliability.¹¹⁷ Finally, the penalty clause assigns the risk of

respect to enforcement of penalty clauses); Larry A. DiMatteo, *A Theory of Efficient Penalty: Eliminating the Law of Liquidated Damages*, 38 AM. BUS. L.J. 633 (2001) (identifying possible issues regarding risk allocation stemming from a party's inability to negotiate for the inclusion of enforceable penalty clauses).

114. See, e.g., *Efficient Penalty Clauses*, *supra* note 113, at 392 (stating economists' critique of the common law penalty doctrine as inefficient because, among other things, it rejects allocation of risk by the parties and leads to inefficient breaches).

115. E.g., Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554 (1977); Andrew Ham, *The Rule Against Penalties in Contract: An Economic Perspective*, 17 MELB. U. L. REV. 649 (1990); Samuel A. Rea, Jr., *Efficiency Implications of Penalties and Liquidated Damages*, 13 J. LEGAL STUD. 147 (1984).

116. See Larry A. DiMatteo, *Penalties as Rational Response to Bargaining Irrationality*, 2006 MICH. ST. L. REV. 883, 909-10 (arguing that the common law of liquidated damages infringes on the freedom to contract and that penalty clauses merely reflect the real economic value of damages that the law fails to realize).

117. *But see id.* at 892-95 (summarizing the outcome of a behavioral decision study, which found that volunteering to insert a penalty clause did not produce a statistically significant increase to the inserting party's perceived reliability).

nonperformance to the most efficient insurer. These arguments view the use of penalty clauses as efficient deal-making devices and the failure to enforce them as an inequitable windfall to the breaching party.¹¹⁸

Comparatively, commentators in the third camp—those who seek a bifurcation—essentially assert that the civil law correctly adopts a presumption in favor of the enforcement of penalty clauses. The presumption of enforceability can be overcome only if the penalty is determined to be manifestly or grossly excessive.¹¹⁹ A similar result would be achieved in American law if the rule against penalties was expunged and the problem of excessive penalties was policed under the doctrine of unconscionability.¹²⁰

The Council of Europe's Resolution 78(3) on Penal Clauses adopts the civil approach that the penalty amount "may be reduced by the court when it is manifestly excessive."¹²¹ Another amalgamation of civil and common law is the *Principles of European Contract Law*,¹²² which was a project envisioned by the Commission on European Contract Law to illuminate the common (and best) elements of the two legal systems. In the area of penalty clauses, the civil approach is understood as the better option—Article 9.509(1) states that "the aggrieved party . . . shall be awarded that sum [penalty] irrespective of its actual loss."¹²³ The only limitation on the enforcement of penalty clauses is a reduction in the amount of the penalty if it is deemed to be "grossly excessive in relation to the loss resulting from the nonperformance and the other circumstances."¹²⁴ The Comment to Article 9.509 provides an

118. *Cf. id.* at 889 (arguing that "many penalty clauses are efficient and should be strictly enforced").

119. *See id.* at 916-17 (asserting that the policing doctrines of unconscionability, duress, and misrepresentation are at once efficient and capable of protecting against manifestly excessive penalties).

120. *See* KRONMAN & POSNER, *supra* note 60, at 94-95 (defining the doctrine of unconscionability as a tool to "protect against fraud, duress and incompetence, without demanding specific proof of any of them").

121. Council of Europe, Comm. of Ministers, Res. 78(3) on Penal Clauses in Civil Law, art. 7 (1978).

122. COMM'N OF EUR. CONTRACT LAW, PRINCIPLES OF EUROPEAN CONTRACT LAW: PARTS I AND II (Ole Lando & Hugh Beale eds., 2000) [hereinafter PRINCIPLES OF EUROPEAN CONTRACT LAW].

123. *Id.* at 453.

124. *Id.*

efficiency rationale for the rule: the parties want to avoid “the difficulty, delay and expense involved in proving the amount of loss in a claim for unliquidated damages.”¹²⁵ The comparative efficiency analysis becomes more complicated when the differences among civil law systems are considered. Although most civil law systems limit the non-breaching party to the stipulated damages provided in the penalty clause, German law allows the non-breaching party to make a claim for damages in addition to the stipulated amount.¹²⁶ The latter approach defeats the efficiency gains attributed to the avoidance of litigation. The best rationale for this allowance is the case where the stipulated amount is set too low and is, thus, under-compensatory.

To summarize, the common law holds that all penalty clauses are unenforceable and provides a void-only remedy. The civil law holds that mutually agreed upon penalties are fully enforceable unless they are deemed to be excessive. Further, the civil law encourages courts to reform the clause instead of voiding it. General economic theory argues that the law is most efficient when enforcing express terms because the contracting parties are in the best position to determine the valuation of such terms.¹²⁷ The argument here against efficient breach theory is that not all breaches are efficient.¹²⁸ In practice, it is rather difficult to determine if a breach is efficient since a *sine qua non* requirement for the efficiency of the breach is full compensation to the promisee, and it is difficult for the courts to determine what constitutes “full compensation” in a given case because subjective valuations are difficult to measure or quantify. In contrast, a penalty clause gives a clear indication of the value that the promisee places on the performance; the fee paid for such clauses can be invested by the likely breaching party to ensure timely performance, and penalties protect sunk costs.¹²⁹

125. *Id.* at 454.

126. *Id.* at 455 n.2.

127. *See supra* Part I.B.1 (discussing the efficiency gains generated by deferring to individual autonomy).

128. *See* Macneil, *supra* note 69, at 950-53 (positing that when contract nonperformance is the most efficient result, breach is but one of many ways to achieve that result).

129. *See* DiMatteo, *supra* note 116, at 902 (noting that subjective valuations, like liquidated damages, are subject to the “limits of cognition”); Tess Wilkinson-Ryan, *Do Liquidated Damages Encourage Breach? A Psychological Experiment*,

Unfortunately, the CISG abdicated its coverage of this contentious area of law by not enacting rules dealing with the enforceability of liquidated damages or penalties. The result is the allocation of the issue to conflicting national laws.¹³⁰ In the case of the common law, it means delegation to a hopelessly conflictive and chaotic jurisprudence.¹³¹ In such areas as penalties and specific performance, the CISG missed the opportunity to harmonize conflicting areas of law.¹³² As a result, from the perspective of global efficiency, the CISG is less efficient than it could be.

B. EVIDENTIARY RULES

The negotiators of the CISG faced what seemed to be an insurmountable conflict between those countries preferring the formal requirement of writing and those recognizing the full enforceability of oral agreements or less formal writings.¹³³ Civil law countries fall into the latter category,¹³⁴ and while the United Kingdom disposed of the statute of frauds,¹³⁵ it remains a requirement in the United States for a number of categories of contracts, including the sale of goods.¹³⁶ The CISG adopted the civil law approach of no writing requirement with one important

108 MICH. L. REV. 633, 644 (2010) (explaining that penalty clauses are a means of facilitating efficient agreements and reflect the parties' judgments as to a cost/benefit analysis of the bargain).

130. See, e.g., Gotanda, *supra* note 109 (suggesting the use of the UNIDROIT Principles of International Commercial Contracts to fill the gap left by the CISG).

131. See DiMatteo, *supra* note 113, at 655-75 (attributing this chaos to the common law's preoccupation with balancing freedom of contract principles with the equities of each case).

132. See Peter A. Piliounis, *The Remedies of Specific Performance, Price Reduction and Additional Time (Nachfrist) Under the CISG: Are These Worthwhile Changes or Additions to English Sales Law?*, 12 PACE INT'L L. REV. 1, 17-19 (2000) (arguing that the CISG missed the opportunity to broaden instances where specific performance is granted, and pointing out that the PRINCIPLES OF EUROPEAN CONTRACT LAW, *supra* note 122, include one such broader specific performance provision requiring a court to award specific performance unless on of the enumerated exceptions are met).

133. Clayton P. Gillette & Robert E. Scott, *The Political Economy of International Sales Law*, 25 INT'L REV. L. & ECON. 446, 460-61 (2005).

134. McMahon, *supra* note 111, at 1027.

135. Asa Markel, *American, English, and Japanese Warranty Law Compared: Should the U.S. Reconsider Her Article 95 Declaration to the CISG?*, 21 PACE INT'L L. REV. 163, 190 n.170 (2009).

136. U.C.C. § 2-201 (1977).

compromise. The compromise allows countries to opt out of the no writing requirement when ratifying the convention.¹³⁷ As a result, a number of countries, mostly former Soviet-affiliated countries, retained their national writing requirements.¹³⁸ Interestingly, the United States elected not to opt out of the no writing rule.¹³⁹

1. Writing Requirement

Before analyzing the efficiency of requiring a written instrument as a prerequisite for contract enforceability, a comment regarding the “opt out” provisions of Articles 12 and 96 is needed. A system that allows for such opting out is inherently inefficient.¹⁴⁰ The presence of alternative, conflicting rules in any law increases uncertainty and transaction costs. To allow an affirmative defense in a contract dispute based on a failure to provide a written instrument adds to the uncertainty of international transactions. Where a custom of oral agreement, honored internationally, is trumped by the

137. CISG, *supra* note 1, arts. 12, 96.

138. *See Status: 1980 - United Nations Convention on Contracts for the International Sale of Goods*, U.N. COMMISSION ON INT’L TRADE L., http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html (listing the following countries as opting out of the no writing rule: Argentina, Armenia, Chile, Russian Federation, Ukraine, Belarus, Hungary, Latvia, Lithuania, and Paraguay).

139. *Id.* (indicating that the U.S. instead exercised its Article 95 rights to declare that it is not bound by paragraph 1(b) of Article 1). The U.S.’s accession to Article 12 illustrates the difference between formal and operative rules. Despite the U.C.C.’s retention of a writing requirement in practice, it has been greatly diminished by the lessening of the threshold for “writing” and “signature,” and the existence of numerous exceptions, such as the written confirmation rule and purchases of specially manufactured goods. *See* Larry A. DiMatteo, *The CISG and the Presumption of Enforceability: Unintended Contractual Liability in International Business Dealings*, 22 YALE J. INT’L L. 111, 166-67 (1997) (discussing the rigidity of the U.C.C.’s statute of frauds with respect to oral agreements and informal letter agreements, but also acknowledging exceptions to the rule). These differences of formal law and law in practice, and the narrowing of evidentiary thresholds, provide insight into the possible inefficiencies of such formalities.

140. *See* Gillette & Scott, *supra* note 133, at 454 (arguing that the ability to opt-out of certain provisions of uniform international sales law undermines the benefits of the standardization as it allows the parties to draft their own party-specific provisions); Paul B. Stephan, *The Futility of Unification and Harmonization in International Commercial Law*, 39 VA. J. INT’L L. 743 (1999) (arguing that the poor degree of harmonization in the CISG makes it of limited benefit to contracting parties).

parochial formality requirements of national legal systems, the efficiency gains attributed to a uniform system of rules are diminished.¹⁴¹

There are contrasting views of the efficiency of the writing requirement. Some argue that requiring a writing promotes transactional certainty and consequently reduces dispute resolution costs.¹⁴² Allowing oral testimony to establish a contract creates a moral hazard, as parties are incentivized to fabricate obligations where none were intended.¹⁴³ However, when the parties believe that a writing is not necessary, a legal regime's requirement of a writing increases transaction costs.¹⁴⁴ Sometimes the negotiation and drafting costs of placing a contract in writing exceed the benefits from entering the contract and a mutually beneficial trade is forgone.¹⁴⁵ In addition, by requiring a writing, an opportunistic party may seek to nullify a bona fide oral agreement and escape a contractual obligation.¹⁴⁶

Economic critique of the writing requirement ultimately depends on whether the benefits of requiring a writing—reducing fraudulent allegations of oral contracts—exceed the costs—increased drafting expense and propensity to nullify bone fide transactions. Enforcing a

141. Cf. Gillette & Scott, *supra* note 133, at 452-53 (asserting that because states have different social, political, and legal structures, it is "entirely unrealistic" to expect uniform rules and that over time litigation within such states will yield non-uniform interpretations as to certain provisions, resulting in a failed standard language).

142. See, e.g., KRONMAN & POSNER, *supra* note 60, at 94-95 (noting that the statute of frauds and parol evidence rules serve a legitimate end in controlling and preventing fraud by limiting instances where an undeserving party may win in a dispute).

143. E.g., Eric A. Posner, *Norms, Formalities, and the Statute of Frauds: A Comment*, 114 U. PA. L. REV. 1971, 1976-77 (1996).

144. *Id.* at 1977-78. Eric Posner describes two expensive outcomes that may occur as a result of parties being unaware of the statute of frauds, codified in Section 2-201 of the U.C.C.—either (1) "courts may enforce section 2-201 and allow promisors to escape their contract obligations" or (2) "courts may strain to evade section 2-201, thus holding promisors to their bargain, but in the process creating complexity and uncertainty in the law." *Id.*

145. *Id.* at 1979.

146. See Zipporah Batshaw Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465, 518-19 (1987) (providing commentary that criticizes the writing requirement as promoting, rather than discouraging, opportunistic conduct).

false allegation of an oral contract violates freedom *from* contract, while failing to enforce a legitimate exchange, violates freedom *to* contract.¹⁴⁷ In accord with this logic, the civil law entrusts courts to ferret out bogus claims of oral contracts, while preserving the efficiency of permitting parties to transact without prior written documentation.¹⁴⁸ The CISG follows this rule as well.¹⁴⁹

2. Parol Evidence Rule

Just as important as the issue of whether to require a writing is the issue of whether a writing limits the admissibility of extrinsic evidence to supplement or contradict the written instrument. Civil law countries, like France, do not make a distinction between oral and written contracts with regard to the admissibility of extrinsic information.¹⁵⁰ Generally, extrinsic evidence is freely admitted in the interpretation of contracts. In contrast, the common law, especially in the United States, relates the integration of an agreement into a written contract to the inadmissibility of extrinsic evidence. The rationale of the sanctity of a written contract is protected by the common law's parol evidence rule and the statute of frauds.¹⁵¹ The parol evidence rule holds that if a writing was intended as a final integration of an agreement, whether or not a writing is required under the statute of frauds, extrinsic evidence is barred if it would

147. Numerous law and economic commentators tend to favor the civil law rule dispensing with the need for a writing. See, e.g., Michael Braunstein, *Remedy, Reason, and the Statute of Frauds: A Critical Economic Analysis*, 1989 UTAH L. REV. 383, 422-38 (1989) (arguing for a repeal of both the writing requirement and the statute of frauds because they tend to hamper economic efficiency); Mark Cantora, Note, *The CISG After Medellin v. Texas: Do U.S. Businesses Have It? Do They Want It?*, 8 J. INT'L BUS. & L. 111, 127 (2009) ("The statute of frauds as used in the U.C.C. is at best superfluous, and at worst, an inefficient default rule.").

148. See Wiseman, *supra* note 146, at 519 (discussing the modification of earlier versions of the statute of frauds by Karl Llewellyn, who added the "merchant rule" to accommodate the traditional practice of merchants confirming deals over the phone and not necessarily in writing).

149. See CISG, *supra* note 1, art. 11 ("A contract of sale need not be concluded in or evidenced by writing . . .").

150. Stefan Vogenauer, *Interpretation of Contracts: Concluding Comparative Observations*, in CONTRACT TERMS 123, 135 (Andrew Burrows & Edwin Peel eds., 2007) (indicating that both Germany and France do not place limits on the admissibility of extrinsic evidence).

151. *Id.* at 135-39.

contradict the plain meaning of the written agreement.¹⁵² In reality, American courts often avoid the parol evidence bar by declaring contract language to be ambiguous and therefore, parol evidence is admitted to clarify, but not to contradict the contract.¹⁵³ The CISG rejects any limitation on the use of extrinsic evidence.¹⁵⁴ The question relevant to the current undertaking is whether the CISG's rejection of a writing requirement and restrictions on extrinsic evidence were efficient choices.

EAL scholarship supports the certainty provided by written agreements and the plain meaning interpretation of them. The protection of written agreements through a rigid parol evidence rule is seen as enhancing the certainty of written agreements.¹⁵⁵ However, the certainty protection provided by the parol evidence rule is partially muted by the fact that there are different versions of the rule.¹⁵⁶ Professor Linzer explains the variations:

152. E.g., Hila Keren, *Textual Harassment: A New Historicist Reappraisal of the Parol Evidence Rule with Gender in Mind*, 13 AM. U. J. GENDER SOC. POL'Y & L. 251, 251 (2005). The common law's parol evidence rule dates back four hundred years, and under the rule, prior inconsistent writings or witness testimony regarding contract negotiations constitutes inadmissible evidence when there is an integrated contract or where the issue relates to the written terms of a partially integrated contract. Arthur L. Corbin, *The Parol Evidence Rule*, 53 YALE L. J. 603, 603 (1944). One commentator argues that Lord Coke's reason for formulating the rule was his pro-market orientation: "Coke seemed interested in the contractual tool itself, the one used by purchasers and farmers. The danger he visualized was in all likelihood the danger of chaos—of never-ending clashes and contradictions between written contracts and oral promises, between legal texts and the human contexts that threaten to change their meaning." Keren, *supra*.

153. See Vogenauer, *supra* note 150, at 138 (making the distinction between admissibility and weight in contract breach cases and stressing that although extrinsic evidence may be admissible, it does not follow that it will be controlling).

154. See CISG, *supra* note 1, art. 8 (allowing in contract interpretation an analysis of intent and conduct of the parties, with due consideration for all circumstances of the contract, including negotiations, practice between the parties, and industry usages and standards).

155. See Peter Linzer, *The Comfort of Certainty: Plain Meaning and the Parol Evidence Rule*, 71 FORDHAM L. REV. 799, 802 (2002) (asserting that a "strict parol evidence rule combined with a strong view of plain meaning" provides predictive stability and comfort).

156. See Robert E. Scott, *The Uniformity Norm in Commercial Law: A Comparative Analysis of Common Law and Code Methodologies*, in THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 149, 167-69 (Jody S. Kraus & Steven D. Walt eds., 2000) (noting the common law's general preference for textualism despite the U.C.C.'s and Second Restatement of

What we call the parol evidence rule is better thought of as a spectrum. Some courts, old and new, presume that almost all documents, however skimpy or haphazard, represent the final word. Others will not go that far, but still apply Williston's famous "four corners rule" strictly, rejecting extrinsic evidence unless questions of integration and ambiguity of meaning are patent on the face of the writing. Other courts, although they recite the four corners approach, actually require the facial uncertainty to be much less palpable, and admit extrinsic evidence more readily. Still others allow extrinsic evidence to show non-integration and ambiguity themselves, and some even go as far as the Restatement (Second) of Contracts and admit evidence to show meaning without regard to ambiguity.¹⁵⁷

In some instances, the parol evidence rule may be "hard" for purposes of determining the completeness of the written contract and "soft" for determining whether an ambiguity exists in the contract.¹⁵⁸ A purely formalist interpretive methodology focused on the four-corners of a writing blunts efforts to uncover the true intention of the parties.¹⁵⁹ EAL holds that the parties are the best evaluators of value and preferences.¹⁶⁰ As such, extrinsic evidence that offers insight into the parties' true intentions provides the most efficient interpretation of contractual terms.

Contracts' codification of contextual interpretation).

157. Linzer, *supra* note 155, at 805-06 (citations omitted). Linzer further notes that "Eric Posner, after sketching out what he called the 'hard-[parol evidence rule]' (roughly the Williston, four-corners, plain meaning approach) and the 'soft-[parol evidence rule]' (roughly that of Corbin and the Second Restatement of Contracts), cautioned his readers that . . . 'reality is [far] more complex than the stylized versions of the parol evidence rule developed for the purpose of analysis.'" *Id.* at 807 (quoting Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533, 534-40 (1998)).

158. *See* Linzer, *supra* note 155, at 805-07 (offering an enumerated characterization of the spectrum, moving from most restrictive to more liberal regimes: (1) document regarded as a final integration (legal formalism); (2) "four corners rule" with patent ambiguity exception (Williston); (3) broader interpretation of what constitutes ambiguity; (4) liberal use of extrinsic evidence to show ambiguity or non-integration; and (5) use of extrinsic evidence to uncover meaning even without ambiguity (contextualism)).

159. *See id.* at 838-39 (explaining that the formalist approach does not consider context, credibility, linguistic sensibility, and many other contextual factors relevant to discerning intent).

160. *See id.* at 838 ("[W]e should opt for the parties' intentions, discerned from their words, read in the context of all relevant evidence, extrinsic or not.").

The CISG rejects the common law's parol evidence rule.¹⁶¹ The CISG evidence regime provides for the liberal admission of parol and other types of extrinsic evidence as well as allows the use of "vague" or open forms of contracting.¹⁶² Professor Triantis argued that vagueness in written contracts can serve certain economic purposes such as lowering transaction costs by lowering the costs of negotiation and the writing of contracts.¹⁶³ Judge Posner also acknowledged the benefits of a certain degree of vagueness in written contracts.¹⁶⁴ He writes, "[d]eliberate ambiguity may be a necessary condition of making the contract; the parties may be unable to agree on certain points yet be content to take their chances on being able to resolve them, with or without judicial intervention, should the need arise."¹⁶⁵ In the end, Judge Posner speaks in favor of a modified "four corners" rule that "allow[s] extrinsic ambiguity to

161. Rod N. Andreason, Note, MCC-Marble Ceramic Center: *The Parol Evidence Rule and Other Domestic Law Under the Convention on Contracts for the International Sale of Goods*, 1999 BYU L. REV. 350, 357-64. It is debated as to whether the parol evidence rule is a rule of civil procedure, and thus American courts may use it in applying the CISG, or a rule of substantive contract law. The better argument is that it is the latter and thus cannot be used in the application of the CISG. See *id.* at 357-59 (quoting MCC-Marble Ceramic Ctr. v. Ceramic Nuova d' Agostino, S.p.A., 144 F.3d 1384, 1388-89 (11th Cir. 1998)) (reasoning that the parol evidence rule is substantive because it does not stop parties from using an "undesirable" means to prove a fact, but instead stops parties from attempting to prove a fact in the first place).

162. *But cf.* George G. Triantis, *The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2*, 62 LA. L. REV. 1065, 1067 (2002) (expressing confusion over parties' willingness to agree to vague terms because such vague standards of contracting create uncertainty and risk the high cost of judicial interpretation).

163. See *id.* at 1071 (stating that the cost of taking the time and energy to specify each possible foreseeable future state of the world has the potential to exceed the gains from doing so).

164. See Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1587 (2005) (identifying a benefit of having flexible contractual language—it allows for adaptability of the language to future unforeseen situations—but also noting that the cost of such flexibility is vagueness). Additionally, gap-filling, under the CISG and U.C.C., for material terms such as price may be cost effective because of the fungible nature of goods and the relative ease of determining market price, whereas such gap filling may be too burdensome for other types of terms. See *id.* at 1587-88 (suggesting, however, that the cost saving would not be significant—and the burden shouldered by a court in determining a "reasonable price" might be prohibitive).

165. *Id.* at 1583.

be shown only by objective evidence.”¹⁶⁶ Evidence of custom or trade usage is an example of objective evidence.¹⁶⁷

In sum, the use of economic logic to assess the parol evidence rule is highly nuanced. Common law courts use the rule to protect the integrity of integrated writings, while simultaneously permitting extrinsic evidence to explain ambiguities.¹⁶⁸ By contrast, most civil law systems and the CISG allow parol evidence, trusting the courts to assess its probative value.¹⁶⁹ While economic theory generally supports the common law approach, the distinction between the common law and civil law approaches to extrinsic evidence should not be over-stated. Given the numerous exceptions to the rule, the two systems often reach the same results. The use of extrinsic evidence will be further studied in the next section’s coverage of contract interpretation.

C. CONTRACT INTERPRETATION

Judge Posner notes that although the literature involving the economic analysis of contract law is deep in the areas of contract formation and remedies, the economic analysis of contract interpretation is more superficial and abstract.¹⁷⁰ Nonetheless, he asserts that contract interpretation is better managed through an economic analysis.¹⁷¹

Contract interpretation deals with three fundamental scenarios: (1) contractual incompleteness, (2) contractual ambiguity, and (3) situations in which the parties seek *ex ante* to establish rules of

166. *Id.* at 1598. Posner further clarifies that, “[b]y ‘objective,’ I mean to exclude a party’s self-serving testimony that cannot be verified . . .” *Id.* at 1598-99.

167. *See id.* at 1600 (“Were evidence of trade usage barred in contract litigation, parties to contracts would be driven to include additional detail in their contracts . . . The need to add this detail would increase the costs of negotiation and drafting, while the benefits would be realized only in the small minority of cases that would result in a legal dispute.”).

168. *See generally* Linzer, *supra* note 155, at 805-08.

169. *See supra* Part II.B.2; CISG, *supra* note 1, art. 8(3) (indicating that consideration should be given to relevant circumstances surrounding the formation of the contract—such as negotiations, practices between the parties, and customary usages—when interpreting a contract).

170. Posner, *supra* note 164, at 1581.

171. *See id.* (“I shall try to show that economics can be of considerable help in understanding the problems involved in interpreting contracts.”).

interpretation that will apply *ex post*.¹⁷² Before discussing these scenarios, the next subsection will address the more abstract question of the efficiency of the objective and subjective theories of contract interpretation.

1. Objective Versus Subjective Theories of Interpretation

The two broad theories of contract interpretation are illustrated by the civil law's adoption of a subjective (agreement in fact) approach and the common law's embrace of the objective (external manifestation of assent) approach.¹⁷³ Article 1156 of the *Code Civile* of 1804, as well as Section 133 of the *Bürgerliches Gesetzbuch* of 1900, require a search for "the common intention of the contracting parties."¹⁷⁴

The divergence between subjective and objective theories of interpretation is not as profound in practice.¹⁷⁵ The subjective theory in the civil law gives way when the objective meaning is clear and the subjective obscure. Thus, Articles 1157 through 1164 of the *Code Civile* acknowledge that the path to subjective understanding is through more objective benchmarks, such as the nature or purpose of the contract, trade usage and custom, and "the context of the contractual document."¹⁷⁶ The German law more expressly abandons subjectivism in favor of the reasonable person interpretive methodology.¹⁷⁷ The CISG adopts a modified subjective approach.¹⁷⁸

The CISG interpretive methodology, as expressed in its Articles 8 and 9, rejects the formalist approach to interpretation associated with the brand of objectivism that focuses solely on the written words of a

172. See *infra* Parts II.C.2-3.

173. See Vogenauer, *supra* note 150, at 125 (stating that the objective and subjective distinction in the context of interpretation speaks to the will or intention of the parties).

174. CODE CIVIL [C. CIV.] art. 1156 (Fr.); Bürgerliches Gesetzbuch [BGB] [Civil Code], Aug. 18, 1896, BUNDESGESETZBLATT [BGBl.] at 42, as amended, § 133 (Ger).

175. See generally DIMATTEO, *supra* note 95, at 45-50.

176. Vogenauer, *supra* note 150, at 126.

177. See *id.* at 139 (discussing the reasonable person as one of two balancing factors which make up the "theory of indication" under German law).

178. See *infra* notes 189-91 and accompanying text; see also CISG, *supra* note 1, art. 29(1) ("A contract may be modified or terminated by the mere agreement of the parties.").

contract.¹⁷⁹ In the common law, this approach is embedded in the duty to read, the four-corners rule, the parol evidence rule, and the plain meaning rule of interpretation.¹⁸⁰ If intent is associated with the meaning of the parties' written agreement, then the EAL would assert that such rules protect the autonomy or will of private parties. However, true intent is most likely to be made available only through a contextual analysis of meaning. The uncovering of "true" intent better protects the principal of private autonomy that underlies contract law.¹⁸¹ The CISG interpretive methodology is best understood as embracing the objective theory of contract interpretation through a full contextual inquiry. This is made clear given the following interpretative framework provided in CISG Articles 8 and 9:

- Statements and conduct "are to be interpreted according to the understanding [of] a reasonable person."¹⁸²
- In applying the reasonable person standard, "due consideration is to be given to all relevant circumstances . . . including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties."¹⁸³
- "The parties are considered . . . to have impliedly made applicable to their contract . . . a usage" widely known in international trade.¹⁸⁴

The major exception to this objectivist framework is the inter-subjectivist methodology found in Article 8(1), mandating that a party is bound to another party's subjective intent "where the other party knew or could not have been unaware what that intent was."¹⁸⁵

179. See CISG, *supra* note 1, arts. 8-9 (indicating that the usages, practices, statements, and conduct of the parties are considered in contract interpretation).

180. Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 *FORDHAM L. REV.* 761, 767 (2002) (stating that the statute of frauds, coupled with these three aforementioned theories, meant that in classical contract law the written document drafted by the parties usually ruled).

181. See DiMatteo, *supra* note 116, at 902-03 (explaining that autonomy is central to contract law and suggesting the use of implicit and explicit consent-based factors to determine the enforceability of penalty clauses).

182. CISG, *supra* note 1, art. 8(2).

183. *Id.* art. 8(3).

184. *Id.* art. 9(2).

185. *Id.* art. 8(1). See generally DIMATTEO, *supra* note 95, at 49-50.

Under this perspective, the objective meaning of a promise is trumped by the known idiosyncratic, subjective meaning of the promise-receiving party. An illustration can be taken from the common law's unilateral mistake doctrine. Generally, a reasonable person interpretation of a contract term will prevail over the mistaken unilateral interpretation of one of the parties.¹⁸⁶ However, the unilateral mistake doctrine provides relief if the subjective error was known or could not have been unknown to the non-mistaken party at the time of contract formation.¹⁸⁷

2. *Intentional Contractual Incompleteness*

There are three rationales for intentional contractual incompleteness: (1) avoiding the transaction costs of negotiating a more complete contract, (2) strategic informational asymmetry, and (3) consensual strategic incompleteness. Judge Posner refers to these types of incompleteness as "deliberate ambiguity."¹⁸⁸ One of the rationales for intentional incompleteness is that such ambiguity is "a necessary condition of making the contract."¹⁸⁹ From an efficiency perspective, such an ambiguity is rational when the cost of clarifying or adding a term is greater than the benefit of having a more complete contract. The costs are likely to outweigh the benefits of completeness where there is a low probability of the event that the term deals with will occur.¹⁹⁰ The more efficient strategy would be to keep the term open for future negotiation.¹⁹¹ Since the overwhelming majority of transactions do not result in costly dispute resolution proceedings, it is often efficient to avoid negotiation of a given

186. See RESTATEMENT (SECOND) OF CONTRACTS § 154(c) (1981) (stating that a party bears the risk of a mistake when "the risk is allocated to him by the court on the ground that it is reasonable in the circumstances to do so").

187. See, e.g., *Smith v. Hughes*, [1871] 6 L.R.Q.B. 597, 610-11 (U.K.) (stating that a buyer is relieved of his obligation to buy a product if the seller believed that the buyer was mistaken as to the nature of the actual product and if the buyer actually was so mistaken).

188. Posner, *supra* note 164, at 1583.

189. *Id.*

190. See *id.* (stating parties may make a decision to delegate to the courts completion of the contract as to a contingency, should it materialize, for negotiation cost reasons).

191. See Avery W. Katz, *Contractual Incompleteness: A Transactional Perspective*, 56 CASE W. RES. L. REV. 169, 173-74 (2005) (noting that this is possible because the law allows for the modification of contracts).

term.¹⁹² The costs of such negotiation outweigh the costs of resolving a dispute over the term in litigation or arbitration due to the low probability of such an occurrence.¹⁹³ So often the gaps and vagueness found in contracts are the conscious choices of the contracting parties.

Strategic informational asymmetry occurs when a party decides to strategically withhold information in order to avoid less beneficial terms that would result by the disclosure of the information. One suggested response is for the courts to fill in the gap with a “penalty default” term that punishes the non-disclosing party.¹⁹⁴ The literature on disclosure in contract law balances the need to protect individual autonomy by not requiring disclosure against the fairness of requiring the disclosure of at least material information. Although the CISG failed to adopt mandatory disclosure rules, its inter-subjective interpretive methodology does place pressure on the information holder to disclose in order to subsequently prove contractual assent.¹⁹⁵

The case of consensual strategic incompleteness exists where both parties suffer from a lack of full information. This lack of full information often revolves around the transactional uncertainty of predicting future events in a long-term contract.¹⁹⁶ The parties may

192. *See id.* at 175 (identifying in particular the high cost of attorney fees that would result from extensive negotiation).

193. *See id.* (making the point that for financial purposes, parties may be willing to risk contractual failure, even if such failure results in litigation).

194. *See id.* (noting, however, that such a penalty would work only if the value of the information is rather modest compared to the penalty); *see also* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *YALE L.J.* 87, 91 (1989) (stating that penalty defaults “are designed to give at least one party to the contract an incentive to contract around the default rule and therefore to choose affirmatively the contract provision that they prefer”). The Ayres-Gertner Model distinguishes between default terms that can be altered by agreement of the parties and immutable contract terms that cannot be altered. *Id.* at 87. Most default terms, known as “majoritarian” defaults, seek to mimic the terms that the parties would have agreed to if they had address them. *Id.* at 93. By contrast, a “penalty default” provides a term that the parties do not want; hence, they are incentivized to affirmatively address the issue so as to avoid the unwanted term. *Id.* at 91.

195. This paper will discuss this notion under the topic of “particularized consent.” *See infra* Part III.

196. *Cf.* Katz, *supra* note 191, at 175 (discussing contract incompleteness as potentially caused by the relatively low probability of an event coming to fruition).

agree to an open term with the aim of renegotiating the issue in the event of a post-formation development.¹⁹⁷ Another reason for such consensual ambiguity is the avoidance of the risk that negotiation over a particular term will lead to a deal-preventing impasse. The agreement to an open term or gap in the contract is likely to be strategic in nature because each party will work to frame the future renegotiation in its favor. Unintentional openness, which will be discussed in the next section's coverage of contractual ambiguity, provides a comparison to consensual ambiguity.

A similar case of strategic incompleteness in both long-term and short-term contracts is related to self-enforcing market mechanisms, such as reputation.¹⁹⁸ In consumer contracts, the consumer expects that a major corporation in a competitive market will agree to a fair settlement of any problem created by a low-probability event. This type of trust boosts the corporation's reputation (which is very valuable in a competitive market in which there is little price competition).¹⁹⁹ Greater sales and the reduction in transaction costs supersede the costs from moral hazard incentives because of consensual strategic incompleteness. The same holds for long-term contracts. The parties decide not to regulate their relationship *ex ante* since they know that for any low-probability event it will be more efficient to modify the contract *ex post*, avoiding the drafting costs and the possible relation-stressing effects of prolonged bargaining.²⁰⁰

197. *Id.* at 169. Economists and legal scholars use the term "incomplete contracting" differently to refer to either obligational incompleteness or contingent incompleteness. Legal scholars utilize the prior term, which refers to "contracts in which the obligations are not fully specified." Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 730 (1992). Economists use the latter term, which refers to a failure to "fully realize the potential gains from trade." *Id.* With this understanding, obligational incompleteness can be used strategically to more fully capture potential gains as events unfold.

198. See generally IAN R. MACNEIL, *THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS* 71 (1980).

199. Ostas, *supra* note 103, at 546-48.

200. Cf. Katz, *supra* note 191, at 175 (indicating that sometimes parties decide to skip the negotiation of some terms pre-contract due after performing a cost benefit analysis). Additionally, the economic significance of "trust" and "confidence" plays a prominent role in the socio-economic approach to contracting. See, e.g., AMITAI ETZONI, *THE MORAL DIMENSION: TOWARD A NEW ECONOMICS* 10 (1988) (explaining that trust arises out of "previous transactions based on rational calculations and efficient 'rules of thumb'").

The problem of filling in gaps in written contracts has been the subject of much EAL literature. This literature is not concerned with contract interpretation *per se*, but instead focuses on the issue of incomplete contracts, generally discussing the issue of the fabrication and selection of default rules.²⁰¹ Defaults can be either immutable or subject to modification by the parties.²⁰² Given our first tenet—deference to individual autonomy, economic reasoning suggests that defaults should be structured so that the parties can easily tailor them to their own needs.²⁰³ In addition, there is a general consensus that defaults will reduce transaction costs if they mimic what the parties themselves would have chosen if they had addressed the term in their contract.²⁰⁴ Judge Posner notes that the parliaments of Germany and other nations of Continental Europe have enacted detailed codes of “contractual obligations, constituting implied terms that the parties can, however, negate.”²⁰⁵ A similar pattern is found in the CISG, which provides a host of gap fillers, most of which can be modified by express agreement of the parties.

201. See generally Ayres & Gertner, *supra* note 197 (theorizing as to how courts and legislatures should handle default rules efficiently from an economic perspective).

202. *Id.* at 87-91.

203. Cf. Schwartz & Scott, *supra* note 10, at 594 (arguing that if default rules are constructed inefficiently then contracting parties will write contracts to avoid them, which increases transaction costs). Generally, legislatures do not possess adequate knowledge of the costs and benefits to contracting parties necessary for drafting efficient problem-solving default rules. Ian Ayers, *Default Rules for Incomplete Contracts*, in 1 NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 585, 279-80 (Peter Newman ed., 1998).

204. See, e.g., Alan Schwartz, *Incomplete Contracts*, in 2 NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 277, 586 (Peter Newman ed., 1998) (commenting that the parties would have organically included such defaults if they could “costlessly contract”). Such rules are often referred to as “majoritarian” defaults. *Id.*; see Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1433 (1989) (arguing that default terms should be what the parties would choose given “full information and costless contracting”). See generally Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or “The Economics of Boilerplate”)*, 83 VA. L. REV. 713, 733-36 (1997) (suggesting that in situations where network externalities prevent parties from choosing optimal individual terms, default terms should be centrally chosen for their substantive efficiency). For an alternate approach to contract interpretation, see generally Avery Wiener Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 COLUM. L. REV. 496 (2004) (advocating a transactional approach to the problem of contract interpretation).

205. Posner, *supra* note 164, at 1586.

3. Contractual Ambiguity

The most common forms of ambiguity, unlike those discussed in the previous section, are those that are unintended. Professor Linzer's critique of a formalist interpretation of written contracts notes that the "flaw in plain meaning is, of course, the notion of a latent ambiguity."²⁰⁶ In the plain meaning and four-corners analysis, extrinsic evidence can only be introduced in cases of patent ambiguity.²⁰⁷ Justice Traynor, in his *Pacific Gas & Electric Co. v. Thomas Drayage & Rigging Co.*²⁰⁸ decision reviewing the parol evidence rule, said the following regarding the determination of ambiguity:

The test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible.²⁰⁹

This idea of an alternative reasonable latent meaning supports a more contextual interpretive methodology. It asserts that one can rarely reach the threshold of sufficient clarity of written words without viewing the context behind the usage.²¹⁰ Thus, seemingly clear contract language may be susceptible to an alternative (non-plain meaning) interpretation through the use of extrinsic evidence.

The objective approach, stripped of the formal requirements of a writing and the parol evidence rule, allows for a fuller contextual inquiry. It is this contextualism that the CISG embraces in order to uncover the true intent of the contracting parties. The formalist or textualist approach holds that bright-line rules such as the statute of frauds, plain meaning rule, four-corner analysis, and parol evidence rule provide greater certainty, and thus reduce transaction costs.²¹¹

206. Linzer, *supra* note 155, at 803.

207. *See id.* at 820-23 (offering an example of a case in which a patent ambiguity existed in the agreement between the parties, which led to the admissibility of parol evidence).

208. 442 P.2d 641 (Cal. 1968).

209. *Id.* at 644.

210. *See id.* (explaining that a contract cannot be limited to the four corners of the document, as this would ignore the intent as well as "presuppose a degree of verbal precision and stability" not actually found in our language).

211. *See* Lisa Bernstein, *Private Commercial Law in the Cotton Industry*:

The contextualist approach asserts that written words are generally indeterminate and a totality of the circumstances analysis is required to uncover true intent.²¹² Furthermore, the so-called bright-line rules of formalism are not very fixed or bright given that extrinsic evidence is allowed to supplement but not contradict a written contract.²¹³ For example, the determination of ambiguity is left to judicial discretion.²¹⁴ This discretion can be used to “find” an ambiguity and allow for the admission of extrinsic evidence in cases where exclusion would work an injustice.

The majority of EAL literature supports the formalist approach to contract interpretation.²¹⁵ Schwartz and Scott argue in favor of the formal interpretation of written contracts in business to business contracts.²¹⁶ This formal approach includes plain meaning interpretation, a hard parol evidence rule, and full enforcement of merger clauses.²¹⁷ Such an approach is viewed as promoting efficiency given the sophistication of businesspersons and their ability to negotiate efficient contracts. In these cases, even where there is a long-term relationship, the inclusion of a merger clause in a

Creating Cooperation Through Rules, Norms, and Institutions, 99 MICH. L. REV. 1724, 1735-44 (2001) (arguing that within the formal operation of the cotton industry’s private legal system, bright-line rules reduce transaction costs and makes misunderstandings less likely).

212. See Miriam R. Albert, *Common Sense for Common Stock Options: Inconsistent Interpretation of Anti-Dilution Provisions in Options and Warrants*, 34 RUTGERS L.J. 321, 331 (noting that this necessarily involves extrinsic evidence).

213. See Linzer, *supra* note 155, at 804-08 (asserting that even courts using a formalist approach apply the rules differently and adopt many exceptions to allow for the admission of extrinsic evidence).

214. See *id.* at 807 (“[I]nstead of a parol evidence ‘rule,’ there is a continuum of many different approaches, all using the same name and often using the same words.”).

215. See, e.g., Mark L. Movsesian, *Formalism in American Contract Law: Classical and Contemporary*, 12 IUS GENTIUM 115, 115 (focusing on the virtues of the formalist approach, such as “bright-line rules, objective interpretation, and party autonomy”); see also David Charny, *The New Formalism in Contract*, 66 U. CHI. L. REV. 842, 842 (1999) (indicating that formalist lawyers attempt to deduce contract rules from an “essentialist understanding of the nature of promise and consent”).

216. See Schwartz & Scott, *supra* note 10, at 547, 618 (stating that firms want courts to enforce the contracts that the parties themselves write and not what a decision maker with a concern for fairness would write).

217. *Id.* at 547.

contract signifies the genuine consent of the parties on the enforcement of their contract without having to worry about judicial discretion.²¹⁸ The probability of such a clause being included in the contract without the will of one of the parties is minimal, thus a strong parol evidence rule seems efficient.

The anti-formalists argue that the efficiency gains in formalism are overstated.²¹⁹ In fact, there are efficiency costs related to a strong parol evidence rule and formalistic interpretation of contracts. Avery Katz argues that such an approach “can encourage parties to expend extra resources in negotiation, on one hand by attempting to manipulate the formal text of the agreement in their favor, and on the other hand by attempting to prevent the counterparty from doing so.”²²⁰ This approach replaces efficient negotiators with inefficient lawyer-drafters, leading to an increase in transaction costs that is not counterbalanced by the parallel reduction in administration (court) costs due to the fact that only a small fraction of contracts end up in court.²²¹

The U.C.C., despite its adoption of a statute of frauds requirement, rejects the plain meaning approach in favor of a totality of circumstances analysis.²²² It further rejects the formality of the promise-based will theory in favor of an agreement-in-fact approach.²²³ The agreement-in-fact approach requires the use of contextual evidence to determine the parties’ true intent.²²⁴

218. *Id.*

219. *See* Katz, *supra* note 191, at 179-80 (indicating that formalistic regimes can introduce unnecessary risk and higher costs).

220. *Id.* at 180.

221. *See id.* (noting that sales and purchasing agents are better placed to promote overall organizational interests than their lawyers and other drafting agents).

222. *See* U.C.C. § 2-202 (1977) (stating that the terms of a written agreement may be supplemented by course of dealing, usage of trade, or course of performance). For a more complete explanation of the “totality of the circumstances” analysis, particularly with regard to the reasonable person benchmark, see DiMatteo, *supra* note 96, at 317-25.

223. *See* U.C.C. § 1-201(3) (1977) (“‘Agreement’ . . . means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in Section 1-303.”).

224. *Cf.* Steven A. McCloskey, *North Carolina Employment Case Law: Contract Principles Abandoned*, 25 N.C. CENT. L.J. 163, 170 (2003) (quoting *Snyder v. Freeman*, 266 S.E.2d 593, 602 (N.C. 1980)) (noting that an agreement in fact is one based upon circumstances showing a mutual intent of the parties).

The differences between the evidentiary thresholds for admitting extrinsic evidence under the CISG and the U.C.C. are not as great as the formal rules indicate. The main difference is that the U.C.C. orders the probative value of the evidence. Section 1-303(e) states that when conflictive, the written agreement prevails over extrinsic evidence, course of performance prevails over evidence of prior dealings and trade usage, and prior dealings prevail over trade usage.²²⁵ In contrast, under the CISG, the judge or arbitrator determines the probative value of the different types of evidence on a case-by-case basis.²²⁶

The ordering/non-ordering distinction is also overblown. The civil law systems generally hold that the written contract is most probative even though there are no formal constraints on the use of extrinsic evidence.²²⁷ Also, despite the U.C.C. ordering rule, a judge applying this rule remains free to determine if the contract language is ambiguous. If the judge determines that it is ambiguous, then extrinsic evidence can be admitted, as demonstrated in *Nanakuli Paving & Rock Co. v. Shell Oil Co., Inc.*²²⁸ The case involved a contract for the long-term supply of asphalt products which expressly granted the supplier the right to post the price at the time of delivery.²²⁹ The contractor asserted that, despite the express term, it was a widely accepted trade custom to honor the prices previously posted under long-term supply contracts.²³⁰ The Court held that, notwithstanding the term's clarity in allowing *ad hoc* price increases, the jury was at liberty to construe the trade usage of "price protection as consistent with the express term."²³¹ The role of contextual evidence was prominent in this case. Despite clear, unambiguous contract language, the court allowed the jury to use evidence of trade

225. See U.C.C. § 1-303(e) (1977) (stating, however, that "the express terms of an agreement and any applicable course of performance, course of dealing, or usage of trade must be construed whenever reasonable as consistent with each other").

226. See CISG, *supra* note 1, art. 11 (placing no limitation on the extrinsic evidence that parties can introduce, and as a result, the decision maker must decide how much weight each piece of evidence is accorded).

227. See *supra* Parts II.B.1-2.

228. 664 F.2d 772 (9th Cir. 1981) (reaching its holding, in part, by using extrinsic evidence that spoke to the intent of the parties in making the contract).

229. *Id.* at 778.

230. *Id.*

231. *Id.* at 780.

custom to trump the operation of the express term.²³²

4. Party-Controlled Rules of Interpretation

Given the inherent ambiguity of written contracts, be it intended or unintended, is there anything the contracting parties can do to prevent the admission of extrinsic evidence in a subsequent dispute? The principle of private autonomy suggests that the parties should be allowed to agree on how their contract is to be interpreted.²³³

One way to overcome the inefficiency of determining and applying default rules of interpretation, be it under common or civil law, is for the parties to agree *ex ante* on the *post hoc* rules of interpretation.²³⁴ For example, the parties may agree to avoid the application of the *contra proferentem* rule.²³⁵ A contract could incorporate the following clause: "The parties agree that any rule of construction to the effect that ambiguities are to be resolved against the drafting party shall not be applied in the construction or interpretation of this Agreement." However, there is no guarantee that a court will disregard traditional rules of interpretation in the face of such a provision.²³⁶

Party-determined rules of interpretation fare better in the common law. The incorporation of a merger clause generally meets with favorable judicial enforcement.²³⁷ This is likely because such clauses

232. *Id.*

233. *See* Katz, *supra* note 191, at 178-80 (indicating that parties could include in the contract terms specifying the interpretive methods to be used in the event a contractual gap arises).

234. *See id.* at 179 ("Contracting parties can also opt into relatively formalistic interpretative regimes by designating the tribunal or rule of law that will hear any dispute that arises under their agreement; and again there are various ways to achieve such a result.")

235. *See* Omri Ben-Shahar, *A Bargaining Power Theory of Default Rules*, 109 COLUM. L. REV. 396, 406 (2009) (defining *contra proferentem* as a principle "under which ambiguous language in the contract is interpreted against the drafter").

236. *See* Katz, *supra* note 191, at 179 ("Even when the substantive rule of interpretation is the same, differences in local legal culture, procedural and evidentiary rules, or other resource constraints may make one tribunal considerably less inclined to take an open-ended approach to gap filling than another.")

237. *See* Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 936, 959-60 (2010) (indicating that utilization of a hard parol evidence

align with the traditional rules of interpretation. The merger clause expressly warrants that the contract is a final and complete integration of the parties' agreement.²³⁸ Its preclusion of the use of parol evidence to interpret or add to the contract's meaning is the same result as if the court, independent of any merger clause, determined that the contract was a complete integration. Thus, a merger clause acts to mimic the parol evidence rule in order to assure its applicability. It is doubtful that a merger clause will prevent the entry of extrinsic evidence under CISG rules. CISG Advisory Council Opinion No.3 attempts to clarify the enforceability of a merger clause within the CISG's liberal evidence regime.²³⁹ It states:

A Merger Clause, also referred to as an Entire Agreement Clause, when in a contract governed by the CISG, derogates from norms of interpretation and evidence contained in the CISG. The effect may be to prevent a party from relying on evidence of statements or agreements not contained in the writing. Moreover, if the parties so intend, a Merger Clause may bar evidence of trade usages.²⁴⁰

The Opinion thus affirms that a merger clause may be viewed as a permissible derogation under CISG Article 6. However, unless it is expressly negotiated and agreed to, it is unlikely to bar extrinsic evidence.²⁴¹

D. CONTRACT FORMATION

The article's assessment of specific provisions in the CISG closes with an inquiry into issues associated with contract formation. As a general rule, civil and common law traditions evolved similar rules regarding contract formation and performance. Examples include

rule by common law courts gives merger clauses presumptive conclusive effect).

238. *See id.* at 932 n.16 (defining such a clause as one indicating that all of the parties' prior understandings are encompassed in the present written agreement).

239. CISG Advisory Council, *CISG-AC Opinion No. 3 on Parol Evidence Rule, Plain Meaning Rule, Contractual Merger Clause and the CISG* (Oct. 23, 2004), available at <http://www.cisgac.com/UserFiles/File/CISG%20AC%20Opinion%203%20English.pdf>.

240. *Id.* at Opinion, ¶ 3.

241. CISG Advisory Council Opinion No. 3 notes that when there is a written merger clause, "in determining the effect of such a Merger Clause, the parties' statements and negotiations, as well as all other relevant circumstances shall be taken into account." *Id.*; *see infra* Part III (exploring the notion of particularized consent).

rules pertaining to anticipatory repudiation,²⁴² transfer of risk,²⁴³ implied warranties of merchantability and for a particular purpose,²⁴⁴ the foreseeability limitation on damages,²⁴⁵ the mitigation principle,²⁴⁶ and excuse.²⁴⁷ In each of these areas, the drafters of the CISG followed the “common core” approach, and adopted the approaches common to both legal traditions.²⁴⁸ However, with regard to two formation issues—effectiveness of acceptance and firm offer—the common law and civil law diverge. Interestingly, in each case the CISG offers a compromise, fabricating a modified third approach—an amalgamation of conflicting civil and common law rules.²⁴⁹

1. Effectiveness of Acceptance

Regarding the effectiveness of an acceptance, the common law offers the mailbox rule—whereby an acceptance is deemed effective on dispatch by the offeree, rather than on receipt by the offeror.²⁵⁰ The mailbox rule protects the offeree’s expectations by forming the contract at the moment of dispatch.²⁵¹ From an efficiency perspective, the rule misallocates the risk that the acceptance will not reach the offeror by placing the risk on the less efficient insurer.²⁵² Under the rule, the risk of a lost transmission is on the offeror despite

242. CISG, *supra* note 1, arts. 71-72.

243. *Id.* arts. 66-70.

244. *Id.* art. 35.

245. *Id.* art. 74.

246. *Id.* art. 77.

247. *Id.* art. 79.

248. *Id.* arts. 35, 66-72, 74, 77, 79.

249. *Id.* arts. 16(1), 16(2)(b), 18(2); *infra* Parts II.D.1-2.

250. The mailbox rule traces to the King’s Bench. *See* *Adams v. Lindsell*, [1818] 106 Eng. Rep. 250, 252 (K.B.) (holding that buyer was allowed to recover damages for breach of contract from the seller, where buyer sent his acceptance of seller’s offer via mail but the arrival of letter was delayed, by no fault of the buyer, and where seller sold the property in question to a third party before hearing back from buyer in a timely fashion).

251. *See* Courtenay Canedy, Comment, *The Prison Mailbox Rule and Passively Represented Prisoners*, 16 GEO. MASON L. REV. 773, 775-76 (2009) (reviewing the traditional rationales offered in defense of the mailbox rule, such as its function “as a shield to the offeree’s reliance interests”).

252. *See generally* Beth A. Eisler, *Default Rules for Contract Formation By Promise and the Need for the Revision of the Mailbox Rule*, 79 KY. L.J. 557, 565, 583 (1991) (arguing on both economic and other grounds that the mailbox rule needs to be reformed).

the fact that the offeree is the party most able to effectuate delivery.²⁵³

Article 18(2) of the CISG rejects the common law's mailbox rule in favor of the civil law's receipt doctrine.²⁵⁴ The allocation of transmission risk to the more efficient insurer supports the receipt rule. Article 16(1) of the CISG addresses the common law's expectancy protection rationale by freezing the offeror's right to revoke once the acceptance is dispatched.²⁵⁵ However, if the acceptance does not reach the offeror within a reasonable time, then the receipt rule reinstates—or “unfreezes”—the offeror's right to revoke the offer.²⁵⁶ Taken together, Articles 18 and 16 provide a creative set of rules allowing for the adoption of the civil law's receipt rule while protecting the expectancy interest to which the common law's dispatch rule is directed.

2. Firm Offer Rule

In the area of firm offer, both civil and common law jurisdictions recognize the importance of prohibiting merchant sellers from revoking offers that the offeree reasonably expects to remain open. However, under the U.C.C., the reasonableness determination is made by the Code's enunciation of formal requirements—the offeror must assure that the offer will remain open for a fixed time not exceeding ninety days, it must be in writing, and signed by the offeror.²⁵⁷ The CISG, by contrast, expands the breadth of the firm offer principle, rendering irrevocable any offer on which the offeree reasonably relied.²⁵⁸

The advantage of the U.C.C. approach is that it provides a bright-

253. See *id.* at 566 (discussing the operation of the rule and the unbargained-for protection given to the offeree).

254. CISG, *supra* note 1, art. 18(2); see Gyula Eörsi, *Problems of Unifying Law on the Formation of Contracts for the International Sale of Goods*, 27 AM. J. COMP. L. 311, 317-19 (1979) (discussing the doctrine and defining it as one in which withdrawal, revocation, and acceptance of an offer become effective only when received by the other party).

255. CISG, *supra* note 1, art. 16(1).

256. *Id.* art. 18(2). Reasonable time is determined by the “circumstances of the transaction” and the “rapidity of the means of communication employed by the offeror.” *Id.*

257. U.C.C. § 2-205 (1977).

258. CISG, *supra* note 1, art. 16(2)(b).

line rule that is efficient to administer. The formalities of a writing, a signature, and a fixed time provide strong proof of a firm offer. The problem with the CISG's approach is that there is no foolproof means by which an offeror can prevent a *post hoc* determination that he made a firm offer. Although Article 6 of the CISG allows for the derogation from CISG rules by agreement of the parties,²⁵⁹ there is no certainty that a court will recognize an affirmation in the offer that it is not open or that it will remain open only for a shorter than customary time. When there is such an affirmation, the question becomes whether the offeree can reasonably rely on the offer beyond the time period stipulated in the offer. There is a plausible argument that a recognized trade usage—perhaps one where an offer typically remains open for a certain period—may trump a provision in the offer stating otherwise, especially if the provision is in a standard form.

The CISG's firm offer rule's failure to adopt a formality requirement is consistent with the fact that the CISG does not require a writing for contract formation. The interpretation rules used to determine whether an offer is firm are the same as the rules for interpreting a consummated contract.²⁶⁰ The CISG's recognition of international trade usage in contract interpretation is the context in which the offeree's reasonable reliance is likely to be determined.²⁶¹ Practices developed by merchants in a given trade generally provide an efficient means of applying the firm offer rule.²⁶² Hence, the drafters of the CISG once again seem to have fabricated a hybrid rule, adopting the common law firm offer principle, but allowing it to evolve over time through trade usage and business custom.

259. *Id.* art. 6.

260. *See* Ferrari, *supra* note 47, at 76-77 (discussing differing opinions as to good faith and its interaction with the CISG in interpretation and offers).

261. *See* CISG, *supra* note 1, art. 9 (stating that unless a usage was observed by the parties, it is not valid unless it is one of the usage regularly recognized in international trade).

262. *Cf.* Henry Mather, *Firm Offers Under the UCC and the CISG*, 105 DICK. L. REV. 31, 31 (2000) (making the point that firm offers will become more prevalent in the future as merchants look to branch out and make deals in unfamiliar markets).

III. PARTICULARIZED CONSENT: MOVING BEYOND LAW TO BEST PRACTICES

In order to avoid the regulatory function of contract law and frame the interpretation process, the use of particularized consent is the most efficient means of accomplishing these goals. Particularized consent is the use of some means, such as negotiation, legal representation, disclosure, or initialing, to heighten the awareness of the other contracting party to particular contract terms.²⁶³ The use of particularized consent in the international sales setting is the best practice for ensuring the enforcement of important contract terms because it merges the subjective and objective approaches to contract law. Obtaining particularized consent provides a heightened objective base to prevent the use of extrinsic evidence to contradict the enforcement of a contract provision.²⁶⁴ It also establishes an evidentiary base against the party seeking the non-enforcement of a contract provision by showing that she did know or should have known the meaning and intent of the provision.²⁶⁵

The use of particularized consent is especially important to buttress the enforcement of non-material or fine print terms that one of the contracting parties deems important. In the battle of the forms scenario, a heightened consent method increases the chances that the designated terms will be enforced.²⁶⁶ The method of particularized consent consists of the building of evidence of knowledge and consent in order to overcome the admission of contradictory extrinsic evidence.²⁶⁷ From an efficiency perspective, a party should consider the use of particularized consent when the benefits of enhancing its enforceability are greater than the additional transaction costs incurred to particularize the consent.

Most legal systems provide a number of immutable rules, mostly in the consumer contract scenario, that aim to ensure the form-receiving party's awareness of certain contract terms. The U.C.C.

263. *E.g.*, DIMATTEO ET AL., *supra* note 22, at 166-68.

264. *E.g.*, Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and Economics Meets the Real World*, 24 GA. L. REV. 583, 612-14 (1990).

265. *See id.* (inferring that actual knowledge of a term warrants its enforcement).

266. *See id.* at 614 (suggesting further that in order to ensure enforceability of a subordinate clause, a seller should not only obtain buyer consent to the central terms of the clause, but also disclose the exact meaning and effect of the clause).

267. *Id.*

provides a limited example of the importance of demonstrating actual consent in the enforcement of a sales contract—in areas such as the exclusion of warranties—by recognizing the importance of conspicuousness.²⁶⁸ The purpose of the conspicuousness requirement is to enhance the likelihood of true consent by alerting the form receiving party of the importance of the particular term.²⁶⁹ The requirement of conspicuousness in areas such as disclaimer of liability and warranty avoidance, set forth in the U.C.C. and the Magnusson-Moss Act,²⁷⁰ is as close as American contract law, generally, gets to the notion of particularized consent. This is a weak form of particularized consent because it rests on the premise that merely displaying terms in a conspicuous manner will lead the receiving party to a better understanding of the terms' content. The rationale is that such conspicuousness provides a cautionary incentive to read and understand the terms.²⁷¹

The United States' Uniform Computer Information Transactions Act ("UCITA") provides a more robust particularized consent regime, albeit in a limited context, by requiring that contracts involving the use of self-help remedies "separately manifest assent to . . . the use of electronic self-help."²⁷² In a more general context, the European Union's Unfair Terms in Consumer Contracts Directive dictates "that a contractual term which has not been *individually negotiated* shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights

268. *E.g.*, U.C.C. § 2-316 (1977). Conspicuity is merely a procedural device or formality. The U.C.C. states that "[c]onspicuous terms include the following: . . . (A) a heading in capitals equal to or greater in size than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same or lesser size; and (B) language in the body of a record or display in larger type than the surrounding text, or in contrasting type, font, or color to the surrounding text of the same size, or set off from surrounding text of the same size by symbols or other marks that call attention to the language." *Id.* § 1-201(b).

269. *See* Robert M. Lloyd, *The "Circle of Assent" Doctrine: An Important Innovation in Contract Law*, 7 TENN. J. BUS. L. 237, 244 (2006) (reiterating that a writing is sufficiently conspicuous under the U.C.C. if the writing is of a larger size or in a contrasting color).

270. *See supra* note 268; Magnusson-Moss Act, 15 U.S.C. § 2302(a) (1975).

271. *See* U.C.C. § 1-201(b) ("'Conspicuous' with reference to a term, means so written, displayed, or presented that a reasonable person against which it is to operate ought to have noticed it.").

272. U.C.I.T.A. § 816 (2002).

and obligations arising under the contract, to the detriment of the consumer.”²⁷³ In the event that there has been no individualized agreement, Article 4 (1) provides that:

[T]he unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.²⁷⁴

The Hungarian Civil Code, in introducing its national law rules on unfair terms, provides that when assessing the unfairness of a contractual term, “all of the circumstances leading to the conclusion of the contract as well as the nature of the stipulated service and the relationship of the condition in question with other contract conditions and other contracts.”²⁷⁵ British courts also insist on a totality of the circumstances analysis when applying the U.K.’s unfair contracts legislation.²⁷⁶ One commentator observes that “the extent to which the other side [is] *familiar* with the particular term” is crucial to determining whether the term is enforceable under U.K. law.²⁷⁷

A final example of the use of particularized consent is found in the *Principles of European Contract Law* which states that “terms which have been individually negotiated take preference over those which have not.”²⁷⁸ More telling is Article 2:104 (“Terms Not Individually

273. Council Directive 93/13, art. 3, 1993 O.J. (L 95) 29 (EC) (emphasis added).

274. *Id.* art. 4.

275. 1959. Évi IV. törvény a Polgári Törvénykönyv (Act IV of 1959 on the Civil Code) § 209/B(3) (Hung.).

276. English Unfair Contract Terms Act, 1977, c. 50, § 11(1) (U.K.); see *Salvage Ass’n v. CAP Fin. Serv. Ltd.* (1995) F.S.R. 654 (Q.B.) 678 (U.K.) (analyzing the fairness and reasonableness of two contract provisions in light of Section 11(1) of the 1977 Act).

277. Richard Lawson, *Matter of Construction*, 156 NEW L.J. 1310, 1311 (2006) (emphasis added). Reiter and Swan use the reasonable expectations approach to determine contractual intent and which terms and standards the parties are expected to enforce. They suggest that “[t]he court should [] strive to protect the reasonable expectations of the parties, discovered through experience in living or through expert evidence where it is helpful.” Barry J. Reiter & John Swan, *Contracts and the Protection of Reasonable Expectations*, in *STUDIES IN CONTACT LAW* 1, 8 (Barry J. Reiter & John Swan eds., 1980).

278. *Principles of European Contract Law [PECL]* art. 5:104 (1999).

Negotiated”) which states that non-negotiated terms cannot be enforced against a party unless “the party invoking them took reasonable steps to bring them to the other party’s attention before or when the contract was concluded.”²⁷⁹ It further raises the threshold of notice by stating that “terms are not brought appropriately to a party’s attention by a mere reference to them in the contract document, even if that party signs the document.”²⁸⁰ Accordingly, these guidelines should be used by the international merchant to ensure the enforcement of contract terms. Obtaining particularized consent is especially warranted when the seller transacts business through intermediaries, such as a foreign sales representative, to ensure that there is strong evidence that the ultimate purchasers have given knowing consent to the terms important to the seller.

Under general economic theory, the providing of additional information, transaction costs aside, should lead to more efficient contract terms. Knowledge of the existence and meaning of a contract term increases the chances that it is the product of consent.²⁸¹ This has been shown to be the case even in the application of such doctrines as unconscionability. An empirical study showed that consent-based factors, and not substantive fairness, were better predictors of unconscionability decisions.²⁸² If consent-based factors are present, such as conspicuousness, negotiation, knowledge, or being represented by an attorney, a court will rarely find a case of unconscionability even in cases of substantive one-sidedness. Alternatively stated, the existence of consent-enhancing factors greatly increases the likelihood of the enforceability of contract terms.

“When a party seeks to incorporate standard terms into an offer or acceptance, courts consider whether such terms have been fairly

279. *Id.* art. 2:104(1).

280. *Id.* art. 2:104(2).

281. *See* Meyerson, *supra* note 264, at 613 (quoting *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965) (“[When a party] signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the terms.”)).

282. Larry A. DiMatteo & Bruce Louis Rich, *A Consent Theory of Unconscionability: An Empirical Study of Law in Action*, 33 FLA. ST. U. L. REV. 1067 (2006).

communicated to the other party.”²⁸³ While “the CISG does not specifically address the incorporation of standard terms, national courts generally agree that the CISG’s provisions on contract formation and interpretation determine whether standard terms have been validly incorporated into the contract.”²⁸⁴ Alternatively, a view can be taken that CISG Article 4 places the issue of validity of standard terms clearly outside the CISG’s scope and puts it within the domestic law domain.²⁸⁵

The argument here is not that the CISG requires or even encourages particularized consent of certain contract terms, but that it is a best practice for parties to obtain particularized consent to terms they deem important. The additional transaction costs of obtaining such consent are likely to be outweighed by the benefits of increasing the probability of enforcement. Offhand, the terms for which particularized consent would most commonly produce efficiency gains include: arbitration, price adjustment, warranties, notice of non-conformity requirements, unusual *force majeure* events, extended inspection rights, damages, and remedy limitation clauses.

Assuming the efficiency of obtaining particularized consent on certain contract terms, the issue becomes how much information needs to be communicated to the form or contract receiving party? Civil law legal systems emphasize that a party must be reasonably aware of the terms the other seeks to incorporate, but how does one measure reasonable awareness?

In general, although not expressly stated in the CISG, the burden of proof falls on the party who benefits from proving a proposition. In the case of standard terms, the party that argues that its standard terms are part of the contract is required to prove that the parties agreed to their incorporation.²⁸⁶ Standard terms—generally referred to in Europe as “general conditions”—are often not discussed in the negotiation of a sales contract, making proof of express agreement to

283. DIMATTEO ET AL., *supra* note 22, at 64.

284. *Id.*

285. *Id.*

286. *See, e.g.*, Council Directive 93/13, *supra* note 273, art. 3 (indicating that the seller or supplier has the burden of proving that the term was individually negotiated).

their incorporation difficult to prove.²⁸⁷

There are a number of factual scenarios in which the incorporation of standard terms is at issue. The first scenario arises at the formation of the contract, when a party attempts to insert its standard terms into the contract—sometimes by simply referencing their existence.²⁸⁸ The second arises when a party attempts to insert its standard terms subsequent to the formation of the contract—often done by placing the standard terms in a subsequent document, such as an invoice, packing slip, or purchase order.²⁸⁹ Lastly, the third arises when both parties attempt to insert their own standard terms into the contract at the time of formation, resulting in conflicting terms.²⁹⁰

This analysis of the use of particularized consent is primarily directed at the first scenario. Particularized consent's main purpose is ensuring the enforcement of a term in the contract. The courts generally respond to the second scenario by holding that standard terms cannot be unilaterally incorporated into a contract subsequent to its formation.²⁹¹ The third scenario is the phenomenon known as “the battle of the forms.” Due to the complexity of the battle of forms and its treatment under Article 19 of the CISG, the third scenario is

287. See Oberster Gerichtshof [OGH] [Supreme Court] Sept. 13, 2001, docket No. 6 Ob 73/01f (Austria), available at <http://cisgw3.law.pace.edu/cases/010913a3.html> (recognizing the requirement that the receiving party be aware of the standard terms, but noting that awareness can be implied and, therefore, acceptance of the terms can be implicit).

288. See *id.* (indicating that implied inclusion of a standard term can be effected only under strict prerequisites).

289. See *id.* (describing the possibility for a standard term to be impliedly added to the contract when the term was “hinted to” in the context of a long-term business relationship and there had no objection to the term).

290. See Kaia Wildner, *Art. 19 CISG: The German Approach to the Battle of the Forms in International Contract Law: The Decision of the Federal Supreme Court of Germany of 9 January 2002*, 20 PACE INT'L L. REV. 1, 3 (2008) (identifying this method as a “battle of forms” in which parties exchange forms containing standard terms that conflict).

291. *E.g.*, *Chateau des Charmes Wines Ltd. v. Sabaté USA Inc.*, 328 F.3d 528, 531 (9th Cir. 2003) (holding that a forum selection clause was not part of the contract as it was not included in the initial oral agreements, but was instead added in later invoices); *Chateau des Charmes Wines Ltd v. Sabaté USA Inc.*, [2005] O.J. No. 4604, ¶¶ 29-31 (Can. Ont. Master) (reaching the same conclusion—that the forum selection clause on the invoices did not constitute part of the contracts between the parties).

not part of the current discussion.²⁹² This is mainly due to the fact that a single party has little control, if any, over the standard terms that a court will recognize in the battle of the forms scenario.

The question remains what is the best method to incorporate standard terms at the time of contract formation? The common approach recognizes that the incorporating party holds the risk of non-incorporation, and thereby has the burden of proof. As a practical matter, the incorporating party should lay an evidentiary base for fulfilling its burden of proof that the terms were an agreed-to part of the contract. Some courts require the terms be made available to the other party prior to or at the time the contract is formed.²⁹³ A court will reject such an attempt to incorporate standard terms if it determines that the parties concluded an oral agreement, which lacked those terms, prior to the exchange of documents or the providing of standard terms.²⁹⁴ This was the case in *ISEA Industrie S.p.A. v. Lu S.A.*, where despite the fact that the standard terms of the buyer were included on the back of a document signed by the seller, the court held that the incorporation was ineffective.²⁹⁵

The majority of CISG case law holds that the receiving party must be made aware of the standard terms by the incorporating party. Further, the incorporating party must communicate its intent that the terms should be incorporated into the contract. In 2010, an American court rejected a buyer's argument that it never agreed to the seller's standard terms placed into the seller's offer, where there was some evidence that the buyer was aware of those terms and the seller's intent to incorporate them.²⁹⁶ The buyer argued "that the mere receipt

292. For a detailed analysis of how the CISG, and in particular Germany, treats conflicting standard terms, see generally Wildner, *supra* note 290.

293. Larry A. DiMatteo et al., *The Interpretive Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence*, 24 NW. J. INT'L L. & BUS. 299, 346-47 (2004).

294. *E.g.*, *Chateau des Charmes Wines Ltd.*, 328 F.3d at 531.

295. Cour d'appel [CA] [Regional Court of Appeals] Paris, Dec. 13, 1995 (Fr.), available at <http://cisgw3.law.pace.edu/cases/951213f1.html> (determining that the terms and conditions present on the back of the form signed by the seller were not accepted because there was no reference to the terms at the time the seller signed).

296. *Golden Valley Grape Juice & Wine, LLC v. Centrisys Corp.*, No. CVF 09-1424 LJO GSA, 2010 WL 347897, *5 (E.D. Cal. Jan. 22, 2010) (indicating that because the terms were sent as an attachment to the offer, and there was evidence that the buyer opened some of the attachments, the buyer cannot say that they were unaware of the terms and conditions sent to them by the seller).

of the General Conditions [was] not enough to accept the conditions,"²⁹⁷ but the court held that the buyer accepted the standard terms of the offer when it sold the product to a third-party.²⁹⁸ Therefore, the court considered the terms to be accepted by conduct.

As previously discussed, a successful incorporation of standard terms requires a threshold of awareness or knowledge by the non-incorporating party and a showing of intent by the incorporating party to incorporate the terms at the time of formation. The requirements of awareness and intent are generally interrelated. A party's awareness of the other party's standard terms can be the basis for a finding of intent. An Austrian court noted that incorporation will be implied if the terms are "included in the proposal . . . in a way that the other party under the given circumstances knew or could not have been reasonably unaware of [the] intent" to incorporate the terms.²⁹⁹ It further noted that intent can be established through express or implied reference in the offer, as well as through the contract negotiations or through an established practice.³⁰⁰

As noted above, incorporation can be based upon an established practice of the parties through a course of dealings. The importance of the existence of a long-term relationship played a key role in a recent Dutch case, which dealt with the issue of whether the acceptance of an offer that merely referenced the seller's standard terms constituted an acceptance of those terms.³⁰¹ The court noted that "there was no established business relationship between the parties," so therefore simple reference to the standard terms was insufficient to make the terms part of the contract.³⁰² Additionally the seller should have provided to "the buyer a reasonable opportunity before or at the time of concluding the contract . . . to become aware of the . . . general conditions."³⁰³ Since this had not occurred, the

297. *Id.* at *4.

298. *See id.* (indicating that pursuant to CISG Art. 19, a buyer may assent to buying goods through conduct relating to payment or dispatch of goods).

299. Oberster Gerichtshof [OGH] [Supreme Court] Dec. 17, 2003, docket No. 7 Ob 275/03x (Austria), available at <http://cisgw3.law.pace.edu/cases/031217a3.html>.

300. *Id.*

301. Rb Utrecht 21 januari 2009, HA ZA 08-1642 (GmbH/Quote Foodprints B.V.) (Neth.), available at <http://cisgw3.law.pace.edu/cases/090121n1.html>.

302. *Id.* at Editorial Remarks.

303. *Id.*

Dutch court concluded that the buyer could not reasonably acquire an understanding that the terms would become part of the contract.³⁰⁴

In an earlier case, a German court took a hard view of intent as requiring express agreement to the existence and content of the standard terms.³⁰⁵ However, the court noted that intent to accept an offer or counteroffer containing the standard terms can be implied. It held that the urging by the original offeror (buyer) for immediate delivery would generally constitute an acceptance of the seller's counteroffer including the standard terms.³⁰⁶ But, ultimately, the court held that because the seller's standard terms were available only in the German language, they were not incorporated into the contract—the language of which was English.³⁰⁷ Notwithstanding this holding, the trend is that incorporation of the terms is appropriate if done so in any *major* language used in international business dealings.

Another German court noted that the final arbiter of whether standard terms are incorporated is the reasonable person.³⁰⁸ In that case, the buyer placed a number of orders with a seller who responded by sending written order confirmations containing the seller's standard terms. The court held that in applying the reasonable person standard, a certain threshold of communication regarding the standard terms was necessary before the terms could be deemed incorporated into the contract. This evidentiary threshold included proof that “the recipient . . . must be provided with the general terms and conditions, or [the recipient] must be given the opportunity to reasonably get to know [them].”³⁰⁹ The court determined that the evidentiary threshold was met, stating that the

304. In its decision, the court invoked German case law “on the application of general conditions on the basis of the CISG, which emphasizes that general conditions will only be applicable if the text of such conditions is handed over to the offeree before or at the time of the conclusion of the contract.” *Id.*

305. Oberlandesgericht Düsseldorf [OLG] [Provincial Appellate Court] Apr. 21, 2004, 15 U 88/08 (Ger.), available at <http://cisgw3.law.pace.edu/cases/040421g3.html>.

306. *Id.* ¶ 1(b)(bb)(1).

307. *Id.*

308. Oberlandesgericht München [OLG] [Provincial Appellate Court] Jan. 14, 2009, 20 U 3683/08 (Ger.), available at <http://cisgw3.law.pace.edu/cases/090114g1.html>.

309. *Id.*

receiving party must have taken notice of the standard terms included in the footers of the confirmations as the first order was countersigned and returned.³¹⁰ In essence, the court held that standard terms inserted into an offer or acceptance met the awareness and intent requirements for incorporation.

In the above case, the German court did not rule on whether standard terms could be incorporated merely by reference in the offer or acceptance, due to the fact that the standard term at issue was written into the confirmation.³¹¹ On the other hand, it does not expressly reject the notion that the full set of standard terms, not expressly written into the offer or acceptance, may be incorporated into the contract in some circumstances. In cases where there is clear intent of a party to incorporate its standard terms or the reference was made over a long course of dealings and the other party failed to object, a finding of an implicit agreement may be reached.³¹² As an aside, the fact that there was no reference in the body of the seller's form to the standard terms—which were included exclusively in the document's footnotes—was not considered important by the court.

Some courts refuse to enforce terms that derogate from CISG rules without proof of particularized express consent. Article 6 states that “parties may exclude the application of this Convention . . . or derogate from or vary the effect of any of its provisions.”³¹³ However, excluding or varying the application of a CISG provision may require more than inserting an express term in the written contract. For example, an Italian court held that the party seeking to enforce the derogation must prove the other party's awareness of the relevant CISG provision and the express intent to exclude it.³¹⁴

310. *See id.* (arguing that the buyer is expected to comprehensively check communications and take notice of any terms and conditions indicated therein).

311. *See id.* (“Buyer is [] expected to check the written communications comprehensively and to take notice of the general terms and conditions included therein.”).

312. *E.g.*, Oberster Gerichtshof [OGH] [Supreme Court] Dec. 17, 2003, docket No. 7 Ob 275/03x (Austria), available at <http://cisgw3.law.pace.edu/cases/031217a3.html>.

313. CISG, *supra* note 1, art. 6.

314. *See* Tribunale di Padova, 25 febbraio 2004, No. 40552 (It.), available at <http://cisgw3.law.pace.edu/cases/040225i3.html> (indicating that knowledge of the CISG's applicability must be clearly shown before the court can credit the parties' intent to have the domestic rule operate).

Another example of the need for particularized consent relates to the express recognition of CISG's Article 29 that a contract can require modifications to be made in writing.³¹⁵ However, an Austrian court rejected that such a provision is sufficient to derogate from Article 11's no writing requirement by failing to enforce a writing requirement clause inserted into a standard form contract.³¹⁶ The court held that such a writing requirement is enforceable only if the party against whom it is being asserted gave informed consent.³¹⁷

In sum, due to the CISG's liberal use of extrinsic evidence, the most efficient means to ensure enforcement of "important" terms is the implementation of procedural steps designed to obtain particularized consent. Particularized consent should be recognized as a best practice when the costs of obtaining consent, including the probability that the term would be construed as a deal-breaker, is outweighed by the value of ensuring the term's enforceability, diminished by the probability of the term's use. Such an approach is aligned with the underlying EAL assumption that terms that are a true expression of the parties' intent are the most efficient.

IV. ASSESSING THE VALUE OF COMPARATIVE EAL

It has been argued elsewhere that comparative EAL is a relatively useless method for comparing laws from different national legal systems. The argument is that the differences in legal culture often justify the development of different contract rules and at the same time are efficient within each given cultural context.³¹⁸ Professors Alpa and Giampieri assert that:

315. CISG, *supra* note 1, art. 29.

316. See Oberster Gerichtshof [OGH] [Supreme Court] Feb. 6, 1996, docket No. 10 Ob 518/95 (Austria), available at <http://cisgw3.law.pace.edu/cases/960206a3.html> (determining that the seller's general conditions in the contract were not agreed upon, and therefore the writing requirement did not govern as the other party was not aware of the requirement).

317. *Id.*

318. See Guido Alpa & Alberto Giampieri, *Law and Economics and Method Analysis: The Contractual Damages Issue*, JUS (1995), <http://www.jus.unitn.it/cardozo/review/Contract/Alpa-1995/alpa.html#damages> (highlighting the negative treatment of voluntary breach by the French and Italian legal systems compared to the tendency in English common law to disregard voluntary breach).

The analysis of some of the rules related to the breach of contract and the relative damages recovery techniques shows that the models of law and economics cannot be always applied: they are always based either on a certain law system or on legal concepts typical to a peculiar experience; the adoption of a perfect, ideal, abstract model may be useful as a general framework, but, in order to achieve practical results, it is necessary to carry out an analysis in light of the applicable law, taking into account the interpretation given by the jurisprudence and the concepts on which same is grounded.³¹⁹

The present article considered instances where the CISG chose among rules from different legal regimes, and the adopted rule in most cases was taken from the civil law. However, it does not necessarily follow that the civil law is more efficient, as oftentimes the apparent choice of one rule still ended with hybridized results. For example, it was noted that CISG's Article 18(2) rejects the common law's mailbox rule in favor of a receipt rule.³²⁰ But, Article 16(1) addresses the major concern underlying the mailbox rule (offeree's expectation of contract formation) by freezing the offeror's right to revoke the offer upon the dispatch of the acceptance.³²¹

Another example of divergence is the CISG's rejection of the U.C.C.'s perfect tender rule in favor of the fundamental breach rule. The perfect tender and the fundamental breach rules are relatively efficient within the context of their use.³²² As noted in Part I.A.1., in the U.S. domestic market, the seller's costs of retrieving or transshipping goods to another buyer, following a rejection, does not amount to the incurring of undue costs. Therefore, the perfect tender rule is better suited for domestic market transactions. In contrast, having goods rejected in a faraway country is likely to result in substantial expenses to the seller. In addition, the buyer in an international transaction is the more efficient party to obtain some value for the non-conforming goods. In the international sales scenario, the fundamental breach approach is the more efficient rule.

Also, the divergence between the CISG's fundamental breach rule

319. *Id.*

320. CISG, *supra* note 1, art. 18(2); *see supra* notes 254-56 and accompanying text.

321. CISG, *supra* note 1, art. 16(1); *see supra* notes 254-56 and accompanying text.

322. *See supra* notes 23-27 and accompanying text.

and the U.C.C.'s perfect tender rule is not as great as it may seem. Reviewing the U.C.C. as a whole shows that the absolute right of the buyer to reject non-conforming tenders of goods under the perfect tender rule is not so absolute. That right is qualified by U.C.C. Sections 2-602 and 2-603, which require, respectively, that the buyer inspect the goods within a reasonable time and give reasonable notice or lose the right to reject,³²³ and "after rejection . . . follow any reasonable instructions received from the seller with respect to the goods"³²⁴ In the absence of such instructions, it further obligates the buyer to obtain salvage value for goods that are "perishable or threaten to decline in value speedily."³²⁵ Thus, the CISG rule, context aside, is not as divergent from the common law rule as initially perceived, and relative efficiency of result is closer than the rejection rule would indicate.

A. EVOLUTIONARY EFFICIENCY

Judge Posner argued that the common law is generally made up of efficient rules.³²⁶ The reason given for such efficiency is that courts in deciding cases intuitively use an economic analysis in the application of legal rules. Others extended this theory to argue that the common law becomes more efficient over time.³²⁷ One version of

323. See U.C.C. § 2-602 (1977). Compare CISG, *supra* note 1, art. 38, with *id.* art. 39.

324. U.C.C. § 2-603(1) (1977).

325. *Id.*

326. See POSNER, *supra* note 10, at 98 (explaining that the "common law method is to allocate responsibilities between people engaged in interacting activities in such a way as to maximize the joint value, or, what amounts to the same thing, minimize the joint cost of the activities").

327. See generally John C. Goodman, *An Economic Theory of the Evolution of Common Law*, 7 J. LEGAL STUD. 393 (1978) (suggesting that efficiency increases are the result of either judges preferring efficiency or a process of natural selection whereby more efficient rules persist and less efficient ones are replaced or overruled); Priest, *supra* note 8 (noting that even when both parties are not interested in setting a precedent, the common law still evolves toward efficiency); Rubin, *supra* note 60 (indicating that when both parties are interested in setting precedent, inefficient rules will evolve out of the law); Jeffrey Evans Stake, *Evolution of Rules in a Common Law System: Differential Litigation of the Fee Tail and Other Perpetuities*, 32 FL. ST. L. REV. 401 (2005) (positing that internal and external competition helps to develop efficient rules in the common law process). But see generally Ramona L. Paetzold & Steven Willborn, *The Efficiency of the Common Law Reconsidered*, 14 GEO. MASON L. REV. 157 (1991) (arguing against the purported general tendency of the common law to evolve efficiently;

this evolutionary model asserts that those cases most likely to be disputed involve inefficient rules.³²⁸ Disputes involving the application of efficient rules are more likely to be settled out of court. Thus, courts over time are given the opportunity to work inefficient rules out of the common law. Professor Rubin qualifies this assertion by noting that evolutionary efficiency is not uniform throughout the common law because it depends more on the characteristics of the litigants than it does on the actions of judges.³²⁹

Evolutionary efficiency is most likely to happen when both parties to the dispute are interested in setting a precedent where the existing rule is inefficient.³³⁰ The only further modification of this version of evolutionary theory is that the characteristics of the parties change over time. Cases of only one or no interested parties could become cases of two interested parties. This is likely to happen in response to changes in the market—or government regulation thereof. From the perspective of the long-term evolution of legal rules, all rules will evolve towards efficiency or the government will intervene in an

necessity of “recurrence, legal standing of cost-bearers, representativeness, and stability” probably apply only in reality to a small portion of cases within the common law system or do not exist at all); Adam J. Hirsch, *Evolutionary Theories of Common Law Efficiency: Reasons for (Cognitive) Skepticism*, 32 FLA. ST. U. L. REV. 425 (2005) (making the point that common law rule-making is limited by bounded rationality; common law change is often inadvertent).

328. See Hirsch, *supra* note 327, at 428 (indicating that “relentless pressure of periodic, lopsided litigation exerts itself upon an inefficient rule until it gives way”).

329. Rubin, *supra* note 60, at 53. Professor Rubin distinguishes levels of evolutionary efficiency based on the characteristics of the disputing parties. The pairings of parties is divided into cases where both parties are interested in setting a precedent, where only one party is interested in setting a precedent, and where neither party is interested in setting a precedent. See *id.* at 53-57 (analyzing the outcomes in each situation). It is only in the first scenario (two-party interest) that *efficient* evolutionary outcomes are most likely. If the defendant in the first scenario is subject to an inefficient rule, then he/she will be incentivized to litigate. In short, “efficient rules will be maintained, and inefficient rules litigated until overturned.” *Id.* at 53. In the second scenario (one-party interest), the party interested in setting or retaining a precedent is over time more likely to get a solution favorable to his side. See *id.* at 55 (suggesting that this is due to the tendency for that party to bring many claims to court). This solution (rule change) may not be the most efficient one. In the third scenario (no-party interest), the status quo rule will persist because neither party has an incentive to litigate for a rule change and are most likely to settle out of court based upon the existing rule. *Id.* at 56.

330. *Id.* at 53.

attempt to provide more efficient rules.³³¹

The importance of the evolutionary efficiency argument is that it is internal to a given legal system. If we assume that both the civil and common law systems evolve toward more efficient rules, then we are still presented with the question of which one is more efficient in cases where they have evolved different rules. This is where comparative law and economics has a role to play. This comparison would be most striking if legal systems were highly insulated. The greater the level of insularity the more one would expect to see divergence in rules and the relative efficiency of rules.³³² This is not the case with the civil and common law systems, as both systems have been exposed to each over the centuries. This allowed for greater convergence in the systems through cross-fertilization, transplantation, and harmonization.³³³ More recently, the evolution of the common market assisted convergence in European contract law.

The CISG provides an opportunity to examine, from an efficiency perspective, some of the remaining vestiges of divergence in the law of sales. Some argue that when legal systems compete, the more efficient one will win the battle of competing rules.³³⁴ The findings of this article tentatively support this argument.

331. *Cf. id.* (indicating that governmental agencies and other corporate bodies are repeat players, and thus are necessarily interested in cases both for their individual outcomes and precedential value).

332. *See, e.g.,* Michael Joachim Bonell, *The UNIDROIT Principles and CISG - Sources of Inspiration for English Courts?*, 19 PACE INT'L L. REV. 9, 9-10 (2007) (explaining how countries that are parties to international conventions often interpret them with regard to their existing domestic laws as opposed to interpreting the conventions in a way that recognizes their international character).

333. *See generally id.* (explaining that the convergence in European contract law is a by-product of the evolution of the common market).

334. *See* Daniel Klerman, *Jurisdictional Competition and the Evolution of the Common Law: A Hypothesis*, 8 AUSTL. J. LEGAL HIST. 1, 1-3 (2004) (indicating that competition is important in the evolution of efficiency, but that it is not the sole factor); Todd J. Zwicki, *The Rise and Fall of Efficiency in the Common Law: A Supply-Side Analysis*, 97 NW. U. L. REV. 1551, 1554 (2003) (discussing the competition between courts of concurrent jurisdiction in England and the evolution of pro-plaintiff rules).

B. BENEFITS OF COMPARATIVE EAL

Comparative EAL is part of a long history of comparative law analysis.³³⁵ Legal systems borrowed rules from each other for many years. Some transplanted entire areas of law. Comparative legal historian Alan Watson noted that “legal transplants—the moving of a rule or a system of law from one country to another, or from one people to another—have been common since the earliest recorded history.”³³⁶ Comparative contract law has existed as long as comparative law. Given the different sources—Roman Law for the civil law and English judge-made law for the common law—scholars continue to compare divergences in the contract law between the two systems.³³⁷ Due to the divergence in the rules of these two major legal systems, business practitioners and legal scholars have long sought a harmonizing, supranational law that would facilitate transborder transactions. The CISG is a recent product of that search.

It is only natural that comparative legal scholarship should analyze such movements between legal systems. Such a descriptive endeavor leads to prescriptive suggestions of which legal system-specific rules better respond to modern, international transactions. EAL provides one means of choosing between divergent national rules. Private international law conventions, like the CISG, provide opportunities to apply EAL principles to non-nation-specific private law. This is especially true when alternative rules were available to drafters of

335. See generally Rudolf B. Schlesinger, *The Past and Future of Comparative Law*, 43 AM. J. COMP. L. 477 (1995) (presenting the historical perspective of one of the founders of modern comparative private law, Professor Schlesinger). See also Ferdinand F. Stone, *The End to be Served by Comparative Law*, 25 TUL. L. REV. 325, 330 (1951) (indicating that comparative law has long been highlighted as important by business, science, government, and social service).

336. ALAN WATSON, *LEGAL TRANSPLANTS: AN APPROACH TO COMPARATIVE LAW* 21 (2d ed. 1993).

337. See generally CONTRACT LAW TODAY: ANGLO-FRENCH COMPARISONS (Donald Harris & Denis Tallon eds., 1989) (reporting an academic collaboration which concluded that French and English contract law are similar because contracts perform the same function in both systems, but that the bodies of law diverge in their application); G.H. TREITEL, *REMEDIES FOR BREACH OF CONTRACT: A COMPARATIVE ACCOUNT* (1988) (comparing remedies available to the victim for breach of contract in civil and common law countries); John D. McCamus, *Disgorgement for Breach of Contract: A Comparative Perspective*, 36 LOY. L.A. L. REV. 943 (2003) (comparing American and English law in regards to disgorgement for breach of contract).

such conventions. The fact that the CISG is a blend of common and civil law rules makes it an ideal avenue for comparative EAL scholarship.

C. COMPARATIVE EAL AND THE CISG

The current comparative efficiency analysis suggests three general areas for further inquiry—two descriptive and one normative. The first area is whether the CISG makes international sales contracting more or less efficient. This descriptive analysis can and should be done at two levels. The first level—the one implored in this article—looks at the choices presented to the CISG drafters and the resultant adopted rules to assess the efficiency of the selected rules. The second level analysis recognizes the likely divergence between the rules as written and the rules as applied. This divergence is most likely in the CISG context due to the fact that its rules are applied by courts from different legal traditions. This divergence requires an analysis into whether jurisprudential developments in the application of CISG rules make the rules more or less efficient. At the same time, an ongoing normative analysis would involve taking the findings of the comparative efficiency analysis and asking what changes should be considered to make international sales law more efficient?

The intellectual benefit of comparative efficiency analysis in the context of the CISG is that it forces the evaluator to critically assess nation-specific rules. A major benefit of the use of EAL in comparative law is that it improves the means by which scholars from different legal traditions are able to communicate. The nomenclature of efficiency—transaction costs, most efficient insurer, default rules, and wealth maximization—can be applied across legal systems. It provides a means to more rigorously describe the consequences of competing rules. Economic rationales may also be used to justify a compromise between competing rules. The CISG's acceptance of the receipt rule³³⁸ can be seen as the proper allocation of risk to the best insurer. The freezing of the revocation of offer power upon the dispatch of the acceptance³³⁹ can be seen as an efficient attempt at protecting the expectancy of the offeree. In the

338. CISG, *supra* note 1, art. 18(2).

339. CISG, *supra* note 1, art. 16(1).

end, the underlying policies behind the adoption of divergent rules among different legal systems cannot be uncovered through EAL. Yet, EAL allows for a better description of the degree that divergence exists.

A final example of the descriptive power of EAL can be seen in the area of pre-contractual liability. On the surface there seems to be two diametrically opposed rules—the civil law's acceptance of the duty of good faith negotiations and the common law's rejection of any good faith obligation prior to contract formation. But in fact, as discussed earlier,³⁴⁰ the common law evolved means to overcome the inefficiency of a party incurring sunk costs while promoting the efficiency of allowing parties the freedom to investigate potentially beneficial collaborations without incurring liability. This balance of protecting reasonable reliance and not inhibiting exploratory negotiations can be seen in the evolution of the common law's principle of promissory estoppel and the recognition that parties can enter into a binding agreement to negotiate in good faith.³⁴¹

CONCLUSION

Law and economics allows for the study of the comparative efficiency of rules found in different legal systems. It also allows for the normative claim that only the better or more efficient rules should be adopted at the level of uniform international sales or contract law. The ability to select or fabricate efficient rules offers an alternative to a common-core approach to unification and harmonization of national laws. The economic analysis of law provides a means of selecting the more efficient laws from among conflicting national rules.³⁴²

Additionally, the CISG provides a medium for such a comparative analysis, as it is a hybrid or amalgamation of civil and common law rules.³⁴³ The drafters were faced with competing or conflicting rules offered by the two legal systems, and their ultimate

340. See *supra* note 107.

341. See Tess Wilkinson-Ryan & David A. Hoffman, *Breach is for Suckers*, 63 VAND. L. REV. 1003, 1039 (2010) (indicating that courts, when analyzing a claim for promissory estoppel, tend to look more at the promisee's reasonable reliance than the actual promise).

342. See *supra* Part I.B.

343. See *supra* Part I.A.1.

selection of one or the other provides an opportunity to test the theoretical efficiency of each. This article begins with such an analysis and, in the end, concludes that the drafters were mostly successful in selecting the more efficient rules. However, the lack of comprehensiveness and the abdication of coverage of numerous areas of sales law renders the overall efficiency of the CISG less than optimal.

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