Contracts Tea no. 2 (April 2011)

Federal district courts seem to struggle with the application of CISG. In particular, recent decisions show a misunderstanding of CISG principles of offer and acceptance and the role of the parties' intent in CISG.

In two recent cases, American courts applied the CISG and reached the correct result. The reasoning and some dicta, however, show a misunderstanding of some CISG provisions, i.e. article 8 and article 19.

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In *Hanwa Corp. v. Cedar Petrochemicals, Inc.,* 2011 WL 165404 (S.D.N.Y.), a federal district court held that a Korean buyer of goods had not made an effective offer to purchase under Article 14 of the CISG because it had not revealed an intent to be bound when it made its bid for the goods. Here are the facts: Cedar Petrochemicals, Inc. ("Cedar"), a New York corporation, and Hanwa Corp. ("Hanwha"), a Korean corporation, had previously entered into twenty transactions for the purchase and sale of various petrochemicals over six years. In May 2009, Hanwha bid on 1,000 metric tons of the petrochemical Toluene at market price $640 per metric ton. Cedar accepted the bid and sent Hanwha the contract. One week later, Hanwha returned a modified contract that substituted its preference for Singapore law and Incoterms 2000 instead of New York law, the UCC, and Incoterms 2000. The email containing the modified contract provided that no contract would "enter into force" unless Cedar countersigned the new contract. Cedar refused and told Hanwha that there was no contract between the parties, and Cedar had the right to sell to another party. By that time, the price had risen from $640 per metric ton to $790.50. Hanwha sued Cedar alleging breach of contract for failure to deliver at the agreed-upon price and anticipatory breach of contract.

After having found that CISG governed because both parties are domiciliaries of signatory nations and the parties could not agree on alternative law, on the issue of whether Hanwha had made a binding offer under CISG, the court held that it had not. Indeed,

there was no "sufficiently definite" binding offer pursuant to CISG law based on the totality of the circumstances. Under Article 14, the offer must be sufficiently definite and both parties must possess intent to enter the contract. Under Article 8, intent is determined by a reasonable person standard evidenced by verbal statements, conduct, and prior dealings. Under Article 19, "[a] reply to an offer which purports to be an acceptance, but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer." Here, Hanwha never intended to be bound. After Hanwha modified Cedar's contract documents and proposed a different choice of law, Cedar rejected the change. These activities constitute a counter-offer, and a rejection of the counter-offer, within the meaning of Article 19(1). By objecting immediately and insisting on its own terms, Cedar made clear that it regarded the change as material, thus rendering the different choice of law a material term under Article 19(2). The court considered the course of dealing between the parties: in the twenty previous transactions the parties did not perform until after an achieved agreement, explicit or implicit on the terms of the contract. The result is correct.

The interesting part of the decision, however, lies in the dictum. The court appears to misunderstand Article 8(1) and seems to think that the CISG adopts a subjective approach (meeting of the minds) to contract formation. That is not correct. Under the CISG, subjective intent is important to determine whether a contract exists and what its terms are, but only "where the other party knew or could not have been unaware of what that intent was", i.e. only when the other party could not have been unaware of that subjective intent." (article 8(1)) This is not any different from the American objective approach.[1] Exactly as American law, the CISG follows a sort of modified objective approach (see article 8(2)).[2] In the case at hand, there is no

[1] Restatement (Second) of contracts §20 (effect of Misunderstanding)

[2] Article 8

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

contract between the parties not because Hanwha and Cedar had no *subjective* intention to be bound and their minds never met but because *objectively* they showed no intention to be bound unless on their terms.

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On February 8, 2011, in *CSS Antenna, Inc. v. Amphenol-Tuchel Electronics, GMBH,* 2011 WL 462747 (D. Md.), the district court held that an exclusive forum selection clause ("FSC") contained in a seller's general T&C was not part of a contract. These are the facts: after intensive negotiation and presentation of samples, in 2004 Amphenol-Tucher Electronics GmbH, a German company with a repo office in Michigan ("Seller") and CSS Antenna, Inc., an American company with place of business in Maryland ("Buyer"), started to make business together. Indeed, in 2004 Buyer began placing purchase orders for Seller's cables through Seller's Major Account Manager in Seller's Michigan office. Seller responded to each of these orders by sending a purchase confirmation form to Buyer's billing department. The parties conducted business through this purchase order and purchase confirmation arrangement until April 2005, when they signed an Inventory and Supply Agreement. Even after April 2005, however, the parties continued to conduct business through the purchase order and purchase confirmation system. Seller's purchase confirmation form contained a reference to its standard terms. In 2006, Buyer began experiencing problems with Seller's cables that the Buyer claimed were not waterproof as guaranteed. In 2009 Buyer sued Seller in

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

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

Maryland. In June 2010, Seller filed a motion to dismiss contending, *inter alia*, that only the courts in Michigan had jurisdiction over the case pursuant to its standards terms that contained an FSC identifying Michigan as the exclusive forum to bring a claim. Buyer opposed the motion, claiming it had never given its consent to the FSC. The District Court rejected Seller's motion, finding that the FSC was not part of the contract. This is correct. The reasoning of the court presents some flaws in the interpretation of CISG, however.

First, correctly the court identifies the purchase order form sent by Buyer as the initial offer. Second, the court refers to Article 19 of CISG to qualify Seller's purchase confirmation form as counteroffer. But in the analysis of this article, the reasoning does not stand. The court says that an acceptance by the offeree was *not* necessary for the FSC to be part of the contract. In particular, the court says that acceptance by the offeree would be necessary only if the purchase confirmation form had constituted a modification of a pre-existing contract ex Art. 29(1). For the court, however, the FSC did not become part of the contract. The court based its reasoning on Article 8. According to the court, since the confirmation did not mention the FSC and the language of the FSC itself was ambiguous, Seller's intent to have the terms of the FSC inside the contract was not clearly shown. Besides, there was no evidence that Buyer had actual knowledge of it. The reasoning shows a misunderstanding of both article 29 and article 8. Luckily, the combination of these two mistakes produces a correct result.

Article 19 is similar (even if not identical) to UCC 2-207. It provides that an acceptance that materially alters an offer is deemed a counteroffer. In addition, Article 19(3) specifies some issues that are always material and the "settlement of dispute" is among these.[3] So,

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[3] Article 19 (1): A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer. (2) However, a reply to an offer which purports to be an acceptance but contains additional or different terms which do not materially alter the terms of the offer constitutes an acceptance, unless the offeror, without undue delay, objects orally to the

unlike what the court states, an express acceptance of FSC, was required for FSC to be part of the contract.

The reasoning shows also a misunderstanding of Article 8. Article 8 applies to establish whether there is a contract between the parties. Article 8 expresses a modified objective approach very similar (if not identical) to American law: there is contract if a reasonable person in the same circumstances, would think that there is a contract. If a party was aware of the real intention of the other party, however, the subjective intent steps in (i.e. the real party takes the place of the hypothetical reasonable party). Article 8 on the same token, deals also with interpretation of terms. And again it provides for a modified objective approach that works in the same way. Article 8, however, dos not deal with which terms are or are not part of a contract. To identify which terms are part of the contract, the correct reference is to article 19 with its materiality standard.

In conclusion, this is why the court's reasoning is wrong: saying that a specific acceptance is not necessary, is equal to say that a certain term is not "material". The consequence should be that the term becomes part of the contract. Once a term is part of the contract, however, you cannot use article 8 to invalidate it. Article 8 can only illuminate the interpretation that the parties give to the term.

In the case at hand the FSC was not contained in the purchase confirmation. It seems also that the reference to Seller's T&C was obscure. If that is true, in this particular case, the FSC would not be part of the contract, not based on article 19, and even less based on Article 8, but because the FSC was never communicate to the other party. In substance, there would be no contract on FSC.

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discrepancy or dispatches a notice to that effect. If he does not so object, the terms of the contract are the terms of the offer with the modifications contained in the acceptance. (3) Additional or different terms relating, among other things, to the price, payment, quality and quantity of the goods, place and time of delivery, extent of one party's liability to the other or the settlement of disputes are considered to alter the terms of the offer materially.

A Federal District Court of NY denies final approval to the Google Books Settlement

On a motion pursuant to Rule 23 F.R.Civ.P. for final approval of a proposed settlement of a class action brought against Google Inc., the District Court Southern District Of New York (Judge Chin) overturn the settlement entered between Google and several groups representing authors and publishers (so called "Google Books Settlement"). The question was whether the settlement was fair, adequate, and reasonable. The court concluded that it was not.[4]

Even if the Google project known as "Google Books" is well known, let us recall the basic facts, as emerging from the district court's order: in 2004, Google partnered with major university libraries to scan their collections (books and other writings) and make them available on the Internet. Google scanned more than 12 million books and delivered digital copies to the participating libraries, creating an electronic database of books, and made text available for online searching. In fact, Google users can search the digital library and view excerpts (called "snippets") from books.

The problem was that millions of the books were still under copyright, and Google did not obtain permission. As a consequence, in 2005, several authors and publishers[5] started a class action for copyright infringement (the authors seeking both damages and injunctive relief, and the publishers seeking injunctive relief). Google defended alleging "fair use" under § 107 of the Copyright Act, 17 U.S.C. § 107. After document discovery, the parties started settlement negotiations. On October 28, 2008, the parties filed with the court a proposed settlement agreement that was preliminarily approved on November 17, 2008. After notice of the

[4] Slip opinion available at http://www.scribd.com/doc/51326248/Google-Book-Settlement-Opinion-Denny-Chin (last visited April 21, 2011).

[5] Association of American Publishers (AAP) and the Authors Guild.

proposed settlement had triggered hundreds of objections, the parties began discussing possible modifications. As a result, on November 13, 2009, the parties executed an amended settlement agreement ("ASA") and filed a motion for approval with the court. The court entered an order of preliminarily approval.

Under the ASA, Google, on a non-exclusive basis, was authorized to (1) continue to digitize books and inserts, (2) sell subscriptions to an electronic books database, (3) sell online access to individual books, (4) sell advertising on pages from books, and (5) make certain other prescribed uses. In consideration, Google would pay to rightsholders 63% of all revenues received from these uses. It was specified that (i) rightsholders could exclude their books from some or all of the uses and they could remove their books altogether from the database; (ii) at any time rightsholders could ask Google not to digitize any books not yet digitized, and Google would use "reasonable efforts" not to digitize any such books; (iii) rightsholders could also request removal from the registry of a book already digitized, and Google was obligated to remove the book "as soon as reasonably practicable, but it any event no later than thirty (30) days"; (iv) As for books and inserts digitized before May 5, 2009, Google would pay $45 million into a Settlement Fund to make Cash Payments to Rightsholder.

After the ASA was disseminated, hundreds of class members again objected[6] and some 6800 class members opted out.

The district court did not approve the ASA. Weighting the factors of Grinnel[7], the court found that even if "the ASA was the product of arm's length negotiations between experienced, capable counsel" and "further litigation would be complex, expensive, and time-consuming", one factor "weigh[s] against approval of the settlement: the reaction of the class. … Not only are the

[6] Department of Justice had objected to ASA.

[7] City of Detroit v. Grinnell, 495 F.2d 448, 463 (2nd Cir. 1974).

objections great in number, some of the concerns are significant. Further, an extremely high number of class members -- some 6800 -- opted out."[8] The judge ruled that the scope of the settlement was too broad.[9] Besides, the court found that (1) the approval of the ASA was beyond its power of approval under Rule 23 F.R.Civ.P. [10]; (2) "the ASA would … raise international concerns, and foreign countries, authors, and publishers have asserted that the ASA

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[8] Slip opinion p. 19.

[9] While the digitization of books and the creation of a universal digital library would benefit many, the ASA would simply go too far," the judge wrote. Slip opinion p. 1.

> It would permit this class action - which was brought against defendant Google to challenge its scanning of books and display of 'snippets' for on-line searching - to implement a forward-looking business arrangement that would grant Google significant rights to exploit entire books, without permission of the copyright owners. Indeed, the ASA would give Google a significant advantage over competitors, rewarding it for engaging in wholesale copying of copyrighted works without permission, while releasing claims well beyond those presented in the case. Slip opinion p. 1-2.

[10] The court says that

> the ASA can be divided into two distinct parts. The first is a settlement of past conduct and would release Google from liability for past copyright infringement. The second would transfer to Google certain rights in exchange for future and ongoing arrangements, including the sharing of future proceeds, and it would release Google (and others) from liability for certain future acts. … I conclude that this second part of the ASA contemplates an arrangement that exceeds what the Court may permit under Rule 23. As articulated by the United States, the ASA 'is an attempt to use the class action mechanism to implement forward-looking business arrangements that go far beyond the dispute before the Court in this litigation'. Slip opinion p. 21.

would violate international law"[11]; (3) "the ASA would release claims well beyond those contemplated by the pleadings"[12]; (4) the created mechanism of guardianship over orphaned works would be better suited for Congress; (5) it was unfair that Google obtains the right to sell digital copies of the books, after having infringed copyrights;[13] (6) the mechanism of "opt out" from the agreement is unfair to many authors;[14] (7) the ASA would allow Google to control the search market.

The consequence of the court's ruling is that the parties are sent back to the table to negotiate another settlement agreement.

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[11] Slip opinion p. 24.

[12] The court explains:

> This case was brought to challenge Google's use of "snippets," as plaintiffs alleged that Google's scanning of books and display of snippets for online searching constituted copyright infringement. Google defended by arguing that it was permitted by the fair use doctrine to make available small portions of such works in response to search requests. There was no allegation that Google was making full books available online, and the case was not about full access to copyrighted works. The case was about the use of an indexing and searching tool, not the sale of complete copyrighted works. Slip opinion p. 24-25.

[13] These are the words of the court:

> While its competitors went through the 'painstaking' and 'costly' process of obtaining permissions before scanning copyrighted books, Google by comparison took a shortcut by copying anything and everything regardless of copyright status. Slip opinion p. 27.

[14] [I]t is incongruous with the purpose of the copyright laws to place the onus on copyright owners to come forward to protect their rights when Google copied their works without first seeking their permission. Slip opinion p. 35.