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CLEARING THE CLOUDS ON THE CISG'S WARRANTY OF TITLE

Donald J. Smythe[*]

Abstract: The risk of intellectual property infringement claims poses an increasing threat to international trade. The UN Convention on Contracts for the International Sale of Goods (CISG) is the most prevalent body of law governing international sales. Important questions will inevitably arise, therefore, under the CISG about the scope of the seller's warranty of title. Courts will be called upon to interpret Article 42 of the CISG, which provides a warranty of title governing third-party intellectual property claims, or the parties' contract if they execute a customized warranty of title term. This Article analyzes the appropriate scope of the seller's warranty of title against third-party intellectual property claims under the CISG. It draws on the CISG's legislative history, the CISG case law, the underlying policy of the warranty of title, and an important German Supreme Court precedent in an analogous case to reject the "cloud on title" standard that has been applied in U.S. cases under the Uniform Commercial Code. This Article argues instead that, unless the parties' contract clearly indicates otherwise, the seller under a CISG contract should only be held liable for third-party intellectual property claims against the buyer if (1) the buyer resells the goods in the seller's jurisdiction and the claim arises under the intellectual property laws in the seller's jurisdiction, (2) the buyer informed the seller about the third-party's intellectual property rights prior to contracting, or (3) due to special circumstances, such as the seller having a branch in the jurisdiction under which the third-party's intellectual property rights are created, the seller—but not the buyer—knew or should have known about the third-party's intellectual property rights.

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I. INTRODUCTION

The risk of intellectual property infringement claims poses an increasing threat to international trade. The diverse range of intellectual property laws across the global economy and the proliferation of "patent trolls" and "trademark squatters" have recently contributed to a plethora of disquieting stories about intellectual property infringement claims disrupting the smooth flow of international commerce, often at great expense to the companies involved.[1] It seems inevitable that important questions about a seller's liability for intellectual property infringement claims against buyers will arise under the law of international sales. These are at heart questions about the seller's warranty of title under an international sales contract.

The UN Convention on Contracts for the International Sale of Goods (CISG or the Convention) is the most important body of law governing international sales; it has been adopted in eighty-three nation states, including the United States, and most of the world's major trading nations.[2] In the United States the CISG applies with the full force of federal law to most international sales transactions whenever a court determines that U.S. law applies to a contract for the sale of non-household goods between parties with places of business in different Contracting States (i.e., nation states that have adopted the CISG).[3] The CISG was the product of negotiations between representatives from many nations with diverse legal systems and traditions. As a consequence, the CISG's rules are quite sparse by comparison to the Uniform Commercial Code (UCC) or other nations'

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[1] The media have reported on cases involving well-known companies with widely recognizable brands, such as Starbucks, Penfolds, Tesla, and Pfizer, which have become embroiled in costly trademark infringement suits with alleged trademark squatters. *See, e.g.*, Steven Seidenberg, *Trademark Squatting On the Rise in the U.S.*, INSIDE COUNSEL MAGAZINE (May 1, 2010), http://www.insidecounsel.com/2010/05/01/trademark-squatting-on-the-rise-in-us; Sophie Brown, *Brand wars: Battling China's trademark 'squatters'*, CNN (July 17, 2014), http://www.cnn.com/2014/07/17/world/asia/china-trademark-squatters-penfolds/. The media has also reported on the proliferation of patent trolls and their threats to domestic and international commerce. *See, e.g.*, *Patent trolls: Why no one likes them—Abuse of the patent system benefits neither inventors nor the economy at large,* THE ECONOMIST (Mar. 3, 2015), http://www.economist.com/news/business-and-finance/21645604.

[2] *See* United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, S. TREATY DOC. NO. 98-9 (1983), 1489 U.N.T.S. 3 [hereinafter CISG], http://www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf. The U.S. Senate ratified the CISG in 1986, giving it the force of federal law when the Convention came into effect on January 1, 1988. The count of "Contracting States" is as of September 26, 2014. *See* PACE LAW SCHOOL INSTITUTE OF INTERNATIONAL COMMERCIAL LAW, CISG: TABLE OF CONTRACTING STATES (Aug. 12, 2015), http://www.cisg.law.pace.edu/cisgcountries/cntries.html.

[3] *See* CISG, *supra* note 2, art. 1(a), 2(a). In some Contracting States the CISG might apply even if the parties do not have places of business in different Contracting States. *See id*., art. 1(b). Of course, the CISG allows parties to contract around its own rules in favor of others. *See id*., art. 6.

domestic sales laws and it generally does not use the same commercial law terms. The CISG, for instance, does not use the term "warranty of title"—or even the word "warranty"—but it nonetheless states rules in Articles 41 and 42 that appear to be very similar to the warranty of title provisions in UCC § 2–312. For ease of reference, Articles 41 and 42 will be referred to in this Article as the CISG's "warranty of title" provisions.

A sale typically involves the conveyance of title to goods in return for a price.[4] The seller's warranty of title thus plays a pivotal role. The broader the warranty, the greater the assurance the seller provides to the buyer that the goods will be free from defects in title that might give rise to claims against the buyer after title has conveyed; of course, the broader the warranty, the greater the seller's potential liability for any claims against the buyer's title. Given the growing risks of intellectual property infringement claims in a diverse global economy, important questions will inevitably arise under the CISG about the scope of the seller's warranty of title, and courts will be called upon to interpret Article 42, which provides the CISG's warranty of title governing third-party intellectual property claims against the buyer, or the parties' contract if they execute a customized warranty of title term.[5]

Courts will face challenges in interpreting Article 42 because the language is not particularly clear and does not expressly answer some important questions. Indeed, because the language is less than crystal clear, parties may be inclined to draft customized warranty of title terms for their contracts.[6] But customized contract terms may also raise difficult questions about their interpretation, since the parties may not anticipate all the contingencies and circumstances that may give rise to warranty of title issues. While similar interpretative questions have been addressed under the UCC, international sales involve different circumstances than domestic sales and the warranty of title under the CISG raises unique issues.

As a general matter, warranty of title issues can arise from non-intellectual property claims against the goods or intellectual property claims against the goods. Under the UCC, U.S. courts have generally adopted the "cloud on title" standard to determine whether the warranty of title under

[4] The CISG itself does not expressly define the term "sale." The UCC, however, states that "[a] 'sale' consists in the passing of tile from the seller to a buyer." U.C.C. § 2-106(1) (AM. LAW INST. & UNIF. LAW COMM'N 2012).

[5] The CISG has adopted the principle of party autonomy and respects the parties' freedom of contract as much as possible. *See* CISG, *supra* note 2, art. 6 ("The parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions."). *Id*.

[6] In fact, one distinguished commentator has advised that in important transactions the parties should draft customized warranty of title provisions. *See* JOHN O. HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION 398 (4th ed. 2009) ("In important transactions in which third-party claims are possible, the buyer should insist on contractual provisions that clearly state the protection that the seller provides in the case of third-party claims . . . .").

UCC § 2–312(1) has been breached in cases involving non-intellectual property claims against the goods. Although it is less than perfectly clear, the cloud on title standard holds the seller liable not only for valid claims, but also for those that, while not valid, are not clearly spurious and still raise "colorable claims" against the buyer's title.[7] The case law construing the scope of the seller's warranty of title under UCC § 2–312(3), which governs intellectual property claims, is not as well developed, but a recent Californian case, *Pacific Sunwear v. Olaes*, has extended the cloud on title standard to intellectual property claims as well as non-intellectual property claims.[8] If *Pacific Sunwear* is persuasive, a seller will be held liable under the UCC for any colorable third-party intellectual property claim against the buyer as well as colorable non-intellectual property claims.[9]

While the cloud on title standard may be appropriate for domestic sales under the UCC, the unique characteristics of international sales make it inappropriate for third-party intellectual property claims under the CISG. In fact, international sales raise more difficult questions about the seller's liabilities for third-party intellectual property claims against the buyer than domestic sales. In a purely domestic sale,[10] the seller may reasonably be presumed to have constructive or actual knowledge of any registered intellectual property rights that might give rise to a third-party intellectual property claim, since the rights would be registered or otherwise created under the laws of the jurisdiction in which the seller is located. In fact, the seller could be held liable for beaching an intellectual property right arising in the seller's own jurisdiction simply by virtue of manufacturing or selling the good.[11] It would be perfectly reasonable, therefore, to hold the seller liable for a colorable third-party intellectual property claim, even if the claim ultimately proved invalid. In an international sale, however, the seller should not generally be presumed to have actual or constructive knowledge of all intellectual property rights that might give rise to a third-party claim against the buyer since the seller is not generally located in the jurisdiction under which the third-party's intellectual property rights are registered or otherwise created; the buyer, on the other hand, often is.

This Article analyzes the appropriate scope of the seller's liabilities under Article 42 of the CISG. More specifically, it addresses whether the

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[7] *See, e.g.*, Colton v. Decker, 540 N.W.2d 172, 176 (S.D. 1995).

[8] Pac. Sunwear of Cal, Inc. v. Olaes Enterprises, Inc., 167 Cal. App. 4th 466 (2008). The court reasoned that the burden of nonfrivolous claims should be placed on the seller because the seller will generally have superior knowledge of the existence of such claims. *Id*. at 470.

[9] *Id*.

[10] The term "purely domestic" sale as used here and elsewhere in this Article means a sale in which the seller and buyer are both located in the domestic jurisdiction. Thus, it excludes sales that would be governed by domestic law but in which the seller is located in a foreign jurisdiction.

[11] *See, e.g.*, Roger D. Blair & Thomas F. Cotter, *An Economic Analysis of Seller and User Liability in Intellectual Property Law*, 68 U. CIN. L. REV. 1, 1–4 (1999).

seller should be held liable under the CISG for a breach of the warranty of title when a third–party makes an intellectual property claim against the buyer based on an intellectual property right in the jurisdiction of the buyer's location or the jurisdiction in which the buyer resells the goods. It draws on the underlying policy of the warranty of title in a sales transaction, the CISG's legislative history, the CISG case law interpreting Article 42, and an important German Supreme Court precedent in an analogous case to argue that, unless the parties' contract clearly indicates otherwise, the seller in a CISG contract should only be held liable for third-party intellectual property claims against the buyer if (1) the buyer resells the goods in the seller's jurisdiction and the claim arises under the intellectual property laws in the seller's jurisdiction, (2) the buyer informed the seller about the third-party's intellectual property rights prior to contracting, or (3) due to special circumstances, such as the seller having a branch in the jurisdiction under which the third-party's intellectual property rights are registered or otherwise created, the seller but not the buyer knew or should have known about the third-party's intellectual property rights.

The next section of this Article provides a brief overview of the growing risks of intellectual property infringement claims in international sales. The third section provides some background on the CISG, and the fourth section elaborates on the CISG's warranty of title provisions in Articles 41 and 42. The fifth section discusses the legislative history of Article 42, reviews the case law interpreting Article 42, and highlights the most germane unanswered question: whether the seller or the buyer should bear liabilities for a third-party intellectual property claim based on an intellectual property right in the jurisdiction in which the buyer is located or in the jurisdiction in which the buyer plans to resell the goods? The sixth section draws on the underlying policy considerations and an important German Supreme Court precedent in an analogous case to suggest a rule to govern when the seller should be liable for third-party intellectual property claims under the CISG. The last section concludes and offers a summary.

II. THE GROWING RISKS OF INTELLECTUAL PROPERTY INFRINGEMENT CLAIMS IN INTERNATIONAL SALES

Patent "trolls" and trademark "squatters" have recently made prominent headlines.[12] A patent troll is a person or company that purchases patents from inventors, not in the hopes of actually using them for productive purposes, but rather, in the hopes of using them to make patent infringement claims against other persons or companies that are engaged in

[12] *See, e.g.*, Seidenberg, *supra* note 1; Brown, *supra* note 1; THE ECONOMIST, *supra* note 1.

productive activities.[13] A trademark squatter is a person or company that acquires trademarks, not in the hopes of actually using them to help market a product or service, but rather, in the hopes of making trademark infringement claims against other persons or companies that do use them to market their products or services.[14] As the pejorative terms themselves suggest, patent trolls and trademark squatters are widely alleged to create costs and impediments to other companies and to global commerce generally, and the incidence of patent trolling and trademark squatting is widely alleged to be on the rise.[15] Indeed, the threats to commerce have motivated the Electronic Frontier Foundation and the U.S. Patent and Trademark Office to publicize the issues and offer prophylactic advice to potential targets.[16] Nonetheless, in spite of the efforts to combat them,[17] patent trolls and trademark squatters likely pose increasing risks to international sales.

In fact, intellectual property infringement claims likely pose particular risks to international sales simply because of the diversity of intellectual property laws across the global economy and the unfamiliarity of many trading parties and potential trading parties with the laws outside their own jurisdictions. For example, a report of the U.S. Patent and Trademark Office suggests that U.S. patent holders have often lacked the awareness and familiarity with the patent system in China necessary to protect themselves against patent infringement claims by Chinese companies that are more familiar with their domestic patent system.[18] To confound matters, U.S. patent holders have experienced difficulties in obtaining patents through international filing mechanisms, such as the Patent Cooperation Treaty administered by the World Intellectual Property Organization.[19] Foreign patent holders may experience similar difficulties acquiring patent

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[13] *See, e.g.*, *Patent Trolls*, ELEC. FRONTIER FOUND., https://www.eff.org/issues/resources-patent-troll-victims (last visited Mar. 20, 2016). For a more through explanation, see Karen E. Sandrik, *Warranting Rightful Claims*, 72 LA. L. REV. 873 (2012).

[14] S*ee, e.g.*, Scott Baldwin, *Don't Sit and Wait: Stopping Trademark Squatters*, 4 INVENTORS EYE 1 (2013), http://www.uspto.gov/custom-page/inventors-eye-don-t-sit-and-wait-stopping-trademark-squatters. For a more extended discussion, see Kitsuron Sangsuvan, *Trademark Squatting*, 31 WIS. INT'L L.J. 252 (2013).

[15] *See, e.g.*, Sandrik, *supra* note 13; Sangsuvan, *supra* note 14, THE ECONOMIST, *supra* note 1; James Bessen, *The Evidence Is In: Patent Trolls Do Hurt Innovation*, HARV. BUS. REV. (Nov. 2014), https://hbr.org/2014/07/the-evidence-is-in-patent-trolls-do-hurt-innovation.

[16] Baldwin, *supra* note 14; ELEC. FRONTIER FOUND,, *supra* note 13.

[17] The U.S. Supreme Court's decision in *Alice Corp. v. CLS Bank Int'l*, 134 S. Ct. 2347 (2014) is credited for making it more difficult to troll software patents, but although the number of patent infringement cases in the United States declined in 2014, it remains high. *See, e.g.*, Nicholas Wells & Eric Chemi, *Can't Kill Off the Patent Trolls Yet*, CNBC (May 19, 2015), http://www.cnbc.com/2015/05/19/.

[18] U.S. PAT. & TRADEMARK OFF., REPORT ON PATENT ENFORCEMENT IN CHINA 2 (2012), http://www.uspto.gov/ip/global/China_Report_on_Patent_Enforcement_%28FullRprt%29FINAL.pdf.

[19] *Id*.

protection in the U.S. Trademark squatting, on the other hand, has been facilitated by the use of two different systems for registering trademarks: the first-to-use system, which is prevalent in nations with common law systems, and the first-to-file system, which is prevalent in nations with civil law systems.[20] Under the first-to-use systems, trademark squatting is rare because the acquisition of trademark rights depends on their use,[21] but the first-to-file systems facilitate it because trademark squatters do not have to invest in actually using the trademarks to acquire rights in them and are therefore able to target well-known brands that have not yet been registered in their jurisdictions.[22]

As a consequence, several companies with well-known products and brands have become embroiled in highly publicized international intellectual property infringement disputes. For example, Starbucks was the target of a trademark infringement claim in Russia,[23] Treasure Wine Estates, which owns the Penfolds brand, was the target of a trademark infringement claim in China,[24] Tesla was also the target of a trademark infringement claim in China,[25] and Pfizer, which owns the Viagra brand, was the target of both trademark and patent infringement claims in China.[26] Although there are pressures on governments to rectify the problems, there do not appear to be any imminent cures, and the threats to international commerce will likely remain high for the foreseeable future.[27] As the volume of international trade increases, the risks of warranty of title claims under the CISG will probably also increase. This will make the interpretation of Article 42, as well as customized warranty of title contract terms under the CISG , an important matter in the years to come.

III. THE CISG

The CISG was initially approved at a United Nations Commission on International Trade Law (UNCITRAL) conference in 1980 and went into effect on January 1, 1988.[28] Work on the CISG had been begun, however, by UNCITRAL in 1968, and it was strongly influenced by work that the International Institute for the Unification of Private Law (UNIDROIT) had

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20 Sangsuvan, *supra* note 14, at 261.
21 *Id*. at 262.
22 *Id*. at 264.
23 Seidenberg, *supra* note 1.
24 Brown, *supra* note 1.
25 *Id*.
26 *Id*.
27 *See, e.g.*, Baldwin, *supra* note 14; Wells & Chemi, *supra* note 17.
28 JOHN O. HONNOLD, DOCUMENTARY HISTORY OF THE UNIFORM LAW FOR INTERNATIONAL SALES: THE STUDIES, DELIBERATIONS, AND DECISIONS THAT LED TO THE 1980 UNITED NATIONS CONVENTION WITH INTRODUCTIONS AND EXPLANATIONS 1 (1989).

done on the unification of international private law over the three decades prior to that.[29] Although the CISG's rules may seem spare by comparison to most nations' domestic laws, it was the product of considerable deliberation and debate, as well as compromise and cooperation.

The purpose of unifying international private law was, in the words of John Honnold, "to free international commerce from a Babel of diverse domestic legal systems."[30] To that end, the drafters of the CISG recognized that the greatest challenge would lie in the application of the new rules. They worried, in particular, about a "homeward trend bias"— a tendency for courts to draw on domestic law in interpreting CISG provisions, whether expressly as a means of filling purported gaps in the CISG, or implicitly in allowing domestic law to influence their interpretations and applications of CISG rules and principles.[31] Fortunately, to help mitigate those concerns, scholars have endeavored to preserve the legislative history of the CISG and to organize the documents and other materials to make them accessible to courts, scholars, and students.[32]

IV. THE CISG'S WARRANTY OF TITLE

The CISG does not provide any titles for its provisions, and its language does not use common law terms. Articles 41 and 42 of the CISG, however, clearly state rules that are similar to the warranty of title provisions in the Uniform Commercial Code (UCC) § 2-312.[33] Article 41

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[29] As Honnold explains, the initial UNCITRAL Working Group included representatives from thirty-six nation states, including nine from Africa, seven from Asia, five from Eastern Europe, six from Latin America, and nine from Western Europe and former Commonwealth nations. *Id*. at 1–3.

[30] *Id*.

[31] *See, e.g.*, LARRY DIMATTEO ET AL., INTERNATIONAL SALES LAW: A CRITICAL ANALYSIS OF CISG JURISPRUDENCE 2–3 (2005); Harry M. Fletcher, *The Several Texts of the CISG in a Decentralized System: Observations on Translations, Reservations and Other Challenges to the Uniformity Principle in Article 7(1)*, 17 J.L. & COM. 187, 200–04 (1998). *See also* U.N. Secretariat, Secretariat Commentary on the Draft Convention on Contracts for the International Sale of Goods, UNCITRAL, U.N. Doc. A/Conf. 97/5 (Mar. 14, 1979), http://www.globalsaleslaw.org/index.cfm?pageID=644#. The commentary for Article 7 explains that "it is especially important to avoid different constructions of the provisions of this Convention by national courts, each dependent upon the concepts used in the legal system of the country of the forum." *Id*. art. 7.

[32] *See* HONNOLD, *supra* note 28. *See also Albert H. Krtizer CISG Database*, PACE L. SCH. INST. INT'L COM. L., http://www.cisg.law.pace.edu/ (last visited Mar. 20, 2016).

[33] U.C.C. § 2-312 (AM. LAW INST. & UNIF. LAW COMM'N 2012):

> (1) Subject to subsection (2) there is in a contract for sale a warranty by the seller that
> (a) the title conveyed shall be good, and its transfer rightful; and
> (b) the goods shall be delivered free from any security interest or other lien or encumbrance of which the buyer at the time of contracting has no knowledge.
> (2) A warranty under subsection (1) will be excluded or modified only by specific language

states that a seller must deliver goods which are free from any non-intellectual property right or claim of a third party unless the buyer agreed to take the goods subject to such a right or claim.[34] CISG Article 42 states that a "seller must deliver goods which are free from any" relevant third-party intellectual property[35] right or claim of which "the seller knew or could not have been unaware" of at the time of contracting.[36] For the sake of Article 42, a relevant intellectual property right or claim is one arising under "the law of the [nation in which] the goods will be resold or [] used, if it was contemplated by the parties" that the goods would be resold or used in that nation at the time of contracting or, "in any other case, under

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> or by circumstances which give the buyer reason to know that the person selling does not claim title in himself or that he is purporting to sell only such right or title as he or a third person may have.
> (3) Unless otherwise agreed a seller who is a merchant regularly dealing in goods of the kind warrants that the goods shall be delivered free of the rightful claim of any third person by way of infringement or the like but a buyer who furnishes specifications to the seller must hold the seller harmless against any such claim which arises out of compliance with the specifications.

[34] *See* CISG, *supra* note 2, art. 41, which states:

> The seller must deliver goods which are free from any right or claim of a third party, unless the buyer agreed to take the goods subject to that right or claim. However, if such right or claim is based on industrial property or other intellectual property, the seller's obligation is governed by Article 42.

[35] The drafters intentionally used the words "industrial property or other intellectual property" in Article 42 to ensure that the scope of the provision would be interpreted broadly, presumably by which they meant that it would be interpreted to include trademark and copyright as well as patent claims, HONNOLD, *supra* note 28, at 334.

[36] CISG, *supra* note 2, art. 42:

> (1) The seller must deliver goods which are free from any right or claim of a third party based on industrial property or other intellectual property, of which at the time of the conclusion of the contract the seller knew or could not have been unaware, provided that the right or claim is based on industrial property or other intellectual property:
> (a) under the law of the State where the goods will be resold or otherwise used, if it was contemplated by the parties at the time of the conclusion of the contract that the goods would be resold or otherwise used in that State; or
> (b) in any other case, under the law of the State where the buyer has his place of business.
> (2) The obligation of the seller under the preceding paragraph does not extend to cases where:
> (a) at the time of the conclusion of the contract the buyer knew or could not have been unaware of the right or claim; or
> (b) the right or claim results from the seller's compliance with technical drawings, designs, formulae or other such specifications furnished by the buyer.

the law of the [nation in which] the buyer has its place of business."[37]

Article 43 states a notice requirement that the buyer must meet to preserve any rights under Articles 41 and 42. The buyer loses the right to rely on Article 41 or 42 if the buyer fails to give the seller notice "specifying the nature of the [third party's] right or claim . . . within a reasonable time,"[38] although "the seller is not entitled to rely on" the buyer's failure to meet the notice requirement if the seller knew about the third party's right or claim and its nature.[39] As a general matter, the notice provisions under the CISG are significant because some courts have applied them quite strictly.[40] In this case, however, the notice provisions clearly also place an awareness burden on the buyer; the buyer must provide notice within a reasonable time of any third party rights or claims that the buyer "ought to have become aware of . . . ."[41] Much of the early discussion and debate about the warranty of title under the CISG was about the buyer's notice requirements, and some participants believed they tilted the CISG heavily in favor of the seller.[42]

V. BACKGROUND ON ARTICLE 42

Unfortunately, the legislative history of the CISG and the case law that is easily accessible to U.S. and other English language courts do not shed much light on the most important questions about the scope of the CISG's warranty of title. In particular, they do not clearly define when a seller will be liable for third-party intellectual property claims against a buyer. They do offer some glimmers of insight, but even those are obfuscated by contradictory developments and opinions.

A. The Legislative History

It is significant that the CISG separated its warranty of title provisions into two separate Articles. The initial drafts of the CISG protected the buyer only against "claims" by a third party; some participants in the drafting process expressed concerns that such third party "claims" would not extend

[37] CISG, *supra* note 2, art. 42(1) ("[P]rovided that the right or claim is based on industrial property or other intellectual property: (a) under the law of the State where the goods will be resold or otherwise used, if it was contemplated by the parties at the time of the conclusion of the contract . . . or (b) in any other case, under the law of the State where the buyer has his place of business.").

[38] CISG, *supra* note 2, art. 43(1) ("The buyer loses the right to rely on the provisions of article 41 or article 42 if he does not give notice to the seller specifying the nature of the right or claim of the third party within a reasonable time . . . .").

[39] CISG, *supra* note 2, art. 43(2) ("The seller is not entitled to rely on the provisions of . [Article 43(1)] . if he knew of the right or claim of the third party and the nature of it.").

[40] *See infra* Section IV.ii.(a).

[41] *See* CISG, *supra* note 2, art. 43(1).

[42] *See* HONNOLD, *supra* note 28, at 107.

to third party claims based on intellectual property rights.[43] Additional language was subsequently drafted to more clearly extend the warranty of title to claims based on "industrial or intellectual property."[44] The Special Working Group that drafted the language intended to limit the seller's liabilities for third party intellectual property rights or claims to those "of which at the time of the conclusion of the contract the seller knew or could not have been unaware."[45] It is relevant that the word "ought" is not used—the language does not place any burden on a seller to make itself aware of potential third party intellectual property rights or claims. Even at that, some participants in the discussions and debates apparently believed that third party intellectual property rights and claims were simply too complex to be addressed under the CISG.[46]

In fact, there was considerable concern about the scope of the CISG's warranty of title provisions throughout the drafting process. Early in the process, before the drafting language was extended to cover the warranty of title to intellectual property claims expressly, some participants raised concerns that the word "claim" might be construed to hold the seller liable for any third party claims, regardless of whether they were "frivolous or vexacious."[47] Other representatives, however, argued that the word "claim" could "only be interpreted to mean a valid or well-founded claim."[48] Indeed, one representative expressed a concern that because the word "claim" was ambiguous, the scope of a valid third party claim might be determined by domestic laws rather than the CISG.[49] Others appeared to feel the warranty of title had little substance and might, if anything, simply create needless confusion and litigation.[50] One thing, however, is quite clear: there was no agreement about the scope of the CISG's warranty of title.

Later in the drafting process, after the 1977 UNCITRAL "Sales" Draft had expressly extended the drafting language to cover a "right or claim based on industrial or intellectual property,"[51] UNCITRAL's Committee of

43 *Id*. at 151.
44 *Id*. at 333.
45 This is the language used in the draft as well as the final language of CISG, Article 42(1). CISG, *supra* note 2, art. 42(1).
46 HONNOLD, *supra* note 28, at 334.
47 *Id*. at 107.
48 *Id*.
49 *Id.* This is a legitimate concern. Article 7(2) of the CISG states that if courts are unable to answer a question using a CISG provision or general principles on which the CISG is based, they are to apply choice of law rule sunder private international law and answer the question using the relevant domestic legal rule. *See* CISG, *supra* note 2, art. 7(2) ("Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.").
50 HONNOLD, *supra* note 28, at 128.
51 *Id*. at 333.

the Whole[52] adopted a proposal that the seller breached the warranty of title if the buyer was rendered unable to resell or use goods because of a third party intellectual property claim.[53] Although this clarified that the warranty of title provided a buyer with substantive protections against third-party intellectual property claims, it still did not clarify what the word claim meant—whether it meant a valid claim or any claim at all or something in between. Since the word claim clearly had different meanings for different participants in the earlier discussion and debates,[54] the same ambiguity about the scope of the CISG's warranty of title provisions governing third-party non-intellectual property claims now extended to its coverage of third-party intellectual property claims.

UNCITRAL produced a draft version of the CISG in 1978, which was very similar to the final version of the CISG that was adopted in 1980. It then requested that the Secretary-General of the UN provide a commentary on the draft provisions. The Secretariat Commentary on the 1978 Draft Convention clearly suggests that sellers should bear extensive liabilities for third party non-intellectual property right claims. The Commentary states that the seller breaches its obligations not only when a third party's non-intellectual property claim is valid, but even when the third party has merely made a claim in respect of the goods.[55] The Commentary clarifies, however, that the seller's liabilities do not extend to frivolous third party claims, but it emphasizes that the seller has a burden to demonstrate to the buyer that the claim is frivolous or, if the seller fails to do so to the buyer's satisfaction, the seller must take appropriate action to free the goods from the third party's claim.[56]

The Secretariat's Commentary, however, clearly implies that sellers should bear significantly less liabilities for third party intellectual property claims. It observes that, while the seller is liable, at least to some extent, for third-party intellectual property claims under most nations' domestic laws, that makes sense because the seller is usually both a producer and a seller within its domestic legal system,[57] but that the seller in an international transaction should not normally be expected to have as much knowledge about intellectual property rights in the buyer's legal system as its own, and that it is the buyer that typically decides where the goods will be used or sold, sometimes after the sale has been concluded,[58] and therefore the seller

[52] UNCITRAL established the "Committee of the Whole" to evaluate the UNCITRAL "Sales" Draft. The Committee established a Drafting Committee and several other subcommittees but it discussed and debated the 1977 "Sales" Draft as a group. *Id*. at 318.

[53] *Id*. at 334.

[54] *See* discussion *supra* Section IV.

[55] HONNOLD, *supra* note 28, at 426.

[56] *Id*.

[57] *Id*. at 426–7.

[58] *Id*. at 427.

should not be liable for third party intellectual property claims under international sales law to the same degree in all cases.[59] Indeed, the Commentary observes that the drafting language holds the seller liable only if the seller "knew or could not have been unaware" of the third party claim.[60] It clarifies that "the seller could not have been unaware of the third-party claim if that claim was based on a patent application or grant which had been published in the country in question."[61] However, it observes that it is possible for a third-party to have "industrial or intellectual property" rights or claims "even though there has been no publication" and in those cases "the seller is not liable to the buyer."[62] Although the Commentary does not define what it means by "no publication," this is presumably a reference to rights or claims based on unregistered trademarks or copyrights.

The Commentary does, however, imply that there are limits to the seller's liabilities. Most importantly, it observes that the draft language "provides that the seller is not liable to the buyer if at the time of the conclusion of the contract the buyer knew or could not have been unaware of the third-party's right or claim."[63] Unfortunately, it does not help to clarify when that would be the case—in other words, when it should be deemed that the buyer knew or could not have been unaware of the third-party's right or claim. If the Commentary intended that it should be deemed a buyer could not have been unaware of a third-party claim based on a published patent application or grant (obviously in the country in question) then there would have been no point in previously stating that it should be deemed a seller could not have been unaware of a third-party claim based on a published patent application or grant. The seller would clearly bear no liabilities for a third-party claim based on a published patent application or grant. Moreover, it is only reasonable to presume that the Commentary would state such an intention about the buyer's liabilities expressly since it had stated its intentions about the seller's liabilities expressly.

Subsequent to the Secretariat's Commentary, the UN General Assembly convened a Diplomatic Conference to act on UNCITRAL's draft.[64] The drafts of Articles 41 and 42 were deliberated and debated by the First Committee (a Second Committee deliberated and debated the draft provisions governing the CISG's entry into force).[65] The First Committee debated the merits of separating intellectual property rights and claims from non-intellectual property ones but ultimately adopted Articles 41 and 42 as

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[59] *Id*.
[60] *Id*.
[61] *Id*.
[62] *Id*.
[63] *Id*.
[64] *Id*. at 3.
[65] *Id*. at 3–4.

drafted.[66] Much of the real debate revolved around the scope of the seller's obligation under Article 42. The Canadian representative proposed an amendment to Article 42 that was intended to prevent buyers from making ill-founded claims and also to expedite settlement in cases in which the buyer suffered no serious prejudice or inconvenience.[67] Although the Canadian representative withdrew the proposal, it was obviously motivated by a concern that sellers could be liable for ill-founded or de minimus claims as Article 42 had been drafted and the concern was shared by some other representatives.[68]

The German Democratic Republic (GDR) representative proposed an amendment that would limit the seller's exposure to liabilities for claims under Article 42 to two years. The proposal was supported by some other representatives, including the one from Belgium who expressed a concern that not limiting the period for which the seller would remain liable would put too much of a burden on the seller to make inquiries into rights that it was not well-equipped to do. The French representative, on the other hand, argued that the buyer was in an even worse position than the seller to know about such third-party rights.[69] Although the representatives were clearly divided on the GDR representative's proposal, it was ultimately rejected.[70] Nonetheless, it also reflected serious concerns about the seller's liabilities under Article 42.

Viewed as a whole, the legislative history of the CISG suggests an almost complete reversal in the conception of the scope of the seller's liabilities for third-party intellectual property claims under Article 42. The initial concerns about imposing the burden on the seller to acquaint itself with foreign intellectual property rights systems that motivated a separate warranty of title provision of third-party intellectual property claims were never disclaimed but they appeared to be forgotten as the drafting process continued, and by the time the CISG was adopted the prevalent view appeared to be that the seller's liabilities under Article 42 were as broad as under Article 41. The Secretariat's earlier concerns that the seller in an international transaction should not normally be expected to have as much knowledge about intellectual property rights in the buyer's legal system as in its own legal system, and that it is the buyer that typically decides where the goods will be used or sold, sometimes after the sale has been concluded,[71] were not manifest in the discussions and debates at the subsequent Diplomatic Conference. Of course, the failure of the Diplomatic

[66] *Id*. at 549, 648.
[67] *Id*. at 548.
[68] The Dutch, Swiss, and Swedish representatives all expressed their sympathy with the concern. *Id*.
[69] *Id*.
[70] *Id*. at 549.
[71] *Id*. at 426–7.

Conference to affirm those concerns does not negate them, nor should it diminish their persuasiveness in the interpretation of Article 42.

B. The Case Law

One of the challenges in interpreting the CISG, and a challenge to achieving uniformity in its application, arises from the fact that the case law is written in multiple languages and translations of the cases are not easy to find. Fortunately, the Pace Law School Institute of International Commercial Law has compiled many translations of CISG cases from their original languages to English.[72] Although the case precedents are not entirely uniform and do not answer the most germane questions, courts have clearly found reasons not to hold sellers liable for third-party intellectual property claims against the buyer. At least one case rejected a buyer's claim under Article 42 for the buyer's failure to provide adequate notice of an infringement claim under Article 43; other cases rejected buyers' claims because the buyer had prior knowledge of the intellectual property infringement; only two cases address the scope of sellers' liabilities under Article 42 directly and, although they interpreted them differently, the more persuasive case interpreted them narrowly.

1. The Buyer's Failure to Provide Notice Within a Reasonable Time

In a case involving plastic faceplates for mobile telephones,[73] a German court addressed whether the buyer met the notice obligations under Article 43 as required to proceed with a claim under Article 42 for a trademark infringement claim against the goods. The Austrian seller had supplied the German buyer with plastic faceplates for its mobile phones shortly before the market for mobile phones collapsed.[74] In a suit against the seller, the buyer subsequently claimed that many of the faceplates had been confiscated because of a trademark infringement claim by Nokia against the buyer, and that it had also been required to pay over $100,000 Euros in damages to Nokia to settle the trademark infringement claim. Although the opinion did not clarify how long the buyer delayed in providing notice of Nokia's trademark infringement claim to the seller, it held that the buyer did not comply with the duty to notify the seller about Nokia's claim under Article 43.

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[72] *See Cases on the CISG*, PACE L. SCH. INST. INT'L COM. L., http://www.cisg.law.pace.edu/cisg/text/caseschedule.html (last visited Mar. 20, 2016).

[73] Landgericht Köln [LG] [District Court] Dec. 5, 2006, 85 O 200/05 (Ger.), http://cisgw3.law.pace.edu/cases/061205g1.html.

[74] *Id.*

2. The Buyer's Prior Knowledge of Intellectual Property Infringement

In a case involving blank CDs,[75] a German seller, which had bought the CDs from a Taiwanese company, resold them to an Austrian buyer. The Taiwanese company apparently had a license to sell the CDs in Germany but not in Austria.[76] The buyer subsequently retained payment of the contract price for the CDs on the grounds that it might be liable for payment of license fees for the CDs.[77] The seller disputed the buyer's claim contending that the buyer could not be held liable to the Taiwanese company because there had been no breach of the license and disputed the buyer's right to retain payment.[78] The Supreme Court of Austria held that under Article 42 the seller had an obligation to deliver goods free of any third-party right under the law of the jurisdiction in which the goods were to be resold if this was contemplated by the parties at the time of contracting or, in any other case, in the law of the jurisdiction in which the buyer had its place of business.[79] It observed that the lower court had failed to determine where, at the time of contracting, the parties had contemplated the goods would be resold and remanded the case for a determination.[80] Presumably, the seller would have been liable if it had been contemplated by the parties at the time of contracting that the goods would be resold in a jurisdiction in which they would have been subject to a third-party intellectual property claim. What is perhaps most interesting about the Court's opinion is that it appears to construe the seller's obligations under Article 42 so broadly. The Court states that not only may valid third-party intellectual property claims trigger the seller's liability, but so might unjustified claims.[81]

In a case involving what the opinion described as counterfeit furniture,[82] a Spanish company sold furniture to two French buyers who were subsequently subjected to intellectual property infringement claims by another company. The resulting dispute was put to a French court which had to decide, among other things, whether the seller should be liable for the infringement claims under Article 42.[83] The French court observed that one of the buyers actually knew the furniture infringed on a third-party's

[75] Oberster Gerichtshof [OGH] [Supreme Court] Sept. 12, 2006, 10 Ob 122/05x, http://cisgw3.law.pace.edu/cases/060912a3.html (Austria).
[76] *Id.*
[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] *Id.*
[81] *Id.*
[82] Tribunal de grande instance [TGI] [ordinary court of original jurisdiction] Versailles, Nov. 23, 2004, 01/08276 (Fr.), http://cisgw3.law.pace.edu/cases/041123f1.html. The reference to "counterfeit furniture" suggests the case involved a trademark infringement claim.
[83] *Id.*

rights and the other had consulted with professional designers and could not have been unaware that the furniture was "counterfeit."[84] The court observed that the furniture had been featured in magazine articles and museums, and that previous infringement claims by the creator had been widely reported in the news media.[85] Both buyers own retail chains of stores and were advised by professional designers who should have known about the creator's rights in the furniture.[86] The case helps to clarify that the provisions in Article 42 relieving the seller from liability when the buyer could not have been unaware do at least have some real teeth, although it does not clarify how much.

In a similar case involving printed textiles,[87] another French court clarified that the buyer's knowledge or constructive knowledge of an infringement trumps the seller's liability under Article 42 even where the seller clearly also knew about the infringement. In that case, a German company sold printed textiles to a French company that another company claimed infringed its intellectual property rights in the patterns.[88] The seller apparently had stores of its own in France and also knew that the fabrics would be resold in France.[89] This, of course, would normally implicate the seller for liabilities under Article 42. According to the court, the buyer, however, could not have been unaware of the infringement and this relieved the seller of any liability for the infringement claims.[90] The opinion does not elaborate on why the buyer could not have been unaware of the infringement, but does observe that the buyer operated six clothing stores in eastern France and refers to its professional capacity.[91] Since six clothing outlets is, at best, a small chain, the opinion may suggest that the circumstances in which courts will infer the buyer could not have been unaware of a third-party intellectual property right in the goods are somewhat broader than the counterfeit furniture case had suggested.

In another case decided in a French court,[92] a Spanish company sold footwear to a French company. The French buyer was sued by a third-party for infringing a trademark and the buyer paid 300,000 French francs to settle the infringement claim.[93] The buyer then sued the seller of the footwear for breaching Article 42 of the CISG. The buyer won at trial but

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[84] *Id.*
[85] *Id.*
[86] *Id.*
[87] Cour d'appel [CA] [regional court of appeal] Colmar, Nov. 13, 2002, 1B 98/01776 (Fr.), http://cisgw3.law.pace.edu/cases/021113f1.html.
[88] *Id.*
[89] *Id.*
[90] *Id.*
[91] *Id.*
[92] Cour d'appel [CA] [regional court of appeal] Rouen, Feb. 17, 2000, 1998/710, http://cisgw3.law.pace.edu/cases/000217f1.html.
[93] *Id.*

on appeal the judgment was overturned.[94] The appellate court observed that the buyer was an "informed professional" and should have known about the third-party's trademark rights in France and been able to avoid the infringement claims.[95] Moreover, the court observed that, in supplying the footwear, the seller complied with instructions from the buyer, and that Article 42 relieves the seller of liability for an infringement claim when that is the case.[96] If anything, the case illustrates that the provision in Article 42 relieving the seller of liability when it merely complies with instructions from the buyer can be important.

3. The Scope of the Seller's Liabilities

Only one accessible case has addressed the scope of the seller's liabilities under Article 42 directly. In a case decided in a Dutch court,[97] a Dutch company bought textiles from an Italian company. A third-party subsequently claimed copyrights in the designs of the textiles and sued the Dutch buyer.[98] The buyer was ordered to pay damages and thereupon sued the Italian seller asserting, among other things, a breach of Article 42 of the CISG.[99] The Dutch court devoted most of its opinion to clarifying the applicable law, in the end deciding that Italian law should apply, and that under Italian law the CISG was applicable.[100] What is perhaps most interesting about the opinion, however, was the court's ruling that under Article 42 the buyer must prove that the seller knew or could not have been unaware of the intellectual property infringement.[101] The court thus appeared to reject the view, expressed by the UN Secretariat during the legislative history of the CISG, that it should be presumed a seller could not have been unaware of a third-party intellectual property right when the intellectual property is publicly recorded under the relevant national intellectual property system.

One additional Israeli case involving boots also addressed the scope of a seller's liabilities under Article 42, although perhaps more obliquely.[102] In that case, an Israeli seller was sued by a Belgian buyer after the boots were confiscated in transit by U.S. Customs authorities because they violated a well-known trademark.[103] The case was appealed all the way to the Israeli

94 *Id*.
95 *Id*.
96 *Id*.
97 Hof, 21 mei 1996, 95/246 AL (Neth.), http://cisgw3.law.pace.edu/cases/960521n1.html.
98 *Id*.
99 *Id*.
100 *Id*.
101 *Id*.
102 CA 3912/90 Eximin SA v. Itel Style Ferarri Textiles & Shoes Ltd. 47(4) PD 64 (1993) (Isr.).
103 *Id*.

Supreme Court. Although the Israeli Supreme Court determined that the Hague Sales Convention should apply, not the CISG, it nonetheless drew an analogy with the CISG, and split the liabilities between the seller and buyer because both should have known about the trademark infringement and were both, therefore, partly to blame.[104] The Court correctly reasoned that under Article 42 the fact that the buyer knew or could not have been unaware of the trademark would trump the fact that the seller also knew or could not have been unaware of the trademark and relieve the seller of liability.[105] Interestingly, however, the Court nonetheless held that both parties should bear part of the liabilities in the case under the good faith obligations on the parties under Israeli law.[106] As the case commentary notes, to the extent that the Court drew an analogy with the CISG the ruling may only confound the proper interpretation of Article 42.[107] Moreover, the case illustrates the hazards of applying domestic rules to an international sales transaction because it can clearly lead to outcomes that appear to be inconsistent with the CISG.

C. The Important Unanswered Question

Article 42 raises some obvious interpretative questions that neither the legislative history nor the case law help to answer clearly. First of all, should the seller be presumed to know about potential third-party intellectual property claims if the third-party's intellectual property rights are registered or created under the domestic laws of the buyer's location or the location where the buyer plans to resell the goods? Second, should the buyer also be presumed to know about a third-party intellectual property right registered or created in a jurisdiction where the buyer plans to use or resell the goods?

If the answer to the first question is "yes" and the answer to the second one is "no," then the seller presumably should be held liable whenever a third-party makes a claim against the buyer based on an intellectual property right in the jurisdiction in which the buyer is located or the jurisdiction in which the buyer plans to resell the goods. If the answer to the first question is "no" and the answer to the second one is "yes" then the buyer presumably should bear the risk of such a claim. If the answer to both questions is "no," then the seller presumably should be liable only if the buyer can prove that the seller knew or could not have been unaware of the third-party intellectual property right[108] without conceding that it also knew

[104] *Id.*
[105] *Id.*
[106] *Id.*
[107] *Id.*
[108] *See* CISG, *supra* note 2, art. 42(1) ("The seller must deliver goods which are free from any right or claim of a third party based on industrial property or other intellectual property, of which at the time

or could not have been unaware of the third-party intellectual property right;[109] of course, if the fact that the intellectual property right is registered or created under the laws of the buyer's own jurisdiction or the jurisdiction in which the buyer plans to resell the goods does not create a presumption that the seller knew or could not have been unaware of the right, the buyer will have great difficulty bearing that burden of proof.[110]

The two questions boil down to the one of central interest to this article: who should bear the liabilities for a third-party intellectual property claim based on an intellectual property right registered or created in the jurisdiction in which the buyer is located or the jurisdiction in which the buyer plans to resell the goods, the seller or the buyer? To answer that question correctly, we will need to make the right presumptions about the parties' knowledge. Of course, the answer must also accord with the governing rules and principles of the CISG.

VI. INTERPRETING THE WARRANTY OF TITLE UNDER THE CISG

Contract laws serve both utilitarian and ethical purposes. One of the important utilitarian purposes of contract laws is to reduce the costs of transacting, since the lower the transaction costs, the great the potential gains from trade. Most contract laws—including the CISG—allow the parties to draft customized terms for their agreements.[111] If transaction costs were zero and the parties were perfectly rational, they would always be able to draft customized terms for their agreements that would maximize their joint surplus from transacting.[112] Unfortunately, parties are never perfectly rational and there are significant costs to negotiating, drafting, and enforcing customized contract terms.[113] Given that there are significant transaction costs, the best that even the most rational parties can hope for is

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of the conclusion of the contract the seller knew or could not have been unaware . . . .").

[109] *See* CISG, *supra* note 2, art. 42(2) ("The obligation of the seller under the preceding paragraph does not extend to cases where (a) at the time of the conclusion of the contract the buyer knew or could not have been unaware of the right or claim . . . .").

[110] The language of Article 42 appears to make this clear; if there was any uncertainty, this is one matter that the case law appears to have clarified. See *supra* Section IV.ii.(b).

[111] *See* CISG *supra* note 2, art. 6 ("The parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions.").

[112] This is a basic implication of the Coase Theorem. *See generally* R.H. Coase, *The Problem of Social Cost*, 3 THE J.L. & ECON. 1 (1960). As an aside, this is apparently the most cited law review article of all time. *See* Shapiro, Fred R. Shapiro and Michelle Pearse, *The Most-Cited Law Review Articles of All Time*, 110 MICH. L. REV. 1483, 1489 (2012).

[113] This is axiomatic and hardly worthy of a citation, but it is worth noting that bounded rationality and transaction costs are important enough to have provided the foundational assumptions for an entire school of economic thought, the so-called New Institutional Economics. *See, e.g.,* Oliver E. Williamson, *The New Institutional Economics: Taking Stock, Looking Ahead*, 38 J. ECON. LIT. 595–613 (2000).

a contract that allows them to earn as much joint surplus as possible net of the transaction costs. To that end, contract laws are often helpful because they provide default rules that the parties may contract under instead of incurring the significant costs of negotiating and drafting customized contract terms.[114] The CISG provides an important set of contract default rules and, in many international sales, the parties may rely on the default rules to govern their transactions. This makes the interpretation of the CISG's rules, including Article 42, important to the economic purposes of the parties.

A. Interpreting the CISG Default Rules Under Article 42

If the parties to an international sale governed by the CISG choose not to draft a customized warranty of title term, then the default rule in Article 42 will govern whether the seller is liable for a third-party intellectual property claim against the buyer. If a dispute arises about the interpretation of Article 42, the clear directive in Article 7(1) is that it should be interpreted with due regard to the international character of the CISG, the need to promote uniformity in its application, and the desire to promote good faith in international trade.[115]

1. Good Faith in International Trade and Reasonable Commercial Standards

Unfortunately, it is not necessarily obvious what Article 7(1)'s admonishment to pay regard to the international character of the CISG and to promote uniformity in its application and good faith in international trade implies. At a minimum, the international character of the CISG and the desire to promote uniformity in international sales argue strongly that courts should look beyond case precedents from their domestic jurisdictions to those from foreign ones;[116] they may also argue for consulting scholarly commentary, at least to the extent that it addresses problems of contract interpretation.[117] To the extent that it applies to the interpretation of the CISG, the promotion of good faith in international trade at a minimum

[114] *See, e.g.*, ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS, 217–24 (5th ed. 2008).

[115] *See* CISG, *supra* note 2, art. 7(1) ("In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.").

[116] This has been strongly urged in scholarly commentary and by some courts, although U.S. courts have not always heeded the admonishment. HONNOLD, *supra* note 6, at 125–31.

[117] John Honnold suggests that Article 7(1) implies courts should consult scholarly writings in interpreting the CISG. If one accepts that the principles of Article 7(1) should apply to the interpretation of contract terms under the CISG as well as the CISG itself, then to the extent that scholarly commentary may offer useful guidance in interpreting specific contract terms, such commentary should also be consulted. *Id*.

arguably requires a liberal interpretation of some CISG provisions.[118] Beyond that, it may also require an appeal to the reasonableness standard as well as the practices established between the parties and usages within their industry.[119]

Indeed, as John Honnold explains,[120] Article 7(1) may have implications similar to those of the good faith obligation under the Uniform Commercial Code (UCC). Under Article 2 of the UCC, good faith is defined to mean "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."[121] According to the Official Comments of the UCC, "fair dealing is a broad term … that is concerned with the fairness of conduct..." and should be "determined in light of reasonable commercial standards….".[122] The overarching requirement of good faith under the UUC, therefore, is dictated by reference to reasonable commercial standards. Since the purpose of most commercial transactions is to earn profits, reasonable commercial standards presumably should help to minimize the costs of transacting and allow the parties to earn, on average, as much joint surplus as possible subject to the requirement that they are treated fairly.

2. Asymmetric Information and the Policy Purpose of a Warranty of Title

The economic purposes of the warranty of title should be relevant to the reasonable commercial standards that guide its application. As a general matter, the warranty of title helps to reduce transaction costs by alleviating informational asymmetries and assigning the liabilities associated with third-party claims against the buyer to the party that is most efficiently able to avoid them.[123] A sales transaction typically entails the transfer of title to goods for a price. Problems might arise, however, if there is asymmetric information between sellers and buyers about the "quality"[124] of the title that is being conveyed from the seller to the buyer. For example, suppose the seller knows there is a third-party who might make a property claim

[118] *Id*. at 135–36.

[119] *Id*. at 136.

[120] *Id*. *See also* Troy Keily, *Good Faith and the Vienna Convention on Contracts for the International Sale of Goods (CISG)*, 3 VINDOBONA J. INT'L COM. L. & ARB. 15 (1999).

[121] *See* U.C.C. § 2-103(1)(b) (AM. LAW INST. & UNIF. LAW COMM'N 2012). In fact, this is now the general definition of good faith under all the Articles of the UCC. *See* U.C.C. § 1-201(b)(29).

[122] U.C.C. § 1-201, cmt. 20.

[123] The informational asymmetries can create a so-called "lemons problem." *See, e.*g., George A. Ackerloff, *The Market for "Lemons": Qualitative Uncertainty and the Market Mechanism,* 84 QUART. J. ECON. 488, 489–91 (1970).

[124] The reference to "quality" of title refers to the risk of liabilities associated with third-party property claims against the goods. A title subject to less risk of such claims is obviously better than one subject to greater risk.

against the goods after the sale but the buyer does not. This constitutes what is called a "hidden information problem."[125] As a consequence of such a problem, the buyer might unwittingly pay a higher price for the goods than they are worth. The mere risk that the seller might have hidden information bearing on the risks of third-party challenges against the buyer's title could therefore discourage the buyer from transacting.

The warranty of title may also help to mitigate information asymmetries associated with hidden actions, which can create what are commonly known as "moral hazard" problems.[126] For example, the owner of an automobile could make major repairs with used parts; the used parts might contain vehicle identification numbers different than those on the remaining original parts of the automobile.[127] If the owner sells the vehicle to a buyer who is unaware of the used parts, a police stop or other inspection could disclose the discrepancies to the authorities and may raise questions about the buyer's title. The seller's actions, hidden from the buyer because they were prior to the sale of the automobile, would thus cause the buyer to suffer a claim against title to the automobile. The risk that the seller's hidden actions might compromise the buyer's title after a sale creates a lemons problem of a somewhat different kind than the one created by hidden information but it is no less of an impediment to sales transactions.

In theory, the price that buyers are willing to pay for a good depends on the quality of the title they expect to receive, but buyers often have less information about the quality of the title than the seller. Since sellers may have private information that is hidden and cannot be verified by the buyer, the buyers cannot distinguish the quality of the titles that will be conveyed by different sellers and they will therefore only pay a price appropriate for goods with titles of the average quality of all titles of goods of the same type on the market.[128] An individual seller therefore has no incentive to sell a good whose title is of higher than average quality—or, in other words, subject to fewer potential third-party claims. In theory, the low quality title sellers could actually force high quality title sellers out of the market and buyers could end up with no alternative to low quality title goods, even though they might be willing to pay a premium for goods with verifiably

[125] Economists have distinguished between two basic kinds of asymmetric information problems: "hidden action" problems and "hidden information" problems. Hidden information problems arise in situations where one party to a transaction has information that is of value to the other party but the information cannot be revealed in any simple manner. *See* Bengt Holmstrom, *Moral Hazard and Observability*, 10 BELL J. ECON. 74, 74–91 (1979) (discussing informational asymmetries in economic problems in a seminal Article).

[126] *Id*. at 74–76.

[127] The example is from the classic case, Colton v. Decker, 540 N.W.2d 172, 174–75 (S.D. 1995).

[128] In fact, they would only pay a price that was appropriate for a product of average quality if they were risk-neutral; if they were risk-averse they would pay less than that.

high quality titles.[129] The warranty of title may help to mitigate asymmetric information problems by making the seller liable for third-party claims against the buyer when the seller knew about the risks but the buyer did not.

Under the CISG a warranty of title will apply by default under Articles 41 and 42 unless the parties draft a customized warranty of title provision that displaces the CISG's default rules. If there is a third-party claim against the buyer or some other defect in title after the sale, the buyer may be entitled to a remedy, if the claim or defect constitutes a breach of the warranty.[130] The warranty of title thus acts as a kind of insurance policy provided by the seller in any sale, unless properly waived, that protects the buyer against third-party property claims against the goods or other defects in title. To the extent that the warranty of title is well devised, it will therefore mitigate information asymmetries, reduce the costs of transacting, and improve the economic efficiency of markets. A well-devised warranty of title would arguably thus comport with reasonable commercial practices of fair dealing and promote good faith in international trade, but the important question is, how should the warranty of title be devised to mitigate information asymmetries and reduce transaction costs? To be more specific, what test should be used to determine whether the seller bears the liability for a claim against the buyer's title?

3. The Cloud on Title Standard

U.S. courts have generally adopted the "cloud on title" standard in cases arising under the UCC.[131] There is a cloud on title if the buyer's title is or may be subjected to a colorable challenge. A colorable challenge is one which is "not spurious" and casts a "substantial shadow" on the title such that it is not free from "reasonable doubt."[132] The language is less than crystal clear and commentators have not surprisingly urged that the UCC standard be clarified. Nonetheless, it is clear that under the UCC a third-party claim against the buyer's title usually does not have to be valid to constitute a breach of the seller's warranty of title.[133] It seems equally clear that a frivolous or spurious claim would not constitute a breach.[134]

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[129] In other words, they end up with no alternative but to buy a "lemon."

[130] Under the CISG, damages might be available under Articles 74–77. *See* CISG, *supra* note 2, at 688–89. If the seller's breach is "fundamental," as defined in Article 25, the buyer may also be able to avoid the contract under Article 49. *See* CISG, *supra* note 2, at 682.

[131] *See, e.g.,* Colton, 540 N.W.2d at 176 ("[M]ere initiation of a colorable challenge, one which is not spurious, regardless of the outcome, is sufficient to violate the warranty of title."). In this case, the court held that the seller was liable for a breach of the warranty of title under the UCC after the buyer's vehicle was impounded by state authorities because conflicting vehicle identification numbers on used parts created a shadow on the buyer's title. *Id.* This is an example of a colorable challenge.

[132] *Id*.

[133] *Id.*

[134] *Id*.

Most of the UCC cases have addressed third-party non-intellectual property claims against the buyer. In a recent case, however, the Court of Appeals of California has extended the cloud on title standard to third-party intellectual property claims against the buyer as well.[135] In the *Pacific Sunwear* case, the court addressed whether a third-party trademark infringement claim against a buyer that was denied a summary judgment on the grounds that the third-party had not "established a likelihood of confusion"[136] and was subsequently settled was sufficient to breach the seller's warranty of title under UCC § 2-312(3). The court held that "the warranty covers a broad scope of infringement claims and is not limited to claims that ultimately will prove successful in litigation,"[137] and thus it "applies to all claims of infringement that have any significant and adverse effect on the buyer's ability to make use of the purchased goods, excepting only frivolous claims that are completely devoid of merit."[138]

The cloud on title standard probably comports with reasonable commercial standards in a domestic sales transaction. In a purely domestic sale, the seller can reasonably be presumed to have actual or constructive knowledge about any potential intellectual property rights claims against the goods since the intellectual property rights that would provide a basis for the claims would arise under the laws of the jurisdiction in which both the seller and buyer are located and the seller therefore should know about the potential claims prior to the sale. In fact, the seller would be a potential target for the claims prior to the sale, simply by virtue of using the intellectual property.[139] Thus, it is arguably reasonable to extend the cloud on title standard commonly used under the UCC for non-intellectual property warranty of title claims to those that are based on third-party intellectual property rights claims as well.[140]

4. The Unique Characteristics of International Sales

In an international sale, however, the seller cannot so easily be presumed to have constructive or actual knowledge of potential third-party intellectual property claims against the goods since the seller is typically located in a jurisdiction other than the one under which the third-party's intellectual property rights will be made. The seller would therefore not

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[135] Pac. Sunwear of Cal., 167 Cal. App. 4th at 481 ("[T]he warranty . . . applies to all claims of infringement that have any significant and adverse effect on the buyer's ability to make use of the purchased goods, excepting only frivolous claims that are devoid of merit . . . .").

[136] *Id*. at 470.

[137] *Id*. at 481.

[138] *Id*.

[139] Blair & Cotter, *supra* note 11, at 1–4.

[140] That does not mean, of course, that the standard cannot be improved. For a suggested refinement, see Sandrik, *supra* note 13, at 905–915.

normally know much about the intellectual property laws under which any intellectual property claims might be made. The one exception, which would apply only in rare and unusual cases, would arise if the buyer re-sold the goods in the jurisdiction in which the seller was located and the third-party claim was based on intellectual property rights created in the seller's own jurisdiction. Aside from that exception, the buyer should normally be presumed to know at least as much as the seller about the laws of the jurisdiction under which any third-party's intellectual property claim would be based.

In an international sale, the buyer is also generally the party that should be better able to avoid the risks of a third-party intellectual property claim by searching the jurisdiction's records in advance of the sales transaction for registered intellectual property rights that might be infringed by the goods. The buyer is obviously located in the jurisdiction under which the claims might be made or plans to resell the goods in a jurisdiction under which the claims might be made and should therefore be able to conduct a search of the records at lower cost than the seller. The buyer's cost savings would derive not only from the buyer's physical presence, which should by itself allow the buyer to conduct the search at lower costs, but also from the buyer's greater familiarity with the laws of the jurisdiction, including the intellectual property laws and the system for registering intellectual property rights.[141] In many sales transactions, the seller will have neither the time nor the resources or competence to conduct an adequate search of the intellectual property records in distant and unfamiliar jurisdictions. In fact, in many cases the seller might not even imagine that any third-party might make an intellectual property claim. Regardless, the buyer should be presumed to have at least as much foresight about the possibility of such claims as the seller and to be better able to forestall the possibility of a title problem.

The basic problem is analogous to the one involving goods that violate the local laws, regulations, customs, or standards of the jurisdiction in which the buyer is located.[142] For example, suppose the seller delivers an

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[141] The buyer arguably should be more familiar than the seller with the laws of its own jurisdiction and, if it plans to resell the goods in a foreign jurisdiction, arguably should be at least as familiar with the laws of that jurisdiction as well—unless, of course, the buyer plans to resell the goods in the seller's own jurisdiction, an unlikely exception.

[142] This is a common problem in sales across jurisdictions and has therefore arisen under the UCC as well as the CISG. *See, e.g., Award Made in Case No. 2129 of 1972*, *in* COLLECTION OF ICC ARBITRAL AWARDS 1974–85, at 23 (Sigvard Jarvin & Yves Derains eds., 1990) (automobile parts conformed to German standards but not to Ohio standards); *Award in Case No. 3779 of 1981*, *in* COLLECTION OF ICC ARBITRAL AWARDS 1974–85, at 138 (Sigvard Jarvin & Yves Derains eds., 1990) (whey powder conformed to contract when tested by North American methods but not when test by European methods), Medical Marketing Int'l, Inc. v. Internazionale Medico Scientifica, S.R.L., No. CIV. A. 99-0380, 1999 WL 311945 (E.D. La. May 17, 1999) (mammography machines complied with Italian regulations but did not comply with FDA regulations).

expensive piece of medical equipment to the buyer, but the equipment violates health regulations in the buyer's jurisdiction even though it complies with those in the seller's jurisdiction.[143] Who should bear the liabilities, the seller or the buyer? As a general matter, the buyer probably should be more familiar with the health regulations in its own jurisdiction than the seller. The seller may not have made any other sales or have had any other operations or business in the buyer's jurisdiction. The buyer, on the other hand, is not only located in its own jurisdiction, but obviously plans to use or resell the seller's medical equipment in that jurisdiction. As a general matter, therefore, the buyer is in a better position to know about the health regulations, and to take any actions necessary to forestall compliance problems. Policy considerations thus generally support assigning liabilities for noncompliance with local laws or regulations to the buyer to help alleviate informational asymmetries that might otherwise impede or inhibit efficient transactions.

There is a strong analogy between questions about whether the seller should be liable for claims against the buyer because of the failure of goods to conform to the laws or regulations in the buyer's jurisdiction and questions about whether the seller should be liable for claims against the buyer because the goods infringe on a third-party's rights under the intellectual property laws in the buyer's jurisdiction. If goods fail to comply with regulations in the buyer's jurisdiction, then the buyer may be subject to a claim by the government. If goods infringe on an intellectual property right under intellectual property laws in the buyer's jurisdiction, then the buyer may be subject to a claim by a third-party who owns the intellectual property right. In each case, the claims against the buyer arise under the laws of the buyer's jurisdiction. Both cases, therefore, raise questions about whether the seller or buyer should bear the liabilities for claims arising under the laws of the buyer's jurisdiction.

5. A German Supreme Court Precedent in an Analogous Case

There is, in fact, some persuasive authority under the CISG that supports assigning liabilities to the buyer cases where goods fail to comply with laws or regulations in the buyer's jurisdiction. The German Supreme Court addressed a question under the CISG about whether the failure of goods to conform to local regulations constituted a breach of Article 35 in *Entscheidunger des Bundersgerichtshofs in Zivilsachen*.[144] In that case, a

[143] This is not a warranty of title issue since it does not involve any defect in, or claim against, the buyer's title to the goods. Under the U.C.C. it is probably best treated as a warranty of merchantability issue under U.C.C. § 2-314 or a warranty of fitness issue under U.C.C. § 2-315. Under the CISG it would probably be best treated under the analogous provisions in CISG Article 35(2)(a) or 35(2)(b).

[144] Bundesgerichtshof [BGH] [Federal Court of Justice] Mar. 8, 1995, ENTSCHEIDUNGEN DES BUNDESGERICHTSHOFS IN ZIVILSACHEN [BGHZ] 129, 75–86, 1995 (Ger.),

Swiss company sold a large order of mussels to a German buyer. The mussels conformed to the contract description of the goods, but did not comply with the cadmium concentration limits recommended by the German health authorities.[145] Although the mussels were not sufficiently high in cadmium for the German authorities to consider them unsuitable for consumption, they were high enough in cadmium to be considered "not harmless" and the buyer wanted to return them and declare the contract avoided under CISG Article 49.[146] The seller won at trial and the buyer subsequently appealed.[147] On the first appeal, the German Court of Appeals observed that the contract did not expressly indicate whether the laws of the seller's or buyer's jurisdiction applied, but in any case declined to hold that the lack of conformity with German law constituted a fundamental breach under CISG Article 25, as required for the buyer to avoid the contract under CISG Article 49.

On further appeal, to the German Supreme Court observed:

> The mere fact that the mussels should be delivered to the storage facility in G.G. does not necessarily constitute an agreement regarding the resalability of the goods . . . in Germany, and it definitely does not constitute an agreement regarding the compliance with certain public law provisions on which the resalability may depend.[148]

The Court therefore undertook an extensive survey of the commentary on questions about whether the "ordinary uses" and "fitness for a for a particular purpose" provisions under CISG Article 35(2((a) and 2(b) required that the mussels conform with the law of the buyer's jurisdiction, and concluded that "it is not important for the purposes of subsection . . . [35(2)(a)] . . . whether the use of the goods conflicts with public law provisions of the import country." The Court further reasoned:

> In any event, certain standards in the buyer's country can only be taken into account if they exist in the seller's country as well . . . or if, and this should possibly be examined within the scope of CISG Art. 35(2)(b), the buyer has pointed them out to the seller . . . and, thereby, relied on and was allowed to rely on the seller's expertise or, maybe, if the relevant provisions in the anticipated export country are known or should be known to the seller due to the particular circumstances of the case.[149]

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http://cisgw3.law.pace.edu/cases/950308g3.html.

[145] *Id.*

[146] *Id.*

[147] *Id.*

[148] *Id.*

[149] *Id.*

The analogy between the question of whether goods are defective because they fail to conform to the laws or regulations in the buyer's jurisdiction and the question of whether title to goods is defective because of a third-party intellectual property claim under the laws or regulations of the buyer's jurisdiction (or the jurisdiction in which the buyer plans to resell the goods) makes the German Supreme Court's opinion relevant and compelling. Since Article 7(1) directs courts to interpret the CISG to promote uniformity in its application and good faith in international trade, and since those arguable require that analogous cases be treated in similar ways, *Entscheidunger des Bundersgerichtshofs in Zivilsachen* has great persuasive force. In fact, *Entscheidunger des Bundersgerichtshofs in Zivilsachen* has been cited favorably by a U.S. court in *Medical Marketing Int'l,*[150] which summarized the rule as follows:

> A seller is generally not obligated to supply goods that conform to public laws and regulations at the buyer's place of business . . . [T]his general rule carries with it exceptions in three limited circumstances: (1) if the public laws and regulations of the buyer's state are identical to those enforced in the seller's state, (2) if the buyer informed the seller about those regulations, or (3) if due to "special circumstances," such as the existence of a seller's branch office in the buyer's state, the seller knew or should have known about the regulations at issue.[151]

Since registering or otherwise creating intellectual property rights in one jurisdiction does not generally provide a right to make an infringement claim in another jurisdiction, the first of the limited exceptions summarized by the court in *Medical Marketing Int'l* is inapt. There is, however, an analogous, if unlikely, scenario. It is theoretically possible that the buyer could resell the goods in the seller's own jurisdiction. Of course, the seller should be aware of any third-party intellectual property rights registered or created under the laws of its own jurisdiction—in that case, the third-party could sue the seller regardless of whether the sale occurred.[152]

6. A Rule for Applying Article 42

One can draw on the analogy between claims based on the failure of goods to conform to local laws or regulations and claims based on third-party intellectual property rights, to suggest a rule to govern the application of Article 42 as follows: the seller in a CISG contract should only be held

[150] Medical Marketing Int'l, Inc. v. Internazionale Medico Scientifica, S.R.L., No. CIV. A. 99-0380, 1999 WL 311945, at *2(E.D. La. May 17, 1999).

[151] *Id*.

[152] Blair & Cotter, *supra* note 11, at 1–4.

liable under Article 42 for third-party intellectual property claims against the buyer if (1) the buyer resells the goods in the seller's jurisdiction and the claim arises under the intellectual property laws in the seller's jurisdiction, (2) the buyer informed the seller about the third party's intellectual property rights prior to contracting, or (3) due to special circumstances, such as the seller having a branch in the jurisdiction under which the third party's intellectual property rights are registered, or the seller but not the buyer knew or should have known about the third party's intellectual property rights.[153]

B. Interpreting Customized Contract Terms

In some cases, especially where the stakes are high and the parties are relatively sophisticated, the parties might decide to draft a customized warranty of title term. Since the CISG expressly authorizes the parties to contract around almost all of its default rules, courts would generally respect the parties' customized contract term, and so the mere fact that the parties drafted one would not raise any issues.[154] Of course, if the parties subsequently had a dispute about the meaning of their customized warranty of title contract term, the task of interpreting it might be put to the courts.

The CISG does not provide any bright lines rules to govern the interpretation of parties' customized contract terms, but it does offer some guidance, especially in Article 8. Article 8(1) states that statements made by a party are to be determined by the party's subjective intent where the other party knew or could not have been unaware what that intent was.[155] Unfortunately, Article 8(1) will rarely apply. Article 8(2) states that where Article 8(1) does not apply, statements made by a party are to be interpreted according to the understanding of a reasonable person of the same kind as the other party in the same circumstances.[156] What is perhaps most interesting about Article 8(2) is not that it uses a reasonableness standard, but that it implies a party's statements should be interpreted according to how the other party should reasonably have interpreted them. Article 8(2) therefore appears to imply that if one of the parties drafts a writing for a

[153] The special circumstances noted are only illustrative. There might be many other circumstances that justify assigning liabilities to the seller. For example, the seller might be a large, sophisticated corporation that has previously made many sales in the jurisdiction under which the third-party's claim arises, and the buyer, on the other hand, might be a much less sophisticated actor dealing in goods of the particular kind for the first time.

[154] *See* CISG, *supra* note 2, art. 6.

[155] *See* CISG, *supra* note 2, art. 8(1) ("[S]tatements made by and or other conduct of a party are to be determined by his intent where the other party knew or could not have been unaware what that intent was.").

[156] CISG, *supra* note 2, art. 8(2) ("[S]tatements made by and or other of a party are to be determined according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances.").

contract and there is a dispute about the interpretation of one of the terms, a court should interpret the term in the same way that a reasonable person of the same kind as the other party in the dispute would have done under the same circumstances.[157] It appears to be similar to the *contra proferentem* rule that is commonly used to resolve contract interpretation disputes in the United States,[158] although it may not disfavor the drafter quite so much as it favors the reasonableness of the interpretation. Since customized contract terms are commonly drafted by the party with more resources and experience,[159] Article 8(2) seems both reasonable and fair.

Although it may not be obvious that Article 8(2) applies to contract interpretation when both of the parties participated in drafting the contract terms, upon some reflection it also appears to imply that courts should apply a reasonableness standard in interpreting contract terms that were jointly drafted. Presumably, if both parties took a role in drafting a contract term they should each be treated as having made a statement expressing the term through their participation in the drafting process and their expression of the term should be interpreted according to how a reasonable person of the same kind as the other party to the contract would have done under the same circumstances.[160] Article 8(2) thus appears to direct courts to interpret a jointly drafted contract term in the same way that a reasonable person of the same kind as each of the parties under the same circumstances would have interpreted it. Since an interpretation of a contract term that is construed as reasonable from each of the opposing parties' sides (instead of from only one side) could only be described as "reasonable," Article 8(2) appears to direct courts to apply a version of a reasonableness standard in interpreting jointly drafted contract terms.[161]

Unfortunately, the application of Article 8(2)'s reasonableness standard may not be as simple as it initially appears. If the parties have a genuine interpretive dispute, it may be possible that, relative to each of them, a person in the position of the other party could have a reasonable

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[157] HONNOLD, *supra* note 6, at 158.

[158] *Id*.

[159] *See, e.g.*, Friedrich Kessler, *Contracts of Adhesion – Some Thoughts About Freedom of Contract,* 43 COLUM. L. REV. 629 (1943) (classic Article exploring the implications of unequal bargaining power for the contractual writings drafted by the parties).

[160] The language of Article 8(2) refers to "statements . and other conduct" of a party. *See* CISG, *supra* note 2, art. 8(2). Presumably, a written contract term that was drafted or jointly drafted by a party should be treated as a statement by that party and should, therefore, be subject to Article 8(2).

[161] This should not be surprising. A reasonableness standard is stated in several CISG provisions. Indeed, one distinguished commentator has claimed that a reasonableness standard is one of the general principles on which the CISG is based. *See* PETER SCHLECHTRIEM, UNIFORM SALES LAW—THE UN CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS 21 (1986) ("[That] the parties must conduct themselves according to the standard of the 'reasonable person,' which is expressly described in a number of provisions and, therefore, according to Article 7(2), must be regarded as a general principle of the Convention.").

interpretation of the contract term under the same circumstances that differed from their own. In fact, it may be possible that, relative to each of the parties, a reasonable person in the position of the other party could have more than one—perhaps even several—reasonable interpretations of the term.[162] In other words, relative to each of the parties, Article 8(2) might imply a set of multiple reasonable interpretations that could be imputed to the other party. Since a reasonable interpretation would have to be mutually reasonable, it would have to lie in the intersection of the sets of reasonable interpretations that could be imputed to each of the parties. Article 8(2) would thus imply three possibilities.[163] The intersection of the sets of reasonable interpretations could (1) identify a unique reasonable interpretation of the term,[164] (2) identify a set of more than one reasonable interpretations of the term,[165] or (3) might not identify any reasonable interpretation of the term.[166] If Article 8(2) identified a unique reasonable interpretation, then that would arguably be the one a court should apply. But what if Article 8(2) did not identify a unique reasonable interpretation, either because it identified multiple reasonable interpretations or none at all?

As several scholars have observed,[167] Article 8(3) directs courts to look beyond any contract writing to almost any extrinsic evidence bearing on the meaning of a contract term.[168] Although the extrinsic evidence might

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[162] The language of Article 8(2) seems to overlook this possibility, since it uses the definite article when it refers to "the understanding that a reasonable person . . . would have had in the same circumstances." But it also uses the indefinite article in referring to "a reasonable person." Since reasonable people can disagree, they could in principle have different understandings of a contract term under the same circumstances. Thus, in applying Article 8(2) a court could contemplate the different understandings that more than different reasonable persons could have had of a contract term under the same circumstances. CISG, *supra* note 2, art. 8(2).

[163] It is tempting but unnecessary to draw Venn diagrams. Nonetheless, readers who are so inclined may like to conceptualize the alternatives in set-theoretic terms. To that end, let P1 denote the set of reasonable interpretations that could be imputed to the first party, and let P2 denote the set of reasonable interpretations that could be imputed to the second party.

[164] In other words, the intersection of P1 and P2 might consist of a single mutually reasonable interpretation. This we could rightly call a unique reasonable interpretation of the contract term.

[165] One alternative possibility is that the intersection of P1 and P2 might consist of more than one mutually reasonable interpretation. Under the application of Article 8(2), the contract term would thus be ambiguous.

[166] A third and final possibility is that intersection of P1 and P2 might consist of the null set—that is, it might not include any mutually reasonable interpretations. In this case, Article 8(2) would not imply any interpretation of the contract terms at all, even any ambiguous ones.

[167] *See, e.g.*, Parol Evidence Rule, Plain Meaning Rule, Contractual Merger Clause and the CISG, CISG Advisory Opinion No. 3 (Oct. 23 2004), http://www.cisg.law.pace.edu/cisg/CISG-AC-op3.html. *But see* CLAYTON P. GILLETTE & STEVEN D. WALT, SALES LAW: DOMESTIC AND INTERNATIONAL 150 (1999).

[168] *See* CISG, *supra* note 2, art. 8(3) ("[D]ue 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.").

be helpful in many cases, it could also confound an interpretive problem and increase the number of possible reasonable interpretations of a contract term since reasonable people might (reasonably) rely on different extrinsic evidence in arriving at their understandings of what the contract term entails. Article 9 might also bear importantly on an interpretation problem. Article 9(1) implies that the parties are bound by what those familiar with the UCC would consider usages of trade, course of dealings, or courses of performance.[169] Of course, these are simply other kinds of extrinsic evidence and, while they may be helpful in many cases, they might also confound contract interpretations in others. The greater the range of the extrinsic evidence admitted, the more likely the evidence will imply contradictions and multiple reasonable interpretations of a contract term. The question thus remains: what if Article 8(2) in conjunction with all the available extrinsic evidence fails to identify a unique reasonable contract interpretation?

Article 7(1) suggests an answer. Article 7(1) directs courts to interpret the CISG with regard to its international character and the need to promote uniformity in its application and good faith in international trade.[170] Of course, on its face, Article 7(1) expressly governs only the interpretation of the CISG's own rules, not any contract terms that displace them. Nonetheless, one could argue that Article 7(1)'s directive to interpret the CISG to promote uniformity in its application and good faith in international trade reflects underlying principles of the CISG.[171] Since Article 7(1) directs courts to resolve questions concerning matters governed by the CISG but for which the Articles of the CISG do not expressly provide an answer by applying the principles on which the CISG is based, it arguably implies that courts should interpret contract terms to promote uniformity in international sales law and good faith in international trade in cases where both of the parties drafted them but Article 8(2) does not imply a unique interpretation. In other words, Article 7(1), in conjunction with

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[169] *See* CISG, *supra* note 2, art. 9(1) ("The parties are bound by any usage to which they have agreed and by any practice which they have established between themselves."). Article 9(2) clarifies that the parties impliedly agree to any usages which they ought to have know about. CISG, *supra* note 2, art. 9(2) ("The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract . . . a usage of which [they] knew or ought to have known.").

[170] *See* CISG, *supra* note 2, art. 7(1) ("In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.").

[171] There is a long-standing debate about how liberal courts should be in construing the general principles on which the CISG is based. *See, e.g.*, HONNOLD, *supra* note 6, at 146–48; *see also* Camilla Baasch Andersen, *General Principles of the CISG—Generally Impenetrable?*, *in* SHARING INTERNATIONAL COMMERCIAL LAW ACROSS NATIONAL BOUNDARIES 13 (Camilla B. Andersen & Ulrich G. Schroeter eds., 2008); Andre Janssen, *The CISG and Its General Principles*, *in* CISG METHODOLOGY 261 (Andre Janssen & Olaf Meyer eds., 2009); Joseph Lookofsky, *Walking the Article 7(2) Tightrope Between CISG and Domestic Law*, 25 J.L. & COM. 87 (2005).

any extrinsic evidence admissible under Articles 8(3) and 9, might help courts to select a single (and obviously reasonable) interpretation of a contract term if Article 8(2) either suggests multiple reasonable interpretations or none at all.

Most scholars and commentators appear to agree that courts should use Article 8 to interpret contract terms under the CISG,[172] but to the author's knowledge, no one has specifically addressed whether Article 7(1) implies principles that courts could use to interpret contract terms when their use of Article 8 fails to resolve difficult interpretive problems.[173] Nonetheless, many commentators have argued for construing the principles on which the CISG is based broadly. John Honnold, for example, emphasizes the importance of the character and texture of a body of rules and characterizes most of the CISG's provisions, presumably including Article 7(1),[174] as what others have referred to as "muddy standards"[175] in contrast to "sharp-edged" rules.[176] As Honnold argues, "a code that lays down general principles to cover a wide variety of transactions and is expected to endure, calls for an approach very different from tax laws and similar legislation that is written in great detail and is subject to frequent legislative adjustment."[177] Thus, he believes the CISG's rules and the principles on which they are based should be construed broadly to help achieve the larger purpose of international legal codification and unification.[178] As Honnold and many other scholars view the matter,[179] the risk of construing the CISG

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[172] *See, e.g.*, CISG Advisory Council Opinion No. 3, *supra* note 167; HONNOLD, *supra* note 6, at 153–54; SCHLECHTRIEM & SCHWENZER, COMMENTARY ON THE UN CONVENTION ON THE INTERNATIONAL SALE OF GOODS (CISG), ART. 8, (Ingeborg Schwenzer ed., 2nd ed. 2005).

[173] Of course, it might be possible to identify other principles of the CISG that could be used to aid in contract interpretation. Peter Schlechtriem, for example, might argue that reasonableness is a sufficiently general principle of the CISG that it should govern contract interpretations when Article 8(2) is unavailing. Under a broad construction of such a reasonable principle, a court could apply its own reasonable interpretation of a contract term instead of applying the algorithm in Article 8(2) that requires contemplation of the understandings of reasonable persons. SCHLECHTRIEM, *supra* note 168.

[174] Honnold does not expressly state that Article 7(1) provides more of a standard than a sharp-edged rule, but he does not list it among the rules that he describes as sharp-edged. HONNOLD, *supra* note 6, at 150.

[175] The classic Article is Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 577–78 (1988).

[176] HONNOLD, *supra* note 6, at 150.

[177] *Id*.

[178] *Id.* at 151–52. Of course, not everyone agrees. Indeed, one scholar has argued that the goal of uniformity comes at the expense of other important values, and that a homeward trend bias, which would result from construing the principles of the CISG narrowly, might improve the legitimacy of the CISG over the long-term. *See* Karen Halverson Cross, *Parole Evidence Under the CISG: The "Homeward Trend" Reconsidered*, 68 OHIO ST. L.J. 133, 138 (2007).

[179] HONNOLD, *supra* note 6, at 147; *see* Michael Joachim Bonell, *General Provisions: Article 7*, *in* COMMENTARY ON THE INTERNATIONAL SALES LAW: THE 1980 VIENNA SALES CONVENTION ¶ 2.2.1 (C.M. Bianca & M.J. Bonell eds., 1987) ("[T]he Convention . . . is intended to replace all rules in legal systems previously governing matters within its scope. . . . This means that in applying the Convention

and its principles narrowly is that this opens the door to the gap-filling provision in Article 7(2) which allows recourse to domestic laws to resolve questions arising under the CISG and thus threatens to make international sales law less uniform.[180]

To the extent that Article 7(1) implies principles on which the CISG is based, therefore, it arguably implies the following: (1) if Article 8(2), in conjunction with all the admissible extrinsic evidence, does not provide a unique reasonable interpretation of a contract term, courts should choose from among the possible reasonable interpretations suggested by Article 8(2) the one that best comports with Article 7(1)'s admonishment to promote uniformity in the application of the CISG and good faith in international trade; and (2) if Article 8(2), in conjunction with all the admissible extrinsic evidence, does not suggest any reasonable interpretations of a contract term, courts should choose an interpretation that best comports with the admonishment of Article 7(1) to promote uniformity in the application of the CISG and good faith in international trade. Since good faith in international trade arguably implies the need for reasonable commercial standards of fair dealing,[181] this should at least provide a reasonable interpretation of the contract term under the CISG. Unless the contract term clearly indicated that a different rule should apply, it would also result in the application of the same rule as the one courts should apply under Article 42. Thus, it would help to further the coherence and uniformity of international jurisprudence under the CISG as well.

Ultimately, therefore, the backstop in interpreting a customized warranty of title provision—or any other customized contract term—under the CISG should be provided by the general principles of Article 7(1). Since Article 7(1) also governs the interpretation of all of the provisions in the CISG that would otherwise apply to parties' contracts by default, including the warranty of title provisions under Article 42, this implies that unless the parties' contract clearly indicates otherwise, the warranty of title under a contract governed by the CISG should be interpreted to promote uniformity in its application and good faith in international trade. Thus, unless the parties' contract clearly indicates otherwise, the seller in a CISG contract should only be held liable for third-party intellectual property claims

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there is no valid reason to adopt a narrow interpretation."); Bruno Zeller, *The UN Convention on Contracts for the International Sale of Good—A Leap Forward towards Unified International Sales Laws,* 12 PACE INT'L L. REV. 79, 105–06 (2000). *But see, e.g.*, Cross, *supra* note 185.

[180] Not everyone agrees with the goal of achieving uniformity in international sales. Clayton P. Gillette & Robert E. Scott, *The Political Economy of International Sales Law* 2-4b (N.Y.U. Law & Econ. Research Working Paper No. 05-02, 2005) (arguing that sophisticated parties will generally prefer to draft their own customized contract terms and choose the law that applies to their agreements, and that the CISG thus only offers a useful alternative if the transaction costs of drafting customized contract terms are very high, but the transaction costs are not that high).

[181] *See, e.g.*, HONNOLD, *supra* note 6, at 136; Keily, *supra* note 120, at 15.

against the buyer under a customized warranty of title contract term if (1) the buyer resells the goods in the seller's jurisdiction and the claim arises under the intellectual property laws in the seller's jurisdiction, (2) the buyer informed the seller about the third-party's intellectual property rights prior to contracting, or (3) due to special circumstances, such as the seller having a branch in the jurisdiction under which the third-party's intellectual property rights are registered, the seller but not the buyer knew or should have known about the third-party's intellectual property rights.

VII. CONCLUSION

The risk of intellectual property infringement claims appears to pose an increasing threat to international trade. Important questions will inevitably arise under the CISG, therefore, about the scope of the seller's warranty of title and courts will be called upon to interpret Article 42 of the CISG, which provides a warranty of title governing third-party intellectual property claims, or the parties' contract if they draft a customized warranty of title term. Unfortunately, the CISG's legislative history and the CISG case law construing Article 42 do not offer much help. The underlying policy of the warranty of title in a sales transaction, on the other hand, clearly implies that Article 42 should be interpreted to mitigate informational asymmetries and reduce transactions costs, and in an international sales transaction, this generally favors assigning liabilities for third-party intellectual property claims to the buyer.

Similar policy considerations and the weight of scholarly commentary on an analogous question also arising under the CISG have motivated the German Supreme Court to state a rule that assigns liabilities to the buyer, subject to certain exceptions, when goods fail to conform to the laws or regulations of the buyer's jurisdiction. When translated to questions about sellers' liabilities for third-party intellectual property claims against buyers under the CISG, the rule implies that, unless the parties' contract clearly indicates otherwise, the seller under a contract governed by the CISG should only be held liable for third-party intellectual property claims against the buyer if (1) the buyer resells the goods in the seller's jurisdiction and the claim arises under the intellectual property laws in the seller's jurisdiction, (2) the buyer informed the seller about the third-party's registered intellectual property rights prior to contracting, or (3) due to special circumstances, such as the seller having a branch in the jurisdiction under which the third-party's intellectual property rights are registered, the seller but not the buyer knew or should have known about the third-party's intellectual property rights. This is the rule that will best promote uniformity in the application of the CISG and good faith in international trade.