

## TO BELIEVE OR NOT TO BELIEVE: GOOD FAITH IN THE CISG

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*Article 7(1) of the United Nations Convention on Contracts for the International Sale of Goods (CISG) requires that the instrument be interpreted by having, amongst other things, due regard to the observance of good faith in international trade. Common law Contracting States have shown a reluctance to adopt a common practice of engaging with or including the CISG as part of standard contractual terms. It has been suggested that this practice is based on potential inconsistencies or conflicts that may arise as between established common law doctrines and the CISG provisions. This paper seeks to explore the argument with respect to the requirement of good faith in the CISG and the manner in which it has been interpreted and applied in both Australia and overseas. The author concludes that a common law application of notions of good faith is not dissimilar to the requirements in the CISG and such arguments do not present a significant barrier to the adoption of this international instrument.*

### I INTRODUCTION

The indeterminacy of words and their meanings provides both opportunities and limitations. When dealing with parties from different countries with varying legal systems, cultures and languages, we are further warned that words are infused with meaning based on the experiences and backgrounds of their users, and often cannot be relied upon to have any fixed interpretation without further clarification.<sup>1</sup>

The United Nations Convention on Contracts for the International Sale of Goods (CISG)<sup>2</sup> was approved in Vienna in 1980.<sup>3</sup> Whilst it came into force in 1988, it took a number of years for the CISG to build a loyal following amongst Contracting States and to be acknowledged as one of the great examples of unifying international law. In earlier scholarly texts supporters of the CISG engaged in much commentary around the reluctance of Contracting States to apply the CISG, or more accurately, to apply the CISG in accordance with its objectives. Much of the criticism was levered at common law Contracting States where prevalent practices in contract drafting tended to exclude the application of the

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<sup>1</sup> Vicky M Rogers and Albert H Kritzer, "A uniform international sales law terminology" (2003) [reproduced from Ingeborg Schwenzer / Günter Hager ed., *Festschrift für Peter Schlechtriem zum 70. Geburtstag*, Mohr Siebeck], 223 <<http://www.cisg.law.pace.edu/cisg/biblio/rogers2.html#6>> at 30 April 2011.

<sup>2</sup> *United Nations Convention on Contracts for the International Sale of Good*, opened for signing 11 April 1980, 1489 UNTS 3 (entered into force 1 January 1988).

<sup>3</sup> Bruno Zeller, "Is the Sale of Goods (Vienna Convention) Act the perfect tool to manage cross border legal risks faced by Australian Firms?" (1999) 6(3) *Murdoch University Electronic Journal of Law*, [3] <United Nations Convention on Contracts for the International Sale of Goods> at 28 April 2011.

CISG. Whilst the exact basis for this approach remains unclear many of the arguments are directed towards the possibility of inconsistencies between established common law doctrines and certain provisions of the CISG. In international initiatives, or rather with all laws, the aim is to create certainty by ensuring uniformity in application. Given the nature of the law itself and the 'indeterminacy of words and their meaning' this does not always prove possible. To this end parties to a contract would seek to establish the most secure basis to their agreement and their counsel would advise accordingly. Whilst it may be unavoidable to accept existing uncertainties in domestic laws it is easy to see why parties would shy away from adding any further to this burden.

In trying to ascertain why there is still an existing resistance to the CISG, and using Australia as an example, this paper will focus on Article 7(1), which states "*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.*" This provision, and indeed the concept of good faith, remains subject to some debate both in the international and domestic arena. This paper will first provide a brief outline of the CISG and its implementation in Australia; secondly this paper will review the way in which Article 7(1) and the concept of good faith has been interpreted; finally this paper will consider whether there is a genuine difficulty in reconciling the interpretation and application of Article 7(1) with the common law position in Australia or whether, as has been argued, this barrier is simply based on a failure or unwillingness to engage and understand.

## II BACKGROUND TO THE CISG

The concept of an international sales convention that would provide default rules for sales contracts between parties in different states had its origins sometime around the 1920s.<sup>4</sup> Scholars suggested that the diversity of domestic sales laws applying to cross-border transactions was causing uncertainty and complications.<sup>5</sup> Unfortunately, the initial attempts at drafting a uniform instrument were not hugely successful and the resulting treaties had very few significant signatories. It was felt that they were drafted without sufficient consultation and were Eurocentric in nature.<sup>6</sup> The final version of the CISG was drafted in consultation with a wide range of common law and civil law States resulting in a number of compromises on various provisions of the CISG, including Article 7(1). Even the United Kingdom, one of the most notable non-signatories to the CISG, played a very active part in the negotiation process.<sup>7</sup> The CISG was incorporated into Australian domestic law in 1989 through the State-based Sale of Goods (Vienna Convention) Acts.<sup>8</sup> The application of the CISG is not mandatory in the sense that parties may seek to specifically exclude it from their sales contract. However, if parties either fail to exclude the CISG or refer to the application of the domestic jurisdiction of a Contracting State, then the CISG will apply as it forms part of such domestic law by virtue of the relevant State legislation.<sup>9</sup>

<sup>4</sup> Jacob Ziegel, "The Future of the International Sales Convention from a Common Law Perspective" (2000) 6 *New Zealand Business Law Quarterly* 336, 336.

<sup>5</sup> *Ibid.*

<sup>6</sup> *Ibid.*

<sup>7</sup> Bruno Zeller, "The Development of Uniform Laws, A Historical Perspective," (2002) 14 *Pace International Law Review* 163, 168 <<http://digitalcommons.pace.edu/intlaw/188/>> at 28 April 2011.

<sup>8</sup> Robin Burnett and Vivienne Bath, *Law of International Business in Australasia* (2009) 3.

<sup>9</sup> Zeller, above n3, [17].

Before moving on to consider Article 7(1) in more detail it is helpful to look at the first Australian authority to consider the application of the CISG, not least because it deals with the issue of good faith. It has been noted that Australia made a rather promising start in applying the CISG in accordance with Article 7(1) although arguably this momentum was not sustained.<sup>10</sup> In *Renard Constructions (ME) Pty Ltd v Minister for Public Works*<sup>11</sup> (*Renard*) the Minister suspended the relevant construction work on the basis that Renard would not be able to complete the works in time, despite assurances from Renard to the contrary. Renard argued that the Minister had acted unreasonably in excluding Renard from the work site and accordingly had breached an implied condition of the contract to act reasonably. Whilst the CISG was not found to be directly applicable to the circumstances Priestley J concluded that there was an obligation on the Minister to act reasonably, a concept which he likened to a good faith requirement.<sup>12</sup> For the purposes of this paper Priestley J made an important statement, that is:

In ordinary English usage there has been constant association between the words fair and reasonable. Similarly, there is a close association of ideas between the terms unreasonableness, lack of good faith, and unconscionability. Although they may not be always co-extensive in their connotations, partly as a result of the varying senses in which each expression is used in different contexts, there can be no doubt that in many of their uses there is a great deal of overlap in their content...<sup>13</sup>

### III THE INTERPRETATION AND APPLICATION OF GOOD FAITH IN ARTICLE 7(1)

In order to appreciate some of the difficulties with interpreting the concept of good faith it is important to have an understanding of the legislative history of Article 7(1). The current drafting of Article 7(1) has been described as a “statesman-like compromise”.<sup>14</sup> because, theoretically, the concept of good faith is treated quite differently in civil law and common law jurisdictions. The approach to good faith in the German civil code is often cited as an example because it clearly defines the principle of good faith; this then forms the basis of all obligations, not only those arising in contract and tort law but also property, public law and procedural law.<sup>15</sup> The antithesis of this position is arguably found in the United Kingdom’s approach where there is no general principle of good faith and most certainly not for pre-contractual obligations. In saying this, it is important to note that English courts are very familiar with the idea of good faith although couched in concepts of reasonableness, fairness and equity throughout English authorities.<sup>16</sup> The position in Australia will be outlined in more detail later in this paper but similarly to the United Kingdom the High Court of Australia is yet to confirm a final position with

<sup>10</sup> Lisa Spagnolo, “The last outpost: automatic CISG opt outs, misapplications and the cost of ignoring the Vienna Sales Convention for Australian lawyers” (2009) 10 *Melbourne Journal of International Law* 142, 169 – 170.

<sup>11</sup> *Renard Constructions (ME) Pty Ltd v Minister for Public Work* (1992) 26 NSWLR 234.

<sup>12</sup> Spagnolo, above n10, 170.

<sup>13</sup> *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 265.

<sup>14</sup> Keily, T. “Good Faith and the Vienna Convention on Contracts for the International Sale of Goods (CISG)” (1999) 3(1) *Vindobona Journal of International Commercial Law and Arbitration* 15, 15.

<sup>15</sup> Nathalia Hofmann, “Interpretation Rules and Good Faith as Obstacles to the UK’s Ratification of the CISG and to the Harmonization of Contract Law in Europe” (2010) 22 *Pace International Law Review* 145, 159.

<sup>16</sup> *Ibid* 164.

respect to the implied term of good faith. The final common law jurisdiction which is worth mentioning is the United States where the *Uniform Commercial Code* (UCC) includes an express obligation to act in good faith.<sup>17</sup> In the UCC ‘good faith’ is defined as “honesty in fact and the observance of reasonable commercial standards of fair dealing”. In the US the good faith obligations cannot be excluded but the parties may agree on standards by which performance of the obligation is to be measured (as long as these are not manifestly unreasonable).<sup>18</sup>

Overall the purpose of Article 7(1) is to outline the basic criteria for the interpretation of the CISG, those being international character, uniformity and good faith. Generally commentators agree that these criteria have been well selected in light of the overall goals of the CISG.<sup>19</sup> However, the introduction into Article 7(1) of an obligation to observe good faith in the interpretation of the CISG was subject to extensive grounds of debate.<sup>20</sup> Of primary concern was whether the guiding principle of good faith in interpretation of the CISG would extend to the parties’ conduct under the CISG or rather, whether the parties’ conduct could realistically be assessed without resorting to the implied concept of good faith.<sup>21</sup> In the Secretariat Commentary to Article 7(1) (which at the time was still known as Article 6) the statement was made that the principal of good faith is broad and applies to all aspects of the interpretation and application of the provisions of the CISG.<sup>22</sup> Despite these comments there appears to be a consensus amongst scholars that good faith in Article 7(1) is a principle of interpretation and not a duty.<sup>23</sup> In practice however this position is not always reflected in the authorities, primarily because the concept of good faith (or similar notions) are present throughout other articles of the CISG<sup>24</sup> and it is no doubt simpler to rationalise decisions using consistent terminology. A common law practitioner would be justified in displaying some scepticism around the idea that good faith can be applied autonomously as an interpretation tool without creeping into a decision maker’s mindset when considering a party’s actions. This appears to be the tendency in many common law jurisdictions and it would arguably follow that decision makers in an international forum would suffer a similar fate.

The potential for the extension of the good faith provision can be seen in *BRI Production “Bonaventure” v Pan. African Export*.<sup>25</sup> In this case a manufacturer entered into an agreement to supply goods on the basis that the buyer would send

<sup>17</sup> Uniform Commercial Code, Article 1  
<<http://www.law.cornell.edu/uniform/ucc.html>> at 30 April 2011.

<sup>18</sup> Australian Government Solicitor, “The Commonwealth as a Model Contractor? Good Faith in Government Contracting” *Commercial Notes No.34* (2010) <<http://www.ags.gov.au/publications/agspubs/legalpubs/commercialnotes/comnote34.html>> at 17 April 2011.

<sup>19</sup> Alexander S Komarov, “Internationality, Uniformity and Observance of Good Faith as Criteria in Interpretation of CISG: Some Remarks on Article 7(1)” (2005) 25 *Journal of Law and Commerce* 75, 76.

<sup>20</sup> Ibid 82.

<sup>21</sup> Troy Keily, “Good Faith and the Vienna Convention on Contracts for the International Sale of Goods (CISG)” (1999) 3(1) *Vindobona Journal of International Commercial Law and Arbitration* 15, 16.

<sup>22</sup> Secretariat Commentary, *Guide to CISG Article 7*, [4] <<http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-07.html>> at 17 April 2011.

<sup>23</sup> Hofman, above n15, 166.

<sup>24</sup> Ibid 165.

<sup>25</sup> Appellate Court Grenoble, France, Case No. 93/3275, 22 February 1995 <<http://cisgw3.law.pace.edu/cases/950222f1.html>> at 16 April 2011.

the goods to South America and Africa. The seller repeatedly requested proof that the goods would be sent to the nominated destinations however it became apparent in later shipments that the goods were being sent to Spain instead. The seller refused to trade any further triggering proceedings before a French Court of Appeal. The Court applied the CISG in accordance with Article 1(1)(a) and invoked Article 8(1) of the CISG in order to conclude that the buyer had not respected the wishes of the seller even when the seller's intentions were clear. This was held to be a fundamental breach thus allowing the seller to avoid the contract. The Court ordered that the buyer pay damages for abuse of process and confirmed that the conduct of the buyer was contrary to the principle of good faith in international trade in Article 7(1), a position which was aggravated by "the adoption of a judicial stand as plaintiff in the proceedings".<sup>26</sup> The application of good faith in this case goes well beyond an interpretive tool, particularly in light of the fact that the decision considers not only the buyer's performance of its obligations during the contract term but also the buyer's stance with respect to the court proceedings. The court appears to be suggesting that for a party to commence proceedings when they are clearly at fault is not in good faith.<sup>27</sup>

A more recent example can be seen in a 2006 case heard by the Canton Appellate Court of Thurgau in Switzerland.<sup>28</sup> The court ultimately held that the agreement in question could not be defined as a contract of sale and thus the CISG did not apply. However the court considered Article 8 in some detail with a number of references to the principle of good faith. The Court held that even if not expressly mentioned, the principle of good faith would apply to the interpretation of the parties' intent. In concluding its commentary on this aspect the Court specified that the principle of good faith serves as a guideline for interpretation with respect to the contract as a whole but also the interests of the parties.<sup>29</sup> These are merely two examples of the multitude of cases which consider the concept of good faith and how it should be applied to international sale contracts. It is hard to find examples of cases where the principle has not involved some consideration of the parties' actions. This is not a surprising outcome. Whilst commentators generally agree that, in theory, there is no duty to act in good faith, the objective in Article 7(1) would be undermined if parties were allowed to escape liability by acting contrary to the principle.<sup>30</sup> Succinctly put "*good faith cannot exist in a vacuum and does not remain in practice as a rule unless the actors are required to participate.*"<sup>31</sup>

#### IV GOOD FAITH IN AUSTRALIA – DEFINITIONS AND AUTHORITIES

Similarly to the international arena the concept of good faith has been the subject of much debate within Australia, both in relation to its exact meaning and the standards it imposes and whether such standards can be implied into contracts in the absence of words to the contrary. With respect to the first of these issues, defining an express term of good faith involves a careful balance between giving effect to the parties' intentions, avoiding unreasonable outcomes (which may also be contrary to public policy) and abiding by established legal principles. As a broad

<sup>26</sup> Hofman above n15, 166.

<sup>27</sup> Keily, above n21, 20.

<sup>28</sup> Canton Appellate Court Thurgau, Switzerland, Case No. ZBR.2006.26, 12 December 2006 (*Building Materials Case*) <<http://www.cisg.law.pace.edu/cisg/wais/db/cases2/061212s1.html>> at 16 April 2011.

<sup>29</sup> Ibid.

<sup>30</sup> Keily, above n21, 19.

<sup>31</sup> Ibid.

statement it has been suggested that good faith embraces three notions, an obligation on the parties to cooperate in achieving their contractual objects, compliance with honest standards of conduct and compliance with honest standards which are reasonable having regard to the interests of the parties.<sup>32</sup> Whilst these general definitions appear to make a great deal of sense, authorities show that the crux of the issue lies in the specifics of good faith, that is what conduct must the parties actually engage in, or abstain from, in order to satisfy the duty to act in good faith. One of the most recent cases to consider this issue is *Strzelecki Holdings Pty Ltd v Cable Sands Pty Ltd*<sup>33</sup> (*Strzelecki*) where the West Australian Court of Appeal held that parties engaged in good faith negotiations owe each other no fiduciary duty and are not required to act in the interests of the other party.<sup>34</sup> In terms of establishing applicable standards Pullin JA defined a party's obligations as being no higher than subjecting itself to the process of negotiating, keeping an open mind and being willing to consider the other party's proposals and putting forward options for resolving differences.<sup>35</sup>

The findings in *Strzelecki* are a fairly accurate summary of the general position of Australian courts with respect to an express duty of good faith. Where an agreement requires the parties to act in good faith the court will impose certain duties on the parties to give effect to this term in light of the commercial circumstances.<sup>36</sup> The more complicated question, which is relevant in light of Article 7(1) of the CISG, is whether an Australian court will imply a duty of good faith into an agreement that makes no express reference to one. Whilst a number of judgements, including *Renard*, make strong reference to the existence of such an implied duty the High Court of Australia is yet to rule affirmatively on the issue. In the case of *Royal Botanic Gardens and Domain Trust v South Sydney City Council*<sup>37</sup> it was noted that the implied duty of good faith is in conflict with the age old adage and legal principle *caveat emptor*, that is, buyer beware. In that case Kirby J went on to state that the *caveat emptor* principle is inherent in common law conceptions of economic freedom and it would be inconsistent with Australian law, as it currently stood, to imply such a duty into all written contracts.<sup>38</sup>

#### V CONCLUSION: THE NOTION OF GOOD FAITH IN ARTICLE 7(1) OF THE CISG – IS IT REALLY A BARRIER?

It is interesting to note that the differences between the interpretation of good faith in the Australian authorities, and the interpretation of good faith in Article 7(1), are primarily a matter of semantics. Whilst it is true that the highest of Australian courts has not yet acknowledged the existence of a general principle of good faith, comparable considerations such as fairness and reasonableness permeate Australian judgements.<sup>39</sup> Further, Australia has recognised implied duties of good faith in

<sup>32</sup> Justice James Douglas, "Exploring the Recent Uncertainty Surrounding the Implied Duty of Good Faith in Australian Contracts Law: the Duty to Act Reasonably – Its Existence, Ambit and Operation" (Speech delivered at the LexisNexis Contract Law Master Class, 24 August 2006), [5] <<http://www.cisg.law.pace.edu/cisg/biblio/douglas1.html>> at 27 April 2011.

<sup>33</sup> *Strzelecki Holdings Pty Ltd v Cable Sands Pty Ltd* [2010] WASCA 222.

<sup>34</sup> Ibid [62].

<sup>35</sup> Ibid.

<sup>36</sup> Allens Arthur Robinson, "Focus: Trusting in Good Faith", 7 February 2011 <<http://www.aar.com.au/pubs/const/foconstfeb11.htm>> at 30 April 2011.

<sup>37</sup> *Royal Botanic Gardens and Domain Trust v South Sydney City Council* (2002) 76 ALJR 436.

<sup>38</sup> Ibid [87].

<sup>39</sup> Hofman, above n15, 163.

specific contracts, including employment agreements<sup>40</sup> or where there is a special relationship between the parties.<sup>41</sup> Many of the perceived differences between common law principles and the CISG provisions (for example the requirement for consideration and the application of the parole evidence rule) have been resolved by common law courts and should pose no greater difficulty in a common law environment than any other exercise in legal interpretation.<sup>42</sup> The notion of good faith in Article 7(1) is mandatory and cannot be excluded. However, even when the concept has been applied in its broadest sense, and perhaps beyond its original intention, the outcomes have not been dissimilar to those which may eventuate under a common law approach. The difficulty may relate to the focus on the term 'good faith' and the idea that this may impinge on a party's freedom to contract and strategise in ways which cannot be predicted (particularly where such obligation is applied to a party's conduct during the litigious process).

The question of whether Australian parties should submit to the jurisdiction of the CISG, or continue the long-held practice of excluding it, is not one that can be answered comprehensively in this paper. With respect to good faith it is apparent that the application of Article 7(1) may present a slight shift from the standard common law position but, in light of the tendency in Australian authorities to recognise some concept of good faith (albeit not couched in those terms), this should not form the basis for any exclusion. On the flip-side, even some of the more ardent supporters of the CISG agree that parties should consider whether the CISG is the appropriate law as, despite its many advantages, it may not suit the parties' interests. With respect to the standard practices in Australia the general consensus is that parties and their lawyers should simply be more conscious of the CISG and the rationale behind excluding it. Given the trend towards globalisation an inability or unwillingness to engage with this uniform international framework will not only limit the competitiveness of Australian practitioners but also be detrimental for entities who remain unaware of the options available to them when engaging in cross-border transactions.<sup>43</sup> It is fair to say that many practitioners would seek to exclude the CISG for good reason. However, the practice of doing so based on a legacy of fear in dealing with legal frameworks and precedents beyond their own is not one that will prove sustainable in the long-term.

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<sup>40</sup> *Rogan-Gardiner v Woolworths Ltd (No. 2)* [2010] WASC 290.

<sup>41</sup> Justice Douglas, above n32, [24]-[25].

<sup>42</sup> Henning Lutz, "The CISG and Common Law Courts: Is there Really a Problem?" (2004) 35 *Victoria University Law Review* 711, 722.

<sup>43</sup> See generally Spagnolo, above n10.

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