

Lucas Souza Novaes

ECONOMIC ANALYSIS OF CONTRACT INTERPRETATION IN THE CISG

2021

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ABSTRACT

Primarily this article aims to explain Article 8 CISG function inside the Convention and present the importance of an economic perspective in the interpretation of commercial contracts. Furthermore, an interplay between this economic interpretation and Article 8 CISG will be presented as an especially coherent method to solve interpretative issues and preserve essential aspects of international business agreements which are object to CISG. The final goal is to establish the economic analysis of contracts through Article 8 CISG as an essential tool to promote efficiency and uniformity in awards and decisions, maintaining international trade contracts functioning adequately.

Key words: International Commerce. CISG. Article 8 CISG. Interpretation of Contracts. Law and Economics. Economic Interpretation. Economic Analysis of Article 8 CISG. Efficiency. Uniformity.

SUMMARY

INTRODUCTION.....	4
I. ECONOMIC INTERPRETATION OF COMMERCIAL CONTRACTS.....	6
II. ARTICLE 8 CISG.....	13
III. ECONOMIC ANALYSIS OF ARTICLE 8 CISG.....	16
CONCLUSION.....	20
REFERENCES.....	21

INTRODUCTION

International trade is extremely important in prompting economic and social growth to our globalized society. It promotes efficiency in production, reduces trade fluctuations, provides employment, enables consumers to enjoy a greater variety of goods, alongside a vastly extent of other positive points.

Despite the recognized relevance of international commerce, risks are also inherent in foreign transactions and business partners have to be aware of them while drafting a commercial agreement.

Nonetheless, a perfect foresight of all the situations that can occur after a contract is formed is impossible and it is extremely costly for the parties to attempt to discuss most of the possible scenarios². As a result, issues not properly discussed, on purpose or not, come to light when parties least expect, jeopardizing the signed agreement, that can be void or contain unbalanced and ambiguous provisions.

In light of this panorama, proper interpretation of parties' intentions in the contract formation process, with consideration to the economic aspect of the deal, is of crucial importance to provide coherent solutions to these issues and preserve essential aspects of the business relationship.

However, in international practice, the intention of the parties is often not quite precise from the wording established in the contract and cannot be determined by a simple analysis of the agreement's content.

Apart from this being a problem itself, parties can also potentially take advantage of the situation, by twisting the content of the provisions agreed, in an attempt to benefit themselves in a troubled panorama, such as when litigating.

The United Nations Convention on Contracts for the International Sale of Goods

² ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write**, p. 17-25. Penn Institute for Economic Research. Working Paper No. 06-024, 2006. ANDERLINI, Luca. **Courts of Law and Unforeseen Contingencies**, Oxford Journals, 2007, p. 3-17. DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**, p. 372-438. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371. KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 CASE W. RES. L. REV. 169, p. 173-74 (2005). POSNER, Richard A., **The Law and Economics of Contract Interpretation**, University of Chicago, Law School Chicago Unbound Journal Articles Faculty Scholarship, 2004, p. 1583-1613. TRIANTIS, George G. **The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2**, 62 LA. L. REV. 1065, 1067 (2002), p. 1067-1079.

(CISG) is a consolidated multilateral treaty that was designed to enhance international trade among Contracting States, establishing a uniform framework for international commerce³.

Article 8 CISG provides a north to clarify interpretative matters, highlighting in its third paragraph, that all relevant aspects in the negotiations of a contract are to be considered when determining the intention of the parties:

Article 8

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

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

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

Furthermore, economy and international business contracts are intrinsically connected, while an economic perspective in interpreting foreign trade agreements is also embraced by the wording of Article 8 CISG⁴ and should be used alongside improve

³ HUBER, Peter. MULLIS, Alastair. **The CISG: a new textbook for students and practitioners**. Munique: Sellier, 2007, p. 1-7. SCHLECHTRIEM, Peter; BUTLER, Petra. **UN law on international sales: The UN Convention on the International Sales of Goods**. Springer, 2009, p. 1-11.

⁴ DIMATTEO, Larry A. **The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment**. University of Miami, 1997, p. 349-371. KRITZER, Albert H. **The Convention on Contracts for the International Sale of Goods: Scope, Interpretation and Resources**. Kornell Review of the Convention on Contracts for the International Sale of Goods, 1995. *Vindobona Journal of International Commercial Law & Arbitration*, 2007. LAUTENSCHLAGER, Félix. **Current Problems Regarding the Interpretation of Statements and Party Conduct under the CISG - The Reasonable Third Person, Language Problems and Standard Terms and Conditions**. SCHMIDT-KESSEL, Martin. **Article 8 CISG on Schlechtriem & Schwenger: Commentary on the UN Convention on the International Sale of Goods (CISG)**. 3a ed. Oxford: Oxford University Press, 2010.

the comprehension of agreements, promote efficiency and preserve the essence of the business relationships and all of its aspects.

For example, by analyzing, in light of Article 8(3) CISG, the market that the business partners are inserted, informational asymmetry between them, the transaction costs incurred in the sale and all of parties' behavior from an economic perspective, the comprehension of the international contract enhances to a next levels. In light of that, a court or an arbitral tribunal will reach a more efficient and uniform solution to a determined case, than it would have without an economic analysis.

Also utilizing the common language of economic analysis of law to analyze a provision of an international Convention that it's applied by a vastly extent of different legal traditions promotes uniformity, which is one of the main goals of CISG⁶.

Considering the exposed panorama, the present article will: **(I)** present the economic interpretation of commercial contracts; **(II)** explain Article 8 CISG content and its function inside the Convention and **(III)** establish an economic analysis of Article 8 CISG as an efficient method to clarify interpretative issues and preserve essential business aspects of international commercial contracts, also promoting uniformity through its application.

I. ECONOMIC INTERPRETATION OF COMMERCIAL CONTRACTS

Commercial contracts are economic instruments that regulate the future of a business relationship. A complete contract properly sets rights and obligations, allocates risks and attempts to avoid any subsequent issues.

Nonetheless, issues are bound to arise, simply because a perfect foresight of all

⁵ KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 CASE W. RES. L. REV. 169, 173-74 (2005). POSNER, Richard A., **The Law and Economics of Contract Interpretation**, University of Chicago, Law School Chicago Unbound Journal Articles Faculty Scholarship, 2004, p. 1583-1613. TRIANTIS, George G. **The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2**, 62 LA. L. REV. p. 1065, 1067 (2002).

⁶ DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371.

the situations that can occur is impossible, as the future is unpredictable and commercial transactions are extremely dynamic. Also, trying to get close to this perfect foresight can be infinitely costly and parties may be unable to agree on every single point⁷.

Considering this panorama, either an issue will not cross parties' mind or will be rationally set aside by them in favor of economizing in transaction costs, consequently delegating the completion or clarification of a contract to a court or tribunal, should an issue materializes.

When the contingency arise, and the contract is vague or ambiguous, is crucial to utilize an adequate interpretative method to properly understand parties' intentions and provide a solution that preserves essential aspects of the deal and its equilibrium.

The economic analysis of law can provide an efficient perspective to analyze business agreements, that are inherently economic instruments, as previously mentioned. The approach for interpretation among economic analysis of law jurists is highly divided between the formalistic and substantive approach⁹.

⁷ ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write?**. Penn Institute for Economic Research. Working Paper No. 06-024, 2006. ANDERLINI, Luca. **Courts of Law and Unforeseen Contingencies**, Oxford Journals, 2007. DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371. KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 CASE W. RES. L. REV. 169, 173-74 (2005) POSNER, Richard A., **The Law and Economics of Contract Interpretation**, University of Chicago, Law School Chicago Unbound Journal Articles Faculty Scholarship, 2004. TRIANTIS, George G. **The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2**, 62 LA. L. REV. 1065, 1067 (2002).

⁸ ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write?**. Penn Institute for Economic Research. Working Paper No. 06-024, 2006. ANDERLINI, Luca. **Courts of Law and Unforeseen Contingencies**, Oxford Journals, 2007. DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371. KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 CASE W. RES. L. REV. 169, 173-74 (2005) POSNER, Richard A., **The Law and Economics of Contract Interpretation**, University of Chicago, Law School Chicago Unbound Journal Articles Faculty Scholarship, 2004. TRIANTIS, George G. **The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2**, 62 LA. L. REV. 1065, 1067 (2002).

⁹ DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371. KATZ, Avery W. 2004 **'The Economics of Form and Substance in Contract Interpretation'** 104 Columbia Law Review 496-538.

The present article will comment on both approaches, with an increased focus on the substantive perspective, since it is the compatible approach with the CISG, in light of the already introduced Article 8 CISG, which will be further elaborated later on.

Schwartz and Scott defend the formalistic approach, containing a plain meaning interpretation, a hard parol evidence rule and full enforcement of merger clauses. In their view, this approach promotes efficiency, given the sophistication of businesspersons and their ability to negotiate efficient contracts without worrying about judicial discretion¹⁰.

On the other hand, Corbin and Katz, are in favor of a substantive approach and argue that the efficiency gains in formalism are overstated¹¹. According to the substantive economic approach for contractual interpretation, when providing a solution to an interpretative issue, it is important to consider the inherent economic factor of a commercial contract, the trade usages of the market parties are inserted and the context in which the contractual document was signed, so its nature and purpose are preserved¹².

Katz, for instance, states that in a formalistic scenario sales and purchasing agents, which are better placed professionals in negotiation, will be normally set aside by lawyers, during the negotiations, in an attempt to manipulate the formal and law related aspects of the agreement in their favor, while also preventing the counter-party from doing so¹³.

Therefore, in his view, such approach will most likely result in a less fluid and less genuine negotiation, not reflecting the actual intent of the parties and leading to an increase in transaction costs with lawyers, that unlikely will be counterbalanced by a

¹⁰ SCHWARTZ, Alan – SCOTT Robert E. 2003. '**Contract Theory and the Limit of Contract Law**' Yale Law Journal 113, 541-619. SCHWARTZ, Alan & SCOTT Robert E., **Contract Interpretation Redux**, 119 Yale L.J. 926, 932 (2010).

¹¹ CORBIN, Arthur L. 1998. **Corbin on Contracts vol 5**, chapter 24. Newark, NJ. Lexis Nexis. KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 CASE W. RES. L. REV. 169, 173-74 (2005).

¹² DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371. KATZ, Avery W. 2004 '**The Economics of Form and Substance in Contract Interpretation**' 104 Columbia Law Review 496-538.

¹³ KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 CASE W. RES. L. REV. 169, 173-74 (2005).

reduction in litigation costs¹⁴.

DiMatteo and Ostas also understand that the substantive method of interpretation is the most efficient, since analyzing a contract by a purely formalistic interpretative method can obstruct efforts to uncover the true intention of the parties, who are the best evaluators of value and preferences relating to their business relationship¹⁵. Albert, for instance, highlighted that written words are generally vague and a complete analysis is required to reach the true intent¹⁶.

Accordingly Corbin¹⁷ and Traynor in the decision of *Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co*¹⁸, emphasized the mismatch between traditional interpretative measures, such as the parol evidence rule, and the complexity of commercial reality, arguing that a more substantive approach is required to do justice to actual bargains and to protect economic expectations.

Triantis and Posner understand that is preferable to have a contract with a certain degree of vagueness, than trying to reach an impossible perfect contract to be enforced and interpreted from a formalistic perspective¹⁹.

From an efficiency perspective this intentional incompleteness will be beneficial when the cost to clarify or add a term in the business agreement will exceed the welfare of having a more complete contract²⁰. For example, the costs of discussing events with

¹⁴ KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 CASE W. RES. L. REV. 169, 173-74 (2005).

¹⁵ DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371.

¹⁶ ALBERT, Miriam R. **Common Sense for Common Stock Options: Inconsistent Interpretation of Anti-Dilution Provisions in Options and Warrants**, 34 RUTGERS L.J. 321, 331.

¹⁷ CORBIN, Arthur L. 1998. **Corbin on Contracts vol 5**. Newark, NJ. Lexis Nexis. Chapter 24.

¹⁸ **Pac. Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co**. Supreme Court of California. July 11, 1968. S. F. No. 22580.

¹⁹ POSNER, Richard A., **The Law and Economics of Contract Interpretation**, University of Chicago, Law School Chicago Unbound Journal Articles Faculty Scholarship, 2004. TRIANTIS, George G. **The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2**, 62 LA. L. REV. 1065, 1067 (2002).

²⁰ ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write?**. Penn Institute for Economic Research. Working Paper No. 06-024, 2006. ANDERLINI, Luca. **Courts of Law and Unforeseen Contingencies**, Oxford Journals, 2007. DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**.

low probability of occurrence are likely to surpass the benefits of including a contractual provision relating to the event²¹.

Furthermore, Triantis and Posner also view deliberate incompleteness even as a condition to sign a contract in some cases, as the parties might be unable to discuss certain points, either for lack of information or the stressing effects of prolonged bargaining²².

This scenario usually revolves around the uncertainty of predicting every event that can potentially happen, especially when negotiating long-term agreements. In this panorama parties are usually content to take their chances on being able to resolve the issues, with or without litigating, if they arise²³.

In case an event occurs, the prevailing opinion among economic analysis of law scholars is that simulating what the parties would have provided had they drafted a complete contract is the most adequate approach and it represents reduction in the

American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371. KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 CASE W. RES. L. REV. 169, 173-74 (2005) POSNER, Richard A., **The Law and Economics of Contract Interpretation**, University of Chicago, Law School Chicago Unbound Journal Articles Faculty Scholarship, 2004. TRIANTIS, George G. **The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2**, 62 LA. L. REV. 1065, 1067 (2002).

²¹ ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write?**. Penn Institute for Economic Research. Working Paper No. 06-024, 2006. ANDERLINI, Luca. **Courts of Law and Unforeseen Contingencies**, Oxford Journals, 2007. DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 371-349. KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 CASE W. RES. L. REV. 169, 173-74 (2005) POSNER, Richard A., **The Law and Economics of Contract Interpretation**, University of Chicago, Law School Chicago Unbound Journal Articles Faculty Scholarship, 2004. TRIANTIS, George G. **The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2**, 62 LA. L. REV. 1065, 1067 (2002).

²² POSNER, Richard A., **The Law and Economics of Contract Interpretation**, University of Chicago, Law School Chicago Unbound Journal Articles Faculty Scholarship, 2004. TRIANTIS, George G. **The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2**, 62 LA. L. REV. 1065, 1067 (2002).

²³ ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write?**. Penn Institute for Economic Research. Working Paper No. 06-024, 2006. ANDERLINI, Luca. **Courts of Law and Unforeseen Contingencies**, Oxford Journals, 2007. DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371. KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 CASE W. RES. L. REV. 169, 173-74 (2005) POSNER, Richard A., **The Law and Economics of Contract Interpretation**, University of Chicago, Law School Chicago Unbound Journal Articles Faculty Scholarship, 2004. TRIANTIS, George G. **The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2**, 62 LA. L. REV. 1065, 1067 (2002).

transaction costs²⁴.

Anderlini, Felli and Postlewaite go further stating that, in a world in which perfectly clear and complete contracts are not feasible, courts and tribunals should not act as passive enforcer of business agreements. Instead, judges and arbitrators shall act actively, playing a welfare-enhancing role²⁵.

They concluded that if the parties are asymmetrically informed, for example, and in consequence sign an inefficient business agreement, a court or an arbitral tribunal could certainly intervene beyond what it is written in a contract to ameliorate the inefficiency that results from this asymmetry.

Therefore, whoever decides upon an inefficient provision following this perspective will provide, in consideration to every essential aspect involving the deal, a provision parties would have written had they perfectly translated all of their concerns in an agreement²⁷.

²⁴ AYRES, Ian 1998. **'Default Rules for Incomplete Contracts'** in Peter Newman (ed.) *The New Palgrave Dictionary of Economics and the Law*. London – New York: Macmillan. Vol 1, 585-589. ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write?**. Penn Institute for Economic Research. Working Paper No. 06-024, 2006. ANDERLINI, Luca. **Courts of Law and Unforeseen Contingencies**, *Oxford Journals*, 2007. COOTER, Robert; ULEN, Thomas. *Law and economics*. 6a ed. London: 11/02698. September 4th, 2012. DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. *American University International Law Review*, Washington, v. 26, n. 2, 2011, p. 349-371. KATZ, Avery W. **Contractual Incompleteness: A Transactional Perspective**, 56 *CASE W. RES. L. REV.* 169, 173-74 (2005) POSNER, Richard A., **The Law and Economics of Contract Interpretation**, University of Chicago, Law School Chicago Unbound Journal Articles Faculty Scholarship, 2004. POLINSKY, A. Mitchell. **An introduction to law and economics**. 4a ed. Alphen aan den Rijn: Wolters Kluwer, 2011. SHAVELL, Steven. **Foundations of economic analysis of law**. Cambridge: Harvard University Press, 2004. SHAVELL Steven 2006. **'On the Writing and Interpretation of Contracts'** 22 *Journal of Law, Economics, and Organization*, 289-314. TRIANTIS, George G. **The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2**, 62 *LA. L. REV.* 1065, 1067 (2002). WILLIAMSON, Oliver. **The Transaction Cost Economics project: the theory and practice of the governance of contractual relations**. Cheltenham: Edward Elgar, 2013, p. 16-61.

²⁵ ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write?**. Penn Institute for Economic Research. Working Paper No. 06-024, 2006.

²⁶ ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write?**. Penn Institute for Economic Research. Working Paper No. 06-024, 2006.

²⁷ ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write?**. Penn Institute for Economic Research. Working Paper No. 06-024, 2006.

The suggested approach also promotes the disclosure of relevant information for the solution of an issue, preventing parties of taking advantage of themselves by virtue of strategic informational asymmetry²⁸. In this subject, the literature balances the need to protect individual autonomy by not requiring a disclosure against reasonableness and fairness, while giving incentives for the disclosure of material information at least²⁹.

In *Hadley v Baxendale*, the court held that a defendant who breached a contract was liable only for damages that might reasonably have arisen given the known facts rather than the higher damages that were actually suffered because of circumstances known only to the plaintiff³⁰.

Furthermore, Kaplow also provided a counter-argument for formalistic scholars, such as Schwartz and Scott, that believe courts often cannot properly determine the facts necessary to enforce the parties' substantive bargain as they ideally would wish, due to the complexity of this process³¹.

Using a formal decision-theoretic model, Kaplow concluded that the optimal choice between rules and standards, and the optimal level of complexity of legal rules, depends upon empirical considerations such as the relative cost of ex ante and ex post decision-making, the costs of information acquisition, and the probability that a dispute will arise³².

Thus, stated that although limits on judicial competence do provide a reason to follow simple rules, in general one cannot conclude that rules dominate standards or that simplicity dominates complexity for all or even most purposes³³.

²⁸ ANDERLINI, Luca, FELLI, Leonardo & POSTLEWAITE, Andrew. **Should Courts Always Enforce What Contracting Parties Write?**. Penn Institute for Economic Research. Working Paper No. 06-024, 2006.

²⁹ DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371.

³⁰ **Hadley v Baxendale** 1854 9 Ex 341 (23 February 1854)

³¹ KAPLOW, Louis. **A Model of the Optimal Complexity of Legal Rules**, 11 J.L. Econ. & Org. 150 passim (1995).

³² KAPLOW, Louis. **A Model of the Optimal Complexity of Legal Rules**, 11 J.L. Econ. & Org. 150 passim (1995).

³³ KAPLOW, Louis. **A Model of the Optimal Complexity of Legal Rules**, 11 J.L. Econ. & Org. 150 passim (1995).

In *Nanakuli Paving & Rock Co. v. Shell Oil Co., Inc.*, for example, the court analyzed the trade usages of the asphaltic paving industry of Hawaii extensively, and the alleged complexity of a substantial analysis was not an impeditive factor to reach a decision relativizing the written content of the contract in favor of essential facts surrounding the case³⁴.

Considering the exposed, in comparison with the formalistic approach, the substantive approach for interpreting commercial contracts, despite its complex character, can create a complete panorama of the business relationship and offer efficient worthy tools in the solution of contingencies, through the disclosure of information which is relevant for the contractual analysis, reduction of transaction costs, refinement of an inefficient contract and prevention of parties taking advantage of themselves.

II. ARTICLE 8 CISG

Article 8 CISG governs the interpretation of parties' statements and conducts in the formation or enforcement of a contract which is subject to the Convention. The provision is divided in 3 paragraphs that combined set the standards to be analyzed when interpreting parties' behavior.

Primarily it is important to note that Article 8(3) CISG provide what should be considered when analyzing the conduct of a party, either through Article 8(1) CISG or Article 8(2) CISG, determining that due consideration is to be given to all relevant circumstances of a case, including the negotiations, practices or usages established and any subsequent conduct of the parties. This provision also indicates clearly that the wording of a contract is not the only important aspect to clarify interpretative uncertainties in CISG, which adopts an approach similar to the substantive approach³⁵.

In *MCC-Marble Ceramic Center, Inc x Ceramica Nuova D'Agostino, S.p.A.*, the leading case on the impact of Article 8 CISG on procedural rules that rely exclusively in

³⁴ *Nanakuli Paving & Rock Co. v. Shell Oil Co.* - 664 F.2d 772 (9th Cir. 1981).

³⁵ DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law.** American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371.

the wording of a an agreement, the United States Court of Appeals for the Eleventh Circuit consolidated the incompatibility of these rules with CISG³⁶. Therefore, the parol evidence rule and the four corners rule, for example, are not applicable under CISG³⁷.

Article 8(1)CISG sets a subjective intent criteria to clarify interpretative issues, providing that statements made by a party in an agreement have to be interpreted according to the actual intent behind the statement, should the other party knew or could not have been unaware what that intent was³⁸.

The subjective intent criteria of Article 8(1) CISG is rarely conclusive, as the actual intent of a statement or conduct, and whether the other party could or could not be unaware of the intent, are often difficult matters to properly define subjectively³⁹.

To cases which Article 8(1) CISG is not applicable, Article 8 (2) CISG provides an objective intent criteria, determining that in this scenario statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same business type as the other party would have had in the same circumstances⁴⁰.

The hypothetical reasonable person should be intimately connected with all the circumstances of the case and, in light of article 8(3) CISG, courts and tribunals should

³⁶ United States Court of Appeal for The Eleventh Circuit. **MCC-Marble Ceramic Center, Inc. v. Ceramica Nuova D'Agostino**. 1999.

³⁷ CISG-AC Opinion No. 13, **Inclusion of Standard Terms under the CISG**, Rapporteur: Professor Sieg Eiselen, College of Law, University of South Africa, Pretoria, South Africa. Adopted by the CISG Advisory Council following its 17th meeting, in Villanova, Pennsylvania, USA, on 20 January 2013.

³⁸ FARNSWORTH, Edward Allan. **Article 8. In: Bianca-Bonell Commentary on the International Sales Law**, Giuffrè: Milan, 163-174, 1987. HONNOLD, John O. **Uniform Law for International Sales under the 1980 United Nations Convention**, 3rd ed. (1999), pages 124-131. Kluwer Law International, The Hague.

³⁹ SCHMIDT-KESSEL, Martin. **Article 8 CISG on Schlechtriem & Schwenger: Commentary on the UN Convention on the International Sale of Goods (CISG)**. 3a ed. Oxford: Oxford University Press, 2010.

⁴⁰ LAUTENSCHLAGER, Félix. **Current Problems Regarding the Interpretation of Statements and Party Conduct under the CISG - The Reasonable Third Person, Language Problems and Standard Terms and Conditions**. Vindobona Journal of International Commercial Law & Arbitration, 2007. DIMATTEO, Larry A. **The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment**. University of Miami, 1997. SCHMIDT-KESSEL, Martin. **Article 8 CISG on Schlechtriem & Schwenger: Commentary on the UN Convention on the International Sale of Goods (CISG)**. 3a ed. Oxford: Oxford University Press, 2010.

look to every relevant aspect of the deal such as pre-contractual negotiations, post-formation inquiries, usages and practices⁴¹.

The objective criteria is the main concept of interpretation in CISG, and it highlights that a business perspective should be used when analyzing contracts that are object to the Convention, after all, its mandatory to perceive a panorama of the market and its economic aspects to define a reasonable person of the same business type as a contracting party⁴².

In Roland Schmidt GMBH x Textil Werke Blumenegg⁴³, parties signed a contract for the sale of a used rotary textile printing machine. After making the down payment, the buyer discovered that the machine had to be equipped with additional components to work as intended and refused to pay the remaining price.

The Swiss Federal Supreme Court held that the buyer was an experienced trader of the kind of goods involved, and the seller could reasonably expect the other party to know the limitations of a 12 years old machine in comparison to a new one, specifically due to the fact that the buyer made a prior statement according to which it found the machine perfectly workable when it first checked.

As a result, the sales agreement, which did not precisely provide a solution to the issue, was interpreted in light of the buyer's statement and market knowledge,

⁴¹ DIMATTEO, Larry A. **The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment**. University of Miami, 1997. KRITZER, Albert H. **The Convention on Contracts for the International Sale of Goods: Scope, Interpretation and Resources**. Kornell Review of the Convention on Contracts for the International Sale of Goods, 1995. Vindobona Journal of International Commercial Law & Arbitration, 2007. LAUTENSCHLAGER, Félix. **Current Problems Regarding the Interpretation of Statements and Party Conduct under the CISG - The Reasonable Third Person, Language Problems and Standard Terms and Conditions**. SCHMIDT-KESSEL, Martin. **Article 8 CISG on Schlechtriem & Schwenger: Commentary on the UN Convention on the International Sale of Goods (CISG)**. 3a ed. Oxford: Oxford University Press, 2010.

⁴² DIMATTEO, Larry A. **The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment**. University of Miami, 1997. KRITZER, Albert H. **The Convention on Contracts for the International Sale of Goods: Scope, Interpretation and Resources**. Kornell Review of the Convention on Contracts for the International Sale of Goods, 1995. Vindobona Journal of International Commercial Law & Arbitration, 2007. LAUTENSCHLAGER, Félix. **Current Problems Regarding the Interpretation of Statements and Party Conduct under the CISG - The Reasonable Third Person, Language Problems and Standard Terms and Conditions**. SCHMIDT-KESSEL, Martin. **Article 8 CISG on Schlechtriem & Schwenger: Commentary on the UN Convention on the International Sale of Goods (CISG)**. 3a ed. Oxford: Oxford University Press, 2010.

⁴³ Switzerland 22 December 2000 Federal Supreme Court (**Roland Schmidt GmbH v. Textil-Werke Blumenegg AG**).

accordingly to Article 8(2) CISG, therefore, the seller was entitled to the outstanding payment.

The Insulating material case decided by the Austrian Supreme Court of Justice also involved the objective intent criteria for interpretation. In this case an Austrian company received delivery of insulated material from a Romanian Seller⁴⁴. Although, the orders were allegedly placed by a person acting as the buyer's representative. Therefore, the company refused to pay the purchase price, claiming it never ordered the goods.

Nevertheless, the Court ruled that even if it is considered that the goods were not expressly ordered, the fact that the Austrian company had used a large part of the material, shortly after it received it, creates a reasonable ground for the Romanian seller to interpret such conduct, at least, as an implied acceptance.

Hence, regardless of being signed by a legitimate representative of the Austrian Company or not, the agreement was interpreted in light of the implied acceptance, in accordance to article 8(2) CISG, thus the Romanian Seller was considered entitled to the purchase price.

In light of the exposed, since it provides that standards for interpretation in CISG, it is possible to realize that Article 8 CISG is one of the most important provisions in the Convention. The article utilizes a similar approach to the substantive interpretation, enforcing the observation of an international commercial contract as a whole economic instrument, which the provisions, and the conducts by the parties, interact directly among themselves to create a bigger and clearer picture of a business relationship without any textual or formalistic limitation.

In conclusion, the goal of Article 8 CISG is to enhance the likelihood of courts and tribunals reaching a proper solution to an interpretative issue, with the assistance of a clear picture of the commercial deal.

III. ECONOMIC ANALYSIS OF ARTICLE 8 CISG

Despite already being an essential provision in CISG, the efficiency and

⁴⁴ Austria 13 December 2012 Supreme Court (**Insulating material case**).

uniformity in the application of Article 8 CISG can improve even further with the establishment of notions and concepts of law and economics of contractual interpretation alongside it⁴⁵.

Regarding the efficiency factor, Article 8 CISG wording, as previously mentioned, embraces an economic analysis of contract interpretation for solving interpretative issues⁴⁶.

Firstly, Article 8(3) CISG establishes that to determine the intention of the parties, either through Article 8(1) CISG or Article 8(2) CISG, due consideration is to be given to all relevant circumstances of a case, including the negotiations, practices or usages established and any subsequent conduct of the parties. Moreover, Article 8(2) CISG objective intent criteria, which provides the hypothetical reasonable person standard, depends on a market analysis, showing an economic facade⁴⁷.

This scenario reveals that Article 8 CISG harmonize with the substantive approach for economic interpretation of commercial contracts. As the substantive approach, by placing no limitation on the extrinsic evidence that parties can introduce, Article 8 CISG also gives the decision maker the task of weighing each evidence in accordance with the facts of each case⁴⁸.

⁴⁵ DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p.349-371.

⁴⁶ DIMATTEO, Larry A. **The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment**. University of Miami, 1997. KRITZER, Albert H. **The Convention on Contracts for the International Sale of Goods: Scope, Interpretation and Resources**. Kornell Review of the Convention on Contracts for the International Sale of Goods, 1995. Vindobona Journal of International Commercial Law & Arbitration, 2007. LAUTENSCHLAGER, Félix. **Current Problems Regarding the Interpretation of Statements and Party Conduct under the CISG - The Reasonable Third Person, Language Problems and Standard Terms and Conditions**. SCHMIDT-KESSEL, Martin. **Article 8 CISG on Schlechtriem & Schwenger: Commentary on the UN Convention on the International Sale of Goods (CISG)**. 3a ed. Oxford: Oxford University Press, 2010.

⁴⁷ DIMATTEO, Larry A. **The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment**. University of Miami, 1997. KRITZER, Albert H. **The Convention on Contracts for the International Sale of Goods: Scope, Interpretation and Resources**. Kornell Review of the Convention on Contracts for the International Sale of Goods, 1995. Vindobona Journal of International Commercial Law & Arbitration, 2007. LAUTENSCHLAGER, Félix. **Current Problems Regarding the Interpretation of Statements and Party Conduct under the CISG - The Reasonable Third Person, Language Problems and Standard Terms and Conditions**. SCHMIDT-KESSEL, Martin. **Article 8 CISG on Schlechtriem & Schwenger: Commentary on the UN Convention on the International Sale of Goods (CISG)**. 3a ed. Oxford: Oxford University Press, 2010.

⁴⁸ DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371.

In this regard, utilizing concepts such as the attempt to reduce transaction costs, the necessary analysis of the informational symmetry between the parties and observing their behavior from an economic perspective in CISG, can certainly enhance the likelihood of a decision regarding interpretative issues being satisfactory.

For instance, in *Scafom International BV x Lorraine Tubes S.A.*⁴⁹ parties signed a contract for the sale of steel tubes. After the agreement was signed the price of the steel, which Lorraine Tubes was supposed to utilize in the confection of the steel tubes rose by about 70%.

The contract did not provided a price adaptation clause, however, regardless of the non-inclusion of such clause, by analyzing the information parties had in the moment the contract was signed, their intention of reducing transaction costs and the essence of what the business relationship intended, it was clear that, had they thought about the issue in the moment the contract was signed, an adaptation clause would be included. Another remedy such as termination, for example, would not fulfill the purpose of the agreement, considering how the Buyer desired the delivery of the goods.

Lorraine Tubes undeniably intended to profit from the sale of the tubes, and reducing its profit margin by 70% disrupted entirely the commercial basis of the sale. The *animus contrahendi* would have disappeared if the same contract was proposed with the circumstances that took place after the contingencies.

The seller claimed it had the right for price adaptation under the CISG. In first instance the claim was dismissed, being finally accepted in third instance.

If an economic analysis of law perspective for interpreting the contract was applied by the court alongside Article 8 CISG already in the first instance, the purpose of the contract could be fulfilled three years prior to the final rulling of the Belgium Supreme Court, what would also represent reduction in the costs incurred in litigation, further enhancing efficiency.

Regarding uniformity, during CISG's *travaux préparatoires* the drafters of the Convention intended to create an uniform law for international trade, which resulted in a

⁴⁹ Hof van Cassatie (Court of Cassation). *Scafom International BV v. Lorraine Tubes S.A.S.* 19 June 2009.

blend of common and civil law rules⁵⁰.

Despite the goal of uniformity, divergences between the rules as written and the rules as applied are likely to occur in the CISG context, due to the fact that its rules are applied by courts and tribunals from different legal traditions, what can potentially lead to a domestic approach when applying CISG⁵¹.

For instance, the decision by the US District Court of Illinois in *Raw Materials Inc. v. Manfred Forberich* highlights the so-called “homeward trend” and was heavily criticized for applying the Uniform Commercial Code to a contract governed by the CISG⁵².

Considering this panorama, another major benefit of using economic analysis of law with CISG is that it enhances the means by which jurists from different legal traditions are able to communicate. Thus, promoting uniformity, as the nomenclature of efficiency-transaction costs, default rules, and wealth maximization is utilized across legal systems, for instances⁵³.

DiMatteo and Ostas present that an example of the power of the economic analysis of law can be seen in the area of pre-contractual liability. Apparently the Civil Law approach, which accepts the duty of the good faith in negotiations, and the Common Law approach that rejects any good faith obligation prior to contract formation are diametrically opposed. However, by virtue of an economic analysis of law the Common Law evolved means to balance reasonable reliance and exploratory negotiations⁵⁴.

Considering the panorama presented, intensifying the comprehensiveness, coverage and application of an economic perspective through Article 8 CISG not only

⁵⁰ HUBER, Peter. MULLIS, Alastair. **The CISG: a new textbook for students and practitioners**. Munique: Sellier, 2007, p. 1-7. SCHLECHTRIEM, Peter; BUTLER, Petra. **UN law on international sales: The UN Convention on the International Sales of Goods**. Springer, 2009. p. 1-11.

⁵¹ DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371.

⁵² United States 6 July 2004 Federal District Court (**Raw Materials Inc. v. Manfred Forberich GmbH & Co., KG**).

⁵³ DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371.

⁵⁴ DIMATTEO, Larry A; OSTAS, Daniel T. **Comparative Efficiency in International Sales Law**. American University International Law Review, Washington, v. 26, n. 2, 2011, p. 349-371.

promotes efficiency when providing solutions to an interpretative issue through a complete picture of a case, but also uniformity, considering different legal traditions are able to communicate in an enhanced way through the economic analysis of law common language.

CONCLUSION

The economic interpretation of commercial contracts is an understudied subject in contract law doctrine, when comparing to formation, defenses, validity, and remedies, for example. The existent literature among scholars is also divided between two main approaches, the formalistic approach and the substantive approach.

The formalistic approach favors the non-admission of extrinsic evidence when determining parties' intentions, defending that everything that is in the four corners of a contract is a sufficient expressions of the will of the parties, which are businesspersons that can properly elaborate a business agreement.

This perspective is heavily criticized by the substantive approach for economic interpretation that defends that a formalistic interpretation obstruct efforts to uncover the true intention of the parties, as words are generally vague and a full contextualist analysis is mandatory to properly interpret a contract.

Substantive approach authors understand that formalistic interpretative measures are incompatible with the complexity of commercial reality and a deeper analysis is required to do justice to actual bargains, protecting economic expectations.

In some cases, for the sake of reducing transactions costs and avoiding stressful prolonged bargaining, parties even decide to include void provisions in their contract, instead of attempting to draft a complete formalistic contract. If an issue occur, parties either can renegotiate the terms or delegate the completion of the contract to a court or tribunal.

In general terms, the substantive approach ambassadors believe that analyzing a contract substantially will help creating a complete panorama of the business relationship, offering efficient tools in the solution of issues, through the disclosure of information which is relevant for the contractual analysis, reduction of transaction costs, refinement of an inefficient contract and prevention of parties taking advantage of themselves.

This perspective harmonizes with Article 8 CISG, which provide a similar

approach to the substantive method of interpretation, determining that due consideration is to be given to all relevant circumstances, usages, practices and subsequent conduct when analyzing parties' intentions. Article 8 CISG also includes a market perspective in its reasonable standard test, provided by Article 8(2) CISG, showing an economic facade.

In light of this compatibility the use of law and economics concepts and notions alongside Article 8 CISG can be used to enhance efficiency and promote uniformity in decisions. The increase in efficiency is due to the fact that CISG's contracts are economic instruments that when analyzed by an economic perspective, preserve their essential aspects, allowing parties to better fulfill the intended purposes of the commercial deal.

In terms of uniformity, the economic analysis of law can serve as a common ground, which enables different legal traditions to communicate in an enhanced uniform way, preventing domestic perspectives in CISG's decisions.

The increase in efficiency and uniformity results in a more adequate functioning of international agreements, what can emphasize the vastly extent of positive effects that originate from international trade.

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