Aufsätze

Warranties and "Lemons" under CISG Article 35(2)(a)

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I. Introduction

Article 35(2)(a) of the UN Convention on Contracts for the International Sale of Goods (the "CISG")[1] imposes on sellers the obligation to deliver goods that "are fit for the purposes for which goods of the same description would ordinarily be used." Although the CISG does not use the phrase, this obligation essentially creates an implied warranty that the goods that are the subject matter of the contract conform to a certain quality standard.[2] The imposition of this obligation on sellers performs two functions that presumably facilitate transactions among parties in distant markets. First, it reduces the risk that sellers will engage in fraud by intentionally substituting an inferior good for the one that buyers expected. Most commercial sellers of goods that have proven defective in some respect, however, have not acted fraudulently. Instead, alleged nonconformities typically occur as a result of unintentional defects in the process of manufacturing goods, notwithstanding the efforts of sellers to take reasonable precautions to provide conforming goods. Thus, the second, and more important, task of Article 35(2)(a) is to allocate to sellers the risk of nonconforming deliveries, even when no negligence or fraud is

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1 United Nations Convention on Contracts for the International Sale of Goods, reprinted in 19 International Legal Materials (1980) 668 ff.

2 See also *Larry DiMatteo et al.*, The Interpretive Turn in International Sales: An Analysis of Fifteen Years of CISG Jurisprudence, 24 Northwestern Journal of International Law and Business (2004) 299, 390; *Anita C. Esslinger*, Contracting in the Global Marketplace: The United Nations Conventions on Contracts for the International Sale of Goods and the Limitation Period in the International Sale of Goods, American Law Institute – American Bar Association Continuing Legal Education ALI-ABA Course of Study (1996) 37, 54; *Asa Markel*, American, English and Japanese Warranty Law Compared: Should the U.S. Reconsider Her Article 95 Declaration to the CISG?, 21 Pace International Law Review (2009) 163, 181; *Henry Mather*, Choice of Law for International

involved, and to provide prospective purchasers with information about products that they could otherwise not easily obtain.

Is there reason to believe that Article 35(2)(a) properly assigns the risk of nonconformity? In addressing that issue, we assume that the objective of international commercial sales law is to replicate for the majority of commercial parties the legal rules that they would select for themselves.[3] By creating legal default rules that reflect the same result for which most parties would bargain, international sales law would reduce the time and effort that parties must invest in order to reach agreement.[4] In effect, we assume that the function of international sales law is to reduce transactions costs[5] rather than to impose a particular regime of commercial practices on resistant parties. Certainly the CISG appears to reject the latter objective, given the broad authority that parties possess under Article 6 to opt out of its provisions. Applied to promises of product quality, this principle implies that Article 35(2)(a) makes sense if most parties to international sales transactions would have bargained to place on sellers the risk that the goods they deliver will not be fit for the ordinary purposes of goods of that description. If that is the case, then only those relatively few sellers and buyers who would prefer to place the risk of product nonconformity on the buyer would have to incur the costs of negotiating about that element of the contract. Because Article 35(2)(a) states only a default rule, not a mandatory rule,[6] parties who prefer a different risk allocation would be able to bargain for their desired rule, but they would be required to negotiate that bargain. If, however, most parties to international sales transactions would prefer that buyers bear the risk of certain nonconformities, then Article 35(2)(a) would be problematic in that it would require large numbers of parties either to incur the costs of bargaining for their preferred rule or to adopt a rule that they find unsuitable for their transaction.

In this essay, we contend that a proper interpretation of the scope of Article 35(2)(a) does, in fact, reflect the risk allocation about quality nonconformity that most commercial parties would prefer and thus constitutes an appropriate default rule. Under certain conditions, sellers can bear risks about product quality more readily than buyers; when these conditions are present, both parties would prefer that sellers assume that risk and incorporate it into the price of the good rather than have the buyer assume the risk and either face higher costs of self-insurance or third-party insurance, or avoid a transaction that would otherwise be mutually beneficial. The rule of Article 35(2)(a), therefore, properly imposes on sellers the risk that they would contractually accept if bargaining had occurred, but only if that Article's scope is limited to situations in which the conditions on which it is based prevail.

That conclusion implicates an additional debate: what is the standard by which compliance with the obligation that Article 35(2)(a) creates should be measured? The requirement that the goods be "fit for the purposes for which goods of the same description would ordinarily be used" is necessarily and inherently ambiguous.[7] It fails to identify with any precision the conditions under which goods are fit for their ordinary purposes and thus conform to the contract. That ambiguity, of course, is inevitable in a treaty that is intended to govern a wide range of transactions that affect an even wider range of goods.[8] Thus, some interpretation of the phrase will be necessary. The few efforts that have been made to develop a more refined standard, however, have been inadequate. While most courts, arbitral panels, and commentators have ignored the issue, those that have considered it choose among a variety of standards of conformity, such as "merchantable," "average quality," and "reasonable quality."[9] The supporters of each of these standards rely on logic

Sales Issues Not Resolved by the CISG, 20 Journal of Law and Commerce (2001) 155, 159 note 25.

3 See *Clayton P. Gillette / Robert E. Scott*, The Political Economy of International Sales Law, 25 International Review of Law and Economics (2005), 446, 447. See also *Clayton P. Gillette*, Harmony and Stasis in Trade Usages for International Sales, 39 Virginia Journal of International Law (1999) 707, 707.

4 One of us has criticized the CISG in general as failing to reflect the legal rules for which commercial parties would have bargained had they negotiated the terms of their contract; see *Gillette / Scott*, *supra* note 3, at 446 ff.

5 See also *Natascha Affolder*, Awarding Compound Interest in International Arbitration, 12 American Review of International Arbitration (2001) 45, 64; *Filip De Ly*, Sources of International Sales Law, 25 Journal of Law and Commerce (2006) 1, 2; *Rolf Knieper*, Celebrating Success by Accession to CISG, 25 Journal of Law and Commerce (2006) 477, 478; *Lars Meyer*, Soft Law for Solid Contracts? A Comparative Analysis of the Value of the UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law to the Process of Contract Law Harmonization, 34 Denver Journal of Internatonal Law and Policy (2006) 119, 122 f.
See, however, *Gilles Cuniberti*, Is the CISG Benefiting Anybody?, 39 Vanderbilt Journal of Transnational Law (2006) 1511 ff., arguing that the CISG does not really reduce costs; see also *Larry A. DiMatteo*, An International Contract Formula: The Informality of International Business Transactions Plus the Internationalization of Contract Law Equals Unexpected Contractual Liability, 23 Syracuse Journal of International Law and Commerce (1997) 67, 68 stating that "[i]n the long-term, th[e] movement towards international unification and harmonization is likely to reduce transaction costs relating to contract formation. In the short-term, however, it further complicates an already complex international legal regime."

6 See also *Susanne V. Cook*, CISG: From the Perspective of the Practitioner, 17 Journal of Law and Commerce (1998) 343, 347.

7 For a reference to the ambiguous nature of Article 35(2)(a), see also *Adam M. Giuliano*, Non-conformity in the Sale of Goods between the United States and China: The New Chinese Contract Law, the Uniform Commercial Code, and the Convention on Contracts for the International Sale of Goods, 18 Florida Journal of International Law (2006) 331, 353.

8 For a brief reference to the uncertainties resulting from the imprecise text of Article 35 CISG, see, e.g., *Marscha A. Echols*, Expressing the Value of Agrodiversity and its Know-how in International Sales, 48 Howard Law Journal (2004) 431 455 note 121.

9 For this list of available standards, see also *Andrea L. Charters*, Fitting the "Situation": the CISG and the Regulated Market, 4 Washington University Global Studies Law Review (2005) 1, 37; *Giuliano*, *supra* note 7, at 351.

and the legislative history of Article 35, although most commentators recognize the non-definitive nature of that inquiry.

In this essay, we claim that proper interpretation of Article 35(2)(a) depends on the reasons why parties would allocate the risk of nonconformity to the seller in the first instance, that is, on the presence of conditions in which sellers are superior risk bearers of quality because they possess information that is useful to buyers, and can employ warranty to exploit that information or convey it to prospective buyers at low cost. Only when one recognizes the advantages that the risk allocation creates and asks whether those advantages will be realized or forgone in a particular situation can one determine whether it is appropriate to impose a warranty on a seller. Moreover, we conclude that efforts to interpret the scope of warranty liability on the basis of such phrases as "average quality" or "reasonable quality" may actually generate perverse effects for the parties.

We begin, therefore, with an explanation of the functions that an implied warranty plays in the allocation of risks about product quality. We then address the implications of different interpretations of Article 35(2)(a). Based on that discussion, we endorse an interpretation of that provision that identifies conforming goods with those that would command a price equivalent to the contract price of the goods from buyers who were aware of the characteristics of the good that allegedly cause a breach of Article 35(2)(a).

II. The Function of Article 35(2)(a)

Why would most commercial parties prefer to place the risk of product quality on the seller rather than adopt the once-dominant default of *caveat emptor*? We contend, consistent with a longstanding literature from economics, that the primary explanation for an implied warranty is related to the question of asymmetric information. That is, sellers will have better information than their buyers about the quality of the goods that are the subject of the contract.[10] This may be because the seller is the actual producer of the goods, and therefore knows how much care was taken in the manufacturing process. Indeed, the seller can frequently control the quality with which the goods were created, either because the seller controls the manufacturing process or has the capacity to bargain effectively with the manufacturer over product quality. As a result, imposing on the seller an obligation to deliver goods of a particular quality will induce the party in the best position to assure quality to achieve an optimal level of care.

Even a seller who only re-sells goods manufactured by others or who assembles components manufactured by others, is likely to have superior information about those goods relative to the buyer. These sellers are repeat players in transactions involving the goods. They will enter into numerous transactions concerning the goods, even if they sell very few goods to any given buyer. Buyers, on the other hand, may only purchase the same products occasionally. As a result, sellers are likely to have superior information about "failure" rates, that is, the frequency of defects even in the presence of reasonable care to prevent them. Armed with this information, sellers are better able than buyers to take the defect rate into account in fixing a price for the goods or in deciding whether it is cost-effective to make further investments in product quality. Again, the legal allocation of risks induces parties with superior information about the costs and benefits of additional product quality to take advantage of that position.

Buyers, on the other hand, would presumably be willing to pay a higher price for goods that come with a warranty, since buyers would expect that, at least in relatively competitive markets, sellers with knowledge of defect rates will price the warranty in a manner that accurately reflects the probability that the product will be nonconforming. If buyers were responsible for defects, they would not know whether the price of the good was appropriate or too high, because they could not accurately predict the probability of defective performance. As in the standard problem of a "market for lemons,"[11] where sellers have superior information about the quality of goods, and buyers cannot readily detect the level of quality of any particular good in the market, buyers have incentives to treat all such goods as being of low quality. As a consequence, sellers of high quality goods will be unable to sell their goods at prices that they would command if buyers were aware of their actual quality. Sellers of high quality goods, therefore, seek to signal their status in order to attract buyers who are willing to purchase goods that they can credibly determine to be of high quality. Under these circumstances, fairly priced warranties become (costly) signals that sellers of high quality goods are willing to send in order to attract buyers who would otherwise avoid making purchases at sellers' prices.[12]

The implications of the above discussion can be made more concrete by the following illustration. Assume that a buyer and seller are contemplating entering into a contract for goods at a price of 10. Assume that the goods are worth 12 to the buyer if manufactured at a particular level of quality and 0 if they are not. Assume in addition that there are two kinds of sellers of the goods, high-quality sellers who manufacture goods that would be worth 12 to the buyer, and low-quality sellers, who manufacture goods that would be worth 0 to the buyer. At the time of purchase, however, the buyer cannot distinguish between high-quality sellers and low-quality sellers. That is, low-quality sellers are able to mimic high quality sellers in ways that disguise the higher likelihood of defects. Assume finally that there is an equal probability that the goods that are the subject of any given contract are of high

10 See also *René F. Henschel*, Conformity of Goods in International Sales Governed by CISG Article 35: *Caveat Venditor, Caveat Emptor* and Contract Law as Background Law and as a Competing Set of Rules, Nordic Journal of Commercial Law (2004/1), 1, 3.

11 *George A. Akerlof*, The Market for 'Lemons': Quality Uncertainty and the Market Mechanism, 84 Quarterly Journal of Economics (1970) 488 ff.

12 See *Sanford J. Grossman*, The Informational Role of Warranties and Private Disclosure about Product Quality, 24 Journal of Law and Economics (1981) 461 ff. This is not to say that every buyer will want a warranty. A buyer who will not use a good for its ordinary purpose may prefer not to pay for a warranty that applies to ordinary uses. It is for this reason that it makes sense to create a default rule rather than a mandatory rule.

quality or of low quality. Thus, at the time that the buyer decides to purchase the goods, they have an expected value of only 6, which reflects the equal probability that the goods are worth either 12 or 0. That is, the expected value of the goods is (.5)(12) + (.5)(0) = 6. A rational buyer will not pay 10 for goods that have an expected value of only 6. High-quality sellers will be unable to convince buyers of their status and will lose sales that both parties would prefer to enter into if those sellers could credibly commit to producing high-quality goods.

Assume next that the law requires that the goods subject to the contract conform to a certain level of performance, and that only the "high-quality" goods would satisfy the legal standard. Sellers who failed to manufacture at the mandated level of quality would be deemed to have breached the warranty and would be liable in damages to buyers. As a result, low-quality sellers will be unable to mimic high-quality sellers. Low-quality sellers would either have to pay too much in breach of warranty damages to make production of their goods worthwhile at prices that competed with high-quality goods, or would have to charge much higher prices in order to cover their warranty costs when their products fail. Moreover, if buyers are confident that they are purchasing the goods from high-quality sellers, because the existence of the warranty drives low-quality sellers out of the market or forces them to identify themselves as low-quality sellers, then buyers would presumably be willing to pay the asking price of 10 for them.

Seen in this way, Article 35(2)(a) solves a problem of asymmetric information that would otherwise frustrate mutually beneficial trade. Because only high-quality sellers can warrant that the goods are fit for the ordinary purposes for which they are used, the existence of a warranty constitutes a signal that can reduce buyer uncertainty about product quality. Sellers of high-quality goods, therefore, should prefer to send these signals, and buyers should be willing to pay prices that incorporate the costs of those signals. Thus, the mere presence of Article 35(2)(a) provides some assurance that contractual breakdowns will not occur, because a product bearing a warranty will be unlikely to be defective.

The seller's superior information about goods also allows it to provide an additional, insurance function that facilitates trade. Even goods that are manufactured by high-quality sellers may occasionally fail. In the event that defects materialize, either the buyer or the seller must bear the related cost, either directly or through insurance. The existence of an implied warranty allows buyers to impose those costs on sellers, even when those defects occur without negligence or other fault, that is, even when sellers have invested optimally in product quality. This may appear to be a more difficult function to justify, since sellers are not necessarily in a better position than buyers to avoid the costs related to defects that were not worth avoiding, that is, defects that occurred even in the presence of due care by the seller. Buyers, one might think, can obtain insurance against those defects as readily as sellers.

Nevertheless, the informational asymmetries between buyers and sellers also suggest that Article 35(2)(a) correctly assigns the insurance function to sellers. The repeat play experience of sellers with respect to the goods is also essential for this explanation. Presumably, if either the seller or the buyer enjoys a cost advantage in insuring against defects, either by self-insurance or third-party insurance, we would want that party to bear the insurance risk in order to minimize the costs related to the transaction.

Prior to a sale, sellers may be in no better position than buyers to identify which particular good will suffer from a defect. If they could identify the defective good in advance, sellers would presumably not sell the good or would sell it only at a deep discount that reflected its lower expected value. But because sellers make multiple sales of the same good, they are more likely than buyers to be familiar with overall defect rates and will be better able than buyers to know the probability that any particular good they sell is defective. Thus, sellers are better able to incorporate an accurate cost of defect risk into the price of every good that is sold. That cost essentially becomes an insurance premium that buyers pay when they purchase the good. Most buyers would presumably want such an "insurance policy" because, in the absence of information about breakdown rates, they could not easily bear the risk that the goods they purchase fail to perform as expected. When a defect ultimately materializes, sellers should be able to compensate the buyer out of the premiums that the seller has presumably collected from all buyers.

An example may make the insurance function of Article 35(2)(a) clearer. Assume that a seller of goods expects to sell 1000 units a year at the competitive price of $1000. The seller knows from historical experience that even if it takes optimal precautions against defects in the manufacturing process, five units every year will contain defects that render them worthless. (We assume here that defects cause no consequential damages for which the seller is responsible.) Sellers cannot identify the defective units in advance. Buyers only purchase these goods occasionally, and thus have insufficient experience to know the defect rate without substantial additional investigation. Armed with their knowledge of defect rates, sellers could sell the goods with a warranty that would make them responsible for defects when they arise. The effect of such a warranty would be to spread the risk of defect among all buyers. Since the total cost of the defects is $5000 (5 defective products x $1000 price), sellers would presumably be willing to incur the risk of defects by selling the components to the same 1000 buyers for $1005 each. That price reflects the cost of producing and selling the good, plus a $5 insurance premium against defects. (We assume for the sake of simplicity that the additional $5 in price does not reduce the number of purchasers of the good.) As long as buyers believe that the additional $5 they are paying for the good accurately reflects the pro rata risk of receiving a defective good, buyers would presumably be willing to pay the $5 premium in order to avoid the risk that the good they are purchasing for $1000 is worthless. Because buyers do not know defect rates as well as sellers, buyers could not easily self-insure against obtaining a defective unit, since they will not know what reserves to create for potential defects.[13]

[13] One might think that there is a contradiction between buyers' relative ignorance of defect rates and buyers' comfort that they are being charged a fair premium for the warranty. But if the goods are

Thus, if buyers and sellers were to bargain explicitly about the allocation of the risk of defective goods, one would anticipate that they would contract for the seller to accept that risk, but for buyers to pay a fair premium for the warranty. Article 35(2)(a) makes that negotiation unnecessary without changing the parties' preferred result by placing the risk on sellers and allowing them to charge the insurance premium. When a buyer discovers that it has purchased one of the defective goods, it makes a claim against the seller, who should be able to compensate the buyer the $1000 price from the premiums that the seller has collected through the price mechanism. If the seller has correctly calculated that there will be five defective goods sold each year and has collected $5000 through the price mechanism, the seller can compensate all buyers of defective goods without adversely affecting the seller's profit, because compensation will be paid from risk premium collections.

The ability of warranty to solve problems of asymmetric information through signaling and insurance, therefore, reveals that Article 35(2)(a) provides the loss allocation rule for which most parties would have bargained. Thus, that Article satisfies the criterion that commercial law should replicate for the majority of commercial parties the legal rules that they would select for themselves. But these explanations also implicate the proper scope of warranty law. Even if sellers should bear the risk of product defects generally, they should not necessarily bear the risk of every nonconformity. The same conditions of superior information that justify allocating risks to sellers in most cases also indicate that sellers should not necessarily be deemed to have violated Article 35(2)(a) when the alleged defect involves a condition with respect to which the seller did not have superior information.[14] We can imagine several cases in which buyers possess better information about performance expectations than sellers. Under these circumstances, the justification for imposing liability for nonconformities on sellers does not easily apply. In the first set of such cases, alleged deviations from contract specifications might be irrelevant to all but the most idiosyncratic buyers. Under these conditions, complaining buyers may be motivated by regret about the underlying deal rather than with the goods themselves, or the complaint may arise out of the fact that the buyer failed to indicate its own unique requirements to the seller .[15] A buyer who is so idiosyncratic that a reasonable seller would not have anticipated its needs may itself possess the superior information about characteristics that make the transaction exceptional. Unless the buyer communicated its unique requirements, the seller will not factor the risk of its failure to satisfy those requirements into the price of the goods. Thus, while it makes sense for sellers to make warranties with respect to the ordinary uses of a good, no efficiency gain is likely to arise where sellers are responsible for unanticipated uses of the good. It is largely for this reason, we assume, that Article 35(2)(a) is properly confined to all "purposes for which goods of the same description would ordinarily be used."[16] That language initially seems consistent with our information-based rationale for the Article. Sellers will only have superior information about the way in which their goods perform when those goods are used in common, frequent ways that provide the seller with a body of experience about the goods' performance. Sellers will not adjust the price of the good to reflect imperfections that are irrelevant to all but the most idiosyncratic buyers. A seller of coffee beans, for example, will not price the risk that a buyer is using sacks of beans to build a dam against flooding. Sellers would generally not incur the cost of protecting against imperfections that do not interfere with the ordinary use of the good, and most buyers would generally not want to pay the additional cost related to avoiding them. As a result, those imperfections should not be considered violations of Article 35(2)(a).

In a second set of cases, the seller may have an advantage in identifying the probability that a good is defective, but the buyer is in a superior position to determine, prior to use, that the particular good that is delivered does, in fact, suffer from a defect. Buyers, that is, may enjoy a superior capacity to inspect the proffered good to determine whether it does, in fact, possess defects. For that reason, Articles 38 and 39 of the CISG properly impose on the buyer the burden of examining goods and deny those who fail to make a timely inspection the right to make claims under Article 35 with respect to defects that a timely examination would have revealed.[17] In these

being sold in a competitive market, then buyers could assume that the premium is fair, even if they do not know the underlying defect rate.

14 See also *Henschel, supra* note 10, at 3 f.

15 Buyers are of course allowed to signify their own requirements; if they do, seller's obligation to comply with those requirements arises from Article 35(2)(b).

16 For a reference in legal writing to the fact that the goods have to be fit for all purposes for which goods of the same description would ordinarily be used, see *Franco Ferrari*, in: Franco Ferrari et al., Internationales Vertragsrecht, 2007, *sub* Art. 35 CISG para. 14; *Ulrich Magnus*, Wiener UN-Kaufrecht – CISG, 2005, *sub* Art 35 para. 20; United Nations Conference on Contracts for the International-Sale of Goods, Official Records: Documents of the Conference and Summary Records of the Plenary Meetings and of the Meetings of the Main Committees (Vienna, 10 Mars-11 Avril 1980), 1981, p. 32; in case law see Tribunale di Forlì, 11.12.2008, available at: http://cisgw3.law.pace.edu/cases/081211i3.html.
It must be noted that this does not mean that the goods must be perfect or flawless, unless perfection is required for the goods to fulfill their ordinary purposes; see ICC International Court of Arbitration, Arbitral award No. 8247, 11 International Court of Arbitration Bulletin 2000, 53 ff. Handelsgericht Zürich, 21.9.1998, available at: http://cisgw3.law.pace.edu/cases/980921s1.html.

17 It must be pointed out, however, that even though it is the examination of the goods that generally allows one to determine that there is a nonconformity that triggers the need for a proper notice under Article 39 CISG, the lack of an examination does not *per se* lead to the loss of the buyer's rights (see also *Franco Ferrari*, Specific Topics of the CISG in the Light of Judicial Application and Scholarly Writing, in Preadviezen uitgebracht voor de Vereniging voor Burgerlijk Recht 1995, 81,158 f.; *Rolf Herber / Beate Czerwenka*, Internationales Kaufrecht. Kommentar zu dem Übereinkommen der Vereinten Nationen vom 11. April 1980 über Verträge über den internationalen Warenkauf, 1991, p. 175; *Burghard Piltz*, Internationales Kaufrecht. Das UN-Kaufrecht (Wiener Übereinkommen von 1980) in praxisorientierter Darstellung, 1993, p. 191; *contra John*

cases, a technical violation of Article 35(2)(a) may exist, because nonconforming goods were delivered. Nevertheless, the dilatory buyer will be unable to take advantage of the violation to reject the goods or claim damages.

Of course, sellers could also perform inspections prior to delivery. The same problem of asymmetric information that leads to warranty liability arguably could justify placing the examination obligation on the seller. That is, a seller charged with liability regardless of the buyer's examination might use its superior information about defects to decide whether to make inspections randomly or with respect to every good sold or produced. Under some circumstances, however, buyers may occupy the superior capacity to inspect the proffered goods. Assume that the same good is amenable to multiple uses, but that the quality of the good necessary to provide adequate performance varies with the use. Each of the multiple uses of the good may be sufficiently frequent that it would qualify as an "ordinary purpose" of the good. Nevertheless, it may be that the seller, who is likely unaware of the use for which each buyer purchased the good, is in an inferior position to determine whether what was delivered was fit for that buyer's use. Instead, each buyer – who knows the use that it will be making of the good and thus the quality that is required for its use – may be better positioned to inspect the goods after delivery to determine whether they are appropriate for that individual use. The common uses of the good may be so numerous that the seller will not be well positioned to gather knowledge with respect to all of them. If the seller's superior access to information concerning likely product performance underlies the creation of a warranty, then the absence of such information should define the limit of the seller's responsibility for defects created without the seller's fault.[18]

Finally, the asymmetric information justification for warranty also suggests a proper resolution of those cases that concern an alleged breach of Article 35(2)(a) where a seller delivers goods that satisfy product standards in the seller's jurisdiction, but not those of the buyer's jurisdiction. For instance, the famed "mussels" case,[19] involved the sale of New Zealand mussels by a Swiss company to a German importer. The German buyer maintained that the level of cadmium in the mussels tendered under the contract rendered the goods unacceptable for sale under German law. That same level, however, was acceptable under Swiss law. The court found that, unless the seller has a branch in the buyer's country or has an ongoing business relationship with the buyer or often exports into the buyer's country or has promoted products in that country, or the buyer brought the stricter regulations of its jurisdiction to the attention of the seller,[20] the regulations of the seller's jurisdiction would apply.[21] As a result, the mussels supplied by the Swiss seller conformed to the contract specifications, notwithstanding that they could not be resold as delivered. Although the factor of superior information played no explicit role in the court's opinion, our analysis suggests that the "mussels" case was correctly decided. On the assumption that sellers of goods in international trade will not have information superior to that of their buyers of the prevailing regulations in buyers' jurisdictions, that decision is consistent with the view that quality warranties should apply only where sellers enjoy an informational advantage. The exceptions cited in the case are also consistent with the theory, since they describe situations (seller has a presence in buyer's jurisdiction, seller frequently sells in that jurisdiction, buyer has notified seller of requirements) in which the seller is more likely to have information about regulations in the buyer's jurisdiction. Nevertheless, there are unfortunate decisions that conflict with or limit the reach of the "mussels" case, and leading commentators find it controversial.[22]

O. Honnold, Uniform Law for International Sales under the 1980 United Nations Convention, 3rd ed., 1999, p. 272), as also pointed out in case law (see Tribunale di Rimini, 26.11.2002, available at: http://cisgw3.law.pace.edu/cases/021126i3.html). This is true, for instance, where the buyer does not inspect the goods and the lack of conformity cannot be discovered by adequately examining the goods (see *Antonio Manuel Morales Moreno*, *Art. 38*, in: L. Díez-Picazo y Ponce de León (ed.), 1998, p. 331). The contrary is also true: „[i]f the buyer discovers a non-conformity without examining the goods, he [nevertheless] has to notify the seller" (*Fritz Enderlein*, Rights and Obligations of the Seller under the UN Convention on Contracts for the International Sale of Goods, in: Petar Sarcevic / Paul Volken (eds.), International Sale of Goods. Dubrovnik Lectures, 1986, p. 166). Of course, as pointed out in case law as well, where the buyer does not discover a defect because of the lack of proper examination and therefore does not notify the seller of the lack of conformity within the time period and in the manner required by Article 39 CISG, the buyer looses the right to rely on the lack of conformity (see Landgericht Berlin, 21.3.2003, available at: http://cisgw3.law.pace.edu/cases/030321g1.html; Landgericht Köln, 30.11.1999, available at: http://cisgw3.law.pace.edu/cisg/wais/db/cases2/991130g1.html; Hoge Raad, 20.2.1998, available at: http://www.unilex.info/case.cfm?pid=1&do=case&id=328&step=FullText; Landgericht Stuttgart, 31.8.1989, available at: http://cisgw3.law.pace.edu/cases/890831g1.html).

18 Of course, if a particular buyer brings to the seller's attention the buyer's anticipated use of the good, and the seller provides assurances that the good is appropriate for that use, the seller lulls the buyer into complacency about the product's quality and should not be heard to complain that the buyer was better positioned to inspect. The buyer's reliance on the seller discourages what might otherwise have been an efficient inspection by the buyer. But that case is properly viewed as one arising under Article 35(2)(b) rather than one involving "ordinary use" under Article 35(2)(a).

19 Bundesgerichtshof, 8.3.1995, available at: http://cisgw3.law.pace.edu/cisg/wais/db/cases2/950308g3.html.

20 For these exceptions, see, e.g., *Charters*, *supra* note 9, at 38. For an application in case law of the need to comply with the standards in the buyer's country, see *infra* note 24.

21 For more recent decisions requiring that the goods generally only conform to the standards of the seller's country, see Oberster Gerichtshof, 12.9.2006, avaiable at: http://cisgw3.law.pace.edu/cases/060912a3.html; Bundesgerichtshof, 2.3.2005, available at: http://cisgw3.law.pace.edu/cases/050302g1.html; Oberster Gerichtshof, 27.2.2003, available at: http://cisgw3.law.pace.edu/cases/030227a3.html; Oberster Gerichtshof, 13.4.2000, available at: http://cisgw3.law.pace.edu/cases/000413a3.html.

22 See, e.g., *Medical Marketing Int'l, Inc. v. Internazionale Medico Scientifica, S.r.l.*, U.S. District Court, Eastern District of Louisiana, 17.5.

Our argument, therefore, is that decisions about whether goods are "fit for the purposes for which goods of the same description would ordinarily be used" should be informed by the same principles of asymmetric information that justify warranty law generally. Since, as we have shown, sellers appropriately bear the risk of nonconformity only when they are better positioned than buyers to avoid or to insure against risks, the language of Article 35(2)(a) concerning "ordinary use" should be interpreted only to cover situations in which the risk that materializes is one that sellers can avoid or insure against more easily than buyers.

III. The Interpretation of Article 35(2)(a)

To a large extent, decisions about the scope of Article 35(2)(a) from courts and arbitration panels have been consistent with the rationale we have posited for its inclusion in the CISG. In addition to the "mussels" case, arbiters have determined, for instance, that technical nonconformities that would not diminish the average buyer's value of the good do not violate the warranty. Thus, printed materials containing misplaced text that does not render their meaning illegible may still conform to the contract.[23] A small number of nonconforming goods within a larger shipment does not render the entire shipment nonconforming if a similar shipment from any other seller would include a similar amount of defects, assuming the remaining defects reflect optimal efforts by sellers to nonconformities and only idiosyncratic buyers would demand a higher level of quality.[24]

But even if courts have intuited to appropriate results, they have not explicitly invoked the justifications for Article 35(2)(a) to define its scope. Instead, they have applied tests that, at best, lend themselves to application consistent with what a more reasoned analysis would dictate. These tests seek to determine whether goods are fit for the purposes for which they would "ordinarily be used" by reference to standards that, as we discuss below, are confusing and misleading in ways that express recognition of the justifications for warranty liability would avoid. Moreover, these tests fail to provide a basis for defining violations of Article 35(2)(a) in the common case where the complaint involves the level of quality with which the goods were produced rather than the idiosyncratic use to which the buyer put the goods. In those situations, goods produced at a high level of quality may perform better than if they are produced at a lower level of quality; but that does not mean that the lower level is unacceptable for "ordinary" purposes. Thus, some interpretation of whether imperfect goods "are fit for the purposes for which goods of the same description" is still necessary, even when goods are to be used for their ordinary purposes. Arbiters and commentators have variously interpreted the obligation on which the CISG language is based as referring to "average quality," "reasonable quality," "merchantable quality," or "satisfactory condition."[25] In this Part, we explore the incentive effects of competing interpretations of Art. 35 (2)(a). Our implicit claim is that the choice among these interpretations should be made by reference to the effect that each possible interpretation will have on the conduct of the parties, since that effect will determine whether sellers have properly exploited the informational advantage that underlies warranty liability.

A. The Netherlands Arbitration Decision

The most thorough discussion of the various interpretations of Article 35(2)(a) can be found in a 2002 arbitral award of the Netherlands Arbitration Institute.[26] That dispute involved the sale of a condensate derived from the exploration of gas fields after separation from the gas stream. The condensate was sold through a series of contracts and refined on behalf of the buyer as part of a condensate / crude oil mix known as "Rijn Blend". The buyer then resold derivative products to various users. The buyer and sellers had entered into contracts for the sale of Rijn Blend for several years, apparently without adverse incident. In mid-1998, however, the buyer indicated that it would not accept any more Rijn Blend under its contracts because it had detected high levels of mercury that made the condensate unacceptable for processing or sale. When no solution to the mercury contamination was found, the buyer terminated the contracts or allowed the contracts to expire. The sellers resold the Rijn Blend at prices below the contract price and sought damages from the buyer.

The buyer contended that the goods did not conform to the contract because of the increased levels of mercury. The Arbitral Tribunal treated the claim as one arising under Article 35(2)(a). It suggested that there were three plausible interpretations of when goods are fit for the purposes for which goods of the same description would ordinarily be used. First, sellers could satisfy their obligations under the Article if they delivered goods of "merchantable" quality. This interpretation can be traced to the legislative history of the CISG. During the drafting sessions, common law countries had argued for a merchantability standard and civil law countries on the European continent had argued for an "average quality" standard. The Canadian delegation proposed an amendment in an attempt to clarify the standard. The proposed amendment would have required goods to be of "fair average quality within the description."[27] The pro-

1999, available at: http://cisgw3.law.pace.edu/cases/990517u1.html (law of buyer's jurisdiction must be satisfied where seller should have known of applicable regulations); Cour d'Appel Grenoble, 13.9.1995, available at: http://cisgw3.law.pace.edu/cases/950913f1.html; *Peter Schlechtriem*, Uniform Sales Law in the Decisions of the Bundesgerichtshof, available at: http://cisgw3.law.pace.edu/cisg/biblio/schlechtriem3.html.

23 See Handelsgericht Zürich, 21.9.1998, available at: http://cisgw3.law.pace.edu/cases/980921s1.html.

24 *La San Giuseppe v. Forti Moulding Ltd.*, Ontario Superior Court of Justice, 31.8.1999 available at: http://cisgw3.law.pace.edu/cases/990831c4.html.

25 See, e.g., *Ingeborg Schwenzer*, in: Peter Schlechtriem / Ingeborg Schwenzer (eds.), Commentary on the UN Convention on the International Sale of Goods (CISG), 2nd ed., 2005, p. 418.

26 See Netherlands Arbitration Institute, Arbitral award No. 2319, available at: http://cisgw3.law.pace.edu/cases/021015n1.html.

posal, however, was withdrawn without further clarification of which test was to be used. That did not mean, of course, that merchantability was the appropriate standard. Indeed, the Tribunal noted that it had discovered no case law holding that merchantable quality was sufficient. Nevertheless, the tribunal concluded that the Rijn Blend was not merchantable because it could not be resold without a price discount and merchantability, in the Tribunal's view, required the existence of a substitute market for the tendered goods at the contract price.

The Tribunal noted that at least one earlier case had used the "average quality" rule,[28] and that German commentators had endorsed that standard based on their domestic law.[29] But the tribunal admitted that no consensus on the acceptability of that standard for purposes of Article 35 had yet emerged. In fact, the Tribunal found that French authors had explicitly rejected application of their domestic views to the CISG which does, after all, require the incorporation of international, rather than domestic interpretations.[30] The Tribunal concluded that average quality, if applicable at all, should be measured by the geographical market within which the Rijn Blend was sold. The Tribunal found that there was a range of mercury levels in the relevant condensates, and that the buyer had failed to prove that the Rijn Blend was below average quality as judged by that standard.

Ultimately, however, the Tribunal rejected both of these standards in favor of a "reasonable quality" standard for Article 35(2)(a). The Tribunal noted that "reasonableness" was supported by two commentators and a prior case. That case, however, itself relied on little more than the expression of buyers' "reasonable expectancy" or "natural expectations" in many domestic laws.[31] But beyond mere citation to those prior endorsements of the standard, the Tribunal's justification for "reasonable quality" was somewhat obtuse. The Tribunal first stated that the need to ensure uniformity under Article 7(1) displaced the need to select either the merchantability or average quality standard, since neither of those dominated case law or scholarly opinion. But the absence of any dominant position surely does not suggest that a different, minority position should prevail over those that are contested. The Tribunal then rejected "average quality" as being so linked with "national notions regarding quality of goods" that it could not be used to interpret Article 35(2)(a), since the CISG implicitly rejected the use of domestic concepts to create international sales law. But this argument is also flawed. It is true that domestic law should not be used to interpret the CISG where the sole reason for adopting an interpretation is that it is consistent with domestic law.[32] But if a particular interpretation, such as average quality, has independent merit, the fact that it is also consistent with domestic law should not disqualify it from being used to construe a provision of the CISG.

Next, the Tribunal found that the "reasonable quality" standard was compatible with the *travaux préparatoires* of the CISG because reasonableness was not excluded by the Canadian amendment. But why compatibility with a withdrawn amendment should be a standard for defining parties' obligations under the CISG seems unclear. As the Tribunal noted elsewhere, withdrawal of the Canadian proposal could also signify satisfaction with the merchantability standard that the Tribunal rejected, or with the absence of any consensus on the issue during the Vienna Diplomatic Conference. The Tribunal contended that the latter explanation was more likely, and that the drafting history did not permit a clear resolution of the ambiguity inherent in Article 35(2)(a). The Tribunal similarly concluded that reasonable quality was consistent with the admonition of Article 7(1) to take into account the international character of the CISG, though there was no suggestion that the reasonableness standard had been adopted by any jurisdiction, much less that it had been accepted as a principle of international law or practice.

The Tribunal also suggested that the reasonable quality standard comported with the obligation in Article 7(2) to fill contractual gaps in a manner consistent with the general principles of the CISG. Since "reasonableness" is used explicitly in open-textured articles of the CISG,[33] the Tribunal reasoned,

27 See Canadian Amendment to Art. 33 [became Art. 35] (A / C0NF.97 / C.1 / L.115), available at: http://www.cisg.law.pace.edu/cisg/1stcommittee/summaries35.html#b.

28 See LandgerichtBerlin, 15.9.1994, available at: http://www.cisg.law.pace.edu/cisg/wais/db/cases2/940915g1.html. It is not clear that the case would have come out differently had a merchantable standard been used.

29 For German authors holding that recourse should generally be had to the standards of the seller's country, see, e.g., *Joachim Aue*, Mängelgewährleistung im UN-Kaufrecht unter besonderer Berücksichtigung stillschweigender Zusicherungen, 1989, p. 74; *Fritz Enderlein / Dietrich Maskow / Heinz Strohbach*, Internationales Kaufrecht, 1991, *sub* Art. 35 para. 8; *Peter Huber*, Vertragswidrigkeit und Handelsbrauch im UN-Kaufrecht – zu OGH, 27.2.2003 – 2 OB 48/02a, Praxis des internationalen Privat- und Verfahrensrechts, 2004, 358, 359; *Magnus*, *supra* note 16, *sub* Art. 35 para. 14.

30 See Article 7(1).

31 See Arbitration Institute, Stockholm Chamber of Commerce, Arbitral award, 5.6.1998, available at: http://www.cisg.law.pace.edu/cisg/wais/db/cases2/980605s5.html.

32 *Contra* see *Macromex SRL v. Globex Intern., Inc.*, U.S. District Court, Southern District of New York, 16.4.2008, available at: http://cisgw3.law.pace.edu/cases/080416u1.html; *Travelers Property Casualty Company of America et al. v. Saint-Gobain Technical Fabrics Canada Limited*, U.S. District Court, Minnesota, 31.1.2007, available at: http://cisgw3.law.pace.edu/cases/070131u1.html; *TeeVee Tunes, Inc. et al v. Gerhard Schubert GmbH*, U.S. District Court, Southern District of New York, 12.8.2006, available at: http://cisgw3.law.pace.edu/cases/060823u1.html; *Genpharm Inc. v. Pliva-Lachema A.S.*, U.S. District Court for the Eastern District Court of New York, 19.3.2005, available at: http://www.cisg.law.pace.edu/cisg/wais/db/cases2/050319u1.html; (stating also, however, that „UCC case law is not *per se* applicable to cases governed by the CISG") *Raw Materials Inc. v. Manfred Forberich GmbH & Co. KG, U.S. District Court*, Northern District of Illinois, Eastern Division, 6.7.2004, available at: http://cisgw3.law.pace.edu/cases/040706u1.html.

33 In the CISG, reference to reasonableness can be found in the following Articles: 8(2) and (3); 16(2)(b); 18(2); 25; 33(c); 38(3); 39(1); 43; 44; 46(2) and (3); 47; 48(2); 49(2)(a) and (b); 60(a); 63(1); 64(2)(b); 65(1) and (2); 72; 73(2); 75; 76(2); 77; Art. 79(1) and (4); 85; 86(1); 88(1), (2) and (3). It is worth pointing out that

the same concept could be used to interpret the meaning of the obligation in Article 35(3). That, too, seems to be a *non sequitur*. The explicit use of a "reasonableness" standard may be appropriate where a provision governs situations that are likely to be so varied that no more specific rule would be appropriate. For instance, a "reasonableness" standard may be appropriate to govern the time by when notice of defects must be given because detection of defects and the consequences of delayed notice may be vastly different with respect to some goods than with respect to others. But that does not entail that the interpretation of what range of quality would satisfy a warranty is subject to the same flexibility. Finally, the Tribunal concluded that if it applied domestic law, Dutch law would apply, and that law would impose a reasonable quality standard.

Once it turned to application of the standard it embraced, the Tribunal concluded that the buyers had a valid claim that Rijn Blend did not satisfy seller's obligations under Article 35(2)(a). But its reasoning to that conclusion made its analysis of the competing standards all the more confusing. The Tribunal contended that sellers failed the reasonableness standard because the price at which they were required to resell the goods reflected a deep discount from the contract price. But the Tribunal had already rejected the application of a merchantability standard which, on the Tribunal's own reading, depended on whether the goods at issue could be resold in the market at the contract price.

Ultimately, however, the Tribunal's disposition appeared to be predicated on an entirely different foundation. The Tribunal concluded that during the period that the contract had been in effect, the buyer had accepted Rijn Blen with mercury levels significantly lower than those that were found in the contested deliveries. The buyer "was entitled under the contracts to a constant quality level of the Rijn Blend corresponding to the quality levels that had been obtained during the abovementioned initial period of the Contracts and on which [buyer] and its customers could reasonably rely." In essence, then, the Tribunal's opinion was based more on the practices established between the parties – which are to be taken into account pursuant to Article 9(1) – than with any objective notion of what quality of goods would satisfy contractual obligations. On that theory, the entire discussion of reasonableness was superfluous. The buyer could have claimed that the goods were nonconforming irrespective of Article 35(2)(a). Article 9(1) binds the parties by any usage to which they have agreed and by any practices which they have established between themselves. Thus, even if the tender of condensate with a particular level mercury contamination would have satisfied any interpretation of "ordinary use" between buyers and sellers with no previous history, practices established between the parties pursuant to which lower contamination levels had traditionally been supplied could trump that standard as between parties engaged in repeat play with each other. Indeed, if one wanted to treat the case as one involving Article 35 at all, it should be treated as an Article 35(1) case. On the Tribunal's reasoning, low mercury content had become part of the contract description of the goods by virtue of the parties' course of dealing. Thus, a subsequent delivery of Rijn Blend with a high level of mercury would fail to conform to the quality "required by the contract."[34]

B. The Unreasonableness of "Reasonable"

None of these difficulties with the Tribunal's decision to use a reasonable quality standard would matter much if that standard were independently defensible, or if "reasonableness" were systematically interpreted in a manner that reflected the asymmetric information problem that underlies warranty law. Our concern, however, is that such a standard does not reflect a standard for which the parties to an international sales contract would have bargained, and thus does not satisfy our objectives for default commercial law rules. This is not simply because the "reasonableness" rule is so vague that parties cannot predict in advance whether they have complied with contract requirements.[35] Rather, we contend that the reasonableness standard creates perverse incentives for sellers to act in a manner that does not exploit their superior information and for buyers to react by distorting their market decisions. In short, there is no reason to believe that parties governed by a "reasonableness" standard would systematically place risks on those who, by virtue of having an informational advantage, are best positioned either to avoid defects or to insure against them. As a result, we predict that buyers and sellers would reject the standard.

To see the difficulty that a reasonableness standard generates, return to the assumption that goods of the same description can fall within a range of quality. Assume that the quality of goods ranges between "high" and "poor," and that goods of "poor" quality would not satisfy Article 35(2)(a) at all. That is, they would not be "fit for the purposes for which goods of the same description would ordinarily be used." That still leaves a wide range of goods that do satisfy Article 35(2)(a). Assume those goods range from "high" to "low." This range presumably describes the goods that are of "reasonable" quality. That is, all of these goods would satisfy the requirements of Article 35(2)(a), even though not all such goods are of the same quality.

It is likely that conforming goods at the "high" end of the spectrum will be more costly to produce than conforming goods at the "low" end. "High" quality goods will likely have that characteristic because they are made of superior raw materials, may be subject to more stringent quality control, or may be manufactured with greater levels of care. These inputs

reference can also be found to unreasonableness; see Articles 34; 35(2)(b); 37; 46(3); 48(1); 86(2); 87; 88(1); 88(2). One of us has argued that pervasive reliance on the concept of reasonableness is an inherent weakness in the CISG because it fails to give commercial actors sufficient notice of their obligations. See *Gillette / Scott*, *supra* note 3.

34 Article 35(1).

35 For criticisms of "reasonableness" standards along these lines, see *Gillette / Scott*, *supra* note 3; *Michael P. Van Alstine*, Dynamic Treaty Interpretation, 146 University of Pennsylvania Law Review (1998) 687,750 f.

increase production costs, so one would expect that "high" quality goods will command a higher price than "low" quality goods, as long as buyers can distinguish "high" from "low." This should be true even if the market structure of the industry is not perfectly competitive. Sometimes, buyers will be able to determine quality at low cost, and thus be willing to pay more for "high" quality goods. For instance, a good manufactured from plastic can easily be distinguished from a good manufactured from metal.

Some of the qualities that distinguish "high" from "low" quality goods, however, may not be readily observable by buyers, although they will be known by sellers. Sellers alone, for instance, will know how much quality control a good was subjected to, or the tolerances for which the good was tested. The consequence of this informational asymmetry will be that buyers will be unwilling to pay for qualities that they are unable to observe until they have purchased the goods. They will fear that sellers will try to pass off as "high" quality goods that are actually of "low" quality. But it is noteworthy that a seller who succeeds in providing "low" quality goods at "high" quality prices will not violate Article 35(2)(a), because, by hypothesis, the good still conforms to the requirements of that provision as long as the quality exceeds the unacceptable "poor" quality. Sellers, therefore, face no liability for providing "low" quality, albeit at "high" quality prices.

But the natural response of rational buyers to this possibility is to replicate the standard reaction to possible "lemons," that is, to treat all goods as being of "low" quality. Buyers, therefore, will be unwilling to pay "high quality" prices for what they believe will be "low quality" goods. In short, a "reasonableness" standard, by embodying a range of quality, reproduces the very problem that implied warranty was intended to avoid. Sellers, at this point, can follow one of two strategies. Either they can find ways to distinguish their "high quality" goods and thus provide buyers with assurance that goods are worth "high quality" prices, or they can cease production of "high quality" goods. If the first strategy is either impractical or relatively costly, sellers will presumably select the latter strategy, since buyers will assume that all goods are of "low quality". In standard "market for lemons" terms, "high quality" goods will, perversely, be driven from the market.

Sellers who desire to serve a market for "high quality" may pursue the first strategy by attempting to provide assurances that their goods are, in fact, of "high quality". Mere statements that goods are of "high quality" will not be effective, since those statements could be mimicked by "low quality" sellers. Thus, sellers who actually sell "high quality" goods would want to invest in costly signals that "low quality" sellers could not afford to replicate. Express warranties may serve this purpose. Under Article 35(1), a seller who makes a statement concerning a characteristic of the good is obligated to provide goods that conform to that representation. Failure to do so constitutes a breach of the contract. Thus, a "high quality" seller could credibly represent that its goods possess those characteristics, and buyers would presumably be willing to pay more for them, because "low quality" sellers could not make the same representation without suffering losses when their goods failed to perform as promised. In theory, Article 35(1) does satisfy our objective of creating default rules that reflect what most commercial parties would want, because most commercial parties who make or rely on express statements would want those statements to be supported by a legal commitment.

But that does not mean that a "reasonableness" standard that forces high-quality sellers to make express statements in order to distinguish their goods is also appropriate. Making express statements will be both costly and risky, insofar as buyers and sellers could disagree on what the express statement entails. Sellers may be reluctant to provide express warranties out of concern that they connote a level of performance even greater than that promised by "high quality" implied warranties and, thus, sellers cannot easily anticipate all the conditions under which successful warranty claims could be made. As a result, sellers might fear that they will suffer exposure to liability even under conditions in which they do not have superior information, or in which defects that they cannot easily control arise. It would be more difficult for sellers to incorporate these liability risks into prices. Thus, under a "reasonable quality" standard, some sellers may not choose to signal high quality, but instead to produce low quality, because doing so avoids the additional liability that they incur by making the express warranty necessary to attract buyers who prefer high quality goods.

That possibility alone, of course, does not necessarily mean that we should avoid a "reasonable quality" standard. Assume, for instance, that the alternative would be to interpret Article 35(2)(a) to mean that sellers warrant that their goods are of "high" quality, rather than that the goods are within a range of "high" to "low" quality. Such a standard could have equally perverse effects. Some sellers may wish to produce goods that are of "low" quality, and to charge lower prices accordingly. Some buyers may prefer such goods, either because they do not need high-quality goods or cannot afford them, and would prefer a low-quality good to none at all. Sellers would presumably produce such goods if they could be confident that they were not bound by the warranty. In theory, at least, the CISG permits disclaimers of warranty, insofar as the obligations under Article 35(2) do not apply "where the parties have agreed otherwise." and Article 6 permits parties to opt out of the CISG default rules. But the CISG is silent on what constitutes an adequate disclaimer. Unlike the UCC, the CISG creates no safe harbor that indicates how those who wish to disclaim warranties can do so.[36] Article 35(2) simply begins with the phrase "Except where the parties have agreed otherwise … ." The result is to make a purported disclaimer susceptible to all the attacks that could be asserted against its effectiveness. The analysis is further complicated by the possibility that the effectiveness of warranty disclaimers may implicate the complex rules concerning validity issues that are excluded from the CISG under

36 See also *Daniel Berkowitz et al.*, Legal Institutions and International Trade Flows, 26 Michigan Journal of International Law (2004) 163, 170, referring to a case that shows that a simple warranty clause designed to clearly allocate rights and responsibilities between the contracting parties can raise complicated questions in the case of complex goods.

Article 4(a).[37] Sellers, therefore, might fear that producing a "low quality" good with an ineffective disclaimer would cause them to be liable as if they had made a "high quality" warranty. As a result, they might avoid producing the good at all or insure against liability by selling the good at a price that discouraged purchase by those who only desire a "low quality" good. Under these circumstances, both buyers and sellers of "low" quality goods would be better served by a standard that embraced both "high" and "low" (though not "poor") quality.

Moreover, the juxtaposition of full warranty under a reasonableness standard interpreted as "high quality" and disclaimer ignores the possibility that some sellers may wish to indicate that their goods are not of the highest quality, but also not of "poor" quality. They would have to disclaim the default warranty, which would indicate that their goods are of "high quality", while simultaneously affirmatively making a more limited warranty.[38] Sellers who face this situation would be required both to incur higher costs in specifying the scope of their intended warranty and higher error costs in the (mis)application of the intended warranty by tribunals adjudicating claimed nonconformities.

C. The Problem of an Average Quality Standard

The "average quality" standard poses a different set of difficulties. The primary problem is that a literal interpretation of the standard would create a moving target, so that sellers would not know what standard of performance they were promising and buyers would not know what standard of performance they were receiving. To see why this is the case, assume again that the plausible quality of goods ranges from "high" to "low," and that goods delivered in the absence of a legal warranty of quality are randomly distributed over this range. Thus, taken literally, the "average" quality of a good would approximate the mean between "high" and "low" quality. Once we use an implied warranty of quality to require that conforming goods be of "average" quality, however, all goods of a quality below the average would fail to satisfy the warranty. As a result, sellers could not satisfy contractual obligations by tendering goods of that quality, unless they explicitly disclaim the warranty. Sellers of below average quality goods who did not want to disclaim warranties (for the reasons suggested above) would drop out of the market.

The effect of that move, however, would be to shift the "average quality" of goods upwards, as the disappearance of below average quality altered the definition of average quality for the goods that remained. Of course, that equilibrium would be short-lived, as the new "below average" quality goods would now fail to satisfy legal requirements. Once the previously "below average" goods disappear, goods that are tendered would all be between the "high" point of quality and the former "average" point of quality. As a result, the actual "average" of tendered goods would move to some point between the old average and the high point. "Average" quality becomes meaningless because of the constant change in the standard. While some buyers might benefit from this infinite regress, because they would receive conforming goods of high quality, other buyers may not, because they would prefer to receive (and to pay for) only goods of "low" to "average" quality.

One possible reaction, again, is for sellers of "below average" quality to disclaim warranties. In that case, below average quality goods would not disappear from the market; but they would be subject to the uncertainties concerning disclaimers that we discussed above. Perhaps more critically, is not clear whether the presence of disclaimers would solve the infinite regress problem. That depends on whether goods bearing the disclaimer would be considered as being in the "same market" as goods bearing the warranty. For instance, assume that some used automobiles are sold through dealerships and carry warranties, while other used automobiles are sold by individuals without any warranty. In asking whether a warranted used automobile was of "average quality," would the relevant market consist of all used automobiles, or only of those sold with warranties? If both warranted and unwarranted cars are included in the calculation of the relevant market, then the infinite regress problem may be solved, if warranted cars

37 See, e.g., Clayton P. Gillette & Steven D. Walt, Sales Law: Domestic and International 367-68 (2d ed. 2009); *Mather, supra* note 2, at 162. Some domestic rules, such as section 2-316(2) and (3) of the UCC, requiring that certain words or types of words be used for a disclaimer to be effective "are validity rules [...]. Furthermore, section 2-316, like section 2-302, is primarily concerned with preventing unfair surprise, and it is generally agreed that section 2-302's unconscionability rule concerns validity. The CISG contains no express rule dealing with this validity issue. (Although the CISG notion of good faith could be relevant, it is merely an underlying principle and not an express rule.). Therefore, the effectiveness of the disclaimer is a validity issue. And if some state's UCC is the applicable law identified by the forum's choice-of-law rules, section 2-316 governs the effectiveness of the disclaimer", *Mather, supra* note 2, at 162-163. This is the view recently adopted in *Norfolk Southern Railway Company, Plaintiff, v. Power Source Supply, Inc.*, U.S. District Court, Western District of Pennsylvania, 25.7.2008, available at: http://cisgw3.law.pace.edu/cases/080725u1.html.
This, however, is just one view, as also pointed out by *Mather* who states that "it can be argued that certain CISG rules expressly deal with the issue, and there is no place for a choice-of-law process". CISG Article 35(2) provides that its implied obligations of the seller (similar to the UCC implied warranties of merchantability and fitness for particular purpose) do not come into play when "the parties have agreed otherwise", *Id.* at 163. This, in turn, means, however, that the CISG, which is based upon the principle of freedom from form requirements, "allow[s] for the exclusion of implied terms regarding conformity, with little or no fanfare", *Markel, supra* note 2, at 182; see also *Christine E. Nicholas*, Teach an Old UCC Dog New Tricks, Business Law Today (2008) 39, 41, stating that the disclaimer need not be in writing.

38 In the United States, the Magnusson-Moss Warranty Act forbids sellers of consumer goods who make any written warranty from disclaiming implied warranties. See 15 U.S.C. §2308(a). This provision, therefore, interferes with the ability of sellers to make warranties that are weaker than those implicit in the Uniform Commercial Code's implied warranty of merchantability.

(sold by dealers) are also generally of above average quality, while unwarranted cars (sold by individuals) are of below average quality. If, however, cars sold by dealers are considered to constitute a different market than cars sold by individuals, then the average quality standard may continue to create a moving target for both buyers and sellers.

The propriety of an "average quality" standard, therefore, depends to some extent on an empirical issue: will goods that are distinguished primarily by the presence or absence of a warranty be considered to be "of the same description" for purposes of Article 35(2)? We do not have data on that issue, and believe that the answer may vary with different kinds of goods. As we suggested above, automobiles with warranties may not be in the same market and, thus, "of the same description" as automobiles without warranties. But perhaps shoes, the subject of the contract in the one case that adopted an "average quality" standard,[39] would fit the same description regardless of whether they included an implied warranty.

Perhaps, however, "average quality" is not meant to be interpreted literally. Perhaps the standard means something closer to "what the average buyer would expect" instead of the quality of the average good in the market. That is, if most buyers would accept the good at the quality offered, then the good conforms to Article 35(2)(a). In effect, "average quality" may mean compliance with the reasonable expectations of buyers.[40]

The problem with that interpretation is that it does not seem to have any meaning independent of the rejected merchantability standard. Given that goods can be produced at various levels of quality and that differences in quality are likely to translate into differences in price, the reasonable expectations of the buyer are likely to depend on the price of the goods. True, some goods will be so defective as to be rendered useless.[41] But useless goods are likely to fail any standard for Article 35(2)(a), and thus those cases are not helpful in distinguishing among interpretations. Thus, whether a good satisfies the reasonable expectations of the average buyer will depend significantly on the price that is charged for it.[42] Two goods of vastly different quality may both satisfy Article 35(2)(a) if the lower quality of one is reflected in the price. Once one recognizes that possibility, however, "average quality" blends into the merchantability standard, to which we turn next.

D. The Merchantability Standard

We interpret "merchantability" for Article 35(2)(a) purposes, and for warranty purposes generally, to require that the goods that are the subject of the dispute can be sold in the same market in which the original transaction occurred to a buyer who is aware of the characteristics complained of at a price that is substantially similar to the contract price.[43] Merchantability thereby avoids the problems that attach to the "reasonableness" and "average quality" standard insofar as it permits the quality of the good at issue to be measured against a standard – market price –[44] that is sufficiently variable to avoid the gross classifications about quality that generate perverse behavior associated with "reasonable" or literal interpretations of "average" quality.

For instance, shoes of a wide variety of quality can be fit for the ordinary purpose of walking around. But shoes that cost $500 are expected to have characteristics different from shoes that cost $50. Thus, price may do a significant amount of work in segmenting markets for goods that might otherwise seem fungible. Moreover, price itself can be viewed as a signal of quality that solves the information asymmetry underlying warranty. By selling goods at a particular price, the seller arguably signals that the good is similar in quality to other goods used for the same purpose that carry similar prices, is better than goods used for the same purpose that sell for lower prices, or is of lower quality than goods used for the same purpose that sell for higher prices. This graduated warranty avoids the pitfalls of "reasonableness" and "average quality" because it recognizes the diversity of quality among goods used for the same purpose and does not induce strategic play by sellers or buyers. Indeed, at some point, price differentials may indicate that nominally similar goods are, in fact, not substitutes at all.

More importantly, price is likely to reflect informational advantages that justify warranty liability in the first instance. Assuming relatively competitive markets, price should reflect the inputs that the seller invests in product quality, and thus it is likely to incorporate the seller's information concerning defect rates. Price also is likely to incorporate information that buyers have about the good. Buyers are unlikely to purchase a good that carries a price in excess of the buyer's expected value for it. When buyers agree to pay a particular price for a good, therefore, they have a set of expectations about the good's characteristics. Sellers who have superior information about the qualitative characteristics of the good reveal those features through the pricing mechanism. Price, in effect, serves as a substitute for a more detailed description of the goods that would constitute an express warranty of quality. Reasonable buyers who would not otherwise be able to discern quality prior to purchase will infer certain characteristics from

39 LandgerichtBerlin, 15.9.1994, available at: http://cisgw3.law.pace.edu/cases/940915g1.html.

40 For this test, see, e.g., *Ferrari, supra* note 16, *sub* Art. 35 CISG para. 14; *Magnus, supra* note 16, *sub* Art. 35 para. 18.

41 See, e.g., Rechtbank van Koophandel Tongeren, 25.1.2005, available at: http://cisgw3.law.pace.edu/cases/050125b1.html.

42 See also *Cesare M. Bianca*, in: Cesare M. Bianca / Michael J. Bonell (eds.), Commentary on the International Sales Law, 1987, p. 279: "circumstances from which the buyer should reasonably deduce that the goods do not conform with the Convention standards are, for example: […] the price corresponds to the price generally paid for poor quality goods."

43 For a somewhat different definition of merchantability, which, however, is also price related, see *Thomas M. Beline*, Legal Defect Protected by Article 42 of the CISG: A Wolf in Sheep's Clothing, available at: http://tlp.law.pitt.edu/articles/Vol_12_Beline.pdf, stating that "the threshold is merchantability such that the goods could be resold at the price in which the buyer expected to resell them."

44 For price as a relevant factor in determining whether the Article 35(2)(a) threshold is met, see also *Willhelm-Albrecht Achilles*, Kommentar zum UN-Kaufrechtsübereinkommen, 2000, p. 95; *Bianca, supra* note 42, at 281.

the price, just as if they had a detailed description of the goods on which they could rely, and will therefore use price as a proxy for quality in calculating whether the good is worth purchasing. If price incorporates the seller's informational advantage about quality, however, then the good that is the subject matter of the contract should be saleable to another buyer in the same market at the contract price if the information at issue was made explicit. The inability to command the same price for the same good under those circumstances reveals a misuse of the seller's informational advantage.

To put the case most clearly, assume that there is a market for a good, a desk, that is manufactured in two different qualities, "high" and "low." Perhaps "high quality" desks are made of solid wood, while "low quality" desks are made of metal. Assume that buyers are aware that "high quality" desks sell for $400 and "low quality" desks sell for $300. Finally, assume that a seller of desks places an advertisement just stating: "Desks for Sale, $400." Buyer orders a desk from the advertisement and receives a desk that is made of metal, not solid wood. Our intuition is that most people would believe that the metal desk was not "fit for the purposes for which goods of the same description would ordinarily be used," within the meaning of Article 35(2)(a). Even though the only "description" of the desk is its price, that description serves as a proxy for a set of quality expectations in the market. A seller who advertised explicitly, "Metal Desks for Sale, $400" would not be able to command the asking price in the market. Where the seller has the kind of informational advantage that justifies warranty liability, price serves as a means of conveying information. Where that signal is false, because the good does not in fact have the quality indicated by price, the reasons for imposing warranty liability are implicated, and thus the seller should bear liability for damages caused by lower than expected quality.[45]

As a result, a merchantability standard that asks whether the good at issue could be resold in the same market at a price similar to the one charged in the contract asks whether the seller was signaling product quality in the very manner that economic theory suggests sellers would want to do in order to avoid the lemons problem and attract buyers. A low-quality seller who sought to mimic high-quality sellers by charging the same price, therefore, should be held responsible for the quality of good indicated by the price, while a seller who charged significantly less should be held to a different – lower – standard and therefore may well not be liable (assuming no other basis for liability), since the low price signaled that its good was of inferior quality.

Indeed, notwithstanding the formal rejection of the merchantability standard in the Netherlands Arbitration case, the Tribunal's rationale for adopting the reasonableness standard actually alludes quite explicitly to the informational asymmetries that we contend are best incorporated into the merchantability analysis. The Tribunal concluded:

> [s]ince it has been established that the increased levels of mercury were to be sought before the point of delivery, the risks of any such increased levels are to be allocated to the [sellers] who had control only over its possible causes and were thus in the better position to detect the increased levels and their causes and to remedy any such quality problem … Under the circumstances, the Tribunal finds that the sellers rather than the buyer had the obligation to remove the mercury in order to be able to deliver the Rijn Blend at a quality level the buyer reasonably could expect in view of the price it was bound to pay and the quality levels it had been used to.[46]

This justification is nothing less than an attempt to allocate losses to the party who, by virtue of having superior information, was best positioned to avoid them. Whether or not the seller satisfied that obligation, the Tribunal notes, is at least partially dependent on the buyer's expectations "in view of the price it was bound to pay." We infer an important point from the Tribunal's invocation, fleeting as it may be, of this analysis in its explanation of the reasonableness stand. Any standard – including reasonableness and average quality – for allocating losses from poor product quality can, in theory, be interpreted in a manner consistent with exploiting superior information. The very indefiniteness of these standards means that they are susceptible to being manipulated in a manner that is consistent with optimal risk bearing. If courts, for instance, adopted a "reasonableness" standard but consistently applied that standard by placing the loss on the party that, by virtue of its informational advantage, was best able to avoid or insure against it, or that reflected "reasonable quality given the price charged," we would have less difficulty with the use of that standard. To some extent, therefore, our embrace of the merchantability standard stems from a sense that it is less susceptible to interpretation that is inconsistent with optimal risk bearing. The Tribunal's opinion suggests that "reasonableness" can be interpreted in a manner consistent with our analysis. Our argument, therefore, is that the elements that are implicit in the Tribunal's definition of "reasonableness" should be made more explicit in order to avoid alternative interpretations of that inherently vague phrase, and that one way to achieve explicitness is to adopt a merchantability standard that is less susceptible to perverse or inappropriate interpretations.[47]

45 The theory works less well where there are continuous prices rather than only a few discrete price levels. For instance, if prices of desks ranged from $300 to $400 in small increments, a seller arguably could advertise a desk for $301 without necessarily incurring additional liability if the desk were only worth $300. Fine distinctions of quality will become debatable in that context. Nevertheless, we believe that our point is valid where prices and quality are correlated in the marketplace and a seller purports to charge a price that the marketplace identifies with a level of quality that varies significantly from that of the advertised good.

46 Opinion paragraph 123.

47 For a reference in legal writing to Article 35(2)(a) setting forth an "implied warranty of merchantability", see, e.g., *DiMatteo et al.*, *supra* note 2, at 397; *Mather*, *supra* note 2, at 163; *Catherine Piché*. The Convention on Contracts for the International Sale of Goods and the Uniform Commercial Code remedies in light of remedial principles recognized under U.S. law: Are the remedies of granting additional time to the defaulting parties and of reduction in price fair and efficient ones?, 28 North Carolina Journal of International Law and

IV. Potential Limitations and Objections to the Standard

There is at least one caveat to our embrace of the merchantability standard as we define it. Essentially, that standard asks whether the goods, with the known defect, would have commanded a similar price in the marketplace. How much weight can price alone carry without creating offsetting difficulties, such as distorting negotiations by implicitly limiting the prices that sellers can charge? In effect, this test can be interpreted to transform price, standing alone, into a warranty. A good that costs twice as much as an alternative is, on this understanding, represented to be far superior in quality, notwithstanding the absence of any express statement, other than price, to that effect. Understood in this way, Article 35(2)(a) conjures images of a medieval "just price" that seeks to ensure a relationship between price and value rather than simply to allocate risks. A seller who charged a higher than average price would be deemed to have provided a good of higher than average quality, and the failure to deliver such a good would subject the seller to a claim under Article 35(2)(a).

That might not be an altogether unhappy result. It would, for instance, provide a substantive rationale to those few cases (all outside the CISG) that find prices unconscionable, notwithstanding that the good at issue is not defective.[48] Moreover, substantial economic theory supports the proposition that, in relatively competitive markets, sellers use price (though not only price) as a signal of quality and that purchasers interpret price as a signal of quality,[49] although some marketing literature suggests that price can also only weakly be correlated to quality.[50] But there is a difference between recognizing that price has utility as a signal of quality and transforming the failure to provide a good that is of a quality consistent with that signal into a basis for legal liability. There exist relatively benign reasons why price may not reflect quality. With respect to some goods, buyers are not purchasing quality alone, at least not quality in the sense of the performance of the good. Luxury goods, for instance, may convey status rather than, or in addition to, quality. Clothing that can readily identify the wearer as either fashionable or of high economic status, for instance, may command a price in order to signal those attributes rather than increased longevity or performance. A $500 pair of shoes that are recognizable as produced for a particular designer may wear no better than a $100 pair of shoes, but still command a higher price because of the reputation that the wearer can enjoy.

The nonqualitative elements of price, such as status, may be most apparent with respect to consumer goods, the sale of which is generally excluded from the CISG's sphere of application.[51] But even with respect to nonconsumer goods, it is plausible that price may incorporate a great deal that is unrelated to matters of quality. Most obviously, prices in oligopolistic markets may reflect the market power of the participants. But because our inquiry is about *relative* prices, much of the noise created by the nonqualitative elements of price are less relevant. For instance, all members of the oligopoly may charge supracompetitive prices, so that all prices reflect more than cost, and hence quality. But to the extent that oligopolistic sellers in the same industry produce goods of different quality, one would still anticipate that their prices (all of which would be higher than would be the case if there were more competition) will still vary so that goods of higher quality would command a higher price than goods of lower quality. To make the point clearer, assume that all oligopolist sellers in the market sold multiple lines of goods, distinguished by quality. One can perhaps think of the automobile market in the United States 50 years ago along these lines. One would expect that the highest quality lines (Cadillac) would command higher prices than the lower quality lines (Chevrolet), even

Commercial Regulation (2003) 519, 550 note 197; *Vivica Pierre*, What do Farmers Impliedly Warrant When They Sell Their Livestock. A Comparison of the Uniform Commercial Code, the Louisiana Civil Code and the Vienna Convention on Contracts for the International Sale of Goods, 19 Southern University Law Review (1992) 357, 394; *Sarah R. Sandberg*, Globalized Horse Trade: A Need for Heightened Sophistication in the Equine Industry, 69 UMKC Law Review (2001) 613, 627; *James M. West / John K. M. Ohnesorge*, The 1980 UN Convention on Contracts for the International Sale of Goods: a comparative analysis of consequences of accession by the Republic of Korea, 12 Transnational Lawyer (1999) 63, 86; see, however, *Henry D. Gabriel*, A Primer on the United Nations Convention on the International Sale of Goods: From the Perspective of the Uniform Commercial Code, 7 Indiana International and Comparative Law Review (1997) 279, 286-287, stating that "Article 35(2)(a) – unlike § UCC 2-314 – does not impose that the goods be merchantable".

48 See, e.g., *Jones v. Star Credit Corp.*, 298 N.Y.S. 2d 264 (N.Y. Sup.Ct. 1969) (unconscionable to charge $900, plus interest charges, for refrigerator worth $300).

49 See *Paul Milgrom / John Roberts*, Price and Advertising Signals of Product Quality, 94 Journal of Political Economy (1986) 796 ff.; *Kyle Bagwell / Michael H. Riordan*, High and Declining Prices Signal Product Quality, 81 American Economic Review (1991) 224 ff.; *Asher Wolinsky*, Prices as Signals of Product Quality, 50 Review of Economic Studies (1983) 647 ff.

50 See, e.g., *Eitan Gerstner*, Do Higher Prices Signal Higher Quality?, 22 Journal of Marketing Research (1985) 209 ff. The marketing literature tends to focus on consumer rather than commercial products and thus may be less relevant to the CISG setting. In addition, at least some of the literature finds a higher correlation between price and quality with respect to infrequently purchased, expensive goods. Again, that result may support the economic theory in cases to which the CISG is relevant. The marketing studies may also suffer from insufficient specification of what constitutes quality. See, e.g., *Valarie A. Zeithaml*, Consumer Perceptions of Price, Quality, and Value: A Means-End Model and Synthesis of Evidence, 52 Journal of Marketing (1988) 2 ff. George Priest found only a "very crude" relationship between warranty duration and expected life of a product, and concluded that the signal theory is only weakly supported. *George Priest*, A Theory of the Consumer Product Warranty, 90 Yale Law Journal (1981) 1297 ff. It is unclear, however, that duration is the only element of quality that induces a consumer purchase.

51 CISG Article 2(a).

though all prices might have been lower had there been more competition in the market overall.

Other market dynamics could also dissociate price from quality. Imagine, for instance, a market structure with a dominant seller that achieved its position as a result of some characteristic other than quality. For instance, the seller may have been a first mover and attained a dominant market position that allows it to command higher prices for goods of a quality similar to that of relatively new entrants who keep prices low in an attempt to establish a foothold in the market. Under these circumstances, it would be inappropriate to identify the dominant seller's product with high quality or the other sellers' products with low quality. Alternatively, a seller may enjoy cost advantages or efficiencies in the productive process that permit it to charge lower prices than those of its competitors. If relatively efficient sellers charge lower prices, however, there is no reason to infer that they are providing a good of lower quality.

Indeed, a complicating factor involves the possibility that one cost element that could affect prices is liability for an above average percentage of defective goods. A seller who raises prices to cover its exposure to liability is certainly not indicating goods of higher quality. Instead, sellers who face low liability costs would be able to signal their high quality credibly by reducing prices. That strategy could not easily be mimicked by sellers whose high prices were dictated by high liability costs.[52] It is possible that purchasers of goods would be able to distinguish between cases in which high price denoted high quality and cases in which high prices denoted low quality, because prices will not operate in isolation. Factors such as seller reputation will enable buyers to discriminate among cases and adjust their reaction to price. But a legal rule that simply equates price with quality, unadorned by the factors that might influence the decisions of individual buyers, will not capture these nuances.

Perhaps these cases mean that courts and arbitral tribunals should consider merchantability in the terms that we have advocated as a presumption, rather than as an iron rule. Assume that a buyer contends that a good for which it paid $x could not be sold in the same market as the one involved in the original transaction for more than $x-$y if the characteristics complained of had been known. That might be sufficient to create a presumption that Article 35(2)(a) has been violated. But the seller might still have an opportunity to demonstrate that its pricing was based on a market advantage that competitors could not exploit, even though the quality of its goods were comparable. Although sellers might be reluctant to attempt to prove that they had significant market power, for fear of antitrust liability, not all market structures that might permit a pricing advantage reveal anticompetitive conduct.

A more complicated scenario might arise if a buyer sought to impose warranty liability and a seller attempted to use price as a shield by demonstrating that its goods were priced the same as those of low quality. In some cases, of course, that should be a perfectly valid defense, such as where the seller's low price really does constitute a signal that it intended to produce a relatively low quality good that might appeal to some buyers. But if the relatively low price reflected nonqualitative factors, such as a cost advantage due to seller's more efficient production, then the reasons for imposing warranty liability on the seller are not diminished. Such a seller would still be in the best position to avoid, price, or insure against defects, and, *ex ante*, both parties would want the seller to assume the quality risk. In theory, we could presumptively allow seller to use price as a shield, but confer on the buyer the opportunity to rebut that presumption by demonstrating that low price was a function of lower production costs. In reality, refutation of the presumption is unlikely, simply because buyers will not have access to information about the seller's internal cost structure that will be necessary for that conclusion. As an empirical matter, however, we question whether the number of cases in which sellers will be able to escape liability as a result of low production costs mimicking low quality will be sufficiently significant to be problematic. Indeed, sellers who enjoy low production costs might be more likely to enhance profits by making express warranties about the high quality of their goods in order to rebut a market perception that their low prices signal low quality. If that is the case, they will be unable subsequently to use pricing as a shield in an Article 35(2)(a) action. Nevertheless, we recognize that one downside to our suggestion is that sellers might fear reducing prices for fear of signaling low quality; and that would interfere with one of the key benefits of market competition – the driving down of prices for goods generally.

IV. Conclusion

Article 35(2)(a) allocates risks between buyers and sellers with respect to the performance of a good. We have argued that any such allocation should reflect the one that commercial parties would make explicitly if they bargained about risk bearing. Whether or not Article 35(2)(a) reflects that position depends on the interpretation of its ambiguous language concerning fitness of the goods for the purposes "for which goods of the same description would ordinarily be used." In light of our objective of making commercial law consistent with the expectations of commercial parties, the best interpretation of that language falls under the rule of merchantability, defined as the ability to resell the goods in the same market in which the original transaction occurred to a buyer who is aware of the characteristics complained of at a price that is substantially similar to the contract price. That definition would satisfy the objective of commercial law because prices will tend to incorporate information about the good with respect to which the seller has superior knowledge, and that information should serve as the basis for any warranty. The fact that a buyer would be willing to pay the market price for the good, even though it knew of the characteristics complained of indicates that the complaining party has idiosyncratic tastes that sellers are poorly positioned to anticipate when pricing defect risks.

52 See *Andrew F. Daughety / Jennifer F. Reingnum*, Competition and Confidentiality: Signaling Quality in a Duopoly When There is Universal Private Information, 58 Games and Economic Behavior (2007) 94, 114.

With respect to "defects" that are the source of idiosyncratic complaints, there is less of an argument for extending a warranty. Nevertheless, because high prices could result from market structure or other characteristics, the capacity to resell the goods under the conditions that we have stipulated should perhaps be treated only as a presumption that the goods are fit for the purposes for which they would ordinarily be used.