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**“It hurts my head to think about it” - SMEs and the Legal  
Framework for International Commercial Contracts**

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**LAWS525 INTERNATIONAL COMMERCIAL CONTRACTS**



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### ***Abstract***

*The exercise of party autonomy through careful contractual drafting allows parties contracting across borders to stipulate the applicable law and dispute resolution process most appropriate to the transaction at hand. This paper reflects on empirical and legal research to consider the perceptions and experiences of small businesses in New Zealand in relation to the legal framework for international commercial contracts. The inclusion of choice of law and dispute resolution provisions can greatly increase certainty in relation to the applicable legal framework. However, the introduction of more suitable default positions for international transactions is warranted to more adequately meet the needs of New Zealand’s SMEs and provide more meaningful access to justice.*

### ***Word length***

*The text of this paper (excluding abstract, table of contents, footnotes and bibliography) comprises approximately 20,300 words.*

*(Participant quotes are included in word count and comprise approximately 1,800 words.)*

### ***Subjects and Topics***

International Commercial law

SMEs/small business

Party Autonomy

Choice of law

Choice of forum

International Arbitration

Bilateral Arbitration Treaty (BAT)

### ***Definitions***

The Ministry of Business, Innovation and Employment (MBIE) divides businesses into the following categories based on number of employees.<sup>1</sup> These definitions have been adopted for the purpose of this paper.

- Small-sized businesses
  - Zero: no employees
  - Micro: between one and five employees

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<sup>1</sup> Ministry of Business, Innovation and Employment *The Small Business Sector Report* (2014) at 10.

- Small: between six and 19 employees
- Medium-sized businesses
  - Small to medium: between 20 and 49 employees
  - Medium: between 50 and 99 employees

# 1. Chapter One: Introduction

## *I Introduction*

### *A The Importance of small business*

International trade is by no means a new phenomenon in New Zealand. However, the accelerated globalisation since the 1980s has transformed the nature of international trade from being the exclusive territory of large and well-resourced players, to inescapable for businesses of all size. The focus of this paper is the legal framework applicable to international commercial contracts for small-medium enterprises (SMEs) in New Zealand with a particular focus on small businesses.<sup>2</sup>

There is a growing consensus globally that SMEs provide stability to the economy and that the success of SMEs can have a positive ‘ripple effect’ on GDP growth and jobs.<sup>3</sup> In New Zealand there are more than 450,000 small businesses, making up over 97% of enterprises in New Zealand.<sup>4</sup> Remarkably, only 20% of New Zealand’s small businesses have generated overseas income.<sup>5</sup>

At both a regional and an international level, the untapped potential of SMEs in the global economy has been recognised as problematic and in need of address.<sup>6</sup> Aside from SMEs who do not export at all, there is also concern for those SMEs with only limited international links, for example those who export only to a single country, or a small group of international countries.<sup>7</sup> While SMEs constitute 60% of the global workforce, they are hugely underrepresented in the global economy.<sup>8</sup>

### *B Empirical research*

There is very little academic writing available that focuses on international commercial contracts for small businesses, and even less with a New Zealand focus.<sup>9</sup> The objective of

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<sup>2</sup> Academic and other empirical research often considers SMEs generally rather than small businesses specifically. However, the majority of the participants in this project were from small businesses.

<sup>3</sup> Ussal Sabbaz “World SME Forum for SME Advancement Globally” (Brochure produced by Union of Chambers and Commodity Exchanges of Turkey (TOBB), 2015).

<sup>4</sup> Ministry of Business, Innovation and Employment, above n 1, at 8.

<sup>5</sup> At 46.

<sup>6</sup> World SME Forum “WSF Mission” (2015) World SME Forum <<http://worldsmeforum.org/about/>>; Ben Shepherd, Olivier Cattaneo and Charles Tsai *Regulatory Reform: Case Studies on Improving the Business Environment for Small and Medium Enterprises (SMEs)* (APEC#215-SE-01.20 2015).

<sup>7</sup> Shepherd, Cattaneo and Tsai, above n 6, at 7.

<sup>8</sup> World SME Forum, above n 6.

<sup>9</sup> An exception to this is Petra Butler and Campbell Herbett “Access to Justice vs Access to Justice for Small and Medium-sized Enterprises: The Case for a Bilateral Arbitration Treaty” (2014) 26 *New Zealand Universities Law Review* 186.

this project is to consider the current legal framework for international commercial contracts and how this framework is serving small businesses.

Ten businesses from diverse sectors were interviewed for this project; eight of the businesses were small businesses with less than ten employees. The remaining two were slightly larger, but still with less than 100 employees.<sup>10</sup> The questions asked in the course of the interviews are contained in Annex 1 to this paper.

In the interests of confidentiality, the identity of the businesses is not revealed in this paper. A brief description of the businesses has been given in Annex 2. One of the most striking features of the interviews was uniqueness of each business, their international practices, and their perception and experiences of international trade as an internationally active small business in New Zealand.

The interviews were conducted in a conversational style and the questions asked in each interview were not identical. This approach was taken to ensure that the participants were given an opportunity to provide anecdotal information and share their personal perceptions of international commercial transactions.

The interviews have informed the discussions within this paper and contribute to a practical consideration of the legal realities of international trade for small businesses in New Zealand.

### *C The Focus of this Project*

Inspiration for this paper came from the owner of a small business who reported:

We operate on the assumption that if an international contract is not performed, we will not be able to enforce performance.<sup>11</sup>

When asked about perceived risks of international transactions, another participant in the project said:

The obvious one is that if we have a disagreement we have basically no legal standing, I am sure we do but I don't even know what it is and it hurts my head to think about it.<sup>12</sup>

The statements, reflecting a perceived lack of legal recourse, are startling for a lawyer or legal scholar and raise questions as to whether the current framework of international commercial law is adequately serving the needs of New Zealand's small businesses.

The thesis of this paper is that without the inclusion of a number of crucial clauses in international commercial contracts, small businesses are left with default legal positions, which lack clarity and are difficult, if not practically impossible to enforce.

Effective contractual drafting by small businesses can significantly increase certainty

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<sup>10</sup> The sample size of 10 businesses is not large enough to yield representative results.

<sup>11</sup> Interview with Business B (Hanneke van Oeveren, Skype, 21 November 2015).

<sup>12</sup> Interview with Business C (Hanneke van Oeveren, 14 December 2015).

and effective access to justice for international commercial transactions. However, the introduction of more meaningful default positions for international transactions is warranted to meet the needs of New Zealand’s SMEs and provide meaningful access to justice.

#### *D Structure of this Paper*

Following this chapter, the remainder of this paper is divided into five chapters.

The second chapter sets the scene for the issues considered in this paper, including the role of both party autonomy and default legal mechanisms in determining the applicable legal framework for international commercial contracts.

The third chapter is concerned with how small businesses approach international transactions and why they may prefer less formal methods of concluding transactions which in many cases does not involve stipulations as to applicable law and dispute resolution.

The fourth chapter considers the unacceptable lack of clarity that arises where the parties have not stipulated the applicable law to the contract.

Chapter five uses a legal case study involving a New Zealand SME to illustrate the difficulties that plague international litigation as the default dispute resolution mechanism. The case study, based on information obtained from two court judgments, illustrates the importance of including a contractually binding choice of forum and choice of law provision in international commercial transactions.

The final substantive chapter briefly considers the advantages and disadvantages of international arbitration as an alternative means of dispute resolution for small businesses. Based on the empirical research undertaken, international arbitration is not currently a preferred dispute resolution mechanism for small businesses in New Zealand. Gary Born’s proposal for a Bilateral Arbitration Treaty provides an opportunity to significantly bridge the gap between small businesses and effective access for justice for small businesses.

The importance of small businesses to New Zealand’s economy justifies state intervention to improve the default legal position for international commercial transactions. Increased certainty and effective access to justice for businesses engaged in international commercial transactions would have far reaching benefits, not only for the businesses themselves, but also for the wider economy.



## 2. Chapter two: Small Businesses and the International Legal Framework

### *I The importance of International Trade to Small Businesses*

Business-to-business transactions and specifically the export of goods to be used by other companies are the most common type of international transaction for small businesses in New Zealand.<sup>13</sup> New Zealand’s small population and correspondingly small market, limit the potential for businesses to grow domestically. At the same time, increased foreign access to the New Zealand market means additional competition for New Zealand businesses.<sup>14</sup> The effects of the increased competition as a result of globalisation, particularly from countries with lower labour costs, has been felt strongly in the manufacturing industry, particularly low-tech manufacturing.<sup>15</sup> Small businesses, like all businesses are unable to shelter themselves from the effects of globalisation.

Access to international markets can also encourage innovation and increased productivity to satisfy diverse markets. Many small businesses are producing products, for which there is not any, or only a very limited market domestically. The special demands and opportunities in overseas markets were mentioned by several of the participants in this project.

We prefer [overseas customers]. Our perception is that there’s more money overseas. New Zealand companies tend to be tight, [they] tend to be more wary of us... We’re more internationally known than we are in New Zealand... International customers tend to be corporates... we deal with some of the biggest companies in the world.<sup>16</sup>

Other participants emphasised the value of the New Zealand brand:

People do appreciate the New Zealand brand, particularly in China, I mean they’ll buy anything from New Zealand.<sup>17</sup>

The Chinese don’t trust their own [food] stuff, they really do want stuff from overseas. They will make sure that what they are buying is not made in China.<sup>18</sup>

Similarly, for some small businesses it is not possible to source all supplies domestically leaving no choice but to look to international markets. One participant working in the jewellery industry commented that;

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<sup>13</sup> Ministry of Business, Innovation and Employment, above n 1, at 8.

<sup>14</sup> Nelly Daszkiewicz and Krzysztof Wach *Internationalization of SMEs: context, models and implementation* (Gdansk University of Technology Publishers, Gdansk, 2012) at 14.

<sup>15</sup> Ministry of Business, Innovation and Employment, above n 1, at 75.

<sup>16</sup> Interview with Business E (Hanneke van Oeveren, 6 January 2016).

<sup>17</sup> Interview with Business D (Hanneke van Oeveren, 6 January 2016).

<sup>18</sup> Interview with Business F (Hanneke van Oeveren, 2 January 2016).

...New Zealand has less and less manufacturing, it has meant that the wholesalers have closed down... So as they drop off the perch, its giving manufacturers like us in New Zealand a lot less suppliers on the ground. So we are now having to do a lot more, and spend a lot more time...<sup>19</sup>

International trade is already, or is becoming, inescapable for many small businesses in New Zealand. The legal questions that traditionally concerned only the “big players”, are becoming increasingly relevant to a great number of transactions entered into by businesses of all sizes and across a range of sectors.

## *II Why are international transactions different?*

### *A Legal Framework*

The most fundamental legal difference between a domestic and international transaction is that in the context of a purely domestic contract there is applicable legal framework is clear.<sup>20</sup> Where two parties located in New Zealand enter into a commercial agreement, in the absence of extraordinary circumstances,<sup>21</sup> the New Zealand courts will have exclusive jurisdiction to hear the dispute and the applicable law to govern the contract will be the laws of New Zealand. Perhaps most importantly any resulting judgment will be readily enforceable against the other party.

For international commercial transactions the position is different. Despite the prevalence of international trade, there is no uniform international framework for international transactions. Equally there is no transnational judiciary armed with the jurisdiction to hear international disputes between commercial parties.

Importantly, the difference from the domestic context is *not* that there is no legal framework for international transactions. However, the legal framework at international law is, in many cases, much less readily apparent and there is a real possibility that the contracting parties will be operating under different assumptions of the applicable legal framework and its implications.

Parties to an international transaction may understandably harbour doubts as to which country’s law applies to their agreement, which court is able to resolve a dispute in relation to the transaction and whether any resulting judgment would be enforceable against the other party.

Establishing certainty and effective access to justice for international commercial

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<sup>19</sup> Interview with Business A (Hanneke van Oeveren, 25 November 2015).

<sup>20</sup> Fabio Bortolotti *Drafting and Negotiating International Commercial Contracts: A Practical Guide* (International Chamber of Commerce, Paris, France, 2013) at 12.

<sup>21</sup> Extraordinarily, the parties to a domestic transaction may wish to choose a foreign law to regulate their transaction, the effectiveness of such a clause is beyond the scope of this paper.

transactions is critically reliant on the exercise of party autonomy.

### *III Party Autonomy versus Defaults*

Party autonomy is at the heart of contract law in most domestic systems.<sup>22</sup> The principle of party autonomy means that contracting parties have the freedom, within the bounds of law, to decide on the terms to which they agree to be bound and the rights of the respective parties under the contract.<sup>23</sup> In the context of international commercial transactions, the contracting parties' autonomy is broader and extends to the ability to choose the substantive law applicable to their contract, the court which will have jurisdiction to hear any dispute arising under the contract, or as an alternative to the courts, another dispute resolution mechanism such as arbitration. Armed with adequate knowledge and legal advice, party autonomy allows sophisticated parties operating across borders to negotiate the legal framework and enforcement mechanisms most suited for the particular transaction at hand.<sup>24</sup>

The law generally provides for default positions, which apply where the parties have not made a choice in relation to a particular issue. Default positions do not threaten party autonomy because the parties are free to contract out of the default position. Default positions can be considered a top-down approach because they require intervention from the state, rather than being reliant on the active choice of the contracting parties. In the context of cross-border transactions, where the interests of various sovereign states are at stake, the ability to implement defaults in a top-down manner is more problematic. An individual state cannot unilaterally introduce effective defaults to apply to international commercial contracts.<sup>25</sup> As a far-fetched example, if the New Zealand parliament were to pass a law that all international contracts involving small businesses were subject to New Zealand law, this could not prevent a foreign court from determining a foreign law to be applicable to the contract. The result is that default positions that apply in relation to choice of law and dispute resolution are diverse, complex and often unsuitable for the transactions entered into by small businesses. In Chapter Four, the United Nations Convention on Contracts for the International Sale of Goods (CISG)<sup>26</sup> will be discussed as an example of a suitable default set of rules applicable to contracts for the international

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<sup>22</sup> There are some exceptions, for example in relation to Brazil see Dana Stringer “Choice of Law and Choice of Forum in Brazilian International Commercial Contracts: Party Autonomy, International Jurisdiction, and the Emerging Third Way” (2006) 44 *Columbia Journal of Transnational Law* 959.

<sup>23</sup> Peter Edward Nygh *Autonomy in International Contracts* (Clarendon Press, 1999) at 1.

<sup>24</sup> Bortolotti, above n 20, at 4.

<sup>25</sup> Nygh, above n 23, at 2.

<sup>26</sup> United Nations Convention on Contracts for the International Sale of Goods (CISG) 1489 UNTS 3 (opened for signature September 1980, entered into force 1986).

sale of goods.

The availability or lack of appropriate default positions has direct consequences for how contracting parties ought to exercise their party autonomy.<sup>27</sup> For example, it has been observed that the Common Law tradition has commonly given rise to the drafting of more exhaustive contractual documents than the Civil Law tradition.<sup>28</sup> One academic paper presents a strong case that the stronger legal framework available in Germany, made up of both mandatory and default rules, means that German contract drafters are able to “stop sooner” in their contractual drafting than their US counterparts.<sup>29</sup>

Appropriate default positions reduce the burden on contracting parties to expressly contract on the matters covered by the defaults. Transaction costs are correspondingly reduced when parties can rely on adequate default positions.<sup>30</sup> Equally, default positions can provide a “safety net” for parties who have not had the opportunity, time or resources to consider the matter covered by the default. The absence of suitable default positions in relation to choice of law and dispute resolution means that in an international context, contracting parties are not well advised to “stop sooner” than making stipulations as to choice of law and dispute resolution. For small businesses that may have less international trading experience, legal resources and a more limited understanding of the legal issues at play, reliance on party autonomy in international trade can result in a lack of effective legal recourse.

#### *IV Lack of Legal Clarity as a Barrier to Trade*

Research conducted by the Ministry of Business, Innovation and Employment (MBIE) found that the most common barrier to expanding overseas for small businesses was inexperience of operating in international market.<sup>31</sup> Unfamiliarity can encompass a wide range of factors including language, culture, domestic regulatory requirements and the structure of foreign markets. Relevant to this project is unfamiliarity with the legal framework for international transactions and the methods of drafting international commercial agreements to best meet the needs of legal certainty and effective access to justice. The following passage from the ICC’s book on drafting international commercial contracts recognises the situation:

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<sup>27</sup> Claire A Hill and Christopher King “How do German Contracts Do as Much with Fewer Words” (2004) 79 *Chicago Kent Law Review* 889 at 892.

<sup>28</sup> Giuditta Cordero-Moss *International Commercial Contracts: Applicable Sources and Enforceability* (Cambridge University Press, Cambridge, United Kingdom, 2014).

<sup>29</sup> Hill and King, above n 27, at 916.

<sup>30</sup> At 916.

<sup>31</sup> Ministry of Business, Innovation and Employment, above n 1, at 8.

One of the main difficulties for those who deal with international contracts, without having specific legal expertise in this field, is the lack of information about the rules and principles that govern cross-border contracts. Without knowledge of a number of basic principles of international trade law, *it is very difficult to understand what is going on when certain legal issues are raised and consequently, to decide which actions should be taken.*<sup>32</sup>

### ***A Is the lack of clarity a barrier to trade?***

In the New Zealand context there has been very little focus on the lack of clarity in relation to the legal framework and access to justice as a barrier to international trade for small businesses.<sup>33</sup> At this point a distinction must be drawn between the fact that there are difficulties of applicable framework and dispute resolution, and the question whether of this reality actually inhibits international trade for small businesses on the other.

#### *1 Academic Discussion*

It is repeatedly recognised in academic writing that the current state of international commercial law is not optimal for meeting the needs of businesses trading across borders.<sup>34</sup> In particular, the conflict of laws rules and the applicability of domestic rules to international contracts have been regarded as a hindrance to globalisation.<sup>35</sup>

The transaction costs involved in the application of domestic laws to transnational commercial transaction have always been regarded as hampering development towards globalised markets. The application of foreign law is regarded as the “globalisation trap”, the division of the world into different legal systems can be regarded as a *non-tariff trade barrier*.<sup>36</sup>

Many of these criticisms are raised in favour of a doctrine of transnational law or the new *lex mercatoria*.<sup>37</sup> For these purposes, the relevance of the new *lex mercatoria* movement is its recognition that the applicability of domestic laws coupled with the rules

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<sup>32</sup> Bortolotti, above n 20, at 11. (Emphasis added).

<sup>33</sup> An exception to this is Butler and Herbett, above n 9. SMEs and the lack of legal certainty and access to justice have been considered by writers in other jurisdictions. For example: in relation to the (Draft) Common European Sales Law: Ellen Ostrow “For The Purposes of this Regulation: Denying Protection to the small business through the Application of the CESL” (2013) 29 American University International Law Review 255.

<sup>34</sup> Ingeborg H Schwenzer “Who Needs a Uniform Contract law, and Why?” (2014) 17 NZACL 10; Bortolotti, above n 20, at 14; Filip De Ly *International business law and lex mercatoria* (North-Holland ; The Hague, Amsterdam ; New York, 1992) at 57.

<sup>35</sup> Klaus Peter Berger *Transnational Commercial Law in the Age of Globalization* (Centro di studi e ricerche di diritto comparato e straniero, 2001) at 3. (emphasis added)

<sup>36</sup> At 3.

<sup>37</sup> Filip De Ly, above n 34, at 58.

of private international law as a barrier to trade.

The responsibility that is placed on contracting parties to improve certainty and predictability of the legal framework has also been described as not offering an adequate environment for international contracts.<sup>38</sup> This paper will seek to show that this is particularly true for smaller businesses in New Zealand.

## 2 *SMEs in the European Union*

As already mentioned, there is very little information available that specifically addresses the lack of clearly applicable legal framework as a barrier to trade for New Zealand SMES. However, legal uncertainty has been recognised as problematic for SMEs in the European Union (EU). In 2011 more than 6000 SME managers across EU member states were surveyed at the request of the European Commission.<sup>39</sup> Contract-related barriers to cross-border trade were ranked highly among the barriers to cross-border trade. In particular, 35% of participants reported that the difficulty of a foreign contract law applying to their transaction was a barrier to trading across borders.<sup>40</sup>

The survey results were used as support for a proposal of a Common European Sales Law (CESL).<sup>41</sup> The CESL was to operate as a self-standing uniform contract law that parties could choose to apply to their cross-border transactions within the European Union.<sup>42</sup> The proposal emphasises that SMEs and consumers are most hindered by variances in domestic contract laws in cross-border transactions. One commentator said:

...the situation of the ‘small’ trader, the farmer, the fisherman, the shopkeeper, the artisan etc. is mostly the same as the consumer; he may have the same difficulties in understanding the terms of the stipulator’s general conditions and he is as weak as she is when it comes to negotiating terms.<sup>43</sup>

Where both parties were businesses, the CESL could only apply if at least one was an

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<sup>38</sup> Bortolotti, above n 20, at 14.

<sup>39</sup> Gallup Organization, Hungary *Flash Eurobarometer No320: European Contract law in business-to-business transactions: Analytical report* (2011) at 4. The European classification of businesses is different. 79% of the businesses interviewed were micro-businesses (less than 9 employees), 16% were small (10-49 employees) the remaining 5% were from medium sized businesses with more than 50 employees.

<sup>40</sup> At 6.

<sup>41</sup> European Commission *Proposal for a Regulation of the European Parliament and of the Council on a Common European Sales Law* (2011/0284 (COD) 2011) at 2.

<sup>42</sup> At 4.

<sup>43</sup> Ole Lando “CISG and CESL, Simplicity, fairness and Social Justice” in Louise Gullifer and Stefan Vogenauer (eds) *English and European Perspectives on Contract and Commercial Law: Essays in Honour of Hugh Beale* (Bloomsbury Publishing, 2014) 237 at 244.

SME.<sup>44</sup> The CESL proposal reflected a strong proposition that in the European context, the current position for determining the law applicable to international transactions is a barrier to trade that most drastically affects SMEs.

Notably, the CESL would not have been default mechanism; it would have remained necessary to determine the national law applicable to the transaction either by reference to the parties’ choice or the default rules of private international law. The opt-in nature of the CESL was among the academic criticisms to the CESL.<sup>45</sup> The proposal has since been shelved while the focus is shifted to the regulation of e-commerce.<sup>46</sup>

### 3 *Are New Zealand SMEs different?*

The European research is compelling evidence that the lack of clearly applicable legal framework is of concern to SMEs,<sup>47</sup> but are New Zealand SMEs different?

Larger enterprises with greater resources are often assumed to have less significant barriers to successfully engaging in international trade than SMEs. However, this assumption is increasingly rejected in New Zealand literature.<sup>48</sup> The flexibility and adaptability of small businesses can also enable them to overcome or side-step barriers to internationalisation.

A “bricolage approach” has been used to describe the ability of SMEs in New Zealand to overcome barriers to international trade.<sup>49</sup> ‘Bricolage’ is a French word which describes “‘tinkering’, ‘making do’, or even ‘DIY’”.<sup>50</sup> One New Zealand study considered the barriers to internationalisation for small businesses and how these were

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<sup>44</sup> (Draft) Common European Sales Law (European Union), art 7. Article 7 defines an SME as an enterprise with fewer than 250 employees and a turnover of less than EUR 50 million.

<sup>45</sup> Hüseyin Can Aksoy “Status Quo Bias, CISG and the Future of the Common European Sales Law” (2013) *European Business Law Review* 461.

<sup>46</sup> Eric Clive “Proposal for a Common European Sales Law withdrawn - European Private Law News” <<http://www.epln.law.ed.ac.uk/2015/01/07/proposal-for-a-common-european-sales-law-withdrawn/>>.

<sup>47</sup> Gary Born “Draft Commentary on Model Bilateral Arbitration Treaty” (13 March 2015) *Kluwer Arbitration Blog* <<http://kluwerarbitrationblog.com/2015/03/13/model-bilateral-arbitration-treaty-released-for-public-comment/>> at 2.

<sup>48</sup> Sabina Jaeger and Romuald EJ Rudzki “Understanding the Processes of International Trade at the Individual level: An Alternative Methodology for Conducting Research into Exporters” (paper presented to Oxford Business & Economics Conference, St Hugh’s College, Oxford University, Oxford, United Kingdom, 22-24 June 2008) at 2; Auckland Chamber of Commerce “International Trade” in *New Zealand Export and Trade Handbook 2015* (Adrenalin Publishing, Auckland, New Zealand, 2015) 10 at 12.

<sup>49</sup> Sabina Jaeger “How SMEs engage in the global economy - cases from New Zealand” (paper presented to Oxford Business & Economic Conference, Oxford, June 24-26 2007) at 7; Dietmar Sternad, Sabina Jaeger and Christina Staubmann “Dynamic Capabilities of resource-poor exporters: A study of SMEs in New Zealand” (2013) 20 *Small Enterprise Research: The Journal of SEAANZ* 2 at 13

<sup>50</sup> Ian Buchanan *A Dictionary of Critical Theory* (1st ed. ed, Oxford University Press, Oxford, 2010).

overcome in practice.<sup>51</sup>

Reflecting on the observed practices, small firms seem to use any path or means on hand to construct their own paths to internationalisation.<sup>52</sup>

The idea is that SMEs are innovative and can make the most of the tools they already have, or develop their own tools to grapple with the challenges of international trade.<sup>53</sup>

Many small businesses, including the majority of those interviewed for this project, have been highly successful in their international endeavours, with little concern about questions of applicable law or dispute resolution. Where current conditions and practices appear to be meeting commercial needs, the sentiment can arise among the businessmen themselves that, “if it aint broke, why fix it?”

#### 4 *Avoiding the need for legal recourse*

Consistently with the bricolage approach small businesses find alternative ways of minimise the risk they take on in entering into an international transaction, which reduce the perceived importance of legal recourse. One of the most obvious, and frequently recommended, methods to minimise risk for a seller of goods or services is to require full payment before delivery or provision of the services.<sup>54</sup> Directly on point, when asked the perceived risks of international trade, one participant said:

Well *obviously you mitigate it*, you approach it differently, but the risk would be that it is much harder, or at least I perceive it to be much harder to enforce any payment. We just don't go there, it is sort of accepted in international transactions that there is a lot more cash on delivery, pay before it leaves.<sup>55</sup>

This view was echoed by another participant who said:

...our credit terms are payment before delivery, so we would never ship without the payment being complete or at the very least a letter of credit. So, no I would not say they are more risky but maybe that is just because we have mitigated against the risks.<sup>56</sup>

Both participants considered the risk of international transactions, at least to a significant extent, to be mitigated by requiring full payment before delivery. There is no doubt that advance payment reduces risk for the seller, however, advance payment cannot be a replacement for legal certainty and effective access to justice.

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<sup>51</sup> Jaeger, above n 49.

<sup>52</sup> At 10.

<sup>53</sup> At 7.

<sup>54</sup> US Department of Commerce International Trade Administration *Trade Finance Guide: A Quick Reference for US Exporters* at 4.

<sup>55</sup> Business B, above n 11.

<sup>56</sup> Interview with Business H (Hanneke van Oeveren, 19 January 2016).



Payment terms reflect a balancing exercise between risk and competitiveness.<sup>57</sup> Requiring payment in full puts the seller in a secure position; they have the money before the goods leave their possession. On the other hand, the method of payment is much less desirable for the buyer who faces the risk of the goods never being shipped, the risk that the goods are non-conforming and the risk that there may be something wrong with the documentation.<sup>58</sup> Consequently, requiring advance payment is unlikely to give the seller a competitive advantage.<sup>59</sup> Requiring payment up front may be considered indicative of cash flow problems or a lack of access to trade finance services.<sup>60</sup>

Requiring advance payment is more likely to be possible where the seller has a unique or highly specialised product or service or where the goods or services are in high demand.<sup>61</sup>

We have a unique product and we partner with people that see the value to their business. We say we don't offer them a machine, we offer them a way to make a margin and it is a win thing for them... the fact that we own the machine has big benefits, cash flow is good, we get the money and it takes the risk out. In the event that things go bad because of something they do wrong and if a dealer decides to take the machine back... in the case that it would go sour we would walk away, there is no need for a legal remedy.<sup>62</sup>

Where SMEs have a more generic product or are operating in a more competitive market, they may not have sufficient bargaining power to demand advance payment.<sup>63</sup> While advance payment is one means to greatly reduce the risk of the transaction for the buyer in a contract for the sale of goods or services, it is not an example of a panacea meaning that the applicable law and access to dispute resolution are no longer important considerations. Aside from contracts where advance payment is not possible, for example the long-term provision of services, advance payment does not prevent the risk of legal action being taken against the seller, for example for non-conformity of the goods.

Building export markets is one of the six pillars of the New Zealand government's Business Growth Agenda (BGA) released in 2015,<sup>64</sup> and the New Zealand government has an optimistic target to increase the ratio exports to GDP to 40% by 2025, up from the

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<sup>57</sup> US Department of Commerce International Trade Administration, above n 54, at 3.

<sup>58</sup> HSBC “Finance” in *New Zealand Export and Trade Handbook 2015* (Adrenalin Publishing, Auckland, New Zealand, 2015) 60 at 63.

<sup>59</sup> US Department of Commerce International Trade Administration, above n 54 at 4.

<sup>60</sup> Cameron Gordon “Import Mangement” in *New Zealand Export and Trade Handbook 2015* (Adrenalin Publishing, Auckland New Zealand, 2015) 26 at 28.

<sup>61</sup> US Department of Commerce International Trade Administration, above n 54, at 6.

<sup>62</sup> Business H, above n 56.

<sup>63</sup> US Department of Commerce International Trade Administration, above n 54, at 6.

<sup>64</sup> Ministry of Business, Innovation and Employment *Business Growth Agenda - Towards 2025* (2015).

current 30%.<sup>65</sup> The importance of supporting small businesses has been recognised as a crucial part in achieving this ambitious target.<sup>66</sup> The ability of small businesses to “work with what they’ve got” and sidestep problems caused by the lack of clearly applicable legal framework does not mean that the need to sidestep these problems is not a hindrance to international trade. Given the importance that has been attached to promoting and protecting the interests of SMEs, both within New Zealand and globally, the goal ought to be to create the best possible environment and remove unnecessary obstacles for SMEs operating across borders.

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<sup>65</sup> At 6.

<sup>66</sup> Ministry of Business, Innovation and Employment, above n 1, at 1.

### 3. Chapter three: How Small Businesses “make” international commercial Contracts

#### *I “Making” International Commercial Contracts*

The word “making” contracts has been used deliberately in the heading to this section. The use of the more usual word “drafting” is a problematic starting point for some small businesses in New Zealand. The word “drafting” provokes an image of the parties creating and signing a formal looking document that contains individually negotiated and carefully worded contractual clauses to reflect the terms of their agreement.

For some small businesses drafting comprehensive contractual documents with their contractual counterparts is a familiar and well-established practice. However, even within the small pool of small businesses interviewed for this project there was a significant variance in how international transactions were concluded and what, if any, documents passed between the parties.

One participant said;

Lots of people don’t have contracts, forget contracts, I mean it’s a joke, it is silly, you don’t have contracts at our level.<sup>67</sup>

Not all participants were equally dismissive of contractual documents, another participant said;

We haven’t got trade agreements in place, which is another thing I am working on... at the moment there is no contract. It actually makes me cringe to have to say that, but it’s something that we’re working on.<sup>68</sup>

A third participant said:

No we don’t. We have done it [drafting contracts] in a previous business I was involved in and we did at various times discuss contractual agreements with suppliers, but... they become super complex and you spend all your times crossing the “t”s and dotting the “i”s and we take the view that it is going to be mutually beneficial to both parties, and if it is not working out we part ways. We work on a gentleman’s agreement with our dealers.<sup>69</sup>

The variance in how transactions are concluded is partly explicable on the diversity of the types of transactions in which the businesses were involved. For example, drafted documents were more frequently considered necessary in situations where there was a concern for the protection of intellectual property or trademarks, for example for

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<sup>67</sup> Business F, above n 18.

<sup>68</sup> Interview with Business G (Hanneke van Oeveren, 11 January 2016).

<sup>69</sup> Business H, above n 56.

businesses working in the software industry.

In the context of international commercial contracts, the reliance on party autonomy for achieving certainty as to the applicable legal framework means that the methods by which small businesses conclude their contracts is of fundamental importance.

### ***A “Piecemeal” contracting***

The first fundamental point to make is that the absence of a contractually drafted document does not mean that there is no *contract*. However, the legal definition of a contract as “a promise that is a legally enforceable agreement between two or more parties,”<sup>70</sup> rather than a physical document, is not one frequently employed by laypeople.

It is a common misconception of laypeople that oral statements cannot be contractually binding.<sup>71</sup> As a general rule, contract law operates on the basis of substance over form, for example at New Zealand law, section 5 of the Sale of Goods Act 1908 provides that:

a contract of sale may be made in writing (either with or without seal), or by word of mouth, or partly in writing and partly by word of mouth, or may be implied from the conduct of the parties...<sup>72</sup>

The author adopts ‘piecemeal contracting’ as a loose term to describe the common practice of concluding agreements through the exchange of documents such as quotes, invoices, trading terms and receipts, in a combination of oral and electronic communications. Fundamentally, the terms of the contract are agreed upon piece by piece rather than recorded in a single negotiated document. In some circumstances a contract may be concluded in person or through a phone call with no documents passing between the parties at all.<sup>73</sup> In other cases, one or both of the parties may send or refer to their standard form terms of trade during the negotiations.

The important feature of piecemeal contracting in this context is that there is no attempt to include all the rights and obligations of the contracting parties into one document, tailored to the particular transaction. In many cases, the parties agree only on the minimum terms necessary for performance.

The following case studies, adapted from the interviews conducted for this project,

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<sup>70</sup> “Parts Of A Legal Contract” The Law Dictionary: Featuring Black’s Law Dictionary Free Online Legal Dictionary 2nd Ed <<http://thelawdictionary.org/article/parts-of-a-legal-contract/>>.

<sup>71</sup> Patricia Moore “You and Your Lawyer” NZBusiness: *The owner manager’s magazine* (October 2010).

<sup>72</sup> Sale of Goods Act 1908 (NZ), s 5.

<sup>73</sup> For example, see *Smallmon v Transport Sales Ltd* [2011] NZCA 340, [2012] 2 NZLR 109. The Smallmons purchased several trucks via a New Zealand SME, Transport Sales Ltd as a sales agent. The sale of the trucks was concluded through oral negotiations. A dispute arose after the trucks could not be registered in Queensland, the case is discussed further in Chapter Four of this paper.

illustrate the difference between piecemeal contracting and the use of a formal contractual document in this regard.

### *1 Case Study 1: An Example of Piecemeal Contracting*

One representative described a routine transaction for the export of a manufactured machine for the woodworking industry as follows.<sup>74</sup> The initial contact is through emails and phone calls, these discussions include negotiations as to the specifications of the machine, the price and the time of delivery. Once the buyer had indicated their desire to proceed with the transaction, a proposal is sent which includes the price, specifications the time and mode of delivery and a retention of title (Romalpa) clause. The proposal also provides for a 20% deposit to be paid up front. The foreign business then submits an order form in its own format. Once the business receives the 20% they begin performance, that is, assembling the machine. In most cases the full price then falls due before the machine is shipped. None of the documents passed between the parties contain choice of law or dispute resolution clauses. Furthermore, the participant does not require the signature of the overseas company on any of their documents.

### *2 Case Study 2: Piecemeal Contracting*

Another participant<sup>75</sup> described a recent transaction for the wholesale of a New Zealand made food product with a new customer. The Asia-based customer came to New Zealand to see meet Business G. The customer came to see Business G to introduce the business and the product. After meeting them, Business G quoted prices for the customer to sell the product in Asia with their own labelling. A few months later the first order came through. Business G told the customer that they would have to designate which documents needed for the import of the product into Asia. While the order was being filled by the production team at Business G, Business G also prepared the necessary export documents and sent an invoice to the customer, stipulating full payment before dispatch. None of the documents included a choice of law or dispute resolution clause.

### *3 Case Study 3: A Contractual Document*

By contrast, a third participant<sup>76</sup> reported the use of formal contractual documents. An expert in international trade had been involved in drafting both an End User Licence Agreement (EULA) as well as a purchase order form. The EULA approximately is 10 pages long and covers a broad

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<sup>74</sup> Business B, above n 11.

<sup>75</sup> Business G, above n 68.

<sup>76</sup> Business E, above n 16.

range of issues concerning the protection of the software and intellectual property. Relevantly for this project, the EULA also contains a clause providing New Zealand law to be applicable to the contract and granting the New Zealand courts jurisdiction to resolve disputes. The purchase order form is specific to the particular transaction and provides the specifications of the particular transaction. The purchase order expressly incorporates the EULA.

Negotiations usually take place via email and the Gotomeeting conferencing tool,<sup>77</sup> which allows for screen sharing. This allows the participant to show parts of the documents to the overseas customer. Following the negotiations, the participant modifies the purchase order form to reflect the outcome of the negotiations. The overseas company is then required to initial every page of both of the documents and sign the last page of the purchase order form

### ***B Party autonomy and piecemeal contracting***

Of the three businesses considered in the case studies, only Business E had a practice of using carefully drafted documents to be signed by the other party including a choice of law and dispute resolution clause. Only case study three demonstrates a clearly applicable legal framework.

Whether small businesses could or should draft highly detailed and comprehensive contracts exhaustively addressing all possible future contingencies is a question for another day. However, as will be developed further, choice of law and dispute resolution clauses should be considered essential clauses, even for small businesses. The concern of this paper is the barriers that small businesses may face to maximising upon their party autonomy in relation to choice of law and dispute resolution. The following section why a contractual document signed by both of the parties is important for ensuring certainty as to the applicable legal framework to the contract.

## ***II The Legal Implications of a Drafted Document***

### ***A Legal Certainty***

Traditional contract formation doctrine is concerned with whether there has been an offer and subsequent acceptance of that offer to form a ‘meeting of the minds’. The courts looked for a valid offer from one party, which had subsequently been unconditionally accepted, by the other. More recently at New Zealand law, there has been a trend of considering the conduct of the parties more holistically to determine whether a contractual nexus has been established, this approach has been termed the “global

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<sup>77</sup> Gotomeeting is an online tool that provides various features for conducting online meetings. See <<http://www.gotomeeting.net>>.

approach”.<sup>78</sup> Similarly, the Uniform Commercial Code (UCC), which applies in almost all US states, provides that “a contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties, which recognizes the existence of such a contract.”<sup>79</sup> These legal developments support the “piecemeal approach” by focusing on “agreement” rather than the technicalities of offer and acceptance.

On the other hand, the CISG still focuses on the traditional elements of offer and acceptance. Part II of the CISG codifies rules related to offers and acceptances respectively. For example, Article 19 provides that if a reply to an offer contains additions, limitations, or other modifications that materially alter the terms of the offer, the reply will amount to a counter-offer.<sup>80</sup> If the reply amounts to a counter-offer, it must then be validly accepted by the original offeror.<sup>81</sup>

Regardless of whether a system of law adheres strictly to the requirements of offer and acceptance or not, agreement or *consensus ad idem* is a crucial requirement of contract.

A piecemeal method of contracting may cause difficulties in determining when a contract has come into existence. However, in this context, the much more crucial is the implications for legal certainty as to terms of the contract, in particular in relation to choice of law and dispute resolution. For example, where goods have been shipped, received and paid for, the issue whether or not a contract has come into existence will not arise. However, the effectiveness of applicable law and jurisdiction clauses may be doubtful.

## ***B Signature***

In most jurisdictions a signature is not required for formation of contract,<sup>82</sup> and requiring signatures on documents may not always be feasible.<sup>83</sup> However, a signature plays an important practical and evidentiary role and can reduce the risk of clauses not having

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<sup>78</sup> John Burrows, Jeremy Finn and Stephen Todd *Law of Contract in New Zealand* (Fourth ed, LexisNexis NZ, Wellington, NZ, 2012) at 40.

<sup>79</sup> Uniform Commercial Code, § 2–204 (1) (Amended 2002).

<sup>80</sup> United Nations Convention on Contracts for the International Sale of Goods (CISG) 1489 UNTS 3 (opened for signature September 1980, entered into force 1986), art 19.

<sup>81</sup> For a detailed discussion of Article 19 see Andrea Fejös “Battle of Forms Under the Convention on Contracts for the International Sale of Goods (CISG): A Uniform Solution?” (2007) 11 *Vindobona Journal of International Commercial Law and Arbitration* 113.

<sup>82</sup> Zheng Sophia Tang *Jurisdiction and Arbitration Agreements in International Commercial Law (ebook)* (1 edition ed, Routledge, 2014) at 49.

<sup>83</sup> At 49.

their intended binding effect. The signature is a clear manifestation of acceptance<sup>84</sup> and implies that the signing party has read and understood the terms to which they are to be bound.<sup>85</sup> Should a dispute arise between the parties, a document containing a choice of law and dispute resolution clause that has been signed by both parties will be of great value. This is particularly true in the context of arbitration agreements. Article II of the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958<sup>86</sup> (New York Convention) provides for the formal requirements of an arbitration agreement as “an agreement in writing”. An agreement in writing is either a clause in a contract or arbitration agreement *signed by the parties* or contained in an “exchange of letters or telegrams”.<sup>87</sup> In some cases, courts have interpreted these requirements strictly.<sup>88</sup> A strict interpretation has led to enforcement only being possible if the parties had either signed the contract or agreement containing the arbitration clause or where both parties had exchanged the agreement in letters or telegrams.<sup>89</sup> Although the requirement of an “exchange of letters or telegrams” appears consistent with a piecemeal method of contracting, not all courts have interpreted the requirement in a uniform manner.<sup>90</sup> A thorough analysis of the formal requirements of the New York convention is beyond the scope of this paper. The important point is that a document containing an arbitration clause signed by both of the parties can provide the greatest likelihood that the formal requirements of the New York Convention will be satisfied.

### ***C Battle of the Forms***

One danger of piecemeal contracting is a “battle of the forms”. A “battle of the forms” arises where both parties to an agreement have sent their own, conflicting terms of trade. The question becomes which of the trading terms are contractual and which are not. If each of the parties’ trading terms contains exclusive choice of jurisdiction and choice of law clauses favouring their own country’s law and courts, the clauses cannot both

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<sup>84</sup> Mindy Chen-Wishart author *Contract law* (5th edition.. ed, Oxford University Press, Oxford, 2015) at 64.

<sup>85</sup> William F Fox *International Commercial Agreements A Primer on Drafting, Negotiating and Resolving Disputes* (Fourth ed, Kluwer Law International, Alphen aan den Rijn, 2009) at 195.

<sup>86</sup> The New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958, 330 UNTS 38 (Opened for Signature 10 June 1958, entered into force 7 June 1959).

<sup>87</sup> *United Nations Commission on International Trade Law (UNCITRAL) Working Group II (Arbitration) Settlement of Commercial Disputes Preparation of uniform provisions on written form for arbitration agreements* Forty-fourth session A/CN.9/WG.II/WP.139 (2006) at 6.

<sup>88</sup> At 7.

<sup>89</sup> Ilias author Bantekas *An introduction to international arbitration / Ilias Bantekas* (Cambridge University Press, New York, 2015) at 71–72.

<sup>90</sup> UNCITRAL, above n 87, at 10.



simultaneously be contractually binding on the parties. The issue is particularly acute when terms of trade have simply been referred to, for example in an email.<sup>91</sup>

One academic paper has recognised and discussed the particular difficulties that arise in relation to choice of law and forum clauses where there is a battle of the forms, in particular the preliminary question of which law the court should apply to determine the “battle”<sup>92</sup> Unfortunately, the answer to that question is beyond the scope of this paper.

Courts and academics all over the world have grappled with the conceptual difficulties of battle of forms and different legal systems will resolve this issue differently.<sup>93</sup> Based on the offer and acceptance analysis described above, it may appear that neither set of terms is contractual unless validly and unconditionally accepted by the other party.<sup>94</sup> However, courts will rarely find that no contract has been concluded at all;<sup>95</sup> the more vexing question is what the terms of the contract are. An offer and acceptance approach would favour the “last shot” approach that the first to reply without insisting on their own terms should be bound by the other party’s terms.<sup>96</sup>

An alternative solution utilised in some jurisdictions is the “knock out” rule. The clauses in the two sets of standard terms that have been individually negotiated or that are consistent between the forms will be considered part of the contract, but those that are inconsistent will be excluded and substituted with default positions.<sup>97</sup> For example, Article 2 of the Swiss Code of Obligations directly addresses the issue of the “battle of the forms” with a “knock out” approach.<sup>98</sup> Provided that the parties have agreed on essential terms, a contract will be binding notwithstanding that secondary terms have been reserved.<sup>99</sup> The Court must then determine the secondary terms with “due regard to

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<sup>91</sup> Incorporation of terms of trade by reference was indeed the practice of some businesses interviewed for this project.

<sup>92</sup> Gerhard Dannemann “The ‘Battle of the Forms’ and the Conflict of Laws” in Francis Rose (ed) *Lex Mercatoria: Essays on International Commercial Law in Honour of Francis Reynolds* (Informa Law from Routledge, 2000).

<sup>93</sup> For a more extensive comparative analysis of battle of forms, see Sieg Eiselen and Sebastian K Bergenthal “The battle of forms: a comparative analysis” (2006) 39 *The Comparative and International Law Journal of South Africa* 214.

<sup>94</sup> Burrows, Finn and Todd, above n 78, at 64.

<sup>95</sup> Dannemann, above n 92, at 201.

<sup>96</sup> Burrows, Finn and Todd, above n 78, at 64; see also Mindy Chen-Wishart, above n 84, at 64.

<sup>97</sup> Eiselen and Bergenthal, above n 93, at 216.

<sup>98</sup> Dannemann, above n 92, at 204. Swiss law is often favoured as a choice of law for international commercial contracts *see* Christiana Fountoulakis “The Parties’ Choice of ‘Neutral Law’ in International Sales Contracts” (2005) 7 *European Journal of Law Reform* 303 at 308.

<sup>99</sup> Swiss Code of Obligations 1911 (Switzerland), art 2(1).

the nature of the transaction”.<sup>100</sup> The CISG Advisory Council considers the issue of the battle of forms to “fall squarely within the scope of the CISG” and favours a “knock out approach”.<sup>101</sup> Under New Zealand domestic law it is unclear which approach will be preferred.<sup>102</sup>

Where there are conflicting choice of law and/or choice of forum clauses, the “knock out” approach is problematic as it is likely to result in a court finding that there has been no contractual agreement on these matters.<sup>103</sup> In this way, the parties’ attempt to stipulate the applicable law and/or dispute resolution mechanism will have been fruitless.

In a practical sense, the parties themselves are both likely to be operating under the assumption that it is their own terms that are contractually binding. Consequently, the parties may both try to assert the law stipulated in their terms or attempt to have a dispute resolved in their own courts. Where a battle of the forms arises, the choice of law or choice of forum clause will not serve their purpose of increasing legal certainty and be of very little value.

“Piecemeal contracting” is used as a loose term to describe transactions that are concluded through a series of negotiations and documents without a formal contractual document being produced. Piecemeal contracting can be risky for achieving certainty. Certainty as to the applicable legal framework and dispute resolution mechanisms through the exercise of party autonomy is best achieved through contractual documents signed by both of the parties.

### *III The Small Business Approach to International Commercial Contracts*

The diversity of New Zealand’s small businesses and their owners cannot be overstated. However, it is possible to identify some characteristics common to many small businesses in New Zealand, which are relevant to how some small businesses approach and perceive international commercial transactions.

#### ***A The importance of Relationships***

There was a recurring theme of a mistrust of contractual documents among the participants in this project. Business-minded negotiators in small businesses may have some reluctance to requiring contractual counterparts to sign legalistic-looking documents, perceived as using verbose clauses to contemplate everything that has the potential to go wrong with a particular transaction. As one participant reported:

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<sup>100</sup> Swiss Code of Obligations, art 2(2).

<sup>101</sup> CISG Advisory Council Opinion No. 13 *Inclusion of Standard Terms under the CISG* (Adopted 20 January 2013).

<sup>102</sup> Burrows, Finn and Todd, above n 78, at 65.

<sup>103</sup> Dannemann, above n 92, at 217.

Good relationships are important to me, I am not really interested in doing deals just for the sake of a deal...I would much rather work on relationships than signing documents and working at a level of distrust.<sup>104</sup>

When asked whether he thought customers read the business' terms and conditions another participant said:” No...and I hope that they don't because it can only be damaging for the relationship.”<sup>105</sup> Even for lawyers, contractual language can be highly intimidating and rarely coincides with how people regularly communicate.<sup>106</sup>

One participant said:

For a layman like myself, even reading a legal document is already something, you have a bit of an idea of what it says, but what it really means you don't really know.<sup>107</sup>

Commercially minded persons are commonly more confident in using quotes, invoices and receipts, but more hesitant to draft or sign contractual documents. Choice of law and dispute resolution clauses are frequently perceived as solely relevant to dispute resolution.

Small businesses and their contractual counterparts enter into commercial agreements because there is a mutual advantage to be gained by both parties and presumably both parties wish the agreement to be performed. The ultimate motive for entering into a transaction is, in the vast majority of situations, to make a profit in some way or form.

Where all the negotiations and the minimum paperwork needed for performance are in existence, the added value of a signed contractual document addressing choice of law and dispute resolution may be questioned. The limited practical value of a contractual document is particularly acute in the case of straightforward or repetitive transactions. Where a business regularly orders supplies from a particular supplier or repetitively sells the same or similar products, a document recording the obligations of the parties, beyond what is required for basic performance, may appear superfluous.

Similarly, businesses that have already been successful in their international endeavours without the use of formal drafted documents may even be hesitant to change their practices in a way that may affect well-established relationships with their contractual counterparts. When one participant was asked whether he had consulted a lawyer in relation to his export ventures he said:

...a ten minute discussion with my solicitor, we sent a machine to the UK which I owned. I had known the dealer for a long time and there was mutual trust but once I

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<sup>104</sup> Business D, above n 17.

<sup>105</sup> Business C, above n 12.

<sup>106</sup> William F Fox *International Commercial Agreements* (Third ed, Kluwer Law International, Hague, The Netherlands, 1998) at 142.

<sup>107</sup> Business B, above n 11.

sent the machine it was effectively out of my hands, he had it but I owned it. I had a ten minute discussion with my solicitor but he said it was a complicated thing *so I said we will forget it and go with the handshake.*<sup>108</sup>

### ***B The Multi-tasking Owner/manager***

The most common motivation for starting a business in New Zealand is a lifestyle change.<sup>109</sup> Studies undertaken in New Zealand have observed that many SMEs have only one person responsible for strategic decision-making, including their approach to international negotiations.<sup>110</sup> This was true for the vast majority of the businesses interviewed for this project. It is not uncommon that the owner of a small business, particularly a micro-sized business, will be overseeing the logistics of the business including international negotiations, managing human resources and at the same time also be involved in the day-to-day operations of the businesses.<sup>111</sup> In many cases, this owner or person responsible for international matters will not be formally qualified in business, nor have formal qualifications in international business or international law. The multi-tasking manager/owner has two implications for how international transactions are carried out by small businesses

#### *1 Time is money*

Firstly, the owner is often the lifeblood of the business whose time, energy and vision is a highly valuable asset. The owner/manager must allocate both time and energy to their various tasks and responsibilities.<sup>112</sup> It has been suggested that for SMEs, the time and money that can be dedicated to preventory measures, such as drafting contracts, may be more limited.<sup>113</sup> Time dedicated to contractual drafting is inevitably time that cannot be spent on other tasks or duties.<sup>114</sup> This impacts on the cost/benefit assessment of contractual drafting, the cost is not only the time spent on the contract but also the time *not spent* on other tasks.

On the other hand, the owner/manager of a small business may have more flexibility in their approach to international transactions because they are less bound by company

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<sup>108</sup> Business H, above n 56.

<sup>109</sup> Ministry of Business, Innovation and Employment, above n 1, at 32.

<sup>110</sup> Jaeger, above n 49, at 7; Sternad, Jaeger and Staubmann, above n 48, at 13.

<sup>111</sup> Elio F Martinez Jr “Representing a Small Business” (2009) 26 GPSolo 28 at 29.

<sup>112</sup> At 29.

<sup>113</sup> MT Croes “Explaining the Dealings of Dutch SMEs with Potential Legal Problems: a plea for a theory-driven approach” (2013) 9 International Journal of Law in Context 239 at 247.

<sup>114</sup> Wyatt McDowell and Lyle Sussman “Alternative Dispute Resolution: How Small Businesses Can Avoid the Courts in Resolving Disputes” (2004) 69 SAM Advanced Management Journal 32 at 32.

regulations and policies.<sup>115</sup> Consistently with the bricolage approach, small businesses may also have more latitude to respond to issues and challenges in a more ad hoc manner.<sup>116</sup> It can be hypothesised that this factor allows small businesses to be more flexible, primarily in avoiding, but also in dealing with legal problems. This flexibility can however also give rise to a sentiment of “I’ll deal with that if it happens”.

While such flexibility may be advantage in the domestic context, the same cannot be said in regard to allocating the legal framework in international commercial contracts. As will be developed further, ignoring the issues of applicable and dispute resolution may leave small businesses in an adverse position should recourse to the legal position become necessary. It is conceivable that the position may be so unfavourable that the small business is left without practical legal recourse.

## 2 *The ability to “hold the reins”*

The second implication of the multi-tasking owner/manager is their involvement with, and understanding of both the day-to-day performance of contracts, as well as the negotiation thereof. In general, smaller businesses will also have fewer customers and fewer individual transactions than larger firms. Where a firm has fewer customers and fewer transactions, it is possible for the owner/manager to “hold the reins” and be personally in control and assess the risk of individual transactions. Smaller businesses may hereby have an increased ability to be selective in whom they deal with and operate on the basis of relationships rather than formal procedures. When asked whether documents for sale to a distributor included anything about dispute resolution or applicable law, one participant said:

No... Eventually we will have to go there but at the moment the relationships are really personal and I deal personally with all these people, and when you’re sitting across the table face-to-face you work it out. But if we get bigger and employ salespeople then we need more detail. As I own the business I can see the big picture, but for a salesperson that is much harder to do.<sup>117</sup>

The comment is illustrative of the (perceived) ability the owner/manager of a small business to avoid the need for legal recourse by retaining oversight by being directly in control of all aspects of their business’ involvement in international commercial transactions. Being required to sign a contractual document or requiring the other party to agree to and sign a drafted contract may induce a sentiment of the agreement no longer being a flexible agreement in the hands of the negotiators, but instead being constricted into a paper straightjacket requiring interpretation by lawyers. The small business

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<sup>115</sup> McDowell and Sussman, above n 114, at 32.

<sup>116</sup> See Chapter IV.

<sup>117</sup> Business H, above n 56.

owner/manager may feel they are letting go of the reins.

### *C The Use of Lawyers*

Even where small businesses do have concern for applicable law and jurisdiction, negotiators are, understandably, reluctant to use documents of which the legal meaning and implications are not completely known or understood.<sup>118</sup> Of particular concern to this project one participant who had not used a lawyer said:

My terms and conditions say...that only New Zealand jurisdiction applies. But what does that mean you know? I mean maybe in the other country there is a rule that no foreign jurisdiction will ever apply to their companies...<sup>119</sup>

One solution would be to involve a lawyer in the drafting process. However, only very few small businesses have the resources to involve a lawyer in their contractual drafting.<sup>120</sup>

Traditional academic writing on international commercial contracts often assumes the involvement of lawyers in the contract drafting stage.<sup>121</sup> However, in many cases the value of the individual transactions will mean that the involvement of a lawyer is not a commercially viable option. One participant in this project said:

For us the amounts are just too small, if we are doing a deal worth 50,000 the profit margin might only be 10%, if we use a lawyer “poof” half the profit is gone.<sup>122</sup>

Furthermore, in relation to international matters, it is not impossible that a small business’s usual lawyer will not have a broad knowledge of the best practice for key clauses in an international commercial contract. This may be particularly true for smaller firms located in regional areas of New Zealand with lawyers who engage in a broad range of legal services for both private and commercial clients. Many small businesses will customarily refer all their legal queries and issues to the same company lawyer.<sup>123</sup>

When asked about the use of drafted documents for international transactions, one participant reported that:

I wouldn’t have a clue where to start and I also probably would fear that if I went to my usual lawyer he wouldn’t have a clue either...<sup>124</sup>

By contrast, it is not uncommon for larger firms to have in-house lawyers, sales

<sup>118</sup> Business B, above n 11.

<sup>119</sup> Business C, above n 12.

<sup>120</sup> Butler and Herbett, above n 9, at 197.

<sup>121</sup> Fox, above n 106, at 87.

<sup>122</sup> Business B, above n 11.

<sup>123</sup> Martinez Jr, above n 111, at 29.

<sup>124</sup> Business B, above n 11.

representatives or negotiators dedicated to international transactions.<sup>125</sup> For small businesses dealing with these larger firms, the involvement of lawyers will be almost unavoidable. One small business, who frequently deals with much larger overseas companies, said;<sup>126</sup>

They are dealing with one person – me. I’m dealing with their finance department and their legal department, like 30, 40 or even 50 people... so you’re dealing with 50 people and they have lawyers on tap that are on payroll and they want to keep those guys busy. And that’s why we say, yeah you can go down that track [changing our standard contract] but you’re gonna be paying our legal fees as well.<sup>127</sup>

Business E sought to overcome the burden of covering level fees by requiring the much larger contractual counterparts to pay for the legal fees should they wish to change the standard terms of trade. For the majority of small businesses engagement of a lawyer with specific knowledge international commercial law matters would be a best-case scenario from a legal point of view. A commercial lawyer with knowledge of international matters will be able to ensure that the small business is able to maximise their party autonomy in relation to the applicable legal framework through careful contractual drafting. Even though it may be theoretically desirable to have a lawyer involved in every negotiation and transaction concluded by a small business, the suggestion is not realistic. Aside from added transactions costs, the frequent involvement of a lawyer is simply not how small businesses “do business”.

#### *IV Choice of law and dispute resolution clauses: the practicalities*

##### ***A Should a DIY Approach be encouraged?***

This paper advocates the inclusion of choice of law and dispute resolution provisions in all international commercial contracts. However the practicalities of including such clauses must be considered, small businesses do not have frequent access to lawyers and businessmen often prefer to ‘hold the reins’ and conclude transactions themselves. Unfortunately there are also various obstacles to small businesses including or agreeing to choice of law and dispute resolution clauses in their contracts without specific legal expertise.

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<sup>125</sup> David Echenberg “Negotiating International Contracts: does the process invite a review of standard contracts from the point of view of national legal requirements?” in *Boilerplate Clauses, International Commercial Contracts and the Applicable Law* (Transnational Publishers, Inc, Cambridge, United Kingdom) 11 at 12.

<sup>126</sup> Business E, above n 16.

<sup>127</sup> Business E, above n 16.

### 1 *The Danger of Pathological Clauses*

Firstly, a DIY approach of contract drafting presents the risk of the clauses not having the legal effect that the parties intended at the time of drafting.

...small and medium-sized undertakings normally copy their contracts from the competitors who, in turn, will have done the same in the past. The resulting legal quality of such agreements is almost always catastrophic.<sup>128</sup>

For example in context of international arbitration<sup>129</sup> there is a concern for so-called pathological clauses.<sup>130</sup> One common mistake is to include a choice of jurisdiction clause alongside a dispute resolution clause.<sup>131</sup> Other causes of pathology are incorrectly designating an arbitration institution, not giving sufficient details as to the arbitration or making arbitration optional.<sup>132</sup>

A participant in this project provided a copy of a turnkey contract to which they had been a party which had been drafted by a large company. The contract contained the following clauses:<sup>133</sup>

#### 24. Mediation and Arbitration

24.1 Mediation followed by arbitration: If a dispute arises out of or relates to this Agreement, or the breach termination, validity or subject matter thereof, or as to any claim in tort, in equity or pursuant to *any domestic or international statute or law*, the parties to this Agreement *expressly agree to endeavour in good faith to settle the dispute by mediation* administered by the Australian Commercial Disputes Centre (ACDC) *before having recourse to arbitration*.

(a) A party claiming a dispute has arisen must give written notice to the other parties to the dispute specifying the nature of the dispute.

(b) On receipt of the notice specified in (a), the parties to the dispute must within 7 days of receipt of said notice seek to resolve the dispute.

<sup>128</sup> Bortolotti, above n 20, at 107 (footnote).

<sup>129</sup> International arbitration is discussed further in Chapter Six of this paper.

<sup>130</sup> Bortolotti, above n 20, at 79.

<sup>131</sup> At 80.

<sup>132</sup> Milo Molfa “Pathological Arbitration Clauses and the Conflict of Laws” (2007) 37 Hong Kong LJ 184 at 163–165.

<sup>133</sup> The author does not have information about how the contract was drafted by the company or whether lawyers were used in the drafting process. The extract has been included as an example of a pathological dispute resolution clause. (Emphasis added).



(c) If the dispute is not resolved within 7 days or within such further period as the parties agree then the dispute is to be referred to ACDC.

(d) The mediation shall be conducted in accordance with ACDC mediation Guidelines which set out the procedures to be adopted, the process of selection of the mediator and the costs involved and which terms are hereby deemed incorporated

(e) In the event that the dispute has not settled within 28 days...the *dispute shall be submitted to arbitration* (administered by ACDC) and conducted in accordance with the ACDC Arbitration guidelines, which are hereby deemed incorporated.

#### 27.6 Governing law and jurisdiction

This agreement will be governed by and construed in accordance with the laws of the state specified in item 19 of the specific terms and conditions and the parties submit to the non-exclusive jurisdiction of the courts of that state. [the State of Victoria was designated in item 19].

Far from providing legal certainty, the complex escalation clause leaves the parties in an unclear position in case of dispute. Firstly, clause 24.1 refers to a claim pursuant to *any domestic or international statute or law*. Given that clause 27.6 provides that the contract is governed by the laws of the state of Victoria, the reference to *any* domestic or international statute or law is puzzling. Is there room to argue on the basis of a different law in the context of the arbitration as opposed to litigation? Could a party make a claim according to New Zealand law? Even more pathological is the provision that the dispute *shall* be submitted to arbitration, while clause 27.6 provides that the parties submit to the *non-exclusive* jurisdiction of the courts of the state of Victoria. Undoubtedly, clause 24.1 requires the parties to go to mediation before arbitration, but what if they went straight to the courts of Victoria, or any other court for that matter? Would the court require the parties to go first to mediation and then arbitration before they would hear the dispute? Would different courts come to different conclusions on this point? Is arbitration compulsory only if mediation has failed? The legal answers to these questions are of secondary importance; the biggest disadvantage of the ambiguity is the uncertainty for the contracting parties.

The example illustrates that choice of law and dispute resolution clauses are not simple clauses that small businesses can “pop into the contract”. The danger of contractual documents not having the legal effect intended by the parties may dissuade parties from considering issues such as choice of law and dispute resolution without access to legal advice. For parties without adequate legal advice, drafting dispute

resolution clauses can be a minefield of traps for the unwary.

## 2 *No easy options*

A second barrier to a DIY approach is that agreement on choice of law and dispute resolution clauses can, in itself, cause complications. The earlier part of this chapter was concerned with how small businesses “make” contracts and why they may prefer less formal methods of contracting. In addition to those considerations, contractual stipulations for choice of law and choice of forum will inevitably require additional negotiation between the contracting parties.

For small businesses in New Zealand, the least unfamiliar approach is likely to be to choose New Zealand domestic law and an exclusive jurisdiction clause in favour of the New Zealand courts.<sup>134</sup> However, stipulations to this effect are likely to be perceived as disadvantageous to the foreign contracting party and are likely to be challenged.<sup>135</sup> In the same way, agreeing to the other party’s law and or jurisdiction is unlikely to be a favourable approach for the New Zealand small business.<sup>136</sup>

The characteristics that make one party’s local courts attractive to it will often make them unacceptable to counter-parties. If nothing else, an instinctive mistrust of the potential for home-court bias usually prompts parties to refuse to litigate in their counterparty’s local courts.<sup>137</sup>

As will be developed in chapter six, international arbitration, while more neutral, is unlikely be a familiar approach for small businesses.

Unfortunately questions of choice of law and jurisdiction are not universal to all transactions entered into by New Zealand’s small businesses, there is no infallible approach.<sup>138</sup> Moreover, simply inserting the clauses into standard terms of trade without bringing it to the attention of the other party may give rise to the risk of a battle of the forms. The individual negotiation on these clauses will inevitably increase transaction costs. The most suitable solutions will depend upon the nature of the transaction, the location of the parties and the bargaining power of the parties.

The negotiation and inclusion of choice of law and choice of forum clauses requires knowledge of the options, time, energy, money and in the best case scenario, a lawyer. In the absence of these resources, that small businesses may put the issues is the ‘too hard

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<sup>134</sup> Bortolotti, above n 20, at 47.

<sup>135</sup> Gary author Born *International commercial arbitration* (2<sup>nd</sup> ed, Kluwer Law International, Alphen aan den Rijn, The Netherlands, 2014) at 74–75.

<sup>136</sup> Herbert Smith Freehills LLP “‘Governing law’ and ‘jurisdiction’ clauses” (June 30 2008) Lexology <<http://www.lexology.com/library/detail.aspx?g=469b7d6f-4f8c-44cb-9f10-dcdd1edf20bf>>.

<sup>137</sup> Born, above n 135, at 74–75.

<sup>138</sup> “‘Governing law’ and ‘jurisdiction’ clauses - Lexology”, above n 138.

basket’ is unsatisfactory, but not surprising.

### ***B Model Contracts – a compromise***

Using a contractual document to increase legal certainty does not necessarily mean starting with a blank page. There is a plethora of model contracts available, most of which have been prepared by international bodies of experts. The International Chamber of Commerce (ICC) is a prominent example, with a selection of model contracts including, International Franchising, Distributorship, Commercial Agency, Sale of Goods and Turnkey Transactions. Of significant relevance to this project, the International Trade Centre, the joint agency of the World Trade Organization (WTO) and the United Nations (UN), has prepared a book containing a series of model contracts drafted specifically with the needs of small firms in mind.<sup>139</sup> The introduction recognises that:

Now [SMEs] are exporting to and importing from all corners of the world. But most small firms do not have access to the legal advice they need...<sup>140</sup>

All of these model contracts advise parties to include provisions for choice of law and dispute resolution and provide standardised wording to be used for this purpose.

#### *1 General and Specific Conditions*

The usual format for the ICC model contracts is to have two separate sets of clauses. There are general conditions, which the parties can choose to incorporate into their contract in their entirety, coupled with specific conditions, which the parties can tailor to the particular transaction at hand.<sup>141</sup> The general conditions provide “a platform of standard legal terms”,<sup>142</sup> they are fall-back provisions in situations where the parties have not expressly contracted in relation to a particular matter. For example, the ICC general conditions in the Model Contract for Goods Intended for Resale contains general conditions in relation to, force majeure, inspection of the goods before payment, non-conformity of the goods and interest in the case of delayed payment.<sup>143</sup> Most importantly, general conditions will usually provide clauses for the applicable law and dispute resolution. Where the general conditions are incorporated into the contract, they will apply where the parties have not expressly agreed otherwise on the matters covered by the general conditions.

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<sup>139</sup> International Trade Centre *Model Contracts for Small Firms: Legal Guidance for Doing International Business* (International Trade Centre, Geneva, 2010).

<sup>140</sup> At iii.

<sup>141</sup> For example: International Chamber of Commerce *ICC Model International Sale Contract - Manufactured Goods Intended for Sale* (International Chamber of Commerce, Rome, 1997) at 5.

<sup>142</sup> International Chamber of Commerce *ICC Model International Sale Contract - (Manufactured Goods) (2013 Revision)* (International Chamber of Commerce, Rome, 2013) at 3.

<sup>143</sup> International Chamber of Commerce, above n 141.

Unlike the ICC model contracts, the ITC model contracts are not divided into general and specific terms. The reason for this is stated to be to ensure that;

...parties may be confident that the contract... is not based on a set of general terms and conditions contained in another document and incorporated “by reference”.<sup>144</sup>

The above consideration is consistent with the concern of small businesses dissuaded from using drafted documents by the potential legal implications of prolix contractual documents. Similarly it avoids the need to send the other party long documents that may not be conducive to the business relationship between the parties.

However, small businesses must be alert to the fact that whether or not they incorporate general conditions into their contract, the law must answer for the matters that they have not provided for in their agreement. The inclusion of general conditions can increase the accessibility of at least some of these answers. While the general conditions by no means cover all possible issues, the conditions are specifically formulated for international transactions and can increase the “self-sufficiency” of the contract.<sup>145</sup>

## 2 *Advantages of Model Contracts*

Model contracts are a tried and tested tool and provide standardised language for small businesses wishing to use a written agreement for their international commercial transaction. The models can act as a type of “checklist” of things to be considered before concluding an agreement. Model contracts can allow small businesses to overcome some of the barriers to concluding a formal contractual document.

In relation to the importance of relationships to small businesses, an advantage of a model contract is that the standardised language, can be viewed as neutral between the parties because it has not been drafted unilaterally by one of the parties or their lawyer.<sup>146</sup> Particularly where general conditions are incorporated, the model contract can be seen as a positive agreement to be subject to a neutral set of provisions rather than one party imposing its terms on the other party. For example the general conditions of the ICC model contracts commonly provide for arbitration according to the ICC rules where the parties have not made a contrary stipulation in writing. Where neutral provisions are proposed, protracted negotiations of individual clauses can be avoided.

Secondly, for the multi-tasking owner/manager, not having to start the drafting process from scratch means that model contracts can save on time and energy. The negotiators are directed to consider the relevant issues. Similarly, the owner/manager can

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<sup>144</sup> International Trade Centre, above n 139, at ix–x.

<sup>145</sup> See part II of Chapter 4.

<sup>146</sup> Bortolotti, above n 20, at 237.

remain in control of the negotiating process and include only the clauses, which he or she understands and sees as beneficial for the contract at hand. Finally the use model contracts can avoid common drafting mistakes. For example, model contracts make clear that clauses providing for litigation and clauses providing for arbitration are alternatives and cue negotiators to choose one or the other.<sup>147</sup>

### 3 *Disadvantages of Model Contracts?*

#### (a) Legal advice

Model contracts cannot realistically replace the need for legal advice. For example where parties wish to incorporate general provisions, it is advisable to engage a lawyer to carefully consider the meaning and implications of the incorporated conditions to avoid surprising outcomes. Some critics perceive that model contracts dissuade parties from employing the services of lawyers for the drafting process.<sup>148</sup> The criticism is warranted to a certain degree. *Legal* best practice would most likely involve the lawyer in the drafting of all international commercial agreements. However, unfortunately best legal practice does not always, and in this regard often does not, coincide with actual commercial practice. As discussed, many small businesses do not regularly engage the services of lawyers. Inevitably, small businesses will continue to prefer to conclude agreements and draft their own documents without the involvement of a lawyer.<sup>149</sup> On this basis it is less risky for small businesses start with the strong foundations of model contracts rather than drafting their own clauses from scratch or copying from competitors. Almost every published model contract contains a kind of disclaimer advising the parties to obtain legal advice, while simultaneously providing a solid basis for a “do it yourself” method of contract drafting.

#### (b) The Reliance on Party Autonomy

Model contracts are a useful tool for small businesses adopting a DIY method of contracting. Importantly for these purposes, the model contracts direct contracting parties to consider applicable law and dispute resolution. In the case of general conditions, parties can incorporate a recommended position in relation to choice of law and dispute resolution for the type of transaction at hand. Unfortunately, none of the participants in this project reported a practice of using model contracts. Unless small businesses are familiar with, and can appreciate the benefits of adopting model contracts, they cannot benefit from the advantages that model contracts have to offer. A vicious cycle can

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<sup>147</sup> For example, International Trade Centre, above n 139, at 16–17.

<sup>148</sup> Observed by Bortolotti, above n 20, at 107.

<sup>149</sup> At 107 (footnote).

emerge, familiarity with model contracts does not increase unless parties are exposed to their use and operation.

Given the characteristics of small businesses discussed earlier in this paper and without an increased understanding of the issues at play, model contracts are not sufficient to fully bridge the gap between the practices of small businesses and certainty in relation to the applicable legal framework for international commercial contracts.

#### *V Should small businesses “draft contracts”?*

Many small businesses do not use contractual documents that specify the applicable law and dispute resolution mechanism. This chapter has outlined various characteristics of small businesses and international commercial contracts that contribute to the practice of many small businesses of not maximising on their party autonomy in relation to choice of law and dispute resolution.

While model contracts are a useful tool for highlighting issues to be considered in an international commercial contract and can allow SMEs to more effectively incorporate choice of law and dispute resolution clauses, they do not address the crux of the issue that small businesses are not well-placed to maximise upon the party autonomy afforded to them in international commercial law.

As the following chapters seek to show, under the current status of international commercial law, choice of law and dispute resolution clauses should be considered essential clauses in all international commercial contracts.

## 4. Chapter Four: Choice of Law

### *I Connection between Choice of Law and Choice of Forum*

Commercially minded businesspeople will often have, if anything, more concern about which court will have jurisdiction in case of a dispute, than which law is applicable to the transaction.<sup>150</sup> In the context of dispute resolution, a businessperson will be primarily concerned about the practicalities of where they can go to get their dispute resolved, how they can ensure that the other party attends, and how they can enforce any resulting judgment.

The applicable law may be looked upon as more of a legal technicality and small businesses are unlikely to be aware of the doctrinal differences in the diverse systems of contract law. In fact, in many cases, these differences may be of little practical relevance, especially where, for example, the CISG applies or other international harmonisation efforts have been successful. Without specific knowledge of the diverse legal systems, there may be a sentiment that, whatever law is used in the unlikely event of a dispute, the law will be able to serve the purpose of resolving the dispute regardless.<sup>151</sup>

An increased sensitivity to issues of jurisdiction over the question of applicable law also results from a lack of understanding of the distinction between which forum has jurisdiction to hear the dispute on one hand, and the applicable substantive law on the other.<sup>152</sup> For example, the possibility of the New Zealand High Court applying Chinese domestic law, or a Chinese Court applying New Zealand law, is unlikely to be contemplated by small businesses with only limited exposure to international litigation. When one participant was asked what law he assumed to apply to his international transactions he said:

Good question, I don't think too much about that, for the reason that we get paid before it goes, so there is no argument to be had. The US may be a bit more interesting because they have that public liability thing and we have high public liability insurance for the US...But in the event we would have got into an argument I pick that *we would do it there* but if we did that we would be burnt in that market anyway, I don't think about it, I try not to.<sup>153</sup>

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<sup>150</sup> Henry D Gabriel DeVan Daggett “Choice of law, Contract Terms and Uniform Law in Practice” Modern Law for Global Commerce (paper presented to Congress to celebrate the fortieth annual session of UNCITRAL, 9-12 July 2007, Vienna) at 2.

<sup>151</sup> Fox, above n 85, at 133.

<sup>152</sup> Bortolotti, above n 20, at 20.

<sup>153</sup> Business H, above n 56.

The participant answered the question of applicable law by reference to the forum that the parties would go to in case of a dispute.

## *II Small Business Perceptions of Applicable Law*

During the interviews, participants were asked what law they assumed to apply to their international transactions where they did not stipulate an applicable law in their contract. Most memorably, one participant jokingly replied “the law of the jungle”.<sup>154</sup>

The majority of the businesses had seemingly never considered the issue. However, when they considered the issue, most of the businesses believed that New Zealand law applied to their cross-border transactions. The relevant rationale for this belief varied.

If someone comes to us to do business then I guess my gut feeling would be that whatever law we work in always applies. So if somebody rings me from the US and wants to buy something from me then I assume that they came to us so our law must apply. The moment we call them instead, then US law might apply.<sup>155</sup>

One participant involved in the manufacture of specialised machinery said

I’ve never really thought about it, but my first guess would be that New Zealand law would apply.<sup>156</sup>

Another participant who sent his manufactured food product to warehouses and distributors in various countries said “I would just assume New Zealand law would apply”.<sup>157</sup> In general the small businesses exhibited very little understanding, and in many cases little concern, for establishing the applicable law to their international transactions.

## *III Why does Choice of Law Matter*

### *A Uncertainty*

Firstly, where the parties have not chosen the applicable law, the law applicable to the contract will be determined by the *rules of private international law of the country whose forum has jurisdiction to hear the dispute*. Unfortunately, this position is not less complicated than it sounds. The Court must first determine whether it has jurisdiction to hear the dispute before questions of applicable law can be resolved. For example, in New Zealand the dominant source of private international law rules is the common law.<sup>158</sup> Where the intention of the parties as to applicable law cannot be established from the

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<sup>154</sup> Business F, above n 18.

<sup>155</sup> Business C, above n 12.

<sup>156</sup> Business B, above n 11.

<sup>157</sup> Business D, above n 17.

<sup>158</sup> A H Angelo *Private international law in New Zealand* (Wolters Kluwer Law & Business, Kluwer Law International ; Frederick, MD, Alphen aan den Rijn, The Netherlands, 2012) at 12.



contract or its surrounding circumstances, the test that the New Zealand court will apply is what country has ‘the closest and most real connection with the contract’.<sup>159</sup>

Most countries have their own unique rules of private international law, therefore, the criteria for determining the applicable law to the contract can vary from country to country. The process of determining the applicable law can protract any legal proceedings that ensue between the parties.<sup>160</sup> There is a distinct possibility that different forums would come to different conclusions regarding applicable law. In the US context, the obscurity of private international law rules have been said to create “chaos for parties who wish to better assess their legal rights, obligations, and risks”.<sup>161</sup>

In many cases, if not stipulated by contract, it will be difficult for a small business to determine, with any degree of certainty, which law is applicable to a particular transaction without recourse to the courts or an expert lawyer. In a contract between a New Zealand small business and a business located in China, the applicable law could be New Zealand law, Chinese law, an international convention such as the CISG or even the law of a third country. Consequently, the small business must consider the potential effect and enforceability of the agreement under Chinese law as well as the other alternatives. Accordingly, while the small businesses may not have considered the matter, without a choice of law clause, the legal content of the obligations is ambiguous.

### ***B The self-sufficiency/default paradox***

One paradox, which emerges when analysing the desirability of including a choice of law clause, is that the less detailed the contract, the more crucial the choice of law clause will be. Freedom of contract allows parties to extensively regulate their own terms. Some scholars have gone as far as to contemplate whether a highly detailed and structured contract could be self-sufficient and therefore exist independently from any legal system.<sup>162</sup> Arguably such a contract would prescribe all the relevant rights and obligations of the parties without the need for recourse to the applicable law. Many legal scholars reject the possibility of drafting a self-sufficient contract,<sup>163</sup> either in theory, or as the following quote suggests, in reality.

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<sup>159</sup> At 35.

<sup>160</sup> Peter S Selvin *Avoiding and Resolving Disputes in International Commercial Transactions (ebook)* (ExecSense, United States, 2012) at 116.

<sup>161</sup> Erin O’Hara *The Law Market* (Oxford University Press, USA, Oxford, 2009) at 57.

<sup>162</sup> Giuditta Cordero-Moss *Boilerplate Clauses, International Commercial Contracts and the Applicable Law* (Cambridge University Press, Cambridge, United Kingdom, 2011) at 88; Giuditta Cordero-Moss *International Commercial Contracts: Applicable Sources and Enforceability* (Cambridge University Press, Cambridge, United Kingdom, 2014) at 8.

<sup>163</sup> Fountoulakis, above n 98; Bortolotti, above n 20, at 101; Nygh, above n 23, at 173.

For small transactions in the hands of lawyers and businesses executives who are both brilliant and psychic, it is conceivable that such a [self-sufficient] contract could be drafted... there is a far more workable alternative, the parties can draft the clauses they believe are necessary to a proper agreement and then can choose the law that fills in the remaining details.<sup>164</sup>

While a fully self-sufficient contract may not be realistic, extensive self-regulation is possible. Apart from mandatory laws that cannot be contracting out according to the applicable law, the parties can agree on any terms they by which they wish to be bound.

(a) Express and Implied terms

Express terms are those which have been expressly agreed by the parties for example in a contractual document. General conditions of a model contract incorporated into the contract are also express terms.

Implied terms, in a sense default positions, are terms that the law imposes where the parties have not made a choice. The New Zealand Sale of Goods Act 1908 is a good example in the domestic context. Section 16(a) of the Sale of Goods Act 1908 provides that:

where the buyer, expressly or by implication, makes known to the seller the particular purpose for which the goods are required, so as to show that the buyer relies on the seller's skill or judgment, and the goods are of a description which it is in the course of the seller's business to supply... *there is an implied condition that the goods shall be reasonably fit for such purpose...*<sup>165</sup>

This implied warranty would only apply between the two contracting parties in New Zealand where the parties had not expressly agreed on a warranty for the goods in their contract or dealings.<sup>166</sup> Section 56 of the Act expressly provides that implied terms are negated by express agreement between the parties.<sup>167</sup>

Where the parties have included in agreed upon only the minimum terms necessary for performance, there will be fewer express terms and consequently more implied terms. The reason that a lack of choice of law clause is particularly problematic in a piecemeal contract situation is that the applicable law, which determines which terms are to be implied into the contract, will not be immediately clear. The parties cannot rely on terms implied by a domestic legal system without first determining which law is applicable.

For small businesses, particularly those who are currently using a piecemeal method of contracting, an attempt to draft a self-sufficient contract is neither realistic nor

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<sup>164</sup> Fox, above n 85, at 131.

<sup>165</sup> Sale of Goods Act 1908, s16(a).

<sup>166</sup> By virtue of the CISG, the Sale of Goods Act (1908) does not apply to contracts for the international sale of goods that are subject to New Zealand law.

<sup>167</sup> Sale of Goods Act, s 56.

desirable. However, paradoxically, the more detailed the contract, the relatively less important the choice of law will be. The paradox has been recognised in the context of uniform laws, those parties who choose a uniform law to apply to their contract are often “sophisticated enough to provide specific terms that contract around many of the default provisions” of the model law.<sup>168</sup> Although the applicable law may still affect the interpretation of the clauses in a highly detailed contract, there will be less chance that the law determined to be applicable will result in surprising outcomes for the parties. Where the contract is largely self-sufficient, the function of the applicable law is ‘residual’.<sup>169</sup>

### *C The purpose of a choice of law clause*

Choice of law is frequently misconceived as solely relevant for dispute resolution. The omission of a choice of law clause may be the result of a hope, or even an expectation, that no dispute will arise and the contract will be quietly performed.<sup>170</sup>

An effective choice of law clause is particularly important where a dispute arises between the parties. However, the utility of a choice of law clause is not solely relevant in a court or arbitral tribunal. The applicable law gives context to the obligations of the parties,<sup>171</sup> for example by complementing the parties’ express terms with implied terms. Similarly, the applicable law may also impose mandatory rules, which cannot be contracted out of.

In the context of international dispute resolution one participant reported

Our last, last case scenario would be to go to a New Zealand lawyer who could send them a threatening letter from a *New Zealand legal perspective*.<sup>172</sup>

A strong legal position according to the law applicable to the contract can be a bargaining chip for renegotiation of a contract and can allow parties to resolve their disputes without the need for litigation or arbitration, which can be both costly as well as damaging to the commercial relationship between the parties.

Where litigation or arbitration proceedings do ensue, a clear choice of law clause can ensure faster and easier proceedings particularly where the choice of law clause is accompanied by a clear choice of forum clause. For many small businesses the complexity of negotiating or resolving a dispute according to a foreign law, for example Chinese law, may be enough to compel the business to relinquish even a valid legal claim. In the vast majority of situations where foreign law is applicable, foreign legal

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<sup>168</sup> DeVan Daggett, above n 150, at 4.

<sup>169</sup> Filip De Ly, above n 34, at 60.

<sup>170</sup> Fox, above n 85, at 133.

<sup>171</sup> David Goddard and Campbell McLachlan *Private international law* (Continuing Legal Education, New Zealand Law Society, Wellington, NZ, 2012) at 159–160.

<sup>172</sup> Business H, above n 56.

advice will also be necessary. The absence of a choice of law clause can hereby reduce effective access to justice where a dispute has arisen.<sup>173</sup> Where the applicable law is made clear by a choice of law clause, parties can ensure that they have access to a lawyer with knowledge of the relevant legal system before a dispute arises. Parties are less likely to be taken by surprise by a lawsuit based on a law, which they had not contemplated as applicable to their agreement,

#### *IV The CISG as an example of a default applicable law*

As has been discussed, the applicable law to a contract will depend on a variety of factors and can affect the terms of the contract. It has been recognised that domestic laws are not always easily accessible or well suited to international commercial transactions.<sup>174</sup> International attempts have been made to increase the certainty of the law applicable to international commercial contracts by introducing uniform laws. The most prominent example is the CISG, drafted by the United Nations Commission on International Trade Law (UNCITRAL) and signed in Vienna in 1980. The CISG is an international convention that contains 101 Articles covering the formation of contract, the obligations of the buyer and seller and the remedies available. The purpose of the CISG was to provide a set of uniform rules for the international sale of goods that was neutral, easily-accessible and avoided the need for knowledge of national laws pertaining to the sale of goods.<sup>175</sup> In this way, the objectives of the CISG appear to be consistent with the needs and practices of New Zealand’s small businesses.

##### *A The value of the default nature of the CISG*

In 1992 the New Zealand law commission produced a report supporting New Zealand’s proposed accession to the CISG. The commission found that:

The Convention should also reduce the costs and uncertainties for New Zealand businesses engaged in international commerce. They will often be smaller and have less bargaining power than the foreign businesses with which they trade.<sup>176</sup>

The New Zealand government chose to intervene to alter the default position for the law applicable to contracts for the international sale of goods. In simplified terms, the CISG applies *by default*, to contracts for the sale of goods<sup>177</sup> where each of the parties are

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<sup>173</sup> For a further discussion on effective access to justice for SMEs see: Butler and Herbett, above n 9.

<sup>174</sup> Bortolotti, above n 20, at 42.

<sup>175</sup> Bernard Audit “The Vienna Sales Convention and the Lex Mercatoria” in Thomas E Carbonneau (ed) *Lex Mercatoria and Arbitration* (Juris Publishing, 1990) 173 at 179.

<sup>176</sup> Law Commission *The United Nations Convention on Contracts for the International Sale of Goods: New Zealand’s Proposed Acceptance* (NZLC R23 1992) at 56.

<sup>177</sup> A contract for the sale of goods generally refers to the exchange of goods for money see Peter Schlechtriem and Petra Butler *UN law on international sales* (Springer, Berlin, 2008) at 22, however

located in different contracting states or when the rules of private international law lead to the application of the law of a contracting state.<sup>178</sup> Where both parties to a contract for the sale of goods are in contracting states and they have not stipulated a choice of law, the CISG will apply by default. The CISG can also apply by virtue of the applicable domestic law.<sup>179</sup> Where the parties have chosen the law of a contracting state or where the law of a contracting state is determined to be applicable, the CISG will apply. With 83 contracting states, the default application of the CISG is not unlikely. Importantly the application of the CISG is only the default position, the parties remain free to expressly contract out of the CISG in part or in its entirety,<sup>180</sup> thus upholding party autonomy.

Although the domestic law applicable to the contract for the sale of goods will not be irrelevant even where the CISG is applicable, its importance is greatly reduced.<sup>181</sup>

### ***B The CISG and small businesses***

The default nature of the CISG is fitting for the characteristics of small businesses who may not have had the resources or foresight to include a choice of law clause.

The *Smallmon* case,<sup>182</sup> heard by the New Zealand Court of Appeal in 2012 demonstrates the value of the default nature of the CISG for New Zealand small businesses. The Smallmons, who were based in Australia, purchased four trucks from a New Zealand agent, Transport Sales Ltd. Consistently with the methods of contracting described earlier in this paper, there was no written contract and no agreement on applicable law or jurisdiction. In all likelihood, the parties had not considered the question of applicable law at the time of transacting. A dispute arose after the Smallmons were unable to register the trucks in Queensland because the necessary compliance plates were missing.<sup>183</sup> The parties had not expressly agreed upon the registrability of the trucks,<sup>184</sup> therefore the question of whose responsibility the registrability was could not be answered by the terms of the parties’ express agreement and was reliant on terms implied by the governing law.

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Article 2 expressly excludes consumer contracts, goods sold by auction as well as the sale of stocks, shares, investment securities, negotiable instruments, money, ships, vessels, hovercraft, aircraft and electricity.

<sup>178</sup> United Nations Convention on Contracts for the International Sale of Goods 1980, art 1(1)(a).

<sup>179</sup> Petra Butler “Dispute Resolution” in Larry A DiMatteo and others (eds) *International Sales Law: Contract, Principles and Practice* (Hart Publishing, Oxford, United Kingdom, Forthcoming).

<sup>180</sup> United Nations Convention on Contracts for the International Sale of Goods, art 6.

<sup>181</sup> Article 7 of the CISG mandates an international approach to the interpretation of the CISG. Where the CISG does not cover a particular matter, recourse to domestic law is expressly subordinated to a consideration of the general principles upon which the CISG is based.

<sup>182</sup> *Smallmon v Transport Sales Ltd*, above n 73.

<sup>183</sup> At 109 (Headnote).

<sup>184</sup> *Smallmon v Transport Sales Ltd* [2011] NZCA, [2012] 2 NZLR 109 at [4].

The Court of Appeal upheld the High Court’s finding that the CISG was applicable.<sup>185</sup> The High Court judge had found that

There is no question that the Convention applied to the transaction between Transport Sales and the Smallmons. It was a contract for the sale of commercial goods between parties whose respective places of business were in different contracting states and who did not purport to contract out of the Convention...<sup>186</sup>

The finding led to the striking out of claims based on domestic law, including claims based on implied terms under the Sale of Goods Act 1908.<sup>187</sup>

The case revolved around Article 35 of the CISG, which is concerned with the seller’s obligations in relation to conformity of the goods delivered. The international nature of the CISG was emphasised by the Court of Appeal. The Court of Appeal made direct reference to leading international decisions on Article 35 of the CISG.<sup>188</sup>

(b) Is the CISG less foreign to New Zealand’s small businesses?

Unfortunately, despite the advantages of the CISG as a uniform law for the international sale of goods, participants in this project who were involved in the international sale of goods were not aware of the existence or operation of the CISG. One participant said “I have never heard of it, I am not surprised there is one, but who cares?”<sup>189</sup> Another participant was more interested “No, [I haven’t heard of it] tell me more”<sup>190</sup> Overall, the most common response was simply “no”.<sup>191</sup>

The participants’ lack of knowledge of the CISG is startling. For many of the participants the CISG would be applicable to many, if not the majority of their international transactions. One of the objectives of New Zealand’s adoption of the CISG was to reduce uncertainty caused by the application of foreign law to contracts for the international sale of goods.<sup>192</sup> The lack of knowledge of the CISG is symptomatic of a general lack of exposure and understanding of the issues pertinent to international commercial transactions. If small businesses are not even aware of the existence of the CISG it is difficult to argue that it has reduced uncertainty. In fact, the opposite argument has been made that parties may be subjected to the CISG, an unfamiliar set of rules

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<sup>185</sup> At [5].

<sup>186</sup> *Smallmon v Transport Sales Ltd* HC Christchurch CIV 2009-409-363, 39 July 2010 at [63].

<sup>187</sup> At [64].

<sup>188</sup> *Smallmon v Transport Sales Ltd*, above n 186, at [42].

<sup>189</sup> Business F, above n 18.

<sup>190</sup> Business G, above n 68.

<sup>191</sup> Business A, above n 19; Business B, above n 11; Business D, above n 17; Business G, above n 68; Business H, above n 56; Interview with Business I (Hanneke van Oeveren, 19 January 2016).

<sup>192</sup> Law Commission, above n 176, at 56.

whose implications they are not familiar with.<sup>193</sup>

However, as will be evident from the foregoing discussion, although they should, many small businesses do not include choice of law clause in their contract. For those parties who have contemplated the law applicable to their agreement, the application of the CISG is unlikely to come as a surprise, particularly where they have had legal advice. For those parties who have not contemplated applicable law, the CISG may not be familiar, but is a valuable default position. Where the consideration of applicable law does not arise until there is a dispute, a small business is likely to be relieved to discover there is a uniform law applicable rather than an unfamiliar, less accessible and doctrinally divergent domestic law, for example, Chinese or Argentinian domestic law. The international nature of the CISG provides neutrality for the contracting parties. The CISG has been drafted specifically with needs of international commerce in mind and presents a compromise between diverging legal traditions. Where the CISG is applicable, both of the parties (and their lawyers) will be on an equal footing for access to persuasive international case law and commentary available free of charge on the international databases which are accessible free of charge.<sup>194</sup> The CISG is officially translated into six languages. Unlike soft law instruments such as the UNIDROIT principles of international commercial contracts or model laws, such as those discussed earlier in this paper, the ability of small businesses to reap the benefits of the international nature of the CISG is not reliant on small businesses making careful decision at the contract drafting stage.

Unfortunately however, the limited scope of the CISG in the overall context of international transactions must be emphasised. The default applicability of the CISG does not extend to a contract the provision of services,<sup>195</sup> a framework distribution agreement,<sup>196</sup> or the sale of goods directly to consumers.<sup>197</sup> Furthermore, even where the CISG does apply, the applicable domestic law may still be relevant for filling gaps for matters not covered by the CISG.<sup>198</sup>

The CISG demonstrates how default legal positions can be introduced to provide a

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<sup>193</sup> Selvin, above n 160, at 124.

<sup>194</sup> Useful databases include *cisg-online*, *unilex*, *CLOUT* and the Pace Law School CISG database.

<sup>195</sup> United Nations Convention on Contracts for the International Sale of Goods 1980, art 7(2) provides "this Convention does not apply to contracts in which the preponderant part of the obligations of the party who furnishes the goods consists in the supply of labour or other services."

<sup>196</sup> Jelena Previ "Selected Critical Issues Regarding the Sphere of Application of the CISG" (2011) 2011 *Belgrade Law Review* 181 at 187, the distinction between a framework distribution agreement and a contract for the sale of goods can be a fine one, for a further discussion see Schlechtriem and Butler, above n 177, at 22.

<sup>197</sup> United Nations Convention on Contracts for the International Sale of Goods, art 2(a).

<sup>198</sup> Schlechtriem and Butler, above n 177, at 42–55.

more suitable “safety net” for small businesses that have not adequately stipulated the legal framework to their contract. While the CISG improves the default position in some circumstances, it unfortunately cannot provide a justification for small businesses not choosing an applicable law for their international transactions. Even where the default applicability of the CISG is anticipated, the parties are well advised to nevertheless include a choice of law clause favouring a domestic law and a potentially superfluous opt-in to the CISG.<sup>199</sup> Such a clause removes doubt as to the applicable law and ensures that parties can benefit from the advantages of a clearly applicable law, which have already been discussed.

### *V Choice of Law: Conclusion*

The majority of small businesses interviewed for this project did not have a practice of including a choice of law clause in their international transactions. The CISG provides an example of a default position, which puts small businesses in a less disadvantageous default position in the context of international contracts for the sale of goods but unfortunately, does not render a choice of law clause redundant. Without a choice of law clause, the applicable law to the contract will, in many cases, be unclear to the contracting parties. Even where the parties do not anticipate any dispute arising between them, choice of law gives legal context and meaning to the agreement between the parties and avoids the complexity that arises where resort to the default position is necessary.

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<sup>199</sup> Louis Del Duca and Patrick Del Duca “Selected Topics Under the Convention on International Sale of Goods (CISG)” (2001) 106 *Dickinson Law Review* 205 at 214; Butler, above n 181, at 7.



## 5. Chapter five: Small businesses and Dispute Resolution

### *I The perceived need for dispute resolution*

Many small businesses refuse to recognise that trade transactions of any nature inevitably give rise to a potential for dispute.<sup>200</sup> When one participant was asked whether he had ever been party to a litigation he said:

No...because America you know, don't kid yourself. The Americans are not going to sue me, I could poison and kill an American [with my product] and they wouldn't sue me because the lawyers would not make enough. They could take me to the cleaners, they could take my business, they could take my wife and children and sell them into slavery and they still would make enough to pay their fee.<sup>201</sup>

### *A A focus on performance*

A focus at the time of negotiation, on the elements of performance rather than the implications and recourse in case of non-performance was a common approach by most participants in this project. Moreover, resolving “issues” before they become “disputes”, as illustrated in the following quote, is almost always preferable to recourse to formal dispute resolution mechanisms such as arbitration or litigation.

When one participant was asked whether he had ever been party to litigation he said:

No...when things have gone wrong we have always sat around the table. Both our businesses are about long-term relationships... we had an issue in the US, it did not get to a dispute with the dealer but we threw a whole lot of money at resolving the issues...and even though it was not our problem, in the long term, benefit is there for us. They may lose interest in selling our product so although we may have a perfect legal issue for not resolving the issue and not spending any money on it, the money is an investment in the future...<sup>202</sup>

The quote reflects a sentiment commonly held by businessmen that formal dispute resolution is absolutely a last resort. Plainly businessmen do not enter into contracts with the intention or desire to end up in a dispute. In reality, the majority of commercial contracts entered into are fully performed and no recourse to legal dispute resolution mechanisms is necessary.<sup>203</sup> However;

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<sup>200</sup> Lorrie Willey “Arbitrate, Don't Litigate! Avoiding the High Costs of Litigation” (2005) 10 The Entrepreneurial Executive 15 at 15.

<sup>201</sup> Business F, above n 18.

<sup>202</sup> Business H, above n 56.

<sup>203</sup> Fox, above n 85, at 4.

Small businesses are learning the same hard lessons that multi-nationals learned about the global marketplace. Even in a successful international transaction, there is a risk that the honeymoon will end and commercial parties will find themselves at odds... small businesses need a fair, flexible and reliable dispute resolution process to ensure that their international commercial disagreements are resolved effectively.<sup>204</sup>

### ***B Party Autonomy***

As can be recognised as a recurring theme throughout this paper, the only method available to small businesses to ensure that they have the best dispute resolution mechanisms possible, is to think ahead and ensure that contractual arrangements include arrangements for dispute resolution. Access to justice is expensive for all businesses, but is particularly burdensome for smaller businesses.<sup>205</sup> In particular, the procedural complexities of international litigation as the default dispute resolution mechanism inhibit effective access to justice for small businesses.<sup>206</sup>

Importantly, encouraging small businesses to maximise their party autonomy and consider dispute resolution at the time of contracting is not for the purpose of encouraging disputes or discouraging amicable dealing between commercial parties. Dispute resolution clauses are not an alternative, but rather a back up to other means of mitigating risk or developing the strongest possible relationships and establishing trust between the contracting parties.

When one participant was asked whether he thought that the mere threat of the disputes tribunal at domestic law was valuable, he replied:

of course... It is basically the difference between two kids in the garden where mum can't see them and two kids where mum is right next to them, you know someone is looking over you.<sup>207</sup>

This quote reflects that access to dispute resolution mechanisms is valuable, whether they are formally invoked or not. There is no such thing as a satisfactory dispute,<sup>208</sup> however, considering dispute resolution at the time of contracting can allow smaller businesses to ensure the least disadvantageous position possible in the unlikely; and unfortunate event that formal dispute resolution mechanism are needed. As one writer put it:

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<sup>204</sup> Susan D Franck “A Survival Guide for Small Businesses: Avoiding the Pitfalls in International Dispute Resolution” (2004) 3 Minnesota Journal of Business Law and Entrepreneurship at 1.

<sup>205</sup> McDowell and Sussman, above n 114, at 37.

<sup>206</sup> Butler and Herbett, above n 9, at 187.

<sup>207</sup> Business B, above n 11.

<sup>208</sup> Gary Born “Bilateral Arbitration Treaty Regime” (Youtube Video, Victoria University of Wellington, 17 May 2015), <[https://www.youtube.com/watch?v=qXIYIExG\\_D0](https://www.youtube.com/watch?v=qXIYIExG_D0)>.

Earlier analysis pays off in the end and permits small businesses to get the most “bang for their buck” in the unhappy event of a commercial disagreement.<sup>209</sup>

## *II Default position for Dispute Resolution: Litigation*

Where the parties have not made any stipulations as to dispute resolution, litigation will be the default mechanism for dispute resolution. Unfortunately, as this chapter will demonstrate, default litigation does not provide the “fair, flexible and reliable”<sup>210</sup> mechanism that smaller businesses need. Where the parties have not included a forum clause in their contractual arrangement, recourse to litigation to resolve disputes is far from straightforward.

### *III A real-life case study*

The problematic features of international commercial litigation are frequently traversed in academic literature.<sup>211</sup> However, the difficulties of international litigation for New Zealand’s SMEs are not merely theoretical. This section presents the issues in a real-life context by focusing on a recent, factual case study from case law. The case study raises issues of jurisdiction and dispute resolution in a piecemeal contracting situation. The case study provides an illustrative example of the practical difficulties that plague cross-border litigation where SMEs have not included a dispute resolution clause.

#### **A Background facts**

The facts for this case study have been taken from two court judgments, one in the New Zealand High Court and one in the Singapore High Court.

Nelson Honey & Marketing (NZ) Ltd (NH) is a New Zealand company involved in the production and sale of honey. In 2014 NH had approximately 20 employees,<sup>212</sup> therefore qualifying as a small business. In February 2013 NH received a purchase order from William Jacks and Company (Singapore) Private Limited (WJ), for two consignments of manuka honey for NZ\$206,300, to be exported from New Zealand by WJ, to Shanghai.<sup>213</sup> The parties had already transacted more than 20 times prior to this

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<sup>209</sup> Franck, above n 204, at 8.

<sup>210</sup> At 1.

<sup>211</sup> See for example, Bortolotti, above n 20, at ch 5; Willey, above n 202; McDowell and Sussman, above n 114; Franck, above n 204; Gary Born *International arbitration and forum selection agreements* (3rd ed, Walter Kluwer Law & Business; Alphen aan den Rijn, The Netherlands, Austin Tex, 2010) at 4–13.

<sup>212</sup> *Nelson Honey & Marketing (NZ) Ltd v William Jacks and Company (Singapore) Private Ltd* [2015] NZHC 1215 at [49] (*NH v WJ*).

<sup>213</sup> *NH v WJ* above n 212, at [2]. *William Jacks & Co (Singapore) Pte Ltd v Nelson Honey & Marketing (NZ) Ltd* [2015] SGHCR 21, at [3] (*WJ v NH*).

February 2013 purchase order.<sup>214</sup> The honey was supplied pursuant to the purchase order and delivered according to NH’s contractual obligations.<sup>215</sup>

The facts provide an example of piecemeal contracting, the terms of the contract for the sale of honey were not recorded in a single document signed by the parties. Most importantly, the parties had not agreed upon the applicable law or jurisdiction.<sup>216</sup>

In October 2013, WJ rejected the consignments of honey, claiming faults with the honey.<sup>217</sup> Late in 2013 NH’s company solicitor who was also board chairman travelled to Singapore with the intention of reaching a commercial settlement with WJ.<sup>218</sup> As can be presumed from the incidence of the litigation proceedings, no settlement was reached.

### ***B The Parallel Proceedings***

When a contracting party contemplates legal action, the first basic question that arises is which court that party should go to lodge their claim. For small businesses a local court is likely to be the most accessible first port of call. A local court will, in most cases, be the most familiar for the small business and their usual lawyer in regards to location, language and civil procedure. In most cases foreign legal advice will be needed before pursuing a claim or defence in a foreign jurisdiction.<sup>219</sup> Similarly, SMEs may see value in reliance and setting of judicial precedents in their own jurisdiction.<sup>220</sup>

One of the biggest difficulties of international litigation is the danger of parallel proceedings. Where parties, like NH and WJ, have not exclusively chosen a forum to hear their dispute, one party may attempt to bring the proceedings in more than one country, or both parties may each attempt to have recourse to their own courts to resolve the dispute.<sup>221</sup> Most countries have their own distinctive rules determining their courts’ jurisdiction over cases involving foreign parties, therefore one court finding itself to have competent jurisdiction does not preclude another court from also finding itself to have

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<sup>214</sup> Mike Ross “Export: Nelson Honey v William Jacks” (3 June 2015) Mike Ross Law Blog <<http://nzbloglex.blogspot.co.nz/2015/06/export-nelson-honey-v-william-jacks.html>>.

<sup>215</sup> *NH v WJ* above n 212, at [19].

<sup>216</sup> A draft distribution agreement had been drafted and circulated between the parties in 2010. Minutes from a meeting between the parties included “any dispute to be in accordance to Singapore law”. Similarly, the draft distribution agreement contained an exclusive jurisdiction clause in favour of the Singapore courts. Both the New Zealand and the Singapore Court held that the parties had not agreed to the exclusive distribution agreement and that, therefore, the parties had not agreed on applicable law or jurisdiction. See *WJ v NH*, above n 213, at [66]-[74]; *NH v WJ* above n 212, at [26]-[43].

<sup>217</sup> *NH v WJ* above n 212 at [2].

<sup>218</sup> At [30]- [31].

<sup>219</sup> Butler and Herbett, above n 9, at 202.

<sup>220</sup> Franck, above n 204, at 2.

<sup>221</sup> Born, above n 215, at 3.

jurisdiction. Uncertainty surrounding jurisdiction inevitably draws out the proceedings because challenges to the court’s jurisdiction giving rise to preliminary proceedings are much more likely. Where the jurisdiction of the court is challenged, the court must first address the issue of jurisdiction before the substantive issues or the “merits of the case” can be considered.

### *1 The parallel proceedings*

In November 2014 NH commenced proceedings in the Nelson High Court against WJ for the failure to pay for the honey ordered pursuant to the purchase order of February 2013.<sup>222</sup> WJ protested the jurisdiction of the High Court in January 2015 and sought either a stay of proceedings or a dismissal of the proceedings from the New Zealand High Court.<sup>223</sup> On 14 May 2015, the proceeding was heard in the Nelson High Court.

Associate Judge Matthews in the Nelson High Court denied WJ’s dismissal or stay of proceedings, finding that the New Zealand High Court was the appropriate forum for the trial on its merits.<sup>224</sup> In considering whether to exercise his discretion in assuming jurisdiction, Matthews AJ found that;

the factors which the court must consider [according to New Zealand’s rules of private international law]...lead to a clear conclusion that this Court should assume jurisdiction over this proceeding.<sup>225</sup>

At a first glance, NH had overcome the first hurdle of international litigation. The Nelson High Court decision established the jurisdiction of the New Zealand High Court, allowing the parties to proceed to full trial in New Zealand. Unfortunately the situation was much more complicated.

In January 2015, the same month that WJ protested to the New Zealand High Court’s jurisdiction, WJ commenced proceedings in the Singapore High Court for non-conformity of both consignments of honey.<sup>226</sup> The Singapore High Court heard the proceedings in September 2015. Unsurprisingly, NH sought, *inter alia*, to obtain a stay of proceedings on the grounds of *forum non conveniens*, that, is that there was a more appropriate forum to hear the case, precluding a finding of jurisdiction by the Singapore Court.<sup>227</sup> In this respect, the preliminary proceedings in New Zealand and the Singapore proceedings are mirror images of one another.

The Singapore High Court found that the New Zealand court’s dismissal of WJ’s stay

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<sup>222</sup> *WJ v NH*, above n 213, at [4].

<sup>223</sup> *NH v WJ* above n 212, at [3].

<sup>224</sup> *At* [66].

<sup>225</sup> *At* [67].

<sup>226</sup> *WJ v NH*, above n 213, at [4].

<sup>227</sup> *At* [4].

of proceedings did not give rise to an estoppel precluding the continuation of the proceeding in the Singapore Court.<sup>228</sup> One requirement for establishing an estoppel at Singapore law is that a foreign court of competent jurisdiction has delivered the earlier judgment.<sup>229</sup> The High Court emphasised that the Singaporean rules of private international law must be applied to determine whether the New Zealand High Court was a court of competent jurisdiction for the purposes of establishing an estoppel.<sup>230</sup>

The issue of whether New Zealand is the appropriate forum is different from the issue whether Singapore is the appropriate forum. It may be argued that this is a semantic distinction that ought not to be drawn, because New Zealand being the appropriate forum would implicitly and logically exclude Singapore being the appropriate forum... There was full contestation in New Zealand over whether New Zealand was appropriate and certain arguments were deployed in that respect, but it cannot be safely assumed arguments that are the exact converse would be deployed in Singapore over whether Singapore is appropriate<sup>231</sup>

According to Singapore’s rules, the Singapore High Court found that the New Zealand High Court was not a court of competent jurisdiction WJ had not submitted to the New Zealand jurisdiction.<sup>232</sup> This finding was in itself sufficient to preclude the estoppel.<sup>233</sup>

The Court also considered whether Singapore was a more appropriate forum than New Zealand. The Singapore High Court came to the opposite conclusion to the New Zealand Court on this point, finding that;

with respect to the location of witnesses and evidence for the purposes of assessing damages, Singapore *is by far the more convenient forum*.<sup>234</sup>

Despite the fact that the New Zealand and the Singapore courts applied similar tests developed from the same common law roots,<sup>235</sup> the two courts came to inconsistent conclusions.

The incidence of parallel proceedings was however taken into account by the Court. The judge held that:

There has thus far been no duplication of effort or wastage of resources with respect to substantive liability, as things currently stand, the fact of parallel proceedings does

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<sup>228</sup> At [27].

<sup>229</sup> At [27].

<sup>230</sup> *WJ v NH*, above n 213, at [31].

<sup>231</sup> At [60].

<sup>232</sup> At [44].

<sup>233</sup> The five requirements for establishing an estoppel at Singapore law are expounded at [27].

<sup>234</sup> *WJ v NH*, above n 213, at [85]. (emphasis added)

<sup>235</sup> Both the Singapore and New Zealand courts applied a test based on the approach propounded in *Spiliada Maritime Corporation v Cansulex Ltd [the Spiliada]* [1987] AC 460 (HL).

not hold much weight. Nonetheless, if proceedings in New Zealand proceed beyond the jurisdictional stage... the inconvenience and expense of trial in two jurisdictions would surely outweigh the convenience of proceedings taking place in Singapore because of the location of evidence and witnesses.<sup>236</sup>

The judge therefore concluded that Singapore was the most appropriate forum only if WJ undertook to abandon the proceedings in New Zealand, that is, that they allow a default judgment to be entered against them if the proceedings in New Zealand were not dismissed.<sup>237</sup>

Following the Singapore High Court’s decision, the Nelson High Court decision determining the New Zealand High Court to have jurisdiction was of limited value to NH. More than foreseeably, WJ would allow a default judgment to be entered against it in New Zealand and would continue to pursue its claim in the Singaporean Courts.

## 2 *Enforcement*

Difficulties surrounding the recognition and enforcement of judgments are a disadvantage of litigation as the default dispute resolution mechanism. The recognition of foreign judgments is, in most countries, left to national rules of private international law. Enforcement was a concern of a number of participants in this project. One said:

...say you take them to the district court, and then what? The [court] will say, you know, that’s terrible and we sentence the company to pay the money, they owe you this amount of money... [The other party] may even agree, thanks for the judgment. But how can you enforce it?<sup>238</sup>

Unfortunately, the participant’s concerns are, at least to a significant extent, well founded. The parallel proceedings in the NH case study also raise problems of enforceability. As described above, the Singapore High Court had found that the New Zealand High Court did not have competent jurisdiction and had refused to recognise the New Zealand decision as giving rise to an estoppel on this basis. Analogous to the position in many jurisdictions, the foreign court being of competent jurisdiction *according to Singapore law* is a requirement for the recognition and enforcement of a foreign judgment in Singapore.<sup>239</sup> Assuming that WJ followed the Singaporean judgment and undertook not to submit to the New Zealand courts, a further default judgment against WJ from the New Zealand High Court would also be unenforceable in Singapore. Unless NH submitted to the Singaporean Courts, similar enforcement issues could also

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<sup>236</sup> At [68] – [69].

<sup>237</sup> At [91].

<sup>238</sup> Business C, above n 12.

<sup>239</sup> *Laws of Singapore* Chapter 0.6 Conflict of Laws (Online Ed) at [6.4.2].

arise for WJ.<sup>240</sup>

More than a year after lodging their claim with the Nelson High Court, two court hearings later, and almost two years following William Jack’s rejection of the honey, NH was left with two conflicting judgments concerning jurisdiction and the prospect of a continuing litigation in a foreign court, half way across the world in Singapore.

### ***A The advantages of an exclusive choice of jurisdiction***

Litigation is rarely the most appropriate vehicle for international dispute resolution for a business of any size.<sup>241</sup> However, the above case study demonstrates that for a small business that has failed to include an exclusive choice of forum clause, the process can be particularly difficult to navigate.

An exclusive choice of jurisdiction clause can mitigate some of the uncertainties of international litigation. The basic function of a choice of jurisdiction clause is to agree, in advance, which court will be tasked with resolving disputes that arise between the parties. While there may, in some situations, be advantages in choosing a non-exclusive jurisdiction clause,<sup>242</sup> this paper is concerned with ensuring maximum legal certainty and avoiding parallel proceedings and will therefore focus on exclusive jurisdiction clauses.

There is a global trend towards recognising party autonomy and respecting exclusive choice of jurisdiction clauses.<sup>243</sup> For example, in New Zealand, where there is an exclusive jurisdiction in favour of foreign court and the defendant challenges the jurisdiction of the New Zealand court on the basis of forum *non conveniens*, the burden will shift to the plaintiff to persuade the Court that the proceeding should not be stayed.<sup>244</sup> Unfortunately, not all states give the same weight to exclusive jurisdiction clauses.<sup>245</sup> For example, the enforcement of jurisdiction agreement in China has been described as “problematic”.<sup>246</sup>

The greatest advantage of a choice of forum clause is likely to be a practical one. The parties have considered the issue prior to the dispute and have clearly attempted to grant jurisdiction to a particular court.

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<sup>240</sup> However it is to be noted that the Nelson High Court decision was under review at the time of the Singapore hearing - *WJ v NH*, above n 213, at [4].

<sup>241</sup> Born, above n 137, at 2.

<sup>242</sup> A non-exclusive jurisdiction clause can avoid curtailing access to remedies available in different jurisdictions. See Gary Born “Forum Selection Clauses Anatomized” (1999) 26 *International Commercial Litigation*.

<sup>243</sup> Tang, above n 82, at 1230.

<sup>244</sup> *Laws of New Zealand Conflict of Laws: Jurisdiction and Foreign Judgments (online ed)* at ch 8.31.

<sup>245</sup> Goddard and McLachlan, above n 171, at 162.

<sup>246</sup> Tang, above n 214, at 4696, 4723.



In situations where a contractual clause has actually been invoked, the simple fact that the clause is invoked may induce the other party to comply with it, irrespective of the actual enforceability of the clause.<sup>247</sup>

A great deal of time, energy and money can be saved where the parties agree on which Court is appropriate to hear their dispute and voluntarily submit to that jurisdiction.

For parties who have become misfortunately embroiled in a legal dispute, a legal foot to stand on for establishing the jurisdiction of a particular court is likely to be invaluable. In practice, the risk of protracted preliminary proceedings is likely to be mitigated given the strong basis for establishing the jurisdiction of the chosen court.

#### *IV Choice of Law and Dispute Resolution Clauses: a summary*

The foregoing chapters have sought to emphasise the difficulties that arise where small businesses have not included choice of law and choice of forum clauses in an international commercial contract. With a lack of effective default positions, choice of law and choice of jurisdiction are essential matters to agree upon before concluding an international transaction to ensure certainty and to avoid some of the difficulties of international litigation.

Unfortunately the characteristics of small businesses and their perceptions of international trade discussed in the foregoing chapters mean that many small businesses are likely to continue to conclude their international transactions without stipulating choice of law or choice of jurisdiction. For this reason, the international framework for international commercial contracts is currently not adequately serving the needs of New Zealand's small businesses. The time has come for more meaningful defaults to become a priority for the New Zealand government.

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<sup>247</sup> Cordero-Moss, above n 28, at 16.

## 6. Chapter six: International Arbitration

### *I The Advantages of International Arbitration*

The need for international arbitration is growing not merely as a result of the expansion of international business; but it is also growing horizontally... This is so because small and medium-sized businesses, hitherto content with their domestic markets, are now going international.<sup>248</sup>

Arbitration is often heralded as the most suitable dispute resolution mechanism for international commercial disputes.<sup>249</sup>

While far from perfect, international arbitration is, rightly regarded as generally suffering fewer ills than litigation of international disputes in national courts and as offering more workable and effective opportunities for remedying those ills which do exist.<sup>250</sup>

Unfortunately, while international arbitration has the potential to greatly improve dispute resolution processes and therefore access to justice for small businesses, the reliance on party autonomy means there is a missing link between small businesses and international arbitration.

### *A Small businesses and International Arbitration*

In general small business owners are more familiar with litigation than alternative dispute resolution mechanisms including international arbitration.<sup>251</sup> The ten participants in this project were asked whether they had any perceptions of international arbitration. Nearly every participant responded the same “no”.<sup>252</sup> Several participants exhibited a clear lack of understanding of arbitration, for example one participant replied “no only mediation in the small claims court, or is that arbitration?”<sup>253</sup>

Most extraordinarily one participant, who claimed he was not familiar with international arbitration, was asked whether he would see the benefit in an easier method of dispute resolution for cross-border disputes, he said:

If there was an internationally known agent for cross-border disputes, and I don't know if there is, for example we go to X and we do our disputes by X as renowned

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<sup>248</sup> Fabien Gélinas “Arbitration and the Challenge of Globalization” (2000) 17 *Journal of International Arbitration* 117 at 4.

<sup>249</sup> At 4.

<sup>250</sup> Born, above n 135, at 73.

<sup>251</sup> McDowell and Sussman, above n 114, at 32.

<sup>252</sup> Business A, above n 19; Business D, above n 17; Business G, above n 54; Business H, above n 56.

<sup>253</sup> Business B, above n 11.

cross-border disputes agency you know with a bunch of people like yourself, working together in Zurich or something... I think it would be quite good to have that...<sup>254</sup>

The mechanism desired by the participant bears very close, if not complete, resemblance to international institutional arbitration.

The unfamiliarity with international arbitration poses a significant roadblock to small businesses benefitting from the advantages that international arbitration has to offer. There will be no arbitration unless the contracting parties have agreed to arbitrate.

### ***B The Advantages of International Arbitration***

Much academic attention has been given to the advantages of arbitration over litigation.<sup>255</sup> This paper will limit the discussion to a number of advantages that are particularly relevant to smaller businesses.

#### *1 Enforceability*

The New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958<sup>256</sup> (New York Convention) provides the most important advantage of arbitration over litigation for SMEs.<sup>257</sup> The New York Convention provides for the recognition and enforcement of international arbitral decisions, in the 156 states that have ratified the Convention<sup>258</sup> (including the majority of New Zealand’s major trading partners)<sup>259</sup> where the requirements of the Convention are met.<sup>260</sup> Where the parties have agreed to have disputes resolved by arbitration, the New York Convention greatly increases the enforceability of the outcome of the dispute resolution process. As evidenced in the case study, there is no equivalent of the New York Convention for international litigation. The ability to obtain a single, enforceable award is crucial for SMEs who have limited time and resources for international dispute resolution.<sup>261</sup>

Unfortunately, this advantage of arbitration may not be widely recognised by small

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<sup>254</sup> Business E, above n 16.

<sup>255</sup> Paul D Friedland *Arbitration clauses for international contracts* (2nd ed, Juris, Huntington, NY, 2007); Born, above n 137; McDowell and Sussman, above n 114; Willey, above n 202.

<sup>256</sup> The New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958, 330 UNTS 38 (Opened for Signature 10 June 1958, entered into force 7 June 1959).

<sup>257</sup> Selvin, above n 160, at 148.

<sup>258</sup> “Contracting states: New York Convention”, above n 255. Notably for New Zealand SMEs, Taiwan is not a signatory to the New York Convention.

<sup>259</sup> “Contracting states: New York Convention” New York Arbitration Convention <<http://www.newyorkconvention.org/countries>>.

<sup>260</sup> Bortolotti, above n 20, at 56.

<sup>261</sup> Franck, above n 204, at 2.

businesses,<sup>262</sup> one participant said

...I think arbitration would very unlikely to be used because I think most of the time people will have these [non-legal] levers in place and if they are not in place then they probably walk away. Unless both parties have a situation where they are not really sure what to do, we have a disagreement and we want to resolve it together, but as soon as that breaks down, *it's really just the inability to enforce.*<sup>263</sup>

The participant was seemingly unaware of the enforcement advantage international arbitration.

## 2 *Neutrality*

As already discussed, choice of law and choice of jurisdiction clauses can be difficult to negotiate between parties located in different countries who both wish to favour their own courts.<sup>264</sup> By contrast, an arbitration clause can provide for an arbitral tribunal and procedure that is neutral in terms of nationality.<sup>265</sup>

By choosing arbitration, small businesses are also able to benefit from the increasingly streamlined features of international arbitration. The adoption of a standard arbitration clause from one of the well-known arbitral institutions is often recommended.<sup>266</sup> There are a multitude of arbitration institutions globally to which parties can choose to submit their disputes,<sup>267</sup> these institutions can manage the process for the parties and offer comprehensive, tried and tested rules to be used for arbitration proceedings.<sup>268</sup> Importantly for small businesses, many of these institutions can offer fast-track procedures which can reduce the time and cost of arbitral proceedings. By opting for arbitration, small businesses will simultaneously increase the global demand for arbitration institutions, rules and procedures, which meet their needs.<sup>269</sup>

In the context of litigation, it will, in most jurisdictions, be necessary to determine a national law as applicable to the contract.<sup>270</sup> By contrast, arbitrators have more flexibility to adjudicate on the basis on non-national, or “soft law” rules such as the CISG or the

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<sup>262</sup> More empirical research would be needed to confirm this hypothesis.

<sup>263</sup> Business C, above n 12. (emphasis added).

<sup>264</sup> See Chapter Three Part IV.

<sup>265</sup> Jan Paulsson, Nigel Rawding, Lucy Reed *The Freshfields guide to arbitration clauses in international contracts* (3rd ed, Kluwer Law International ; Frederick, MD, Alphen aan den Rijn, 2011) at 5.

<sup>266</sup> Franck, above n 206, at 4; Born, above n 215, at 37.

<sup>267</sup> Well-known international Arbitration Institutions include the International Chamber of Commerce, the American Arbitration Association, the Singapore International Arbitration Centre and the London Court of Arbitration.

<sup>268</sup> Bortolotti, above n 20, at 68.

<sup>269</sup> Gélinas, above n 250, at 4.

<sup>270</sup> Butler, above n 179, at 7.

Unidroit Principles of International Commercial Contracts.<sup>271</sup> As discussed in the context of the CISG, non-national rules have the advantage of being neutral between the parties.<sup>272</sup>

### 3 Confidentiality

The disadvantage of the public nature of litigation was recognised by Business E who is involved in the software industry. Business E did use contractual documents, usually stipulating New Zealand law as the applicable law and granting the New Zealand courts exclusive jurisdiction.

I mean for us, we don't want to go to the courts... we don't want anything to do with the courts to slur our name. We're a gold partner to [large software company] and we're a pretty specialist partner to these guys so we need our reputation to be strong globally... So from a legal perspective we don't want to get into litigation because it will surface and these people will come across it and be aware of it.<sup>273</sup>

Business E was not aware of the advantages that arbitration could have in regards to confidentiality. In the context of arbitration disputes are resolved out of the public arena and there is a greater chance that the proceedings will remain confidential.<sup>274</sup> Parties to an arbitration proceeding can agree to limit the disclosure permitted to protect trade secrets and reputations.<sup>275</sup> The flexibility of arbitration means that, in most cases, an express provision providing for confidentiality of the proceedings will be effective.<sup>276</sup>

### ***C A missing link: the reliance on party autonomy***

It is widely recognised that arbitration offers numerous facets of flexibility which state courts are unable to offer. The reason for the flexibility is that unlike state courts, arbitral tribunals obtain their authority from the consent of the parties to submit their disputes to arbitration.<sup>277</sup> The validity of the arbitral award is contingent on the parties' agreement to arbitrate.<sup>278</sup> Contracting parties are able to tailor the arbitration procedure to a significant degree to meet their needs and available resources. The parties have a broad freedom to

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<sup>271</sup> Michael J Bonell “The CISG, European Contract Law and Development of a World Contract Law” (2008) 56 American Journal of Comparative Law 1 at 22; Filip De Ly, above n 34, at 91.

<sup>272</sup> See Chapter Four Part IV.

<sup>273</sup> Business E, above n 16.

<sup>274</sup> Born, above n 215, at 11.

<sup>275</sup> Lloyd Gura *Arbitration* (ExecSense, 2012) at 63.

<sup>276</sup> Ilias Bantekas *An introduction to international arbitration* (Cambridge University Press, New York, 2015) at 103.

<sup>277</sup> Loukas Mistelis “CISG and Arbitration” in *CISG Methodology* (European Law Publishers GmbH, Munich, 2009) at 377.

<sup>278</sup> Born, above n 135, at 97.

determine how the arbitrator or arbitrators will be appointed, the rules of procedure that will be followed and the rules or laws that will be used to resolve the disputes. However,

The plethora of options generated by arbitration’s flexibility can sometimes leave business people and their lawyers feeling like proverbial “kids in a candy store” without a firm guide as to what answers are best for the business.<sup>279</sup>

The flexibility of arbitration is undoubtedly an advantage for those businesses that have the resources and expertise to evaluate the wide range of options that international arbitration offers. The small businesses interviewed for this project did not have any understanding of arbitration or its benefits that would lead them to negotiate arbitration clauses in their contracts. Even where the parties are aware of the advantages of arbitration, there are risks involved with stipulating arbitration in contracts, for example in relation to pathological clauses as discussed earlier in this paper.

Unfortunately, many contracting parties blithely drop a standard form arbitration clause into an agreement without paying too much attention to its consequences and frequently without understanding fully the nature of international commercial arbitration.<sup>280</sup>

Ultimately for many small businesses the reliance on party autonomy through effective contractual drafting is a barrier to them benefitting from the advantages of arbitration.

## *II The Bilateral Arbitration Treaty*

### *A What is the BAT*

The missing link between SMEs and international arbitration has however been recognised by Gary Born who proposes an alternative to the current system of default litigation in the form of a Bilateral Arbitration Treaty.<sup>281</sup> Gary Born has said;

For all the same reasons that states wish to guarantee free trade, guarantee cross-border commerce for the good of us all, for the good of the state... so should states also wish to provide a better default mechanism for international commercial dispute resolution when the parties haven’t already provided for this.<sup>282</sup>

Through the BAT, states would bilaterally or multilaterally agree to make arbitration the default dispute resolution mechanism for disputes arising between businesses transacting between the contracting states.<sup>283</sup> The commentary on the draft BAT reveals that SMEs, who frequently fail to include choice of law and dispute resolution provisions,

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<sup>279</sup> Franck, above n 204, at 3.

<sup>280</sup> Fox, above n 106, at 279.

<sup>281</sup> Gary Born “BITS, BATS and Buts” (paper presented to Kiev Arbitration Days, Kiev, 15 November 2012).

<sup>282</sup> Born, above n 210.

<sup>283</sup> Butler and Herbett, above n 9, at 189.

are intended to be the primary beneficiaries:

The treaty seeks to promote international trade and investment, particularly involving [SMEs]. It does this by reducing one of the barriers to international trade and investment for SMEs – the costs and risks associated with dispute resolution<sup>284</sup>

Importantly for small businesses, the default position would include default position on the additional elements relevant to the arbitral proceedings, which are ordinarily left to party autonomy.<sup>285</sup> For example, the states could agree that the UNCITRAL Rules of Arbitration<sup>286</sup> would be used as the default rules of procedure applicable to the arbitral proceedings.<sup>287</sup> The UNCITRAL rules would provide internationally neutral default procedural rules that have already been extensively tried and tested.<sup>288</sup> The contracting states to the BAT would also agree that the arbitral awards rendered under the BAT would be subject to the New York Convention, allowing for widespread enforcement of awards rendered under the BAT.<sup>289</sup>

### ***B How could the BAT improve the situation for SMEs***

How the BAT could improve SMEs access to effective to justice has already been extensively analysed in a paper authored by Petra Butler and Campbell Herbert.<sup>290</sup> The paper presents a strong case concluding that:

A Bilateral Arbitration Treaty will enable parties to resolve disputes quickly, flexibly, expertly, and in a manner that both parties are trustful of, and which gives effect to their expectations relating to the resolution of disputes. A BAT will give SMEs access to justice in the international space.<sup>291</sup>

There are many justified opinions that arbitration is more suitable for international commercial disputes than litigation. However, arbitration’s reliance on contractual consent, coupled with a lack of understanding of arbitration by small businesses, results in its advantages being less accessible to New Zealand’s small businesses.

The flexible and malleable nature of arbitration is an advantage for larger companies who have the time and resources to expend on drafting careful dispute resolution clauses, which allow for the smoothest possible dispute resolution. However, for small businesses international arbitration is, as one small business representative put it, “way out of

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<sup>284</sup> Born, above n 47, at 2.

<sup>285</sup> Butler and Herbett, above n 9, at 190.

<sup>286</sup> United Nations Commission on International Trade Law *Arbitration Rules* (2014).

<sup>287</sup> Butler and Herbett, above n 9, at 190.

<sup>288</sup> Born, above n 47, at 7.

<sup>289</sup> Butler and Herbett, above n 9, at 200.

<sup>290</sup> Butler and Herbett, above n 9.

<sup>291</sup> At 213.

sight”.<sup>292</sup>

By contrast, the BAT would provide a default dispute resolution mechanism for small businesses to fall back upon in cases where they had not included a dispute resolution clause in their contract. In the unfortunate event that a dispute has arisen, small businesses would have more effective access to justice.

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<sup>292</sup> Business B, above n 11.



## 7. Chapter six: Conclusion

There is an overwhelming consensus among both academics and governments that the prosperity and growth of SMEs should be prioritised for the benefit of the economy. However, the problems that arise from a lack of clearly applicable legal framework for international commercial contracts involving SMEs is a subject that until recently has received very little attention.

The goal of this paper was to assess how small businesses interact with the legal framework applicable to their international commercial contracts. While the practices and experiences of the small pool of participants interviewed for this project varied greatly, several trends emerged; including the practice of piecemeal contracting, a lack of concern for questions of applicable law and a lack of meaningful access to effective dispute resolution. The default positions which apply where the parties have not included choice of law and dispute resolution clauses in their contract are fraught with uncertainty and difficulties for SMEs. For this reason, including choice of law and dispute resolution clauses should be seen as a minimum requirement for international commercial transactions. Unfortunately, for small businesses with limited resources, access to legal advice and understanding of the complexities of international commercial law; considering legal matters is too frequently put in the “too hard basket”.

The importance of SMEs to the global economy justifies state intervention to ensure effective default positions for businesses that may not have the resources or foresight to effectively exercise their party autonomy at the time of contracting. A more accessible legal position will give SMEs the confidence to pursue more international opportunities and diversify their markets. Unfortunately suitable default positions such as the applicability of the CISG to contracts for the international sale of goods are too few and far between.

A top-down approach requiring the cooperation of nation states is undoubtedly less straightforward than domestic law reform. However, as discussed at the outset of this paper, there is already a global movement towards recognising the importance of SMEs to the economy. New Zealand has already been involved in various top-town efforts in the sphere of international trade, including the signing of nine free trade agreements in the last two decades.<sup>293</sup> The preamble of the TTPA expressly recognises a commitment to

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<sup>293</sup> New Zealand Ministry of Foreign Affairs and Trade “Trade and Economic Relations: Trade Relationships and Agreements” (21 August 2014) New Zealand Ministry of Foreign Affairs and Trade <<http://www.mfat.govt.nz/Trade-and-Economic-Relations/2-Trade-Relationships-and-Agreements/#force>>.

supporting the growth and development of SMEs.<sup>294</sup> At this point in time, more focus on the introduction of suitable default legal positions for international commercial contracts is warranted.

The purpose of this paper was to bring attention to deficiencies of the current legal framework for international commercial contracts in the context of New Zealand SMEs. The question of specific solutions, particularly in relation to substantive law, requires further research and collaboration with SMEs. The proposal for a Bilateral Arbitration Treaty is an exciting opportunity in regard to dispute resolution that deserves attention. Effective default positions have the potential to greatly improve the legal position for New Zealand’s SMEs who currently are or who are contemplating trading across borders.

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<sup>294</sup> New Zealand Ministry of Foreign Affairs and Trade “Text of the Trans-Pacific Partnership” (2015) New Zealand Ministry of Foreign Affairs and Trade <<https://www.mfat.govt.nz/en/about-us/who-we-are/treaty-making-process/trans-pacific-partnership-tpp/text-of-the-trans-pacific-partnership>>.

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## **8. Appendix One: Interview Questions**

### ***A Background/general questions***

1. Where is the primary place of business of your business?
2. How many permanent employees does the business employ?
3. What kind of cross-border transactions is your company involved with?
4. Roughly how much of your gross income is received from international trade?
  - a. Less than 5%
  - b. 6-25%
  - c. 26-50%
  - d. 51-75%
  - e. 76-94%
  - f. More than 95%

### ***B Domestic transactions***

5. Do you consider international transactions for the sale or purchase of goods to be more risky than domestic transactions?
6. What do you perceive as the risks of international transactions?
7. What steps does the business take to mitigate this risk?
8. What method of payment do you mostly commonly use in domestic (non-consumer) contracts?
9. If the other party was to commit a major breach of contract, i.e. a failure to pay or a complete failure to perform, what steps would you take to enforce a *domestic* contract?

### ***C Exports***

10. What goods, if any, does the business export overseas?
11. What is the nature of these products?
12. Are goods specifically tailored to individual buyers?
13. How do you assess the risk when entering a new market? Do you generally consider the risk to be the same in all markets?
14. What checks do you do on a buyer before you will transact with them?

15. Do you know what checks international businesses do on your business before they will transact with you?
16. How many export transactions, on average, does the business conduct per year?
17. How are export negotiations usually conducted i.e. in person, over the phone, through email?
18. Who conducts the negotiations e.g. lawyer, sales person, director
19. Are negotiations recorded? E.g. are phone transcripts taken?
20. When exporting goods is a formal contractual document usually created between the business and the buyer?
21. If so, how is this document drafted?
22. Does the business have a standard form contract for exports? Why/why not?
23. Do the businesses you are contracting with often have standard form contracts?
24. Are the terms of the contract individually negotiated?
25. What is the price range of the goods exported?
26. What is the usual method of payment for exports? Why?
27. Do you require a deposit before you begin performance?

#### ***D Imports***

28. What goods, if any, does the business import from overseas?
29. What is the nature of these products?
30. Are goods specifically tailored to you as an individual buyer?
31. Are you aware what, if any, process overseas sellers undergo to assess the risk of trading with you?
32. How many import transactions, on average, does the business conduct per year?
33. How are import negotiations usually conducted i.e. in person, over the phone, through email?
34. Who conducts the negotiations e.g. lawyer, sales person, director
35. When exporting goods is a formal contractual document usually created between the business and the buyer?
36. If so, how is this document drafted?

37. Does the business have a standard form contract for exports? Why/why not?
38. Do the businesses you are contracting with often have standard form contracts?
39. Are the terms of the contract individually negotiated?
40. What is the price range of the goods imported?
41. What is the usual method of payment for imports? Why?
42. Does the seller usually require a deposit before beginning performance?

### ***E Drafting***

43. In the last 5 years. How often have you engaged the services of a lawyer to assist in drafting contracts for international trade?
  - a. Never
  - b. Frequently: give details....
  - c. Occasionally: give details....
44. What law do you assume to apply to your international transactions?
45. Are you usually aware or concerned about which law applies to the contract?
46. Has the business ever adopted a model contract for the international sale of goods?
47. Are you familiar with the United Nations Convention on Contracts for the Sale of Goods?
48. If yes, do you find it beneficial?
49. Does language pose an obstacle to drafting international commercial contracts?

### ***F Dispute resolution***

50. Is dispute resolution an important consideration when entering a new market?
51. Do drafted documents (or other negotiations) usually include a dispute resolution agreement?
52. If so which method of dispute resolution is chosen?
53. If not, why not?
54. If the other party to a *domestic* transaction failed to carry out their obligations in a significant way. E.g. if the goods were not delivered or the goods were not paid for, what steps would the business take to enforce the contract and/or resolve the dispute?
55. What about if it was an international transaction?

56. Has the business been a party to any litigation in the past 10 years (in general)
57. If so, what was the nature of the dispute e.g. Employment, breach of contract etc.
58. Where was the dispute heard?
59. What do you perceive as the advantages or disadvantages of litigation?
60. Do you have any perception of international commercial arbitration?
61. Has your firm been involved in any arbitration proceedings (domestic or international) in the past 10 years?
62. Has your firm been involved in any mediation process in the past 10 years?
63. Has your firm used the disputes tribunal in the past 10 years?
64. Do contracts usually contain a clause on dispute resolution? Why/why not?

### ***G Regionalism***

65. With businesses in which of the following regions has your firm engaged in international trade in the past 10 years?
  - a. Australasia (excluding New Zealand)
  - b. Asia
  - c. South Pacific
  - d. European Union
  - e. United States of America
  - f. Latin America
  - g. Africa
  - h. Other \_\_\_\_\_
66. Do you perceive some regions to be more risky or difficult to trade with?
67. Which country has the business had the most trade with (in terms of income?)



## **9. Appendix two:**

1. Business A is a jewellery business with two permanent employees. Business A imports a large proportion of its supplies from overseas wholesalers and has occasionally exported to consumers located overseas. Less than 10% of business A's gross income comes from international trade.
2. Business B has 9 permanent employees and manufactures machines for the woodworking industry. Business B imports supplies for its manufacturing operations and exports its machines to Australia and Europe. More than 80% of Business B's gross income comes from international trade.
3. Business C has one permanent employee in addition to the owner of the business. Business C designs and writes software for other businesses. Between 20 and 30% of Business C's gross income comes from international trade.
4. Business D has approximately 25 permanent employees and manufactures a food product for both domestic and international market. Business D imports ingredients and packaging for the food product and exports the manufactured product to Australia, China, Singapore, the USA and the UK. Around 15% of Business D's gross income comes from international trade and all future growth is predicted to be from international trade.
5. Business E is a software company who employs between 8 and 14 permanent employees. Business E sells its products and related services in Australia, Asia, Europe, US and the Middle East. Between 80 and 90% of Business E's gross income comes from international trade.
6. Business F employs only casual staff. Business F manufactures a food product using locally sourced ingredients. Business F imports packaging from Asia and exports its manufactured product to Asia. Between 85 and 90% of Business F's gross income is from international trade.
7. Business G produces a food product. Business G has approximately 60 permanent employees. Business G imports packaging from Asia. Business G currently exports its products to Australia, Asia and the US. Between 40-45% of Business G's gross income comes from international trade.
8. Business H has three permanent employees. Business H manufactures a high value machine for the furniture industry. Business H imports some components for the machine and exports the machines to Europe, Australia, Asia and the US. Approximately 90% of Business H's gross income comes from international trade.

9. Business I has five employees in addition to the two business owners. Business H imports ingredients for its manufactured food product, which is currently exported to Australia, Singapore and Malaysia. Business H has only recently started exporting and only 5% of their gross income come from international trade.
10. Business J is a small jewellery business. Business J imports supplies for the manufacture of jewellery which is mostly sold locally but also sold to overseas customers. Less than 5% of Business J's gross income comes from international trade.

