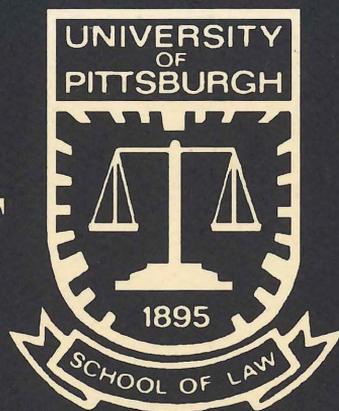


THE JOURNAL OF LAW AND COMMERCE



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AVOIDANCE OF THE CONTRACT IN CASE OF NON-CONFORMING GOODS (ARTICLE 49(1)(A) CISG)

*Ingeborg Schwenzer**

I. GENERAL REMARKS

Article 49(1)(a) CISG provides that avoidance is possible, and only possible, “if the failure by the seller to perform any of his obligations under the contract or this convention amounts to a fundamental breach of contract.” According to Article 25 CISG, a breach is fundamental “if it results in such detriment to the [buyer] as substantially to deprive him of what he is entitled to expect under the contract, unless the [seller] did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result.”

This presupposes that the defect has a certain objective importance. Therefore, the lack of conformity must be so serious that the buyer cannot be required to retain the goods and could not be adequately compensated by damages or a price reduction. The substantiality of the detriment to the buyer may be ascertained by having regard to the express stipulations of the parties, the purpose for which the goods are bought, and finally, to the question of whether it is possible to cure the defect.

II. EXPRESS STIPULATIONS

With regard to express stipulations, it is up to the parties to stipulate what they consider to be the essence of the contract. If the seller then fails to deliver in accordance with the express stipulations given, he cannot argue that he did not foresee any detriment that occurs to the buyer. Consequently, it is not surprising that courts have found a fundamental breach of contract to exist where delivery was made by the seller in derogation from the agreed central features of the goods.¹

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1. See Oberlandesgericht Stuttgart, Germany, 12 Mar. 2001 (CISG-online 841) (unsweetened apple

III. PURPOSE FOR WHICH GOODS ARE BOUGHT

In the absence of express stipulations, regard should be had to the purpose for which the goods in question were bought. Whether or not the goods actually fulfil this purpose will be relevant in determining whether there is a fundamental breach. Where the buyer wants to use the goods himself, the fact that the goods could be resold, whether at a discount price or not, is irrelevant.² Rather, the decisive factor is whether the goods are totally improper for the use intended by the buyer, to the extent that the buyer is not able to make use of or to process the goods differently without unreasonable expenditure.³ Where, however, the buyer is in the resale business, the issue of potentially being able to "on-sell" the goods becomes relevant. A fundamental breach will exist if the goods cannot be resold at all, e.g. food not complying with national health regulations.⁴ In other cases, the question is whether resale of non-conforming goods can reasonably be expected from the individual buyer in his normal course of business. A wholesaler with broader access to markets in the business concerned has more opportunities to resell the goods than a retailer. A retailer cannot be expected to resell the goods at a discount price if, by doing so, he would be likely to damage his own reputation.⁵ In determining the likelihood of this, regard is to be had to the retailer's specific target group of customers.⁶

juice concentrate); Appellationsgericht Basel-Stadt, Switzerland, 22 Aug. 2003 (CISG-online 493) (non-genetically modified food); China International Economic and Trade Arbitration Commission (CIETAC), 30 Oct. 1991 (CISG-online 842) (thickness of a roll of aluminum); Zivilgericht Basel-Stadt, Switzerland, 1 Mar. 2002 (CISG-online 729) (soy protein products).

2. See Landgericht München, Germany, 27 Feb. 2002 (CISG-online 654).

3. See Court of Arbitration of the International Chamber of Commerce, Case No. 7754, Jan. 1995 (CISG-online 843); Oberlandesgericht Stuttgart, Germany, 12 Mar. 2001 (CISG-online 841). *But see* Landgericht München, Germany, 27 Feb. 2002 (CISG-online 654) (globes still could be used for advertising even though they were not able to rotate).

4. See Landgericht Ellwangen, Germany, 21 Aug. 1995 (CISG-online 279); Court of Arbitration of the International Chamber of Commerce, Case No. 8128, 1995 (CISG-online 526); Zivilgericht Basel-Stadt, Switzerland, 1 Mar. 2002 (CISG-online 729). *But see* Landgericht Darmstadt, Germany, 22 Dec. 1992 (CISG-online 177), *affirmed by* Bundesgerichtshof, CLOUT Case No. 123 [Germany, 8 Mar. 1995] (CISG-online 144) (mussels were still good for consumption because there was no health risk).

5. See Landgericht Landshut, Germany, 5 Apr. 1995 (CISG-online 193) (clothes); Hanseatisches Oberlandesgericht Hamburg, Germany, 26 Nov. 1999 (CISG-online 515) (jeans); Oberlandesgericht Köln, Germany, 14 Oct. 2002 (CISG-online 709) (designer clothes). *See also* Landgericht Oldenburg, Germany, 6 July 1994 (CISG-online 274) (partly revising, but not regarding the arguments to Article 25 CISG), Oberlandesgericht Oldenburg, Germany, 1 Feb. 1995 (CISG-online 253) (limited circle of interested sub-buyers would only buy the goods at a discount of 50%).

6. See Oberlandesgericht Köln, Germany, 14 Oct. 2002 (CISG-online 709) (buyers of designer

IV. SELLER'S POSSIBILITY TO CURE

An important limitation on avoidance under the CISG is the seller's possibility to cure. Though the objective essential nature of the defect is always a necessary condition to establish a fundamental breach of contract, it will not always be sufficient. In cases where cure by the seller—e.g. by repairing the goods⁷ or delivering substitute or missing goods⁸—is still possible without causing unreasonable delay or inconvenience to the buyer, there is not yet a fundamental breach, or rather, the buyer may not yet avoid the contract even though the breach otherwise appears to be fundamental.⁹ Here, due regard is to be given to the purposes for which the buyer needs the goods. If timely delivery is of the essence of the contract, repair or replacement by the seller will usually lead to unreasonable delay within the meaning of Article 48(1) CISG.¹⁰ Furthermore, the buyer should not be expected to accept the cure by the seller if the basis of trust for the contract has been destroyed, e.g. due to the seller's deceitful behaviour. When the seller either refuses to cure the defect, simply fails to react, or if the defect cannot be cured by a reasonable number of attempts within a reasonable time, then a fundamental breach will also be deemed to have occurred.

V. DOCUMENTS AND "AVOIDANCE"

With respect to international sales contracts involving documents, special uniform rules and trade usages have been established by the International Chamber of Commerce (ICC). The INCOTERMS 2000¹¹ contain detailed rules governing the obligations of the seller to provide for documents,¹² and

clothes have higher standards).

7. See *Handelsgericht des Kantons Aargau, Switzerland*, 5 Nov. 2002 (CISG-online 715).

8. See *Landgericht Köln, Germany*, 16 Nov. 1995 (CISG-online 265).

9. See JOHN HONNOLD, *UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION* 327-32 (3d ed. 1999).

10. All INCOTERMS 2000 clauses in A4 call for delivery "on the date or within the period agreed for delivery." INCOTERMS 2000: ICC OFFICIAL RULES FOR THE INTERPRETATION OF TRADE TERMS (ICC Publication No. 560, 1999) [hereinafter INCOTERMS 2000]. One German Court has argued that a C.I.F. contract has to be understood as a fixed term contract. *CLOUT Case No. 277 [Oberlandesgericht Hamburg, Germany, 28 Feb. 1997] (CISG-online 261)*. *But see* Court of Arbitration of the International Chamber of Commerce, *Case No. 7645, 1995 (CISG-online 844)* (the INCOTERMS clause C.F.R. does not, however, specify that the abidance within the time limit is an obligation of especially essential importance).

11. See INCOTERMS 2000, *supra* note 10.

12. See *id.* at A8.

the buyer to accept them,¹³ respectively, whereas the Uniform Customs and Practice for Documentary Credits of the ICC,¹⁴ the UCP 500, lay down special rules for cases where payment is to be made by means of documentary credit, including standby letters of credit. Both sets of rules are widely incorporated into international sales contracts.

In international sales contracts involving documents, a distinction needs to be made at the outset between three different situations. First, there are various documents that usually *accompany* a contract of sale, e.g. insurance policies, certificates of origin, certificates of inspection, custom clearance certificates, etc. Second, a contract of sale can require delivery by the handing over of *documents of title*, e.g. bills of lading, dock warrants, warehouse receipts or their respective electronic equivalents. Finally, one has to consider the special situation of payment by *documentary credit*, including letter of credit.

1. *Accompanying Documents*

In the case of accompanying documents, the question of whether the buyer may avoid the contract must be decided by resorting to the general mechanisms of the Convention already established for determining a fundamental breach.¹⁵

Thus, initially, what is decisive is whether the defective documents limit the buyer in reselling the goods or using them according to his plans. If they do not, a fundamental breach can never be assumed. If they do limit him, the seriousness of the defect depends upon whether the buyer can still use the goods in a reasonable way even with unclean documents, or, if not, whether he can easily acquire clean documents himself.¹⁶

2. *Documentary Sales*

In documentary sales contracts, the tender of clean documents is of the essence of the contract. This implies the buyer's right to reject any tender of

13. See *id.* at B8.

14. Cf. ICC Uniform Customs and Practices for Documentary Credits (ICC Publication No. 500, 1993).

15. See CLOUT Case No. 171 [Bundesgerichtshof, Germany, 3 Apr. 1996] (CISG-online 135).

16. See, e.g., *id.* In this case, seller provided for a non-conforming certificate of origin and a non-conforming certificate of analysis. The court held that the seller could easily get a new certificate of origin from the local Chamber of Commerce and that the certificate made by buyer's expert was a valid new certificate of analysis.

non-conforming documents, irrespective of the *goods*' actual conformity or non-conformity with the contract. However, the seller may cure any lack of conformity in the documents. If, for example, the bill of lading is "unclean" because it refers to damage to the goods or their packaging, the seller may tender a new bill of lading relating to other goods, which does not contain such a reservation. If the bill of lading indicates a late loading date, the seller may subsequently purchase goods "afloat" which were loaded on time and tender to the buyer the bill of lading issued for those goods. According to the second sentence of Article 34 CISG, this is possible without any relevant restrictions if the seller handed over the "unclean" documents before the time required by the contract. After this date, curing is only possible under the prerequisites of Article 48(1) CISG. That means that the seller may only remedy the failure if he can do so without unreasonable delay. Special regard is to be had to the stipulations of the contract and the circumstances of the individual case that may make timely performance of central importance.¹⁷

3. *Documentary Credits*

If the contract provides for payment by documentary credit, this implies that the documents have to be "clean" in every respect. Otherwise, the buyer has the right to avoid the contract. This necessity of strict compliance of documents can be derived directly from Article 13(a) UCP 500. Articles 20 *et seq.* UCP 500 set out, in detail, under which circumstances the documents are to be accepted as clean, or may be rejected.

4. *Commodity Trade*

With regard to commodities, special standards have to be applied in determining whether there is a fundamental breach. In the commodity market, string transactions prevail and prices are subject to considerable fluctuations.¹⁸ Therefore, the timely delivery, by handing over, of clean documents—that can be resold in the normal course of business—is always of the essence of the

17. See UNIDROIT Principles 2004 art. 7.3.1, Official Comment 3.b.

18. For iron molybdenum, see Oberlandesgericht Hamburg, Germany, 28 Feb. 1997 (price was 9.70 US \$/kg and changed to 30 US \$/kg). For commodity prices in general, see Klaus Matthies & Hans-Joachim Timm, *World Commodity Prices 1999-2000* (Association d'Instituts Européens de Conjoncture Economique, Working Group on Commodity Prices, 1999), available at <http://www.hwva.de/Publikationen/Report/1999/Report191.pdf> (last viewed 27 Feb. 2006).

contract.¹⁹ If the parties do not stipulate this importance by respective clauses, this can be derived from the circumstances by an interpretation of the contract pursuant to Article 8(2) and (3) CISG.²⁰ As a result, in practice, the seller's possibility to cure any defect in the documents according to Article 48(1) CISG²¹ does not exist in the commodity trade.

VI. FINAL REMARKS: THE CISG AS AN EFFECTIVE SOLUTION

The concept underlying the CISG, that the essential nature of a breach is the decisive factor for the continuing existence of a contract, provides an effective system of remedies. The CISG's concept of avoidance receives support not only due to the interest in upholding the contract, whereby cancellation should only be a remedy of last resort, but also as a reflection of real business practice and the case law in the area. Importantly, the CISG, used in conjunction with the INCOTERMS and the UCP 500, offers a workable solution for the scope of issues and potential problems in the area of commodity and documentary sales law.

19. Cf. UNIDROIT Principles 2004, art. 7.3.1, Official Comment 3.b.; MICHAEL BRIDGE, *THE SALE OF GOODS* 155 (1997); POOLE, *TEXTBOOK ON CONTRACT LAW* ¶ 7.5.3.2 (7th ed. 2004); Peter Schlechtriem, *Interpretation, gap-filling and further development of the UN Sales Convention*, § I.1 nn.15-24, available at <http://www.cisg.law.pace.edu/cisg/biblio/Slechtriem6.html> (last viewed 27 Feb. 2006); Alastair C.L. Mullis, *Termination for Breach of Contract in C.I.F. Contracts Under the Vienna Convention and English Law; Is there a Substantial Difference?*, in *CONTEMPORARY ISSUES IN COMMERCIAL LAW (ESSAYS IN HONOR OF PROF. A.G. GUEST)* 137-60 (Lomnicka & Morse ed., 1997), available at <http://www.cisg.law.pace.edu/cisg/biblio/mullis.html> (last viewed 27 Feb. 2006).

20. See Schlechtriem, *supra* note 19, § I.1 nn.15-24.

21. See *supra* Part IV.