

Avoidance of the contract for non-conformity of goods and the requirement of fundamental breach in the CISG

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Abstract

The present article deals with avoidance of the contract for non-conformity of goods and the requirement of fundamental breach in the United Nations Convention on Contracts for the International Sales of Goods (CISG). In order to avoid a contract for the lack of conformity a fundamental breach is required, hence the study firstly analyses the requirement of fundamental breach defined in article 25 CISG. Secondly, we try to find out how the buyer can avoid the contract under article 49(1)(A) CISG with referring to the numerous decisions of courts and arbitral panels. Finally, the analysis focuses on seller's right to cure after the delivery date and interaction between right to cure and avoidance.

Keywords: CISG, goods, conformity, avoidance, fundamental breach

1. Introduction

In sales transaction, a party may prefer to avoid the contract where things go wrong. The buyer's right to avoid the contract is governed by article 49 CISG^[1] which has been considered one of the most important provisions of the CISG as it has resulted in many cases^[2]. However, in order to avoid the contract, the non-conformity of the goods must amount to a fundamental breach. It is asserted that the delivery of non-conforming goods is the most difficult area within the fundamental breach doctrine,^[3] and one of the most recurrent topics in CISG litigation.^[4] Since The term "fundamental breach" is defined by article 25 CISG, the notion of the right to avoid under article 49 (1)(a) must be understood in conjunction with article 25. It must be remembered however, in order to establish what type of deficiency in the goods may constitute a fundamental breach, decision will always have to be made on a case-by-case-basis.^[5]

This study explores the provisions within the CISG dealing with the buyer's right of avoidance of the contract particularly in case of non-conformity. It examines article 25 CISG dealing with fundamental breach that provides the tests for a breach of contract, because certain remedies are only

available in cases of a fundamental breach. Additionally, the chapter analyses the meaning of avoidance in the context of defective performance, provided for in article 49 CISG, and interaction between the seller's right to cure and the buyer's right to avoid the contract. Hence, readers should obtain guidance and assistance in order to determine whether there was a fundamental breach in cases of delivery of non-conforming goods.

2. The Requirement of Fundamental Breach

In order to avoid a contract a fundamental breach of contract is required. The concept of fundamental breach is defined by article 25 CISG that states a breach is fundamental if it substantially deprives the party of what it was entitled to expect under the contract.^[6] The definition intends to separate a non-fundamental and a fundamental breach of contract. The distinction is of vital importance for the system of remedies, because it can determine the life or death of the contract. For example, damages, reduction of price and repair the goods do not require a fundamental breach while avoidance of contract and delivery of substitute goods may only be requested in case of a fundamental breach.

¹ CISG, Art. 39: (1) The buyer may declare the contract avoided: (a) 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; or (b) in case of non-delivery, if the seller does not deliver the goods within the additional period of time fixed by the buyer in accordance with paragraph (1) of article 47 or declares that he will not deliver within the period so fixed. (2) However, in cases where the seller has delivered the goods, the buyer loses the right to declare the contract avoided unless he does so: (a) in respect of late delivery, within a reasonable time after he has become aware that delivery has been made; (b) in respect of any breach other than late delivery, within a reasonable time: (i) after he knew or ought to have known of the breach; (ii) after the expiration of any additional period of time fixed by the buyer in accordance with paragraph (1) of article 47, or after the seller has declared that he will not perform his obligations within such an additional period; or (iii) after the expiration of any additional period of time indicated by the seller in accordance with paragraph (2) of article 48, or after the buyer has declared that he will not accept performance.

² There are 409 reported cases on the Institute of International Commercial Law CISG database; Pace Law School Institute of International Commercial Law, 'Cases Involving CISG Article 49', available at: <http://cisgw3.law.pace.edu/cisg/text/e-text-49.html#case>, (Visited on November 20, 2015).

³ Peter Huber and Alastair Mullis, *The CISG: A New Textbook for Students and Practitioners* 227 (Sellier European Law Publishers, 2007).

⁴ Leonardo Graffi, "Case Law on the concept of fundamental breach in the Vienna Sales Convention" 3 *IBLJ* 341 (2003).

⁵ Some decisions looked merely at the percentage of defective goods, or at the estimated cost of repair on the total value of the goods. Other decisions, however, gave relevance to a criterion based on the merchantability of the defective goods.

⁶ CISG, Art. 25: "a breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result."

3. Content and Purpose of Article 25 CISG

The existence of a fundamental breach enables the aggrieved party, provided certain other conditions are fulfilled, to avoid the contract. The first part of article 25 characterizes fundamental breach as the detriment caused by one party to the other party, which substantially deprives him of what he is entitled to expect under the contract. The second part of article 25 is conditional, and allows the breaching party to prevent avoidance if he proves that he did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result.^[7] Thus the provision is comprised by two main components that will be discussed in turn: detriment/expectation component relating to the aggrieved party and foreseeability component concerning the breaching party.

3.1 Detriment/Expectation Component

In order for a breach to be “fundamental”, it must cause a “detriment” that substantially deprives the aggrieved party of its reasonable expectations.^[8] What then is detriment? What is substantial deprivation? And what are the contractual expectations of the non-breaching party?

3.1.1 The Detriment as a Precondition for Fundamental Breach

The CISG, does not define the term “detriment”. Nor does it give any example of detriment that rises to the level of a fundamental breach. However, the concept of “detriment” comprises not only actual and future monetary loss, but also any other kind of (actual and future) negative consequences of any possible breach of contract.^[9] The buyer may be substantially deprived of what he was entitled to expect under the contract by a breach although actual damage was not suffered. Suppose, for instance, where a contract concluded to deliver goods in a fixed date and where it was made clear that time was of the essence. In that case, the buyer by any delay, will be substantially deprived of what he was entitled to expect under the contract.^[10]

Detriment must be in existence at the time of the avoidance of the contract. However, it occurs in many instances when the breach of contract continues. Hence, in order to determine when the detriment has become so great that may cause fundamental breach, article 25 CISG turns on the degree of the detriment, namely, substantial deprivation that will be discussed below.

3.1.2 Substantial Deprivation

According to article 25 CISG, to constitute a fundamental breach, the non-breaching party must suffer a detriment which must be such as substantially to deprive him of what he is entitled to expect under the contract.^[11] The wording “substantially to deprive” qualifies the detriment within article 25. But how the “substantiality of the deprivation” is

judged? For the breach to be fundamental, the detriment must be substantial. In this regard, the major emphasis is clearly laid upon the contractual interests of the aggrieved party: “of what he is entitled to expect under the contract.”^[12] For example, it has been held that a fundamental breach by the party in breach is established under article 25 CISG if that party “fails to receive the essence of what could have been expected according to the contract.”^[13]

In sum, a “detriment” within article 25 can lead to fundamental breach only if a party fails to receive the essence of what he was entitled to expect according to the contract.^[14] Thus, the focus is on the judgment of the “contractual expectation” for that purpose which will be discussed below.

3.1.3 Contractual Expectations

The aggrieved party’s expectations are qualified by such phrases as “what he is entitled to expect under the contract” in Article 25 CISG. Under the general principle of freedom of contract parties are undoubtedly free to determine when and under which circumstances a breach of the contractual expectation is fundamental.^[15] This is supported by judicial authority which declares that the buyer should make use of the opportunity to expressly state in the contract which obligations it considers essential.^[16] However, the question arising here is: whether the language of the contract is the only source in defining the contractual expectations of the aggrieved party? It has been stated that the wording “under the contract” refers to all the terms of the contract whether express or implied. In other words, it is not only the express contractual terms that determine the particular expectations, other sources can be discerned from additional provisions of the CISG, usages, or established practices and negotiations.^[17]

It is important to note that according to article 25 the expectation test is objective rather than subjective. Because it does not really matter what the aggrieved party actually expected, but what he was entitled (reasonably) to expect, i.e. what a reasonable third party would have expected under the circumstances.^[18] However, the expectation test is limited by foreseeable deprivation which makes clear that where the damaged party is deprived of a benefit which the breaching party could not foresee and could not reasonably be expected to foresee, the breach is not fundamental. This understanding is further supported by the foreseeability test, which will be discussed below.

3.2 Foreseeability Component

The second part of article 25 is its foreseeability component. Even if the breach of contract has substantially deprived the aggrieved party of what he was entitled to expect under the contract, as discussed above, the breach will not be fundamental if that result was not foreseeable. Therefore, in order to prevent the other party from avoiding the contract,

⁷ Ibid.

⁸ Michael Will, “Article 25” in Cesare Massimo Bianca and Michael Joachim Bonell (eds.), *Commentary on the International Sales Law* 210 (Giuffrè, Milan, 1987).

⁹ Franco Ferrari, “Fundamental Breach of Contract under the UN Sales Convention 25 Years of Article 25 CISG” 25 *Journal of Law and Commerce* 495 (2006).

¹⁰ Supra note 3 at 215.

¹¹ CISG, article 25.

¹² Ibid.

¹³ District Court Saarbrücken, No. 8 O 49/02, Germany, July 2, 2002, available at: <http://cisgw3.law.pace.edu/cases/020702g1.html>.

¹⁴ See supra note 4 at 340.

¹⁵ See discussion at chapter 4.1; Ingeborg Schwenzer, “The Danger of Domestic Pre-Conceived Views with Respect to the Uniform Interpretation of the CISG: The Question of Avoidance in the Case of Non-Conforming Goods and Documents” 36 *VUWLR* 795-801 (2005).

¹⁶ Bundesgerichtshof, No. VIII ZR 51/95, Germany, April 3, 1996, available at: <http://www.unilex.info/case.cfm?id=182>.

¹⁷ See CISG, Art. 30: “The seller must deliver the goods, hand over any documents relating to them and transfer the property in the goods, as required by the contract and this Convention”.

¹⁸ Supra note 3 at 215.

the breaching party has to show that it did not foresee the detrimental consequences, nor would a reasonable person of the same kind and in the same conditions have foreseen these consequences.^[19] Since it is improbable that the breaching party would admit to foreseeing the detriment in question, the standard of the “reasonable person” was introduced.^[20] Thus, the foreseeability test is both subjective and objective in that it depends not only upon whether the breaching party actually foresaw the result, but also on whether a reasonable person of the same kind in the same condition would have foreseen it. It is asserted that since in international sales transactions parties are presumed to be merchants,^[21] a “reasonable person” is considered to be a reasonable merchant. The phrase “of the same kind” refers to a merchant in the same trade, doing the same operations or functions as the breaching party.^[22] The requirement that the reasonable merchant be “in the same circumstances” refers to both regional and world-wide market conditions.^[23]

In my view, if the buyer actually was deprived of his expectations under the contract, there will automatically be a “detriment” and it will be very hard for the seller to show that this result could not have been foreseen by a reasonable person of the same kind in the same circumstances. Therefore, the practical relevance of the foreseeability requirement in article 25 CISG will be limited.

4. Avoidance for Non-Conformity of Goods under Article 49(1) (A) CISG

Under article 49(1) (a) CISG avoidance is 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.”^[24] However, as already mentioned the notion of avoidance for fundamental breach must be understood in conjunction with article 25 CISG. In case of delivery of non-conforming goods by the seller (where amounts to a fundamental breach), the ability for a buyer to avoid the contract is an important feature of the CISG. It is asserted that the delivery of non-conforming goods is the most difficult area within the fundamental breach doctrine,^[25] and one of the most recurrent topics in CISG litigation.^[26]

5. Seller’s Right to Cure after the Delivery Date

Article 48 CISG deals with the seller’s right to cure a breach after the delivery date.^[27] It specifies that the right to cure may arise in two situations, the first is the application of the requirements of article 48(1), and the second is an implied

agreement between the parties under article 48(2). These requirements along with the interaction between the seller’s right to cure and the buyer’s right to avoid the contract will be discussed below.

5.1 Right to Cure under Article 48(1) CISG

According to article 48(1) CISG, under certain circumstances, the seller has a right to remedy at his own expense “any failure” to perform his obligations.^[28] However, practically the delivery of non-conforming goods will be its main field of application.^[29] The seller’s right to cure depends on two conditions: that the contract has not rightfully avoided by the buyer and that he will not suffer unreasonable inconvenience. Unreasonable inconvenience concept cannot be specified in general terms. It varies from case to case depending on the circumstances.^[30] It is stated that it refers to the disturbances that cure would bring to the buyer’s business. The seller must be able to effect cure without unreasonable delay.^[31] There are three kinds of delay caused by curing: a delay which amounts to a fundamental breach of contract and is governed by article 49(1) (a) CISG; a delay which does not constitute a fundamental breach but still appears unreasonable; and finally a delay which is not unreasonable. The seller’s right to cure is only possible in the last kind of delay.^[32]

According to the second sentence of article 48(1), the buyer’s right to claim damage under the Convention is retained even if, the seller performs its obligations by his cure. In this regard, however, two points must be considered. First, the provision states that cure does not exclude a claim for damages if such a claim exists.^[33] Secondly, the provision only refers to those damages which result from the original breach and which cannot be removed by the cure.^[34] The buyer, for example, may claim damages for any loss of profit occurs due to delivery of a machine one week after the agreed time, because he could not use the machine during that period. The same would be true where the defective machine delivers in time but the repair of which took the seller one week. However, if all conditions are fulfilled, the exercise of the seller’s right to cure depends on the nature of the goods and on the type of its failure to perform. Usually he will cure by substituting conforming goods for defective goods or by repairing or replacing a defective component part.

5.2 Right to Cure under Article 48(2) CISG

Under article 48(2) and (3) CISG, the seller must indicate to

the buyer retains any right to claim damages as provided for in this Convention. (2) If the seller requests the buyer to make known whether he will accept performance and the buyer does not comply with the request within a reasonable time, the seller may perform within the time indicated in his request. The buyer may not, during that period of time, resort to any remedy which is inconsistent with performance by the seller. (3) A notice by the seller that he will perform within a specified period of time is assumed to include a request, under the preceding paragraph, that the buyer make known his decision. (4) A request or notice by the seller under paragraph (2) or (3) of this article is not effective unless received by the buyer.

²⁸ CISG, Art. 48(1).

²⁹ Supra note 3 at 218.

³⁰ Ibid.

³¹ Unreasonableness depends on the circumstances of each case, including the nature of the goods and their intended use.

³² Supra note 19 at 252.

³³ The buyer will only be able to claim damages, if the general requirements for such a claim (Art. 45(1) lit. (b), Art. 74 et seq. CISG) are met.

³⁴ Supra note 3 at 220.

¹⁹ Michael Will, “Article 25” in Cesare Massimo Bianca and Michael Joachim Bonell (eds.), *Commentary on the International Sales Law* 206 (Giuffrè, Milan, 1987).

²⁰ Alexander Lorenz, “Fundamental Breach under the CISG”, available at: <http://www.cisg.law.pace.edu/cisg/biblio/lorenz.html#fn31> (Visited on November 20, 2015).

²¹ Supra note 19 at 218.

²² Cesare Massimo Bianca and Michael Jochin Bonell, *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* 219 (Giuffrè, Milan, 1987). It has been argued that the reasonable merchant’s business practices, socio-economic background, religion, and language should also be considered.

²³ Ibid.

²⁴ CISG, Art. 49(1)(a).

²⁵ Supra note 3 at 227.

²⁶ Supra note 4 at 341.

²⁷ CISG, Art. 48: (1) Subject to article 49, the seller may, even after the date for delivery, remedy at his own expense any failure to perform his obligations, if he can do so without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty of reimbursement by the seller of expenses advanced by the buyer. However,

the buyer that he is willing to perform within a certain period and request him to make known whether he will accept the cure or whether he is likely to reject it.^[35] According to article 48(3) a notice by the seller that he will perform within a specified period of time is assumed to include such a request. It is noteworthy however that, under article 48(4) CISG, the seller's request or notice is effective only if received by the buyer. This is one of the exceptions to the dispatch principle as laid down in article 27 CISG stating the duty of a party is discharged through dispatching a notice "by means appropriate in the circumstances"^[36]; according to this rule the risks of error, delay or loss in transmission of a request or notice fall on the addressee. However, if the aggrieved buyer dispatches his objection to the seller's proposed cure by appropriate means of communication and the message does not arrive or is delayed or contains errors in transmission, the buyer's right to rely on the communication is authorized by article 27. In sum, the exception to the general "dispatch" rule under article 27 CISG applies only to the seller's request (the party who is in breach of contract).^[37]

According to article 48(2) CISG, upon the seller's request if the buyer does not reply to that within a reasonable time, the seller will have a right to cure irrespective of whether the requirements of article 48(1) CISG.^[38] Moreover, the buyer may not exercise any remedies inconsistent with performance by the seller during the period of time to cure the defect.^[39] Inconsistent remedies, as in article 46(1) CISG, are avoidance and price reduction.^[40] If, however, the buyer rejects the seller's request within a reasonable time, article 48(2) will have no effect on the existence of a right to cure.

5.3 Interaction between Right to Cure and Avoidance

Article 48(1) CISG stipulates that the seller's right to cure is expressly subjected to article 49 which provides the buyer's right to avoid the contract. Consequently, a controversial question here arises regarding the interaction between right to cure and avoidance; which right shall prevail, the seller's right to cure or the buyer's right to avoid? There are diverging interpretations concerning the relationship between the seller's right to cure and the buyer's right of avoidance. Most courts have held that a lack of conformity will not amount to a fundamental breach if the seller offers and effects speedy repair and replacement without any inconvenience to the buyer.^[41] In an illustrative case, for instance, no fundamental breach was found where repairable parts of a hanger were defective.^[42]

In practice, the possibility of cure has often been considered as a factor in determining a fundamental breach of contract. In Germany, for instance, the Court of Appeals of Koblenz stated that in order to determine a fundamental breach the nature of non-conformity and the willingness of the seller to cure the lack of conformity without any inconvenience to the buyer should be taken into account.^[43] Thus, the seller's breach may not be regarded as fundamental if it can be (and finally is) cured in accordance with article 48(1) CISG.

However, if the buyer has a specific and legitimate interest in immediate avoidance, the possibility of cure shall not be taken into account.

In the author's opinion, when there is a fundamental breach, the buyer is entitled for avoidance the contract without being obliged to do so. Therefore, in the absence of the buyer's declaration of avoidance, cure should be permitted. This is supported by the ideas of good faith and the contract preservation.

6. Conclusion

Avoidance is a remedy for breach of contract which cancels the contract and releases the parties from their obligations under the contract. However, in light of the requirements of international trade, avoidance of the contract should only be granted to the buyer as a last resort which is available when the buyer can no longer be expected to continue the contract. The matter of avoidance for non-conforming goods is riddled with uncertainty and differences of opinion. In the end, a buyer's interest, a seller's interest and economic reasons such as costs and risk of transportation or storage must be balanced to determine whether a certain feature of the contract must be considered fundamental under the circumstances.

7. Reference

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³⁵ Id. at 221.

³⁶ CISG, Art. 27: unless otherwise expressly provided in this Part of the Convention, if any notice, request or other communication is given or made by a party in accordance with this Part and by means appropriate in the circumstances, a delay or error in the transmission of the communication or its failure to arrive does not deprive that party of the right to rely on the communication.

³⁷ The Secretariat Commentary on article 44 of the 1978 Draft, available at: <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-48.html> (Visited on November, 7, 2015).

³⁸ Supra note 3 at 221.

³⁹ CISG, Art. 48(2).

⁴⁰ CISG, Art. 50, second sentence,

⁴¹ Handelsgericht Zürich, No. HG920670, Switzerland, April 26, 1995, available at: <http://www.unilex.info/case.cfm?id=166>.

⁴² Cour d'Appel de Grenoble, No. RG 93/4879, France, April 26, 1995, available at: <http://www.unilex.info/case.cfm?id=109>.

⁴³ Oberlandesgericht Koblenz, No. 2 U 31/96, Germany, January 31 1997, available at: <http://www.unilex.info/case.cfm?id=223>.