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## THE RIGHT TO AVOID THE CONTRACT

*The article focuses on the right to avoid the contract under the CISG. It explores the concept of fundamental breach and its application to cases of seller's as well as buyer's breach. Limits of the right to avoid such as notice requirement, time limits and restitution of the goods are also discussed.*

Key words: *CISG Avoidance of contract Fundamental breach Notice Restitution of the goods.*

### 1. INTRODUCTION

At first sight, there is hardly any agreement between different legal systems as to when a party may avoid the contract because its performance has been disrupted. Not only do they adopt divergent views on the means by which it is to be avoided – by court decision, by one party's simple declaration or *ipso iure* – but in particular, different approaches can be found as regards the preconditions for avoidance, particularly what significance is to be attached to the fault of the party in breach. However, a thorough comparative analysis reveals that under most legal systems it is decisive whether the breach reaches a certain level of seriousness.

This is also the starting point of the CISG. Avoidance is regarded as a remedy of last resort, an *ultima ratio* remedy.<sup>1</sup> Only if the aggrieved

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<sup>1</sup> M. Müller Chen, "Art. 49", *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG)* (ed. I. Schwenzer), Oxford University Press, Oxford 2010<sup>3</sup>, para. 2; e.g. Bundesgerichtshof, 3 April 1996, CISG on line 135; Oberster Gerichtshof, 7 September 2000, CISG online 642; Landgericht München, 27 February 2002, CISG online 654.

party cannot be adequately compensated especially by damages may it declare the contract avoided. The reason for this restrictive approach is that avoidance is the harshest of all remedies and that in an international context it may entail the necessity of transporting back the goods from their place of destination to their place of origin or another place with considerable costs involved.<sup>2</sup>

The CISG provides for avoidance in four different situations; in case of the seller's breach of contract (Art. 49 CISG), in case of the buyer's breach of contract (Art. 64 CISG), in case of an anticipatory breach (Art. 72 CISG) and finally in case of the breach of an instalment sale (Art. 73 CISG). In general, in all of these cases avoidance is only possible if the breach amounts to a *fundamental breach of contract*.

However, in cases of non-delivery by the seller (Art. 49(1)(b) CISG), non-payment or failure to take delivery by the buyer (Art. 64(1)(b) CISG) – but only in these cases – the aggrieved party may fix an additional time for performance and after the lapse of this time declare the contract avoided.

Let me first, however, discuss the concept of fundamental breach.

## 2. FUNDAMENTAL BREACH OF CONTRACT

According to Art. 25 CISG a breach 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”.

The first prerequisite is the breach of a contractual obligation. Unlike especially Germanic legal systems the CISG does not distinguish between different kinds of contractual obligations.<sup>3</sup> All kinds of contractual obligations – especially main and ancillary obligations, synallagmatic and non-synallagmatic obligations, obligations to perform or to refrain from doing something etc. – are treated alike.<sup>4</sup> The obligation may be expressly provided for in the CISG, such as delivery of conforming goods and documents at the right time, at the right place etc., but it may also be a *sui generis* obligation agreed upon by the parties, such as information, training of employees, refraining from reimport, non-competition etc.<sup>5</sup>

<sup>2</sup> J. O. Honnold, H. M. Flechtner, *Uniform Law for International Sales Under the 1980 United Nations Convention*, Kluwer Law International, Zuidpooslingel 2009<sup>4</sup>, para. 181.2.

<sup>3</sup> See e.g. Art. 97 Swiss Obligationenrecht [OR Code of Obligations].

<sup>4</sup> F. Ferrari, “Fundamental Breach of Contract Under the UN Sales Convention 25 Years of Article 25 CISG”, *The Journal of Law and Commerce* 25/2006, 493–494.

<sup>5</sup> U. Schroeter, “Art. 25”, *Schlechtriem & Schwenzler: Commentary on the UN Convention on the International Sale of Goods (CISG)* (ed. I. Schwenzler), Oxford University Press, Oxford 2010<sup>3</sup>, para. 15.

Whether the breaching party was at fault is not decisive in establishing a fundamental breach, although some authors argue that an intentional breach should always be regarded as being fundamental.<sup>6</sup>

Second, the aggrieved party must be substantially deprived of what it was entitled to expect. Insofar as the importance of the interest which the contract creates for the promisee is crucial. It is the contract itself that not only creates obligations but also defines their respective importance for the parties.<sup>7</sup> Thus, if delivery by a fixed date is required the interest in taking delivery on that very date is so fundamental that the buyer may avoid the contract regardless of the actual loss suffered due to the delay in delivery.<sup>8</sup> Likewise in the commodity trade where string transactions prevail and/or markets are highly volatile timely delivery of clean documents is always of the essence.<sup>9</sup>

Third, Art. 25 CISG provides for an element of foreseeability. A breach cannot be deemed fundamental if the breaching party “did not foresee and a reasonable person of the same kind and in the same circumstances would not have foreseen such a result”. Some authors opine that lack of foreseeability and knowledge is a kind of subjective ground for excusing the party in breach. However, knowledge and foreseeability are instead relevant only when interpreting the contract and ascertaining the importance of an obligation.<sup>10</sup> The parties themselves can clarify the special weight given to an obligation; in English legal terminology this would be a “condition”.<sup>11</sup> The importance may also be manifested by relying on trade practice and usage (Art. 8(3), 9 CISG). A reasonable person would have foreseen this. Once the importance of an obligation to the promisee under the contract has been established the promisor will not be heard when alleging that it did not or should not have foreseen the fundamentality of the breach of this obligation.<sup>12</sup>

As it all amounts to simple questions of contract interpretation it is clear that the decisive point in time to establish the importance of the

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<sup>6</sup> *Ibid.*, para. 19; U. Magnus, “The Remedy of Avoidance of Contract under CISG – General Remarks and Special Cases”, *The Journal of Law and Commerce* 25/2006, 426; see M. Karollus, “Art. 25”, *Kommentar zum UN Kaufrecht* (ed. H. Honsell), Springer, Berlin 2009<sup>2</sup>, n.23 (writing that an intentional breach may be fundamental on the basis that the trust between the parties has been destroyed).

<sup>7</sup> P. Huber, A. Mullis, *The CISG – A New Textbook for Students and Practitioners*, Seiler, München 2007, 214.

<sup>8</sup> Schroeter, para. 23.

<sup>9</sup> I. 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”, *Victoria University of Wellington Law Review* 36(4)/2005, 806.

<sup>10</sup> Schroeter, para. 27.

<sup>11</sup> Schwenzer, 796; see Sale of Goods Act 1979 (UK), s 11.

<sup>12</sup> See Appellationsgericht Basel Stadt, 22 August 2003, CISG online 943.

obligation is the time of the conclusion of the contract.<sup>13</sup> Later developments cannot upgrade a former minor obligation to an important one even if the obligor is aware of this fact.

### 3. SPECIFIC CASES

In order to exemplify the abstract notion of fundamental breach I will now briefly explore the different cases and discuss when the promisee may avoid the contract.

#### 3.1. Seller's breach of duties

I will first discuss the seller's breach of duties which in practice account for the lion's share of litigated cases. The most important ones being; non-delivery, delay, and delivery of non-conforming goods including partial delivery. Where the seller must deliver documents, the same principles apply.<sup>14</sup>

Definite non-delivery almost always amounts to a fundamental breach.<sup>15</sup> The seller's refusal to perform constitutes a fundamental breach.<sup>16</sup> Exceptions to this rule apply where the seller may avail itself of a right to withhold performance or where due to fundamentally changed circumstances the seller is no longer obliged to fulfil the contract according to the initial terms but instead suggests to the buyer adjusted terms that a reasonable buyer should accept under the circumstances.<sup>17</sup>

In cases of delay where performance is still possible and the seller is still willing to perform the importance of the agreed delivery date is decisive. Whether time is of the essence primarily depends on the terms of the contract as well as on the respective trade sector. If the buyer insists on a certain delivery date because of its own obligation towards its sub-buyers, if the sale concerns seasonal goods or commodities time is usually of the essence making any delay a fundamental

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<sup>13</sup> See Ferrari, 498; Oberlandesgericht Düsseldorf, 24 April 1997, CISG online 385.

<sup>14</sup> CISG AC Opinion No. 5: The Buyer's Right to Avoid the Contract in Case of Non Conforming Goods or Documents, 7 May 2005, Rapporteur: Professor Dr. Ingeborg Schwenzer, Badenweiler (Germany), para. 5

<sup>15</sup> Schroeter, para. 37; ICC Arbitration Case No. 9978 of March 1999, CISG on line 708: "[a]n absolute failure to deliver the goods definitely constitutes a fundamental breach."

<sup>16</sup> Schroeter, para. 37; Cour d'appel de Grenoble, 21 October 1999, CISG online 574.

<sup>17</sup> Schroeter, para. 37.

breach and thus allowing the buyer to immediately avoid the contract.<sup>18</sup> If time cannot be deemed of the essence the buyer has to fix an additional time for performance before it may avoid the contract (Art. 47(1), 49(1)(b) CISG).<sup>19</sup>

Unlike in many other legal systems – especially those belonging to the Civil law – delivery of defective goods and partial delivery are treated alike under the heading of non-conformity (Art. 35(1) CISG).<sup>20</sup> Thus the same principles apply concerning the possibility of avoidance.

Again, primary consideration must be given to the terms of the contract. It is up to the parties to stipulate what they consider to be of the essence of the contract.<sup>21</sup> Thus a breach can be held to be fundamental if the parties agreed on certain central features of the goods, such as for example soy protein products that have not been genetically modified or goods where no children were involved in manufacturing them or that have been traded fairly.<sup>22</sup>

If the contract itself does not make clear what amounts to a fundamental breach one of the central questions is for what purpose the goods are bought. The decisive factor is whether the goods are improper for the use intended by the buyer.<sup>23</sup> If the buyer wants to use the goods itself it is not relevant whether they could be resold even at a discount price. However, where the buyer is in the resale business, the issue of a potential resalability becomes relevant.<sup>24</sup> The question then is whether resale can reasonably be expected from the individual buyer in its normal course of business.

A fundamental breach will usually not exist if the non-conformity can be remedied either by the seller, the buyer or a third person – e.g. by repairing or delivering substitute or missing goods – without causing un-

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<sup>18</sup> Schroeter, para. 38; Bundesgericht, 15 September 2000, CISG online 770 (finding a fundamental breach for delayed delivery which prevented the buyer from meeting its own obligations); *Diversitel Communications, Inc. v. Glacier Bay Inc.*, Ontario Superior Court of Justice, 6 October 2003, CISG online 1436.

<sup>19</sup> Schroeter, para. 40.

<sup>20</sup> For a comparison of liability for defective goods under different legal systems see I. Schwenzer, “Art. 35”, *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG)* (ed. I. Schwenzer), Oxford University Press, Oxford 2010<sup>3</sup>, para. 4.

<sup>21</sup> CISG AC Opinion No. 5, Comment 4.2; Schwenzer (2005), 800.

<sup>22</sup> See Oberlandesgericht Stuttgart, 12 March 2001, CISG online 841; Appellationsgericht Basel Stadt, 22 August 2003, CISG online 943.

<sup>23</sup> CISG AC Opinion No. 5, Comment 4.3.

<sup>24</sup> See ICC Arbitration Case No. 8128 of 1995, CISG online 526; Bundesgerichtshof, 8 March 1995, CISG online 144; Landgericht Ellwangen, 21 August 1995, CISG online 279.

reasonable delay or inconvenience to the buyer.<sup>25</sup> Here again, due regard is to be given to the purposes for which the buyer needs the goods. If timely delivery of conforming goods is of the essence of the contract repair or replacement usually will lead to unreasonable delay. In finding such unreasonableness the same criteria have to be applied as in case of late delivery. Furthermore, the buyer should not be expected to accept cure by the seller if the basis of trust has been destroyed, e.g. due to the seller's deceitful behaviour.<sup>26</sup> If the seller refuses to remedy the defect, simply fails to react, or if the defect cannot be remedied by a reasonable number of attempts within a reasonable time, then a fundamental breach will also be deemed to have occurred.<sup>27</sup>

### 3.2. Buyer's breach of duties

Let me now turn to the buyer's breach of duties, the main obligations being the payment of the purchase price and taking delivery of the goods.<sup>28</sup>

In general, failure to pay the purchase price on the date due will not amount to a fundamental breach of contract, as the seller's interest to receive payment is not substantially impaired by the delay.<sup>29</sup> However, where timely payment is of the essence, e.g. in case of highly fluctuating exchange markets, a fundamental breach is conceivable.<sup>30</sup> The same holds true if payment by letter of credit against presentation of documents is agreed upon. The letter of credit must be opened for the seller no later than the first day of the period for shipment. Finally, the definite refusal by the buyer to pay the purchase price amounts to a fundamental breach of contract.<sup>31</sup> The same holds true in case of insolvency of the buyer.<sup>32</sup>

Failure to take delivery of the goods by the buyer, again, in general will not constitute a fundamental breach.<sup>33</sup> However, where the seller has

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<sup>25</sup> CISG AC Opinion No. 5, Comment 4.4; Bundesgerichtshof, 3 April 1996, CISG online 135.

<sup>26</sup> CISG AC Opinion No.5, Comment 4.4; I. Schwenzer, "Avoidance of the Contract in the Case of Non conforming Goods (Article 49(1)(a)(CISG)", *The Journal of Law and Commerce* 25/2006, 439.

<sup>27</sup> Landgericht Berlin, 15 September 1994, CISG online 399.

<sup>28</sup> CISG Art. 53; for a discussion of trends in cases that deal with the obligations of the buyer see H.D. Gabriel, "The Buyer's Performance Under the CISG: Articles 53-60 Trends in the Decisions", *The Journal of Law and Commerce* 25/2006, 273.

<sup>29</sup> See Secretariat Commentary on Article 60 of the 1978 Draft Convention on Contracts for the International Sale of Goods, Art. 60, para. 5.

<sup>30</sup> Schroeter, para. 66.

<sup>31</sup> *Ibid.*

<sup>32</sup> *Ibid.*; *Roder Zelt und Hallenkonstruktionen GmbH v. Rosedown Park Pty Ltd et al.*, Federal Court of Australia, 28 April 1995, CISG online 218.

<sup>33</sup> Schroeter, para. 67; see Secretariat Commentary on Article 60, para 5.

a special interest in the buyer taking delivery at the exact contractually agreed upon date, e.g. due to sparse warehouse or transportation capacities, a fundamental breach can be assumed.<sup>34</sup> A fundamental breach also exists if the buyer definitely refuses to take delivery.

If according to the foregoing no fundamental breach can be ascertained or if the seller is in doubt about the weight of the breach it may fix an additional time for the buyer to pay the price or take delivery and after the lapse of this *Nachfrist* it may avoid the contract (Art. 64(1)(b) CISG).

#### 4. NOTICE

The CISG requires that the party having the right to avoid the contract gives notice to the other party (Art. 26 CISG). Unlike in many other legal systems there exists no *ipso iure* avoidance under the CISG.<sup>35</sup> The notice must be communicated to the other party by appropriate means, whereby dispatch of the notice suffices (Art. 27). Today usually notice will be given by email.

#### 5. TIME LIMITS

In general, under the CISG no special time limits exist to declare the contract avoided.<sup>36</sup> Thus the general statute of limitations applies. Depending upon the applicable law this period of time may vary between one year (Switzerland, Art. 210 Code of Obligations) and six years (UK, Sec. 2 Limitation Act 1980). In exceptional cases this time period may be reduced and the party precluded from relying on the otherwise possible remedy of avoidance especially if it has led the other party to believe that it will not exercise this right.

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<sup>34</sup> Huber, Mullis, 328; See Oberlandesgericht Düsseldorf, 24 July 2004, CISG online 916: “[i]n case of the usual sales contract concerning non perishable goods and without peculiarities of storage or transport, neither a breach of the obligation to accept the goods nor a breach of the obligation to make payment of the purchase price automatically constitutes a fundamental breach of contract.” (translation from <<http://cisgw3.law.pace.edu/cases/040722g1.html>>).

<sup>35</sup> Ch. Fountoulakis, “Art. 26”, *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG)* (ed. I. Schwenzer), Oxford University Press, Oxford 2010<sup>3</sup>, para. 3; Honnold, Flechtner, para. 187.1; See Convention Relating to a Uniform Law on the International Sale of Goods (ULIS) Arts. 25, 61 (The Hague, 1 July 1964) (convention pre dating the CISG permitted *ipso facto* avoidance of the contract).

<sup>36</sup> P. Schlechtriem, P. Butler, *The UN Convention on the International Sale of Goods*, Springer, Berlin 2009, para. 162.

However, the CISG itself provides for a time limit to exercise the right of avoidance in two situations.

If the seller has delivered the goods the buyer has to declare the avoidance of the contract within a reasonable time after the delivery of the goods or after it has become aware of the breach or an additional period to remedy the breach has elapsed (Art. 49(2) CISG). A comparable rule in case of buyer's breach of contract exists. If the buyer has paid the price – albeit delayed – the seller must react before it has become aware of the payment or – in respect of any breach other than late performance – within a reasonable time after it has become aware of the breach or after an additional period has expired (Art. 64(2) CISG).

## 6. RESTITUTION OF THE GOODS

In accordance with Roman law and thus Civil law tradition the buyer is precluded from exercising its right of avoidance if it cannot make restitution of the goods substantially in the condition in which it received them (Art. 82(1) CISG). However, there are numerous exceptions to this rule (Art. 82(2) CISG) so that in practice this rarely becomes an obstacle to the buyer avoiding the contract.<sup>37</sup> In fact, this rule is hardly appropriate for modern international commerce. Thus neither the UNIDROIT Principles for International Commercial Contracts (2004), nor the Principles of European Contract Law (2000), nor the Draft Common Frame of Reference (2008) have followed this example. If the buyer cannot return the goods it may still avoid the contract with due compensation for their value.<sup>38</sup>

## 7. CONCLUSION

Although the concept of fundamental breach as a prerequisite for avoidance has been criticised by some authors for its vagueness in practice it has proven to yield just and reasonable results. On the one hand it is flexible enough to be applied to the vast variety of possible breaches of

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<sup>37</sup> Ch. Fountoulakis, “Art. 82”, *Schlechtriem & Schwenger: Commentary on the UN Convention on the International Sale of Goods (CISG)* (ed. I. Schwenger), Oxford University Press, Oxford 2010<sup>3</sup>, para. 12; Oberster Gerichtshof, 29 June 1999, CISG on line 483; F. Mohs, “The Restitution of Goods on Avoidance Contract for Lack of Conformity within the Scope of Art. 82(2)(c) CISG: On the Different Treatment of Defects in Quality, Third Party Intellectual Property Rights, and Defects in Title as Elements of Remedies for the Buyer”, *Review of the Convention on Contracts for the International Sale of Goods (CISG) 2003–2004/2005*, 55.

<sup>38</sup> Art. 84(2)(b) CISG; Huber, Mullis, 245–246.

contract; on the other hand the necessary legal certainty has been achieved by case law and scholarly writing. The superiority of this concept is not the least proven by the fact that all later international attempts to further harmonization and unification of the law of obligations – such as PICC, PECL and DCFR – as well as many domestic laws that have been revised lately have taken over this basic concept of the CISG coupled with the possibility of fixing a *Nachfrist*. Similarly, the CISG's concept of avoidance by notice has gained ground on an international as well domestic level.

To sum up: the CISG concept of the right of avoidance has proven most adequate in practise. It certainly contributes to the fact that nowadays the CISG can be called a true story of worldwide success.