



**SILESIA  
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SCHOOL OF BUSINESS  
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# International Business Law

International purchase-sale [3]  
Liability for breaching a contract

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# Breach of contract

*Can be any **failure to fulfill obligations of one party**. Not only the contractual obligations but also the ones arising from Vienna Convention or from practice and usual habits between parties*

- **if seller breach the contract**

- Deliver goods
- Deliver goods without any defect
- Hand over documents
- Transfer ownership rights

- **if buyer breach the contract**

- Take over goods
- Pay the purchase price

# DEFECTS

The seller has to deliver goods without defects – in practise it is the most common reason for breach the contract

Two types of defects:

## **Factual defects**

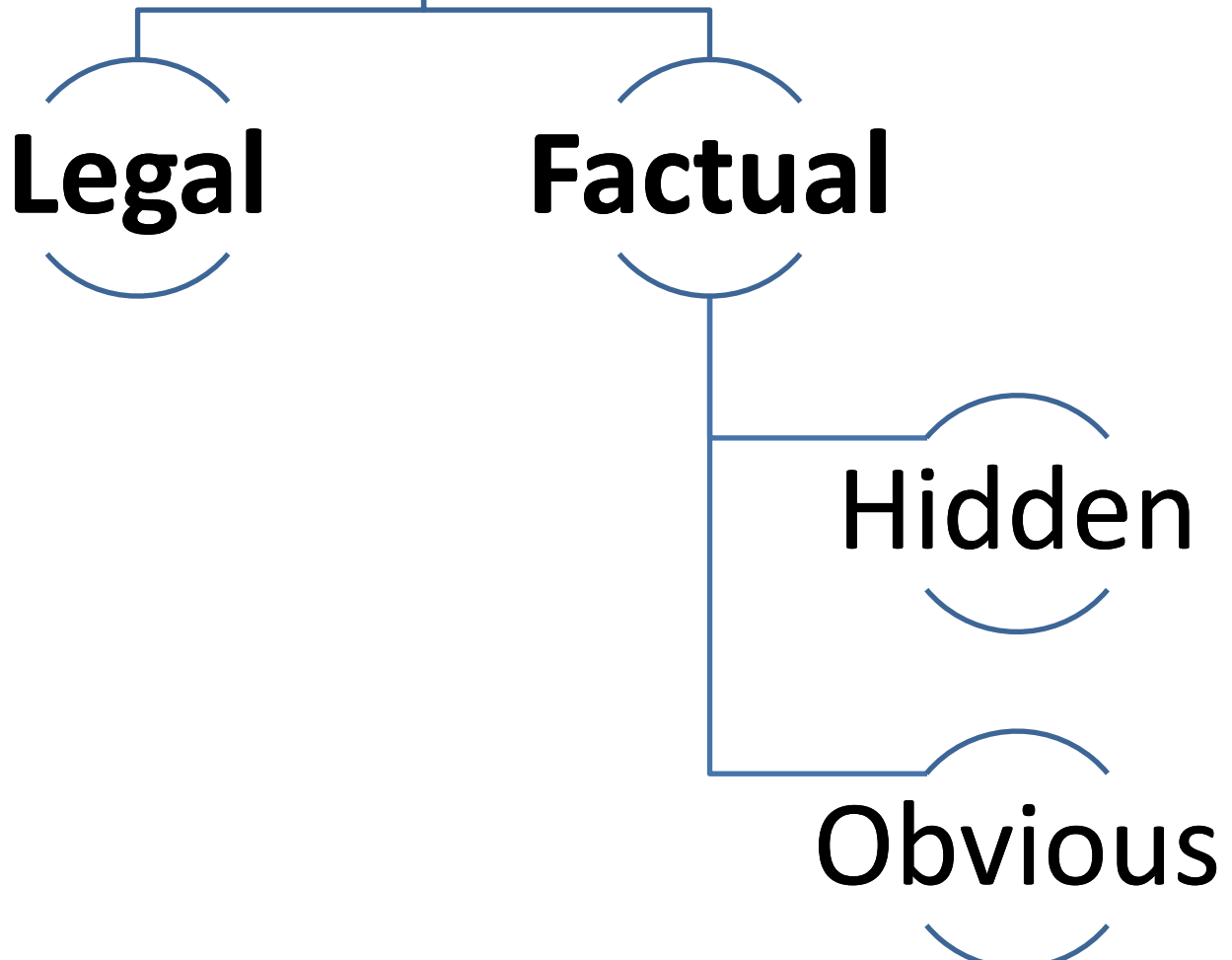
- Quality, manufacturing and quantity
- Factual defect is also goods which is not properly packed

## **Legal defects**

- Transferring of ownership rights which do not follow the law of third party (liens, copyright, industrial property...)

**Defects**

**Defects sorting**



# Process of factual defect notifying

*Art. 36: The seller is liable in accordance with the contract and this Convention for any lack of conformity which exists at the time **when the risk passes to the buyer**, even though the lack of conformity becomes -apparent only after that time.*

The moment of risk transition (art. 36)  
*Seller is responsible for any damage which has been done to goods **to the moment when risk passes to the buyer** even if the damage is obvious after that time.*

**Answer to the following questions are important for buyer:**

1. Until when the defect should be discovered
2. Until when the defect should be notified
3. What content and form should the notification have

# 1. Defect discovery

## Checking the goods (art. 38)

*Art. 38: The buyer must examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances.*

- The buyer has to check the goods or make someone to do so **as soon as possible** – depending on the circumstances
  - *Generally: the more sophisticated goods, the more time the checking takes*
- If the contract include the transport of goods, then **the checking the goods** can be postponed till it's delivered to the destination
  - *It's situation when the goods is handed over, e.g. in Hamburg (the place of fulfillment) and it's transported by cargo ship to the buyer's factory (the destination)*

# Example (*checking the goods by another buyer*)

- *A German seller and Belgian buyer. Object – water polo T-shirts.*
- *T-shirts were sold to another buyer after 6 weeks. In the meantime there were **not checked**.*
- ***The other buyer noticed some defects.***
- *The court rejected the reasoning that T-shirts weren't checked because they could be damaged during the control which was provided by the Belgian buyer.*
- *Decision: The Belgian buyer was obliged to **randomly check the goods** and was not entitled to let the duty of checking the goods to the other buyer.*

## 2. Notifying a defect

### Termination of buyer's rights (art. 39/1)

(1) The buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity **within a reasonable time** after he has discovered it or ought to have discovered it.

#### 1. OBVIOUS defects (can be found at regular checking)

- Esp.: amount, packaging, missing parts
- The buyer has to notify a defect in due time after the defect was discovered.
- Otherwise the buyer's rights are terminated (damage compensation right, right to change or repair of goods, withdraw from the contract or right to reduce the purchase price)
  - Problem: “*reasonable time*” (in practice it's better to set a fixed date in the contract)



## 2. Notifying a defect

### Termination of buyer's rights (art. 39/2)

*(2) In any event, the buyer loses the right to rely on a lack of -conformity of the goods if he does not give the seller notice thereof at the latest within a **period of two years** from the date on which the goods were actually handed over to the buyer, unless this time limit is inconsistent with a contractual period of guarantee.*

## 2. HIDDEN defects

- The buyer has to *notify the defect in two years* from the day when the goods were *handed over to the buyer*.
- Unless this period is in accordance with the contractual guarantee period (the guarantee can be agreed also by contract, there is nothing about that in Vienna Convention)



# Example:

- Czech seller and German buyer, the object: fish
- **The German seller rejected to pay, because fish were infected**
- **Court stated that the buyer didn't check the goods soon enough according to art. 39 (reasonable time)**
  - The court rejected the reasoning of the buyer that it was a hidden defect. The buyer was supposed to arrange the inspection of those fish as soon as it was possible.
  - The court also stated that notifying a defect 4 weeks after it was discovered is insufficient. Sufficient time would be in 8 days (see art. 39)

# Form of notifying

- The buyer is obliged to notify the specification of any defects if they are **obvious**
  - Each defect must be described
- In case of **hidden** defects it is enough to notify them
- The form of the notification is not regulated
  - So **informal agreement** are valid which is basically general regulation known for any purchase contract

# Moderation (Art. 40)

*Art. 40: The seller is not entitled to rely on the provisions of articles 38 and 39 if the lack of conformity relates to facts of which he knew or could not have been unaware and which he did not disclose to the buyer.*

If defects are not notified then buyer's **rights won't be terminated in case that:**

- If the **seller knew or could have known and didn't tell the buyer**

*Example:*

- ***Wine contained 7 % of water** and then was destroyed by state authorities at buyer's expenses.*
- ***According to the court the buyer didn't lose the damage compensation right** even though the buyer didn't test the wine if it was water or not. **The seller had to be aware of the defects.***
- *It is based on different definition of % water in wine by different state regulation*

# Moderation (art.44)

*Art 44: Notwithstanding the provisions of paragraph (1) of article 39 and paragraph (1) of article 43, the buyer may reduce the price in accordance with article 50 or claim damages, except for loss of profit, if he has a reasonable excuse for his failure to give the required notice.*

The buyer didn't send any defect notification **for excusable reasons.**

„Excusable reasons“:

- Natural disasters,
- strikes etc.
- Diseases



# Remedies for breach of contract

- **If the seller fails** to perform any of his obligations under the contract or CISG, **the buyer may**:
  - Exercise CISG rights (art. 46-52)
  - Claim damage compensation (art.74-77)
- **If the buyer fails** to perform any of his obligations under the contract or this Convention, **the seller may**:
  - exercise the rights provided in articles 62 to 65
  - claim damages as provided in articles 74 to 77

# The key for choice of claims (art. 25)

*Art. 25: A breach of contract committed by one of the parties is **fundamental** if it results in such detriment (harm) 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.*

Need to determine whether the breach of the contract is **fundamental (significant)** or not (**insignificant**)

- CORE: **Certain claims** (e.g. withdraw from a contract), are basically connected only with significant breaching a contract

## **Fundamental breach of a contract**

- *I.e. existence of FORESEEABLE SIGNIFICANT DAMAGES*

**Recommendation for practice:** determine directly in the contract what is fundamental breach of contract and what is not

# Performance in natura (46/1)

*Art. 46/1 The buyer may require performance by the seller of his obligations unless the buyer has resorted to a remedy which is inconsistent with this requirement*

- Buyer can require originally promised **performance** if:
  - If **nothing** was delivered → **set a deadline additionally**
  - If the delivery is **defected** (lack of conformity) → **require delivery of substitute goods**
    - **Only in case that the defect is significant !**
    - Only if defects were noticed and claimed on time and properly
  - If the delivery is **defected** – **require to remedy the lack**
    - **Also in case that the defect is insignificant (but also significant) breach**
- There are strict requirements, because it's a problematic issue in international relations (due to transport distances)



# Avoidance of contract (Art. 49)

*(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*

**1. Immediately**, if the seller breached the contract **in a significant way** by failure any of own duties

- *E.g. goods are not delivered (fixed contracts)*
- *It's better to specify in the contract: e.g. late delivery, quantity deviation greater than 5% etc.*

**2. After expiring of additional delivery period** for the event of **failure to deliver goods**

- The seller is obliged to return the purchase price with interest (counted from the time when the purchase was made)

# Example:

- A German buyer and an Italian seller.  
*The object is footwear.*
- *The buyer notified **defects** by telephone 19 days after the deliver.*
  - *The **buyer didn't pay** the purchase price and **avoided** the contract*
- *The seller sued the German buyer and the court decide that it was a **significant** breach of the contract, therefore the buyer had right to avoid.*
  - *The buyer **also met the condition** about notifying the defect, according to Vienna Convention (notification within a reasonable time)*

# Purchase price reduction (art. 50)

*Art. 50: If the goods do not conform with the contract and whether or not the price has already been paid, the buyer may **reduce the price** in the same proportion as the value that the goods actually delivered had at the time of the delivery bears to the value that conforming goods would have had at that time. However, if the seller remedies any failure to perform his obligations in accordance with article 37 or article 48 or if the buyer refuses to accept performance by the seller in accordance with those articles, the buyer may not reduce the price.*

**If goods is not in accordance with the contract, then the buyer may reduce the purchase price**

- *Only **in range** which is corresponding to the **ration between** the price with the goods had in the moment of delivery and the price which the goods would have in that moment if it was without defects.*
- An one-sided action
- Possible to use also if the price was already paid – the right to a refund
- Problem: “the reduction size”

# Right to other performance of a contract (art. 37 and 48) „seller's initiative“

If the seller delivered the goods **before the delivery period**

- Remedy: up to date for delivery the seller **can deliver missing parts** or quantity of goods so the seller can change the defected goods or **repair goods** which was already delivered

If the seller would like to to the same **after the date of delivery**

- Remedy: the seller van **remove defects additionally** in case that....
  - It is without undue delay and
  - It's no excessive harm for the buyer
  - The notification about it is considered as a request – if the buyer don't respond then it will presumed that it means an approval

# Example:

- A Dutch seller and a German buyer. The object is fabrics.
- The buyer notified defects 4 days after delivery - insufficient quantity and goods which was not in accordance with the contract.
- **The seller wanted to use the right to other performance of the contract (art. 48).** The buyer refused and also refused to pay the purchase price and wanted to partially withdraw from the contract
- *The Dutch seller sued the German buyer for not paying the purchase price.*

# Example:

- ***The court decided in favor of the seller***
  - *The buyer didn't specify amount of missing goods therefore couldn't withdraw from the contract (art. 51/1)*
  - *It wasn't significant breach of the contract, among other things, because the seller wanted to fix the problem immediately.*
  - *The buyer refused the offer from the seller to other performance (art. 48)*
  - *The right to withdraw has priority over the right to other performance only in cases of significant breach of contract!*
  - *The buyer didn't have right to ask for price reduction, because he turned down "other performance" according to art. 48*

# **Seller's claims if the contract is breached by the buyer**

## **1. Require in natura performance**

- The seller may set additional deadline for the buyer to meet all obligations
  - Esp. in case that the buyer didn't pay the purchase price or didn't take the delivery

## **2. Withdraw from the contract**

- If the seller breached the contract **in a significant way**
- Or failed to perform the contract even within an additional time period

## **3. Right to specify the goods**

- It should be specified by the buyer (textiles, grains, leathers, etc.)

# Right to damages

- It's sufficient to **claim the right to damages** if one party shows that:
  1. The other party breached the contract, Vienna convention, practise, etc.
  2. The damage occurred
  3. There is a causal relation between breaching the contract and damages
- The fault is not se detected (tzv. **Strict liability**)
- Exempt is also possible if there is a **circumstance excluding responsibility**
  - The obstacle is independent to parties' wills and it couldn't be predicted (so called vis major). When the obstacle is removed then it has to be performed.
    - Wars, revolutions, pirate attacks
    - Natural disasters
    - Power interventions – boycotts, embargoes...
- Compensation range:
  - Real damage (reducing the asset of the damaged party = **loss**)
  - Lost profit (not increasing the asset of the damaged party)
    - *E.g. loss caused by interrupted production due to delivery of defected device or absence of profit due to inability to re-sale of goods*



# Example D.Novak [1]

- Czech seller: DAVID NOVAK – BRICKS PRODUCER and German buyer: DEUTSCHER KOSMETIK GmbH, made a contract. The subject was 120 pallets of bricks. The goods was supposed to delivered to a seller's warehouse in Znojmo (application of **EXW** clause).The goods was properly packed and ready to go
- In the day of delivery **one of buyer's authorised employee** briefly checked pallets and didn't discover any defect. The goods was delivered to the buyer's settlement in Dortmund where it was stocked for 3 weeks
- After this time the buyer decided to build a new wing of own factory for production of soap by using the bricks. During construction the buyer found out that every sixth pallet contains *more than 10% of bricks* which (due to **internal defects**) break into pieces and are not usable. The bricks were used normally)

# Example D.Novak [2]

- The buyer immediately interrupted the construction and **counted the exact overall number of defected bricks**. Then the buyer instantly notified the seller. The expertise study which was made on the buyer's order was found that the defect is **caused by insufficient burning of bricks**.
- The contract contained: *All financial and nonfinancial disputes shall be settled by a general court in Switzerland, on neutral ground*
- The buyer asked for delivery of 30 pallets of bricks as a damage compensation for loss of profits caused by delays
- The seller refused this claim with reasoning they are unjustified and didn't supply any other pallets
- **Therefore the buyer sued the seller in the Czech republic**. The seller objected that the dispute is invalid and was supposed to be solved in Switzerland (because of the clause).

# Questions and answers

- **Q:** What is the legal regime of the contract?  
**A:** Vienna Convention
- **Q:** Consider validity of arbitration clause  
**A:** Valid
- **Q:** Review this situation and decide if the claims were legitimate.  
**A:** Important! The buyer checked the deliver of bricks and didn't see any defects, that meanss it's a hidden one which can be notified in 2 years.  
The buyer did claim it in the right time. It's significant breach of contract -> other performance. The claim has to be reasonable – 30 pallets is too much. Possible to claim only real damages and lost profits
- **Q:** Presume the authorised employee noticed defects: bricks are cracked in the every second pallet, but it was caused by using low-quality clay which was delivered from the German partner. How would the legal classification of the case change?  
**A:** Significantly. It would not longer be a matter of Vienna Convention, but Contract for Work.

# Example

## ABC + Murphy [1]

**Company ABC Compact** is settled in Padua, Italy and the other company is **Murphy, Ltd.** Which was established in Great Britain and now operating in the Czech republic. Those two parties concluded a **sample contract**.

According to that contract ABC should do a research and other marketing activity in the territory of Italy for Murphy, Ltd. And also ABC should take **different industrial goods** on own account and behalf. Details about the goods was regulated in an attachment of the sample contract.

Specific **sub-contracts** were supposed to be concluded in an easier way (via email containing type and amount of goods) because most of provisions regarding purchase and sale was already in the sample contract.

The goods had been delivered regularly for approx. 3 years. All complains were solved and the seller never objected anything. **There is no notarial deed.**

# In the sample contract was also included:

- "Any disputes arising from this contract shall be settled by consolidational process in the International Court of Arbitration in Paris."
- "This contracts as well as its clauses and performance of it is followed by **Czech law**
- "Parties declare that in case of breaching the contract there is a **lump sum for damages** in the amount 10times more than breached performance"
- "The buyer is obliged to check the goods immediately, not later than in three working days after stocking in in the warehouse in Padova, Italy. **Quantitative** defects shall be noticed and summarised in the presence of a notary. This notification should be sent by recorded delivery to the seller in five days after the checking. Other defects – which are not possible to notice at regular check – can be noticed within one year from the date of delivery.
- "Any deviation from this written contract is possible in written form only

After about one year the seller's situation began to change. The seller had **changed the supplier of material** of the production and the new supplier obviously **wasn't very good at technology** of the production.

Three years later the cooperation between parties **hit a snag**. There was following situation: The buyer took over one shipment and kept it in the warehouse. **After approx. two weeks they checked the amount and found out it doesn't match** with the contract. So they lodged a complaint and sent it by recorder delivery by themselves. **And also reduced the purchase price.**

At the same time other **buyer collectively began to complain** about seller's goods. Most common reasoning was that the act of **wearing out came too fast**. According to expert's opinion which it was caused by using inappropriate technology during production of material for goods. The buyer also claimed the same cause and **demanding a compensation.**

# The seller replied following:

“If the claim is a quantitative nature, then it’s inconsistent with contract, because it didn’t follow certain method and deadlines. The contract can be change only in writing.”

“If the claim is a qualitative nature then it’s interesting the situation is about material which was already known as not perfect. However given the one-year period the complaint is unjustified and all claims of its customer has to be dealt on their own.”

“If the claim is about the clause concerning **lump sum**, then it’s invalid from the perspective of the Czech law, because it’s too vague and can’t be specified.”

At the same time the seller stated that withdraw from the sample contract in all parts with one month’s notice, due to untrustworthiness of the buyer.

# Questions and answers

**Q:** What is the legal regime of those contracts?

**A:** Sample contract. Generally it's the same as settlement of distributor, but the choice of Czech law takes precedence. The individual purchase contracts: Vienna Convention

**Q:** What if the buyer wants to sue the seller directly, before a Czech court. Is it even possible?

**A:** The collision of judicial and conciliation procedure is not solved anyhow (only by arbitration). Therefore it is possible to sue them before a court in the Czech republic.

**Q:** Consider the seller's objection concerning the claim about quantitative defects. How could the buyer respond?

**A:** Given that the seller didn't object anything against the complaints in the past, it means they accepted them, so they lost the possibility to demand any written changes in the contract (see art. 29/2). According to that the party lost the opportunity to demand any changes in written contract if the party breach the contract itself.



**Q:** Consider the seller's objection concerning the quality of goods. How could the buyer respond?

**A:** Quality defects are bright example of **hidden defects**. The deadline for claims is reduced by parties **from two year to one year**. However the seller can't rely on the deadline if **he knew about the fact** that material used for the goods wasn't in a good quality (=caused defects) and didn't inform the buyer. In this case the buyer can lay a claim.

**Q:** Presume the dispute is settled before a court or Arbitration Court in Czech republic. Consider the law regime of the clause on a lump sum compensation.

**A:** Apply of Czech law: Most likely it's not a limitation of damages, but a contractual penalty

**Q:** Could the seller withdraw? Consider it, keeping Vienna Convention in mind.

**A:** No, the seller couldn't just withdraw from the contract. Vienna Convention provides two types of withdrawing, a) performing the contract, b) termination of a contract based on a unilateral act – withdrawal from a contract that is fixed to certain conditions