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UNIVERSITY OF SOUTHAMPTON

FACULTY OF LAW, ARTS & SOCIAL SCIENCES

School of Law

**Remedies for Breach of Contract in the International
Sale of Goods**

- A Comparative Study between the CISG, Chinese Law and
English Law with reference to Chinese Cases

by

Yan Li

Thesis for the degree of Doctor of Philosophy

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ABSTRACT

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**REMEDIES FOR BREACH OF CONTRACT IN THE INTERNATIONAL SALE
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**– A COMPARATIVE STUDY BETWEEN THE CISG, CHINESE LAW AND
ENGLISH LAW WITH REFERENCE TO CHINESE CASES**

by Yan Li

The United Nations Convention on Contracts for the International Sale of Goods (CISG) is one of the most successful international instruments that provide uniformity in the rules for international trade. It has been adopted by seventy-three countries and has been in force for twenty-one years. The People's Republic of China (PRC) signed the CISG on 30th September 1981 and many international sales of goods cases have been resolved under the CISG in China. The author will investigate these Chinese cases to examine the effectiveness of the CISG in order to establish whether the application of the CISG has been successful in leading to predictable judgments.

This thesis focuses on remedies for breach of contract in the international sale of goods. Remedies are the main reason why claims are made in the international sale of goods and as such they are fundamental to that trade. The main remedies considered in this thesis are the avoidance of contract, damages and specific performance. In addition, mitigation and the categorisation of the breach of contract are discussed where the former is an important means to restrict the recoverable damages and the latter constitutes the foundation for the study of remedies for breach of contract. Furthermore, the provisions related to the remedial rule of the CISG are those that the Chinese tribunals have applied most in their judgments. Research in this area provides the author with sufficient sources of cases for the examination of the Chinese decisions.

Two other alternative national regimes are compared with the CISG to assess the predictability of decisions under these systems. These are the old Chinese law, i.e., the PRC Foreign-Related Economic Contract Law (FECL) and English law, i.e., Sale of Goods Act 1979 (SGA) together with English case law. The FECL was the governing law of the international sale contract before China acceded to the CISG. The SGA is the present statute of English international sale contract law. The similarities and differences of the remedial rules between the CISG, FECL and English law are compared in this thesis. Analysis of the Chinese cases tried under the rules of the CISG shows that the outcomes of these cases are not predictable. The author will apply the remedial rules of the FECL and English law to the Chinese cases examined here to find out whether the application of either of these two alternative regimes could have led to outcomes that are more predictable. The conclusion of this thesis summarizes the results of the author's examination with regard to the Chinese tribunals' difficulties in making predictable judgments, the causes of difficulty where judgments have been unpredictable and the author's proposals as to how to resolve such difficulties.

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DECLARATION OF AUTHORSHIP

I, Yan Li, declare that the thesis entitled

REMEDIES FOR BREACH OF CONTRACT IN THE INTERNATIONAL SALE OF GOODS

– A COMPARATIVE STUDY BETWEEN THE CISG, CHINESE LAW AND ENGLISH LAW WITH REFERENCE TO CHINESE CASES

and the work presented in it are my own. I confirm that:

- this work was done wholly or mainly while in candidature for a research degree at this University;
- where any part of this thesis has previously been submitted for a degree or any other qualification at this University or any other institution, this has been clearly stated;
- where I have consulted the published work of others, this is always clearly attributed;
- where I have quoted from the work of others, the source is always given. With the exception of such quotations, this thesis is entirely my own work;
- I have acknowledged all main sources of help;
- where the thesis is based on work done by myself jointly with others, I have made clearly what was done by others and what I have contributed myself;
- parts of this work have been published as follows:
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Signed:.....

Date:.....

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12th May 2010
Southampton, UK

ABBREVIATIONS

| | |
|----------|--|
| B/L | Bill of Lading |
| CCIB | China Commodities Inspection Bureau |
| CCL | Contract Law of the People's Republic of China |
| CIETAC | China International Economic and Trade Arbitration Commission |
| CIF | Cost, Insurance and Freight |
| C&F | Cost and Freight |
| CISG | United Nations Convention on Contracts for the International Sale of Goods |
| CISG-AC | The International Sales Convention Advisory Council |
| DTI | Department of Trade and Industry |
| ECL | The People's Republic of China Economic Contract Law |
| FECL | The People's Republic of China Foreign-Related Economic Contract Law |
| FOB | Free on Board |
| GPCL | General Principles of Civil Law |
| HL | House of Lords |
| L/C | Letter of Credit |
| PRC | The People's Republic of China |
| SGA | Sale of Goods Act 1979 |
| ULIS | Uniform Law on the International Sale of Goods |
| UNCITRAL | United Nations Commission on International Trade Law |

CHAPTER 1

INTRODUCTION

1.1 Background

The United Nations Convention on Contracts for the International Sale of Goods (CISG) prepared by United Nations Commission on International Trade Law (UNCITRAL) is one of the most successful international instruments providing uniform rules for international trade.¹ It was signed in Vienna on 11th April 1980 and came into force on 1st January 1988. Currently, the CISG has been adopted by seventy-three contracting states including some major and influential trading nations such as: the USA, China, Australia, Canada and most EU countries.² In the twenty-one years of practice, many international sale contract disputes have been resolved under the CISG by arbitration or judicial tribunals of the contracting states.³ Despite the achievement of outward uniformity, substantive uniformity seems to be unrealistic because in practice different contracting states inevitably come to different interpretations.⁴ Therefore, some official interpretations of the CISG are issued in an attempt to promote the uniform understanding and application of the CISG. For example, the International Sales Convention Advisory Council (CISG-AC) was established in 2001 as a private initiative to issue Opinions to address some

¹ <http://cisgw3.law.pace.edu/cisg/CISG-AC.html#1>. For the legislative history of the CISG, see Peter Schlechtriem 'Uniform Sales Law – The UN-Convention on Contracts for the International Sale of Goods' at <http://cisgw3.law.pace.edu/cisg/biblio/schlechtriem.html#a1>.

² <http://cisgw3.law.pace.edu/cisg/countries/cntries.html>.

³ It is reported that about 90% of the international commercial disputes are resolved by the arbitration tribunals and about 10% are resolved by domestic courts.

<http://www.cisg.law.pace.edu/cisg/text/caseschedule.html>.

A large number of arbitration awards and court decisions made under the CISG can be found at <http://www.cisg.law.pace.edu/cisg/text/casecit.html>.

⁴ Larry A. DiMatteo, Lucien Dhooge, Stephanie Greene, Virginia Maurer and Marisa Pagnattaro, 'The Interpretive Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence', *34 Northwestern Journal of International Law and Business*, (Winter 2004) 299-440.

controversial or unresolved issues of the CISG on its own initiative or by requests submitted to the CISG-AC, in particular, by international organisations, professional associations or adjudication bodies. The members of the CISG-AC are eminent academic scholars, who do not represent any countries or legal cultures and therefore can be more critical and profound in dealing with issues in a non-bias way. Nine CISG-AC Opinions have been issued so far with regard to electronic communications, notice of lack of conformity, parcel evidences, supplies of materials and contracts for the goods and services, fundamental breach and avoidance, the calculation of damages and force majeure.⁵ It should be noted that these CISG-AC Opinions only serve an instructional function and the contracting states of the CISG are not bound to honour them. In consequence, the uniform interpretation and application of the CISG is by no means guaranteed. It is under the individual tribunal's discretion to decide how the CISG should be applied. The focus of this thesis is not as to whether the CISG has assured the uniform interpretation and application by the tribunals of the different contracting states, but whether the CISG has proven to be effective in one selected contracting state – the People's Republic of China, i.e., whether the application of the CISG by the Chinese arbitration and judicial tribunals has resulted in consistent and predictable decisions.⁶

The CISG has been in force in the People's Republic of China (PRC) since 1st January 1988.⁷ When China signed the CISG in 1981 after having participated in the 1980 Vienna Diplomatic Conference, there was no codified contract law or general

⁵ <http://www.cisg.law.pace.edu/cisg/CISG-AC-op.html>.

⁶ The use of the word 'consistent' and its variations in this thesis means that given the same factual evidence, will different tribunals all reach the same decision? The use of the word 'predictable' and its variations are of similar meaning.

⁷ <http://cisgw3.law.pace.edu/cisg/countries/cntries-China.html>.

civil law in China.⁸ Before the CISG was ratified on 11th December 1986, China promulgated three important laws to prepare for the ratification of the CISG: the PRC Economic Contract Law (ECL) on 13th December 1981; the PRC Foreign-Related Economic Contract Law (FECL) on 21st March 1985 and the PRC General Principles of Civil Law (GPCL) on 12th April 1986. The ECL governed the domestic sale contract law and the FECL governed the international sale contract law. The FECL was drawn up based upon the draft of the CISG and therefore the influence of the CISG on the FECL existed from inception to enactment.⁹ This is probably the main reason why many Articles of the FECL read like duplicates of the CISG despite some wording differences. Both the ECL and the FECL have been replaced by the Contract Law of PRC (CCL) since 1st October 1999, the CCL being the Chinese present domestic contract law. Article 126 of the CCL provides that: ‘Parties to a foreign-related contract may select the applicable law for the resolution of a contractual dispute, except as otherwise provided by law. Where parties to the foreign-related contract fail to select the applicable law, the contract shall be governed by the law of the country with the closest connection thereto.’ Article 142 of the GPCL provides that: ‘If any international treaty concluded or acceded to by the People’s Republic of China contains provisions differing from those in the civil laws of the People’s Republic of China, the provisions of the international treaty shall apply, unless the provisions are the ones on which the People’s Republic of China has announced reservations. International practice may be applied to matters for which neither the law of the People’s Republic of China nor any international treaty concluded or acceded to by the People’s Republic of China has any provisions.’ The FECL has similar provisions in Articles 5 and 6. Article 5 of the FECL provides that:

⁸ Fan Yang, ‘The application of the CISG in the Current PRC Law and CIETAC Arbitration Practice’ <http://cisgw3.law.pace.edu/cisg/biblio/yang2.html>.

⁹ *ibid.*

‘For the matters that are not covered in the law of the People’s Republic of China, international practice shall be followed.’ Article 6 of the FECL provides that: ‘Where an international treaty which is relevant to a contract, and to which the People’s Republic of China is a contracting party or a signatory, has provided differently from the law of the People’s Republic of China, the provisions of the international treaty shall prevail, with the exception of those clauses on which the People’s Republic of China has declared reservation.’ Article 142 of the GPCL and Articles 5 and 6 of the FECL reflect China’s position as to the relationship between the domestic law and the international treaty concluded or acceded to by China,¹⁰ i.e., the international treaties adopted by China *per se* prevail over the Chinese domestic law. China reserves the right to apply some Articles when China accedes to the treaties. In the international sale of goods disputes, the CISG is normally applied by the Chinese tribunals either as the chosen law agreed by the parties, or as the closest connected law for being the international treaty concluded or acceded to by China or for being the regularly observed international practice recognised by China when the parties fail to choose the applicable law.¹¹

The CISG has not been ratified by the United Kingdom and it is excluded in many trade association standard contracts.¹² In the UK, the international sale of goods is governed by the English Sale of Goods Act 1979 (SGA) subject to some amendments.¹³ The SGA is applied in the contracts concluded between the parties conducting business abroad having only one connection with the UK – a clause in

¹⁰ Dong Wu, ‘CIETAC’s Practice on the CISG’, *Nordic Journal of Commercial Law* (2/2005).

¹¹ *ibid.*

¹² Steven Gee and Charles Debattista, ‘An English sale of goods Act that will be suitable for the worldwide market’, *Lloyd’s List* (8 December 2004) p. 6.

¹³ The SGA 1979 has been amended by the Sale and Supply of Goods Act 1994 and the Sale of Goods (Amendment) Act 1995: http://www.lemon-co.co.uk/article_sale-of-goods.php.

the contract choosing English law as the applicable law.¹⁴ The Department of Trade and Industry (DTI) has held two formal consultations in 1989 and 1997 as to whether the UK should ratify the CISG.¹⁵ Neither consultation has led to the UK's accession to the CISG because many large and influential organisations were against the ratification.¹⁶ The main concerns were the existence of some significant substantive differences between the SGA and the CISG and the risk involved with even slight wording changes, i.e., the danger of losing the inherent advantages of the certainty conferred by the long-established case law on the interpretation of the SGA.¹⁷ If the UK had adopted the CISG, the substantive differences in the CISG from the SGA would have put at risk the certainty and predictability of English law valued by international traders, not only in resolving their disputes but in preventing disputes.¹⁸ Against this background, the UK government will not consider accession to the CISG until there is widespread support from the English legal profession and influential commercial bodies.¹⁹ The purpose of this thesis is not to judge whether the UK should adopt the CISG, but to find out in the cases where the international sale disputes incurred in China – a contracting state of the CISG, whether the application of English law would have avoided the disputes or would have offered more predictable judgements. The study of English law is important on the grounds that it is the applicable law frequently chosen by contracting parties in the international sale of goods. Also, the close relationship between Britain and China brings about the potential of disputes between the traders of both countries. A

¹⁴ See *ante* fn. 11.

¹⁵ Sally Moss, 'Why the United Kingdom Has Not Ratified the CISG', 25 *Journal of Law and Commerce*, (2005-06) 483-485.

¹⁶ *ibid.*

¹⁷ Law Reform Committee in reply to the DTI's 1980 inquiry ('LRC Report') para.4 discussed in Angelo Forte, 'The United Nations Convention on Contracts for the International Sale of Goods: Reason or Unreason in the United Kingdom', 26 *University of Baltimore Law Review*, (Summer 1997) 51-66.

¹⁸ See *ante* fn.11.

¹⁹ See *ante* fn. 16.

comparative study between these two legal systems will be useful for giving legal advice as to the effect on the choice of law.

1.2 Objectives and Methodology

This thesis focuses on remedies for breach of contract in the international sale of goods. The reason for choosing this subject is that the remedy for the breach of contract is a very important part of international sale contract law. It is related to the matters that the contracting parties are mostly concerned about after a contract is breached and also it is the main reason why many litigation or arbitration claims are filed. In the judicial or arbitration judgements of most cases, the judges or arbitrators have to make their decisions on what remedies the injured seller or buyer are entitled to and why they are entitled to those remedies. The research of this subject is therefore crucial for the study on the predictability of the CISG in resolving disputes in international trade.²⁰

The study of remedies for breach of contract in this thesis is going to cover the main remedies that the seller and the buyer usually claim under the CISG for the breach of contract in the international sale of goods. These remedies are the avoidance of contract (Chapter 2), the recovery of damages (Chapter 3) with the limitation of mitigation (Chapter 4) and specific performance (Chapter 5). Before approaching these remedies, the categorisation of the breach of contract (Chapter 1) has to be addressed because different categories of breach would lead to different remedies. For example, a fundamental breach of the CISG entitles the injured seller or buyer to avoid the contract whereas a non-fundamental breach of the CISG only

²⁰ Some scholars suggest that the UNIDROIT Principles of International Commercial Contracts should be applied to help with the unified interpretation of the CISG. The author disagrees with this approach because there are some fundamental distinctions between the UNIDROIT and the CISG. Using the UNIDROIT principles to interpret the CISG will cause confusions. Thus, the UNIDROIT rules are excluded from the discussion of this thesis.

entitles them to claim damages or require specific performance. The discussion of the categorisation of the breach of contract builds a foundation for studying the remedies for breach of contract as laid out in the aforementioned chapters.

The objective of this thesis is to investigate whether the remedial rules of the CISG have proven to be effective by ensuring predictable decisions in China. The FECL is going to be compared with the CISG to see if different outcomes could have been achieved if the FECL had been applied in those Chinese cases decided under the CISG, where differences exist between the CISG and the FECL. The remedial rules of English law also have some substantive differences from the CISG and are therefore going to be compared with the CISG and the FECL. The relevant provisions of the SGA and English common law are going to be applied in selected Chinese cases to find out whether English law would have led to more predictable decisions.

Each chapter of this thesis starts with the citation of the relevant provisions of the CISG, FECL and English law. From these, their similarities and differences can be ascertained. This is followed by the Chinese cases decided under the CISG in order to examine the predictability of the judgements with regard to some controversial issues. The FECL and English law are discussed to find out whether the application of either of these two laws would have resulted in more predictable solutions to these problematic issues of the CISG. Alternatively, when the CISG has successfully and consistently tackled the issues, whether the FECL and English law would also have arrived at the same results. The concluding part of each chapter analyses what has caused the unpredictability of the judgements under the CISG in the Chinese cases, i.e., whether it is a problem of misunderstanding by the domestic tribunals or

deficiency of the CISG. Some proposals will be put forward by the author regarding how these uncertainties can be avoided or resolved.

1.3 Structure of the thesis

This thesis consists of seven chapters concentrating on the comparative study of the remedies for breach of contract in the international sale of goods under the CISG, FECL and English law.

Chapter 1 provides an overview of the background of the CISG, the Chinese legislative history and the UK's position regarding the adoption of the CISG. It gives a brief introduction as to why the subject of the thesis has been chosen, what the objectives of the research are, and how the structure of the thesis has been organised.

Chapter 2 introduces the categorisation of the breach of contract under the CISG, FECL and English law. Part I of Chapter 2 identifies the similarities and differences of the relevant provisions under the three regimes. Part II of Chapter 2 examines the Chinese cases decided under the CISG regarding the consistency of the categorisation of the breach of contract and regarding the predictability of the remedies awarded for breach of contract in specific situations: non-performance including non-delivery and non-payment; delayed performance including late delivery and late payment; and defective delivery including the delivery of defective goods and the tender of defective documents. Also, the FECL and English law are applied in those Chinese cases to compare which regime is more advantageous in offering predictable judgements.

Chapter 3 discusses the remedy of avoidance of contract for the fundamental breach under the CISG, FECL and English law. Part I of Chapter 3 illustrates the relevant provisions of the avoidance rules under the three regimes by listing their

similarities and differences. Part II of Chapter 3 looks into some Chinese decisions to examine the predictability of the judgments made by the Chinese tribunals in applying the avoidance rule of the CISG. The examination focuses on two main issues. The first issue is where the seller delivers defective goods, what time limits should be imposed upon the buyer to examine the goods and what the consequence is if the buyer fails to object to the non-conformity of the goods within the required time-limit. The second issue is where the goods are sold on shipment terms, whether the buyer has dual rights to avoid the contract by rejecting the non-conforming goods and rejecting the non-conforming documents and what is the relationship between the buyer's dual rights of rejection. In the discussion of these issues, the author also applies the FECL and English law in the decided Chinese cases to compare the predictability of the possible decisions under the avoidance rules of the three regimes.

Chapter 4 deals with the remedy of damages for breach of contract under the CISG, FECL and English law. Part I of Chapter 4 refers to the relevant provisions of the damage rules under the three regimes to illustrate their similarities and differences. Part II of Chapter 4 scrutinizes the consistency of the categorisation of the compensable losses under the CISG in the Chinese cases and the predictability of the recovery of specific compensable losses: the recovery of expectation losses (including the loss on the price difference, the loss of profit and the loss of interest); the recovery of reliance losses (including the loss for issuing and amending the Letter of Credit and the inspection loss); and the recovery of consequential losses (including the buyer's liability to sub-buyers, the repair loss and the litigation loss). Also, English law is applied in the discussion of the recovery of these compensable losses in the Chinese cases to see whether the application of English law would have led to different or predictable results. Because the provisions of damages in the

FECL are almost the same as the CISG, the application of the FECL in the Chinese cases is not specifically discussed in this chapter.

Chapter 5 talks of the mitigation rule for breach of contract. Part I of Chapter 5 examines the relevant provisions of the mitigation rules under the CISG, FECL and English law to demonstrate their similarities and differences. Part II of Chapter 5 investigates the predictability of the mitigation rule applied under the CISG in some Chinese cases with regard to some controversial issues: when a contract is breached whether the injured party should mitigate his loss or require specific performance from the breaching party and whether the injured party's failure to mitigate restricts his right to claim specific performance; at what point in time should the injured seller or buyer mitigate their loss in case of anticipatory breach – at the time of anticipatory breach or when the performance is due; and the ascertainment of reasonable mitigating measures. English law is also discussed in the Chinese cases to analyse whether the application of English law could have led to more predictable solutions. The application of the FECL is not mentioned in this part because the provisions of the mitigation rule of the FECL are very similar to the CISG.

Chapter 6 analyses the remedy of specific performance for breach of contract under the CISG, FECL and English law. Part I of this chapter compares the relevant provisions of the specific performance rules under the three regimes, highlighting their similarities and differences. Part II of this chapter investigates the consistency of the specific performance rule applied by the Chinese tribunals under the CISG in some Chinese cases. The investigation focuses on two main issues: where the seller fails to deliver the goods, whether the buyer can require the delivery of goods from the seller when the goods were not ascertained or specific goods; and in terms of defective delivery, whether or not the buyer can require the seller to repair and

substitute the goods or the buyer can only claim damages. The author also applies the FECL and English law to these cases to compare the predictability of possible decisions under the specific performance rules of the three regimes.

Chapter 7 summarises the whole thesis. It concludes in general as to whether the application of the remedial rules of the CISG has proven to be effective in China, i.e., whether it has led to predictable judgments. Where the decisions were unpredictable, the author looks into the causes of such unpredictability and some possible solutions with reference to the remedial rules of the FECL and English law.

CHAPTER 2

CATEGORISATION OF BREACH OF CONTRACT

- GROUND FOR THE RIGHT OF AVOIDANCE

BASED ON FUNDAMENTAL BREACH

Introduction

The breach of contract under the CISG is categorised into two categories: the fundamental breach and the non-fundamental breach.¹ The different categories of breach entitle the injured party to different remedies: the fundamental breach gives the right to avoid the contract, to require the substitution of the goods or to claim damages; and the non-fundamental breach gives the right to require specific performance, e.g., by the repair of or price reduction of the goods, or to claim damages. The analysis of the categorisation of the breach of contract in this chapter builds a foundation for studying the remedies for breach of contract in the whole thesis. The purpose of this chapter is to explore whether the categorisation of the breach of contract under the CISG is an effective regime for granting predictable remedies. Some Chinese cases, decided under the CISG, are examined to see whether the categorisation of breach in the CISG ensures the predictability and consistency of the remedies awarded by the Chinese tribunals. English law and the FECL² are comparatively studied to see which regime could work more consistently.

The first section of this chapter examines the relevant provisions of the categorisation of the breach of contract under the three regimes by comparing their

¹ CISG Article 25.

² The People's Republic of China Foreign-Related Economic Contract Law.

similarities and differences. The second section of this chapter looks into some Chinese cases with regard to the consistency of the categorisation of breach and the predictability of the awarded remedies in individual cases. English law and the FECL are comparatively studied to see whether they would provide more predictable results had they been applied. In the conclusion of this chapter, the author analyses what has caused those unpredictability (if there are any), in particular, is it a problem of drafting or misunderstanding in application and which regime is more advantageous in respect of predictability and consistency?

2.1 Comparison on the categorisation of the breach of contract under the three regimes: CISG, FECL and English Law

The categorisations of the breach of contract under the three regimes are comparatively examined in this section with regard to the following questions: [a] What are the relevant provisions under the three regimes? [b] Are they similar or different: if they are similar, what are their similarities; if they are different, what are their differences? The study of these issues is helpful in understanding why the breach of the same contractual obligation may lead to different remedies under different laws.

2.1.1 Relevant provisions of the categorisation of the breach of contract under the three regimes

Article 25 of the CISG categorises the breach of contract according to whether the breach is fundamental. The concept of ‘fundamental breach’ is of essential

importance to the remedial system,³ in that different categories of breach are remedied with different consequences under the CISG, i.e. the avoidance of contract, specific performance or damages. The first sentence of Article 25 defines the fundamental breach as: ‘*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*’. This provision outlines the central feature of the fundamental breach - *substantial detriment of material interests*. The second sentence of Article 25 specifies the breaching party’s ‘*foreseeability*’ as a method to exempt his liability resulting from the fundamental breach: ‘*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*’.⁴ Moreover, the provision of the fundamental breach in Article 25 is not absolutely decisive. The parties may derogate from the requirement of the fundamental breach in Article 25 and decide their own criteria by explicit agreement in the contract as authorised by Article 6 of the CISG.⁵

The FECL categorises the breach of contract according to how seriously the non-breaching party’s expected economic interests are harmed. The Chinese tribunals usually categorise the serious breach entitling the non-breaching party to cancel the contract as the fundamental breach, although the notion of fundamental breach was not explicitly adopted by Article 29(1) of the FECL: ‘*A party shall have the right to*

³ Franco Ferrari, ‘Fundamental Breach of Contract Under the UN Sales Convention – 25 Years of Article 25 CISG’, *25 Journal of Law and Commerce*, (Spring 2006) 489-508 [‘Franco Ferrari’].

⁴ Robert Koch, ‘Remarks on Whether the UNIDROIT Principles of International Commercial Contracts May Be Used to Interpret or Supplement Article 25 CISG’. <http://www.cisg.law.pace.edu/cisg/biblio/koch1.html>; *Commentary on the UN Convention on the International Sale of Goods (CISG)*, Peter Schlechtriem, (2nd ed. 2005) [‘Schlechtriem’] p.284.

⁵ CISG Article 6: ‘The parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions.’ See Alison E. Williams, ‘Forecasting the Potential Impact to the Vienna Sales Convention on International Sales Law in the United Kingdom’, *Pace Review of the Convention on Contracts for the International Sale of Goods (CISG)*, (2000-2001) 9-57.

notify the other party that a contract is cancelled in any of the following situations: (1) if the other party has breached the contract, the expected economic interests for which the contract is concluded are seriously affected'. The exemption of the breaching party's liability by his unforeseeability was not adopted by the FECL.

In English law, the breach of contract is classified into three categories: the breach of *conditions*, the breach of *warranties* and the breach of *intermediate terms* (also called *innominate terms*). The SGA only specifies the breach of two types of contractual promises: conditions and warranties. A *condition* is a promise to which the parties attribute such importance that it is treated as being of the essence of the contract,⁶ whether by express words or implication of law. Any failure of performance by one party, irrespective of gravity of the event that has resulted from the breach, entitles the other party to terminate the contract.⁷ It is provided for in the SGA Section 11(3) as: '*a condition, the breach of which may give rise to a right to treat the contract as repudiated*'. The *warranty* is defined by Section 61(1) of the SGA as: '*an agreement with reference to goods which are the subject of a contract of sale, but collateral to the main purpose of such contract, the breach of which gives rise to a claim for damages, but not to a right to reject the goods and treat the contract as repudiated*'.⁸ Where the remedy for the breach of certain terms of the contract is not expressly agreed and where the statutory guidance is also absent, whether a term is a condition or a warranty is a matter of construction. It depends on the court's interpretation of the parties' intention from the construction of the

⁶ *Schmitthoff's Export Trade*, Carole Murray, (11th ed. 2007), ['Schmitthoff'] 5-003.

⁷ *Photo Production Ltd v Securicor Transport Ltd* [1980] A.C. 826, 849, per Lord Diplock; *Chitty on Contracts*, A. G. Chitty, (30th ed. 2008) ['Chitty'] 43-044; *Benjamin's Sale of Goods*, Judah Philip Benjamin, (7th ed. 2006) ['Benjamin']: 10-027.

⁸ See SGA 11(3): '*a warranty, the breach of which may give rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated*'.

contract.⁹ It is confirmed in the SGA Section 11(3) that: ‘*Whether a stipulation in a contract of sale is a condition, the breach of which may give rise to a right to treat the contract as repudiated, or a warranty, the breach of which may give rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated, depends in each case on the construction of the contract; and a stipulation may be a condition, though called a warranty in the contract.*’ The dichotomy of condition and warranty in the SGA is not exhaustive and it is developed in *Hongkong Fir Shipping Co. Ltd v Kawasaki Kisen Kaisha* by indicating the existence of a third type of contractual promises, the ‘intermediate’ or ‘innominate’ terms, the breach of which allows the termination of contract only if the innocent party was deprived substantially of the whole expected benefit of the contract or the breach went to the root of the contract.¹⁰ This approach was applied in the sale of goods contract by *Cehave NY v Bremer Handelsgesellschaft mbH* (*‘The Hansa Nord’*), in which the statement of ‘shipment to be made in good condition’ in the contract was held as neither a condition nor a warranty but an intermediate term,

⁹ Benjamin 10-027; *Bentsen v Taylor, Son & Co.* [1893] 2 Q.B. 274, 281: the decision is also approved in *Bunge Corp v Tradax Export SA* [1981] 1 W.L.R. 711, at 725, HL. The House of Lords discusses contractual construction as to pre-contractual agreements in a recent case *Chartbrook Ltd and another v Persimmon Homes Ltd and another* [2009] UKHL 38. (It is not a sale of goods case, but a contract of construction case). In the decision, the court was prepared to depart from the literal meaning of a contractual term by correcting ‘mistakes’ in the drafting to eradicate commercially irrational result. In the author’s view, the court’s intervention impairs commercial certainty in the interpretation of express terms of the contract and respect should be paid to the both contracting parties’ intention at the time of contracting.

¹⁰ [1962] 2 Q.B.26: the Court of Appeal held that the stipulation of seaworthiness in the contract was neither a condition nor a warranty and whether its breach entitled the innocent party to terminate the contract depended on the nature and effect of the breach. See Benjamin 10-029, Chitty 43-045, *The Sale of Goods*, Michael Bridge, (2nd ed. 1997) p.157. The court’s introduction of innominate terms may impair the certainty of English law with regards to the interpretation of express terms of the contract. Where the court considers a term of contract as innominate, whether the aggrieved party has the right to terminate the contract will depend on the court’s judgment as to the seriousness of the other party’s breach at the time of breach and not depend on the contracting parties’ intention when the contract was made. This approach is likely to increase commercial risks and consequently result in commercial uncertainty on the grounds that the contracting parties will not be able to predict the consequences of their breach until the seriousness of breach is considered by the court.

the breach of which was not serious enough to justify the rejection of the goods in the court's discretion.¹¹

It should be noted that there is a notion of '*fundamental breach*' in English law, dealing with a completely different issue from the notion of 'fundamental breach' in the CISG.¹² The doctrine of fundamental breach in English law regulates the effect of exemption clause, i.e., whether the breaching party is entitled to rely on an exemption clause in a contract after having committed a fundamental breach – a breach which deprives the non-breaching party of the main performance owed under the contract.¹³ This doctrine is believed to be no longer in existence, and it is regarded as an instrument of interpretation based on the construction of the contract in English law.¹⁴

2.1.2 Similarities of the categorisation of the breach of contract under the three regimes

The categorisations of the breach of contract under the three regimes have some similarities in the following three aspects. Firstly, they all require the breach of a contractual obligation as the precondition for the breach of contract. Secondly, the main remedies for the breach of contract are the discharge of the parties from further

¹¹ [1976] Q.B. 44: a part of the goods shipped for C.I.F. contract was defective but not sufficient to make the consignment unmerchantable. It was held that the preservation of the common law rules in Section 62(2) of the SGA prevents the dichotomy of condition and warranty from being exclusive and approves the existence of innominate terms. See *Tradax International SA v Goldschmidt SA* [1977] 2 Lloyd's Rep. 604.

¹² Benjamin 13-042. The English concept of 'fundamental breach' is called a 'false friend' of the fundamental breach doctrine in the CISG: *Uniform Law for International Sales under the 1980 United Nations Convention*, John O. Honnold, (3rd ed. 1999) p.205.

¹³ Benjamin 13-049.

¹⁴ *George Mitchell Ltd v Finney Lock Seeds Ltd* [1983] 2 A.C. 803; see *Photo Production Ltd v Securicor Transport Ltd* [1980] A.C. 827.

performance of the contract and damages. Thirdly, in some circumstances, the criterion for discharge is based on the seriousness of the breach.¹⁵

[a] Breach of the contractual obligations

The breach of a contractual obligation is a precondition for the breach of contract under the three regimes. In the CISG, the ‘breach of contract’ is not defined in Article 25, but it can be inferred from other Articles that the breach of contract includes the party’s failure to perform any of his obligations under a contract or the Convention.¹⁶ The forms of the breach can be non-performance (e.g., non-delivery or non-payment), delayed performance (e.g., late delivery or late payment) or defective performance (e.g., the delivery of defective goods or the tender of defective documents). These can be derived from a contract, the practice established between the parties, or the usages agreed by the parties as specified in Article 9 of the CISG.¹⁷ In the FECL, the ‘breach of contract’ was defined in Article 18: *‘If a party fails to perform the contract or its performance of the contractual obligations does not conform to the agreed terms, which constitute a breach of contract, the other party is entitled to claim damages or demand other reasonable remedial measures. If the losses suffered by the other party cannot be completely made up after the adoption of*

¹⁵ Different notions are used by the three regimes to describe the meaning of discharge: ‘cancellation’ is used in the FECL, ‘avoidance’ is used in the CISG and ‘termination’ is used in English law.

¹⁶ CISG Article 45(1): ‘If the seller fails to perform any of his obligations under the contract or this Convention, the buyer may: (a) exercise the rights provided in Article 46 to 52; (b) claim damages as provided in Article 74 to 77.’ Article 61(1): ‘If the buyer fails to perform any of his obligations under the contract or this Convention, the seller may: (a) exercise the rights provided in Articles 62 to 65; (b) claim damages as provided in Articles 74 to 77.’

¹⁷ CISG Article 9: ‘(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves. (2) The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.’ See Robert Koch, ‘The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)’, *Review of the Convention on Contracts for the International Sale of Goods (CISG) 1998*, (1999) 177-354; see fn.3 Franco Ferrari.

such remedial measures, the other party shall still have the right to claim damages.’ In English law, the contractual obligations breached can be either expressly agreed by the parties in the contract or implied by law.¹⁸ The goods supplied are implied by law to comply with the contractual descriptions and the sample; they are also of satisfactory quality and fit for all the purposes bought for.¹⁹ Therefore, the breach of any of these terms implied by law constitutes the breach of contract, with the same effect as the breach of express terms agreed by the parties in a contract.

[b] Remedies for the breach of contract

The main remedies for breach of contract under the three regimes are either to discharge the parties from further performance of a contract or to claim damages. When a contract is fundamentally breached under the CISG and FECL or when the condition of a contract is breached or when an intermediate term is repudatorily breached under English law, the injured party may treat the contract as discharged and claim damages,²⁰ unless the right of avoidance is waived.²¹ When a contract is not fundamentally breached under the CISG and FECL, or when the warranty of a

¹⁸ Schmitthoff: 5-003.

¹⁹ SGA s.13, 14, 15.

²⁰ CISG Articles 45(1) and (2): ‘The buyer is not deprived of any right he may have to claim damages by exercising his right to other remedies.’ Article 61(1), (2): ‘The seller is not deprived of any right he may have to claim damages by exercising his right to other remedies.’ Article 81(1): ‘Avoidance of the contract releases both parties from their obligations under it, subject to any damages which may be due.’ FECL Article 18. SGA Sections 11(3) and 51(1): ‘Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may maintain an action against the seller for *damages* for non-delivery.’ See Chitty 43-053,054.

²¹ CISG Article 39(1): ‘The buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the sellers specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it.’ The FECL does not have a provision as to waiver but the cancellation for the fundamental breach is called a ‘right’ of the injured party in Article 29(1). SGA Section 11(2): ‘Where a contract of sale is subject to a condition to be fulfilled by the seller, the buyer may waive the condition, or may elect to treat the breach of the condition as a breach of warranty and not as a ground for treating the contract as repudiated.’ See Chitty 43-055, Benjamin 10-028.

contract is breached under English law, the injured party is only entitled to claim damages.²²

[c] Criterion for discharge

The criterion for the fundamental breach under the CISG and FECL is similar to the repudiatory breach of an intermediate term of a contract under English law.²³ They all require the impairment of a material interest, i.e., the extent of the breach needs to be serious and substantial enough to deprive what the injured party is entitled to expect on conclusion of the contract, although the expressions in the three regimes are slightly different. Article 25 of the CISG talks about the substantial deprivation of expected interests;²⁴ Article 29 of the FECL speaks of serious impairment of expected economic interests; and in English common law requires the breach to deprive the whole benefit of a contract in the repudiatory breach of intermediate terms.²⁵

2.1.3 Differences of the categorisation of the breach of contract under the three regimes

The categorisations of the breach of contract under the three regimes have three main differences. The prerequisite for the fundamental breach under the CISG and FECL is different from the prerequisite for the breach of the conditions of contract in English law. Some remedies for the fundamental breach and the non-fundamental breach of contract under the CISG and FECL are different from the remedies for the

²² CISG Articles 45(1) and 61(1); FECL Article 18; SGA Sections 11(3) and 61(1).

²³ *The International Sale of Goods Law & Practise*, Michael Bridge (1st ed. 1999) p.85.

²⁴ Schlechtriem p.286.

²⁵ *The Hansa Nord* [1976] 1 Q.B. (C.A) 44 at 60, 72-73, 84; see Chitty 43-054.

breach of conditions, intermediate terms and warranties of contract under English law.

[a] Substantial deprivation of material interests

The fundamental breach of the CISG and FECL requires the impairment of a material interest substantial to the injured party's expectation on conclusion of the contract.²⁶ The breach of the condition of contract in English law does not have such a requirement. The condition of contract can be the terms either expressly agreed by the parties in the contract or implied by law.²⁷ The breach of the conditions of a contract entitles the injured party to terminate the contract,²⁸ irrespective of the gravity of the event that has in fact resulted from the breach.²⁹ Nevertheless, this situation has been challenged by the introduction of Section 15A of the SGA.³⁰ The buyer's right of termination is limited when the seller breaches the conditions of contract implied by law regarding the quality, the fitness for purpose and the description or sample of the goods as provided in Sections 13, 14, 15 of the SGA. Section 15A states that 'the breach is so slight that it would be unreasonable for him [buyer] to reject them [goods], and if the buyer does not deal as a consumer, the breach is not to be treated as a breach of condition but may be treated as a breach of warranty', 'unless a contrary intention appears in, or is to be implied from, the contract'.³¹ It is advised in Benjamin that in overseas sales such as c.i.f. or f.o.b. contracts, the parties must be taken to have implied to agree to exclude the

²⁶ CISG Article 25; FECL Article 29(1).

²⁷ Benjamin18-284; Chitty 43-052.

²⁸ e.g., in international sales, the express provisions regarding the time of performance, the place of shipment and some other statements about the ship or the goods. See Benjamin18-284; Chitty 43-052.

²⁹ *Photo Production Ltd v Securicor Transport Ltd* [1980] A.C. 826, 849.

³⁰ Section 15A was introduced into the SGA1979 by s.4 (1) of the Sale and Supply of Goods Act 1992 and the purpose of its induction was to prevent a commercial buyer from abusing his right of termination by taking advantage of a trivial breach: Chitty 43-057.

³¹ See further discussion in Benjamin18-284; Chitty 43-057.

application of Section 15A and the buyer's right of rejection should not be affected by such a statutory restriction.³² The reason for the restrictive interpretation of Section 15A is that under English law the interest of commercial certainty is traditionally regarded to be more important than the value of justice in overseas sales, particularly in commodity sales and the buyer must be assured to make his decision quickly and with confidence to reject the goods.³³ Thus, Section 15A would not affect the buyer's right of rejection in the international sale of goods despite the concerns of some scholars.³⁴

[b] Foreseeability

In Article 25 of the CISG, the foreseeability of a substantial detriment is an instrument used to ascertain the seriousness of an obligation breached,³⁵ i.e., if the impairment of the injured party's interest was foreseen or would have been foreseen as substantial by the breaching party or by a reasonable person in the same circumstances, then the breach constitutes the fundamental breach of contract.³⁶ Generally speaking, the function of the foreseeability test in Article 25 is of little value in practice.³⁷ Given the stringency of the test for substantial impairment, it would be unbelievable for a breaching party to fail to foresee the important effect of such a breach.³⁸ The supplement of the foreseeability in Article 25 is regarded as

³² Benjamin 18-284.

³³ Benjamin 18-284.

³⁴ 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?', *Contemporary Issues in Commercial Law*, (1997) 137-160.

³⁵ Schlechtriem p.288.

³⁶ However, the breaching party's unforeseeability of the substantial impairment does not exempt him from his liability because the test of 'substantial deprivation' is dominant in Article 25 of the CISG: Schlechtriem p.287-288.

³⁷ fn.23 p.86. It is noted that in practice, the foreseeability of the defaulting party as to the substantial detriment is very rarely discussed by the courts when a fundamental breach is identified.

³⁸ fn.23 p.86.

superfluous and thereby normally ignored by the court in practice.³⁹ Moreover, the time for assessing the breaching party's foreseeability is left open by Article 25 of the CISG: whether by the conclusion of contract or by the breach of contract.⁴⁰ Comparatively, the foreseeability test was not required either in the fundamental breach of the FECL or in the breach of conditions or intermediate terms in English law. Due to the insignificance of the foreseeability test, the provision of foreseeability in Article 25 of the CISG makes only literal but not substantive difference from the FECL or English law in judging the seriousness of the breached obligation.

[c] Remedies for breach of contract

There are some differences in the remedies for breach of contract under the three regimes. In the CISG, the remedies for the fundamental breach are the avoidance of contract,⁴¹ specific performance,⁴² the substitution of the goods⁴³ and damages;⁴⁴ the remedies for the non-fundamental breach include repair,⁴⁵ price reduction⁴⁶ and damages⁴⁷. In the FECL, the remedies for the fundamental breach are the cancellation of contract,⁴⁸ damages⁴⁹ or 'demanding other reasonable remedial

³⁹ Schlechtriem p.284.

⁴⁰ fn.23 p.86; Schlechtriem p.290.

⁴¹ CISG Article 49(1)(a): the buyer's right of avoidance for the seller's non-performance; Article 64(1)(a): the seller's right of avoidance for the buyer's non-performance; Article 51(2): the buyer's right of avoidance for the seller's partial non-delivery; Article 72(1): the right of avoidance for the anticipatory fundamental breach; Article 73(1)(2): the right of avoidance for the seller's or the buyer's non-performance in instalment contract.

⁴² CISG Article 46(1): the buyer's right to require performance by the seller of his obligations; Article 62: the seller's right to require the performance by the buyer of his obligation: e.g., pay the price, take delivery, or other obligations.

⁴³ CISG Article 46(2): the buyer's right to require the substitution of the goods.

⁴⁴ CISG Article 45(2): 'The buyer is not deprived of any right he may have to claim damages by exercising his right to other remedies'; Article 61(2): 'The seller is not deprived of any right he may have to claim damages by exercising his right to other remedies.'

⁴⁵ CISG Article 46(3).

⁴⁶ CISG Article 50.

⁴⁷ CISG Article 45(2), Article 61(2).

⁴⁸ FECL Article 29(1).

measures’⁵⁰; the remedies for the non-fundamental breach are damages or ‘demanding other reasonable remedial measures’.⁵¹ Although the FECL fails to clarify what the ‘other reasonable remedial measures’ are, the Chinese tribunals normally hold specific performance, repair or substitution of the goods as the reasonable remedies available for the injured buyer to claim. In English law, the remedies for breaching the conditions of contract and the remedies for the repudiatory breach of the intermediate terms are normally the termination of a contract and damages;⁵² and the remedy for breaching the warranties of contract is normally damages only.⁵³ Granting specific performance is also a remedy available for the breach of contract by Section 52 of the SGA,⁵⁴ but it is regarded as an extraordinary and discretionary remedy, and only applicable in very limited circumstances⁵⁵ when the normal sanction of damages is inadequate to compensate the injured party’s loss, e.g., the goods sold are unique.⁵⁶ The remedy of damages is a primary remedy for the breach of contract under English law.⁵⁷ Comparatively, specific performance is a primary remedy under the CISG and FECL, because the performance of contract is regarded as more important than the avoidance of

⁴⁹ FECL Article 34: ‘The modification, rescission or termination of a contract shall not affect the rights of parties to claim damages.’

⁵⁰ FECL Article 18: ‘If a party fails to perform the contract or its performance of the contractual obligations does not conform to the agreed terms, which constitute a breach of contract, the other party is entitled to claim damages or demand other reasonable remedial measures. If the losses suffered by the other party cannot be completely made up after the adoption of such remedial measures, the other party shall have the right to claim damages.’

⁵¹ FECL Article 18.

⁵² SGA Section 11(3).

⁵³ SGA Sections 11(3) and 61(1).

⁵⁴ SGA Section 52(1) ‘In any action for breach of contract to deliver specific or ascertained goods, the court may, if it thinks fit, on the plaintiff’s application, by its judgment or decree direct that the contract shall be performed specifically, without giving the defendant the option of retaining the goods on payment of damages.’

⁵⁵ *The Sale of Goods*, Michael. G. Bridge, 1997 p. 559-560; Peter A. Piliounis, ‘The Remedies of Specific Performance, Price Reduction and Additional Time (Nachfrist) under the CISG: Are these worthwhile changes or additions to English Sales Law?’, *12 Pace International Law Review* (Spring 2000) 1-46.

⁵⁶ Ulrich Drobnig, ‘General Principles of European Contract Law’ *Petar Sarcevic & Paul Volken eds., International Sale of Goods: Dubrovnik Lectures*, Oceana (1986), Ch. 9, 305-332; *Remedies for Breach of Contract—a Comparative Account*, G. H. Treitel, (1988) [‘Treitel’] p.73.

⁵⁷ Francis Reynolds, ‘Some Reservations about CISG’ *L.Q.R.* (April 2003) 294.

contract.⁵⁸ The emphasis on the performance of contract of the CISG and FECL makes it more difficult to avoid a contract than English law. The breach of the same contractual obligation may thereby be categorised into different types of breach and lead to different remedies under the three regimes.

2.2 Examination of the consistency of the categorisation of the fundamental breach in specific situations decided in the Chinese cases under the CISG in comparison with the FECL and English law

In this section, some Chinese cases are examined in which the categorisation rule of the CISG was applied. The aim is to find out whether the breach of the same contractual obligation may be categorised into different types of breach under the CISG, i.e., the fundamental breach or the non-fundamental breach, leading to different categories of remedies, i.e., the avoidance of contract, damages or specific performance. The examination of the Chinese cases is based on different circumstances of the breach of contract: non-performance, delayed performance and defective performance. *[a] Where the contract has totally failed to perform, e.g., the seller refuses to deliver the goods or the buyer refuses to take delivery or make payment, is the non-performance of contract categorised as a fundamental breach or non-fundamental breach of contract and what remedies are granted? [b] Where the performance of contract is delayed, e.g., the seller delivers the goods late or the buyer makes the payment late, is the delayed performance categorised as a fundamental breach or non-fundamental breach of contract and what remedies are granted? [c] Where the goods delivered or the documents tendered are defective, is*

⁵⁸ *ibid.*

the seller's defective performance categorised as a fundamental breach of contract or non-fundamental breach and what remedies are granted?

If the categorisation of the breach of contract in relation to above questions was predictable in the Chinese judgments, it would prove that the categorisation rule of the CISG is effective for the Chinese tribunals to categorise breaches and grant remedies in the disputes of international sale of goods. If the categorisation was not predictable, it would mean that there may be some problems with the CISG itself or some misunderstanding in the application of the CISG. Then, the author will look into what has caused the unpredictability and how the problem can be resolved. The categorisations of the breach of contract under the FECL and English law are also applied by the author to the Chinese cases to see whether or not they would have led to different results. *[a] Where the categorisation of breach was predictable and the same types of remedies were awarded under the CISG, would the application of the FECL or English law also have led to a predictable result and the same remedies? If not, what differences would have been made? [b] Where the categorisation of breach was not predictable and different types of remedies were rewarded under the CISG, would the application of the FECL or English law have led to a more predictable categorisation of breach and more predictable remedies?*

2.2.1 Non-performance of the Contract

[a] Non-delivery

Where the seller fails to deliver the goods as agreed in the contract, does the seller's non-delivery constitute a fundamental or non-fundamental breach of contract by the categorisation rule of the CISG and what remedies are available to the injured buyer?

In international sale of goods contracts, one of the seller's essential duties is to deliver the goods according to Article 30 of the CISG.⁵⁹ A definite non-delivery should normally constitute a fundamental breach according to Article 25 of the CISG because it deprives substantially what a buyer would expect on conclusion of the contract, i.e., the delivery of the goods, unless the seller reserves his duty of delivery under certain conditions to be satisfied,⁶⁰ e.g., the pre-payment of the price or the issue of a bank guarantee or performance bond. It is irrelevant whether the non-delivery is due to the seller's subjective or objective impossibility.⁶¹ A definite non-delivery can be either the seller's actual failure to deliver the goods when the performance is due or the seller's refusal to deliver the goods before or on the delivery date.⁶² The remedies the buyer may claim are the avoidance of contract, the seller's specific performance or damages under the CISG.⁶³

⁵⁹ CISG Article 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.'

⁶⁰ Schlechtriem p.293.

⁶¹ Schlechtriem p.293. Subjective impossibility: e.g., the seller refuses to deliver the goods due to the seller's personal reason. Objective impossibility: e.g., the seller's supplier fails to deliver the goods to the seller and the seller cannot find substitute goods in the market to perform the contract with the buyer.

⁶² Schlechtriem p.293. Whether a particular declaration or a specific behaviour of the seller constitutes the definite refusal of delivery is a matter of interpretation to be resolved according to Article 8 of the CISG: fn. 3 Franco Ferrari; CISG Article 8: '(1) For the purposes of this Convention, statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was. (2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances. (3) In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.'

⁶³ CISG Article 45. There is one exception when the seller is not liable for the buyer's loss caused by non-delivery, if the seller can prove the occurrence of force majeure in accordance with Article 79(1) of the CISG, i.e., the failure of delivery was caused by an impediment beyond the seller's control, or that could not have been reasonably expected or avoided. CISG Article 79(1): 'A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.' The English courts treat the force majeure clause with scepticism. It is rarely successfully claimed unless the event falls precisely within an explicitly drafted force majeure clause in the contract: see *The Marine Star* [1994] 2 Lloyd's Rep.629.

The Chinese tribunals have been very consistent in holding the seller's non-delivery as a fundamental breach of contract and granting the injured buyer the right to avoid the contract, to require the seller's delivery, or to recover damages. Two cases decided by the China International Economic and Trade Arbitrations Commission (CIETAC) are illustrated next as examples.

In the *Silicon metal case*,⁶⁴ the buyer concluded a sale contract with the seller for 300 tons of silicon metal to be delivered F.O.B. in two instalments by August and September 1999 and the payment was agreed to be made by Letter of Credit (L/C) at sight. The time for opening the L/C was not specified in the contract and the buyer opened the L/C on 13th August 1999 before the agreed shipment period. Due to the rising market, the seller refused to deliver the goods. After the buyer requested the delivery several times in vain, the buyer terminated the contract and bought substitute goods in the middle of November 1999. The arbitrators held that the seller's non-delivery amounted to a fundamental breach and the buyer was entitled to terminate the contract and recover the damages for the price difference between the original contract and the substitute sale.

In the *Steel scraps case*,⁶⁵ the seller and the buyer concluded a contract on 1st January 1993 for the purchase of 20,000 tons of steel scraps to be shipped by the end of February 1993 C.I.F to ZhangJiaGang (a Chinese port). It was agreed that the payment should be made in three instalments: \$100,000 cash advance, \$2,272,000 by the L/C within 20 days after the signing of the contract and \$468,000 by remittance within seven days of receipt of the goods. As requested by the seller, the L/C was modified several times and the date for delivery was postponed until 20th May 1993. Later, due to the seller's financial problem, the buyer agreed to make four

⁶⁴ Award of 10 August 2000 [CISG/2000/04] (*Silicon metal case*).

⁶⁵ Award of 27 July 2000 [CISG/2000/03] (*Steel scraps case*).

remittances totalling \$496,000. Despite this, the seller still failed to deliver the goods. The buyer filed an arbitration claim in March 1994 requesting the seller's delivery of the goods. The first arbitration tribunal held that the seller's non-delivery constituted a fundamental breach and the buyer was entitled to require the seller to deliver the goods. After the arbitration award was made, the seller still refused to deliver the goods. Five years later, the buyer filed another arbitration claim to terminate the contract and to request a refund of the money paid with interest and the compensation for the buyer's loss of profit. The Chinese tribunal affirmed that the seller's non-delivery constituted a fundamental breach of the contract. The buyer's claim of the refund of the payment with interest was upheld despite the loss of profit being dismissed.

In both aforementioned cases, the Chinese tribunals consistently categorised the seller's non-delivery as a fundamental breach of contract under the CISG and awarded the injured buyer the remedies to avoid the contract, damages and the enforcement of the seller's performance, as provided by Article 45 of the CISG. If the FECL had been applied in both cases, the result would probably have been the same because the criterion for ascertaining the right of discharge from a contract under the two regimes is both the impairment of a material interest and the remedies for the fundamental breach are both the avoidance of the contract, specific performance and damages as illustrated in the first section of this chapter.⁶⁶ If English law had been applied in these cases, although the buyer should still have been entitled to terminate the contract because the main purpose and the condition of

⁶⁶ FECL Articles 18. See *ante* 2.1.1 [b][c].

the contract for delivering the goods has failed,⁶⁷ the remedies granted by the English court could have been different from the remedies granted by the Chinese tribunals.

In the *Silicon metal case*, the Chinese tribunal applied the CISG and awarded the buyer with the damages for the price difference between the original contract and the substitute sale made in the middle of November 1999 despite the fact that the time for delivery agreed in the contract was August and September 1999. If the FECL had been applied here, then the date for calculating the buyer's damage would also have been based on the date of the substitute sale, i.e., the middle of November 1999. That is because under the FECL, the injured party is not obliged to avoid the contract and mitigate his loss by a prompt substitute sale at the time of breach, as long as he has a plausible reason for not doing so, e.g., if there is still a possibility for the seller to perform the contract.⁶⁸ In contrast, English law ascertains the market price or current price for the substitute sale by the time when the goods ought to have been delivered or if no time was fixed by the time of the seller's refusal to deliver.⁶⁹ Therefore, the English court would have measured the buyer's damages by the market price in August and September rather than in the middle of November when the actual substitute sale was made.

In the *Steel scraps case*, the first arbitration tribunal upheld the buyer's claim to require the seller's performance of contract, regardless of the fact that the goods could be re-purchased in the market. The second arbitration tribunal awarded the

⁶⁷ SGA Sections 11(3), 61(1); Benjamin p.606 12-022: The total failure of performance discharges the innocent party from the contract by implication of the English common law.

⁶⁸ FECL Article 18: 'If a party fails to perform the contract or its performance of the contractual obligations does not conform to the agreed terms which constitutes a breach of contract, the other party is entitled to claim damages or demand other reasonable remedial measures.'

⁶⁹ SGA Section 51 'Damages for non-delivery (1) Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may maintain an action against the seller for damages for non-delivery. (2) The measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the seller's breach of contract. (3) Where there is an available market for the goods in question the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price of the goods at the time or times when they ought to have delivered or (if no time was fixed) at the time of the refusal to deliver.'

buyer's claim for a refund of the price with interest after the seller had not performed the contract for five years since the first arbitration award was made. In English law, specific performance would only be granted if the goods involved are unique and there is no available market for a resale.⁷⁰ If English law had been applied in the *Steel scraps case*, the buyer's first arbitration claim to require the seller's performance would not have been supported and the buyer would only have been awarded a refund and the price difference between the original contract and the market price when the delivery should have been made, i.e., 20th May 1993. The application of the English *prima facie* market rule would have saved the buyer the five years of waiting and made the parties' economic status more certain and predictable. The fundamental reason for the different results under the CISG and English law is that the CISG emphasizes the performance of contract and English law emphasizes the termination of contract.⁷¹ English law values certainty and efficiency more than justice in international trade. After the seller fails to deliver the goods, the injured buyer is expected to go to the market and buy substitute goods straight away and the buyer's recoverable damage is based on the market price when the goods ought to have been delivered or if no time was fixed at the time of the seller's refusal to deliver.⁷² Under the CISG and FECL, after the seller fails to deliver the goods, the injured buyer is still entitled to require the performance by the seller in spite of the fact that the substitute goods are available in the market.⁷³ That is why the application of the FECL in the *Steel scraps case* would have the same outcome as the application of the CISG. The English approach is comparatively more certain and efficient for the contracting parties. The parties know exactly where they stand after

⁷⁰ *Remedies for Breach of Contract-a Comparative Account*, G. H. Treitel, (1988) ['Treitel'] p.73.

⁷¹ See fn.57.

⁷² SGA Section 51.

⁷³ CISG Article 45, 46; FECL Article 18.

the seller fails to deliver the goods at the agreed time: the buyer knows that he must mitigate his damage by buying substitute goods in the market instantly, rather than sitting there and waiting for the seller's instruction on whether the seller is going to deliver the goods later as permitted by the CISG and the FECL.⁷⁴

[b] Failure to take delivery or pay the price

Where the buyer fails to take delivery of the goods or pay the price, does the buyer's non-performance constitute a fundamental breach or non-fundamental breach by the categorisation of the CISG and what remedies are available to the injured seller?

In the international sale of goods contract, the buyer's essential obligations are to take delivery and pay for the goods as required by the contract and the Convention according to Article 53 of the CISG. The buyer's failure to make payment or take delivery,⁷⁵ irrespective of his refusal or impossibility, should fall into the category of a fundamental breach according to Article 25 of the CISG because it deprives substantially the seller's expectation from the contract, i.e., the payment and acceptance of the goods.⁷⁶ The remedies that the injured seller can claim under the CISG are the avoidance of contract,⁷⁷ specific performance⁷⁸ or damages.⁷⁹

⁷⁴ CISG Article 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 retains any right to claim damages as provided for in this Convention.' FECL Article 18.

⁷⁵ The buyer's refusal to take premature delivery does not fall into the category of the definite failure to take delivery: CISG Article 52(1) 'If the seller delivers the goods before the date fixed, the buyer may take delivery or refuse to take delivery.'

⁷⁶ Schlechtriem p. 298 para. 23.

⁷⁷ CISG Article 64: '(1) The seller may declare the contract avoided: (a) if the failure by the buyer to perform any of his obligations under the contract or this Convention amounts to a fundamental breach of contract.'

⁷⁸ CISG Article 62: 'The seller may require the buyer to pay the price, take delivery or perform his other obligations, unless the seller has resorted to a remedy which is inconsistent with this requirement.'

⁷⁹ CISG Article 61(1), Article 75: 'If the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold

The Chinese tribunals have been quite consistent to hold the buyer's failure to take delivery or make the payment as a fundamental breach of contract under the CISG. The injured seller is held to be entitled to avoid the contract, require the buyer to take delivery or make payment,⁸⁰ and recover damages. The following two Chinese cases are illustrated as examples.

In the *Horsebean case*,⁸¹ the buyer bought 2,000MT of horsebean F.O.B. from the seller to be delivered before March 1995 and the payment was to be made by an irrevocable and transferable L/C. The buyer opened the L/C on 15th February 1995 and the delivery date was modified by the parties to be on 21st March 1995 in the L/C. The seller delivered all the goods to the warehouse by 21st March, but the buyer failed to arrange shipment and take delivery of the goods because the seller refused to allow some of the goods to be inspected by a team of Egyptian inspectors sent by the buyer. The buyer bought substitute goods and claimed his damages. It was held by the Chinese arbitrators that the buyer was not entitled to inspect the goods before shipment under the contract and the buyer's refusal to arrange shipment and to take delivery of the goods amounted to a fundamental breach of the contract. Therefore, the buyer's claim of damages was dismissed. Because the seller did not file a counter claim against the buyer, the seller failed to recover any damage resulting from the buyer's unjustifiable avoidance of contract.

In the *Australian raw wool case*,⁸² the buyer bought 50,000kg of Australian raw wool from the seller C.I.F. to be shipped by June 1997. The payment was agreed to be made by '*L/C 180 days from B/L date*' in the contract, whereas another standard term '*General Trading Terms and Conditions for Purchase of Wool and Wool Bar*'

the goods, the party claiming damages may recover the difference between the contract price and the price in the substitute transaction as well as any further damages recoverable under Article 74.'

⁸⁰ Award of 10 May 2005 Case No. G20010386 (*Hat case*).

⁸¹ Award of 8 March 1996 [CISG/1996/13] (*Horsebean case*).

⁸² Award of 6 January 1999 [CISG/1999/04] (*Australian wool case*).

incorporated within the same contract specified that ‘the buyer shall issue an irrevocable L/C from the Bank of China or one of its branches with the seller as the beneficiary *before shipment*’. The Chinese tribunal held that the latter statement prevailed over the former statement because it was less ambiguous and therefore clearer. The buyer’s failure to open the L/C before shipment was categorised as a fundamental breach under the CISG by the Chinese tribunal and therefore the seller was entitled to avoid the contract and recover his damages resulting from the buyer’s breach, i.e., the price difference between the contract and the substitute sale made on 20th October 1997, the storage charges together with the attorney’s fees.

If the aforementioned two Chinese cases had been decided under the FECL, the results would have probably been the same, in that the buyer’s failure to take delivery or make payment would have been categorised as the fundamental breach according to Article 29(1) of the FECL due to the seller’s ‘*expected economic interests for which the contract is concluded are seriously affected*’. Therefore, the seller should be entitled to cancel the contract and claim his damages.

If English law had been applied in the above two cases, the result would probably have been similar to the Chinese decisions. Under English law, the F.O.B. buyer in the *Horsebean case* would have been obliged to arrange shipment and take delivery of the goods and the C.I.F. buyer in the *Australian raw wool case* would have been obliged to open the L/C before shipment as agreed in the sale contract. The buyer’s refusal to take delivery and make payment breached the condition of the contract, i.e., the payment of the goods – the seller’s main aim by making the contract. Therefore, the injured seller would be entitled to terminate the contract⁸³ and recover the

⁸³ SGA Sections 11(3) and 61(1); Benjamin p.606 12-022: The total failure of performance discharges the innocent party from the contract by implication of the common law.

damage resulting from the buyer's non-acceptance⁸⁴ or non-payment.⁸⁵ It should be noted that the time for ascertaining the market price for measuring the recoverable damages in English law is different from that of the CISG. English law ascertains the market price by the *prima facie* market rule, i.e., the time when the goods ought to have been accepted; or if no time was fixed for acceptance, at the time of the buyer's refusal to accept;⁸⁶ and the CISG allows a reasonable time after the avoidance of contract.⁸⁷ In the '*Australian raw wool case*', English law would have ascertained the seller's damages by the market price by June 1997 instead of 20th October 1997 when the substitute sale was actually made.

2.2.2 Delayed performance of the contract

[a] Late delivery

In international sale contracts, it is very common to have provisions that expressly specify the time of performance, e.g., a clause specifying the time of shipment in C.I.F. contracts.⁸⁸ *Where the seller fails to deliver the goods by the time agreed in the contract, does the seller's delay constitute a fundamental breach or non-*

⁸⁴ Ibid; SGA Section 50: 'Damages for non-acceptance: (1) Where the buyer wrongfully neglects or refuses to accept and pay for the goods, the seller may maintain an action against him for damages for non-acceptance. (2) The measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the buyer's breach of contract.'

⁸⁵ SGA Section 49: 'Action for price: (1) Where, under a contract of sale, the property in the goods has passed to the buyer and he wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action against him for the price of the goods. (2) Where, under a contract of sale, the price is payable on a day certain irrespective of delivery and the buyer wrongfully neglects or refuses to pay such price, the seller may maintain an action for the price, although the property in the goods has not passed and the goods have not been appropriated to the contract.'

⁸⁶ SGA Section 50: 'Damages for non-acceptance: (3) Where there is an available market for the goods in question the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted or (if no time was fixed for acceptance) at the time of the refusal to accept.'

⁸⁷ CISG Article 75.

⁸⁸ Alastair Mullis, 'Avoidance for Breach under the Vienna Convention: A Critical Analysis of Some of the Early Cases', *Andreas & Jarborg eds., Anglo-Swedish Studies in Law, Lustus Forlag* (1998) 326-355.

fundamental breach of contract by the CISG? Is the buyer entitled to avoid the contract or only claim damages?

The seller's delay discussed here includes two circumstances: the first circumstance is when the seller failed to deliver the goods by the agreed date but the delivery has not been completely refused and the delivery is still possible; and the second circumstance is when the seller has actually delivered the goods but the delivery was late.⁸⁹ Under the CISG, the seller must deliver the goods by the time agreed in the contract or within a reasonable time after the conclusion of the contract in the absence of an agreed delivery time.⁹⁰ The seller's late delivery does not *per se* constitute a fundamental breach entitling the buyer to avoid the contract.⁹¹ Whether the seller's delay amounts to a fundamental breach depends on how important the agreed delivery time means to the buyer.⁹² The buyer is only entitled to avoid the contract when the time is essential to him, i.e., the delivery time is of special interest to the buyer in light of the circumstances, practice, customs, usages or any other relevant factors,⁹³ or when the seller failed to deliver the goods after the expiry of the additional time fixed by the buyer.⁹⁴ The terms of time for delivery may be considered as essential if the goods are seasonal and the delivery time is expressly fixed in the contract or the buyer has informed the seller before concluding the

⁸⁹ Schlechtriem p. 293.

⁹⁰ CISG Article 33: 'The seller must deliver the goods: (a) if a date is fixed by or determinable from the contract, on that date; (b) if a period of time is fixed by or determinable from the contract, at any time within that period unless circumstances indicate that the buyer is to choose a date; or (c) in any other case, within a reasonable time after the conclusion of the contract.'

⁹¹ Leonardo Graffi, 'Case Law on the Concept of 'Fundamental Breach' in the Vienna Sales Convention', [*Leonardo Graffi*] *Revue de droit des affaires internationales/ International Business Law Journal* (2003) No.3, 338-349.

⁹² Schlechtriem p.293. The justification behind such legal position is that in international trade considerable costs may arise if the standard for the avoidance of contract becomes too lax, see fn. 91 Leonardo Graffi.

⁹³ CISG Articles 8 and 9; see fn. 91 Leonardo Graffi; see fn. 3 Franco Ferrari.

⁹⁴ CISG Article 47(1): 'The buyer may fix an additional period of time of reasonable length for performance by the seller of his obligations.' Article 49(1)(b): 'The buyer may declare the contract avoided 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.'

contract that the buyer has to deliver the goods by a fixed date to his sub-buyers.⁹⁵ Nevertheless, the existence of these circumstances does not automatically transform the seller's delay for a very short period into a fundamental breach. For example, in a German case, the buyer's delivery of summer clothes was one day late but this was held not serious enough to constitute a fundamental breach.⁹⁶

It is controversial under the CISG whether the incorporation of Incoterms such as C.I.F. or F.O.B. in the contract means that time is essential to the contracting parties, the breach of which entitles the avoidance of contract. Some scholars and jurisdictions believe that the breach of delivery time should constitute a fundamental breach⁹⁷ whilst others disagree.⁹⁸ Two approaches may be recommended to the buyer to avoid such uncertainty. One approach is to fix an additional period of reasonable time for the delivery of the delayed goods by the seller according to Article 47 of the CISG. The seller's non-delivery after the lapse of this additional time would entitle the buyer to avoid the contract, in spite of the fact as to whether the seller's original breach was a fundamental breach or not.⁹⁹ The other approach is to stipulate explicitly in the contract the remedy for late delivery, i.e., either the avoidance of contract or damages only. If the remedy is the avoidance of contract, the seller's

⁹⁵ Schlechtriem p.293; see fn. 3 Franco Ferrari; see fn. 91 Leonardo Graffi.

⁹⁶ LG Oldenburg, 27 March 1996, <http://cisgw3.law.pace.edu/cases/960327g1.html>.

⁹⁷ Schlechtriem p. 289 and fn. 44a: OLG Hamburg, 28 February 1997

<http://www.cisg-online.ch/cisg/urteile/261.htm>: 'Use of Incoterm CIF can mean that time is of essence'; see fn. 91 Leonardo Graffi: in C.I.F contracts, the term of time is essential 'by definition'.

⁹⁸ Ulrich Magnus, 'The Remedy of Avoidance of Contract Under CISG – General Remedies and Special Cases', 25 *Journal of Law and Commerce*, (2005-06) 423-436 ['Ulrich Magnus']: the agreement of the INCOTERMS like C.I.F. or F.O.B. in itself does not transform a simple delay into a fundamental breach; see fn. 3 Franco Ferrari: whether the insertion of a CIF clause means that compliance with the contractually fixed deadline is essential and therefore whether the non-compliance constitutes a fundamental breach by Article 25 is questionable.

⁹⁹ See *ante* fn. 88.

delay would instantly entitle the buyer to avoid the contract. If the remedy is damage, the buyer is only entitled to claim damages and not to avoid the contract.¹⁰⁰

In the Chinese cases, the seller's late delivery is normally recognised as a breach of contract and the seller's delay after the expiry of additional reasonable time is treated as a fundamental breach. The breach of such a fundamental breach entitles the buyer to avoid the contract and claim damages, although it is not clear as to the criteria for ascertaining the reasonable period of time.

In the *Shirts case*,¹⁰¹ where the delivery date in the F.O.B. contract was agreed to be before 18th March 1994, the goods were not completely delivered until 14th April 1994. Facing the falling market, the buyer objected to the seller's delay in delivery and refused to pay the price. The seller's delay was held to constitute a breach of contract but the consequence of the delay was not serious enough for the buyer to avoid the contract. The buyer's avoidance of contract was held to be unjustifiable and the seller's claim for the payment of the goods was supported. It was apparent that the seller's delay in delivery for such a short period of time, i.e. one month, was not considered by the Chinese arbitrators to be serious enough to constitute a fundamental breach of the CISG.

In the *Dried sweet potatoes case*,¹⁰² the buyer concluded a F.O.B. contract with the seller for the purchase of 20,000 tons of dried sweet potatoes to be shipped in January 1995. The market rose and the seller delayed the delivery many times with different excuses, such as force majeure and government policy, none of which was sustained by the arbitrators. The buyer filed an arbitration claim on 22nd May 1995 to avoid the contract and request damages despite the seller's claim that the delivery

¹⁰⁰ CISG Article 6: 'The parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions.'

¹⁰¹ Award of 4 January 1995 [CISG/1995/02] (*Shirts case*).

¹⁰² Award of 14 March 1996 [CISG/1996/14] (*Dried sweet potatoes case*).

was still possible. It was held by the Chinese tribunal that the buyer's avoidance of contract was justifiable and the seller was liable for the buyer's damages caused by the seller's breach. Although the notion of 'fundamental breach' was not mentioned in the judgment, it can be assumed that the seller's delay of five months must have been held to constitute a fundamental breach because the buyer was permitted to avoid the contract because of the seller's delay. It was clear that the seller's failure to deliver the goods beyond a reasonable period of time after the agreed delivery date expired was held by the Chinese tribunal as a fundamental breach of the contract, which entitled the buyer to avoid the contract and claim damages.

It seems to the author that in the international sale contracts incorporating Incoterms, the Chinese tribunals do not presume that the seller's breach of delivery time constitutes a fundamental breach of contract, but believe that there is a need to look into the seriousness of the effect caused by the delay to the buyer. The breach of time is only fundamental if the delay is so long that it has deprived substantially the buyer's expected interests on the conclusion of contract.¹⁰³

If the FECL had been applied in the above two cases, the result would have probably been the same. According to Article 29(2) of the FECL, the buyer is only allowed to cancel the contract if the seller fails to deliver the goods within the agreed time as in the contract, and also fails to make delivery within the additional reasonable period of time for late delivery.¹⁰⁴ Under the FECL, a simple delay of performance does not directly lead to a fundamental breach of contract and a second chance for delivery is normally allowed after the expiry of the agreed delivery time.

¹⁰³ *ibid.*

¹⁰⁴ FECL Article 29: 'A party shall have the right to notify the other party that a contract is cancelled in any of the following situations: (2) if the other party fails to perform the contract within the time limit agreed upon in the contract, and again fails to perform it within the reasonable period of time allowed for delayed performance.'

The buyer is only entitled to cancel the contract after the lapse of an additional reasonable period of time.

Under English law, in international sales, the terms as to the time of delivery are *prima facie* the essence of the contract.¹⁰⁵ The breach of delivery time, no matter how slight and how little the consequence, entitles the buyer to terminate the contract unless the parties agree otherwise.¹⁰⁶ The House of Lords has clarified the issue in *Bowes v Shand*.¹⁰⁷ They found that the time of delivery forms part of the descriptions of the goods and therefore the breach of delivery time entitles the buyer to reject the goods. The seller's breach of timely delivery can be committed either by the actual late shipment or by the tender of late shipped B/L.¹⁰⁸ If the above two Chinese cases were decided under English law, the seller's late delivery would have been treated as the breach of conditions of the contract and the buyer would have been entitled to terminate the contract and recover damages caused by the seller's breach.

In the author's opinion, the English position is more efficient and more predictable than the CISG. Under English law, the stipulation of the delivery time in the international sale of goods contract forms a condition of the contract. The buyer aware of such a stipulation is able to make quick decision with confidence as to whether to terminate the contract based on the seller's delay. The open-texture of the fundamental breach in Article 25 of the CISG makes it very difficult for the buyer to judge whether the seller's delay is serious enough to constitute a fundamental breach and thus entitlement to the avoidance of contract.¹⁰⁹ It may be argued that Article

¹⁰⁵ See fn.6 Schmittoff p.87; *The International Sale of Goods Law & Practise*, Michael Bridge (1st ed. 1999) p. 88; Chitty: 43-113, 43-275; Benjamin 18-267.

¹⁰⁶ SGA Section 15A does not apply to express terms, e.g., the time of delivery: the Law Commission Report; Benjamin 12-025; SGA Sections 11(3), 61(1).

¹⁰⁷ (1877) 2 App.Cas.455.

¹⁰⁸ *Re General Trading Co. and Van Stolk's Commissiehandel* (1911) 16 Com.Cas.95. Comparatively, Article 35 of the CISG deals with the goods only and contains no reference to the lack of conformity in documents: see Benjamin 18-267.

¹⁰⁹ Benjamin 18-267 fn.38.

49(1) (b) provides the buyer with a useful instrument by fixing an additional period of reasonable time to request the seller's delivery. The seller's failure to deliver within the additional time entitles the buyer to avoid the contract. In the author's view, such an approach still leaves the buyer with some uncertainty and some inefficiency. For example, how much time is reasonable? The buyer also needs to wait for the lapse of the additional time before avoiding the contract. Facing the fluctuating commodity market in international sales, the certainty and efficiency should be valued more than justice. Therefore, English law is more favourable and predictable than the CISG and the FECL in this respect.

[b] Late payment

Where the buyer made the payment late, does the buyer's delay amount to a fundamental breach or non-fundamental breach by the categorisation rule of the CISG and what remedies can the seller claim from the buyer?

The international sale contracts normally contain some terms specifying the time when the payment needs to be made or when the L/C needs to be opened.¹¹⁰ Under the CISG, the buyer has the obligation to pay the price by the date agreed in the contract.¹¹¹ The buyer's mere delay in making payment does not generally constitute a fundamental breach of contract under Article 25 of the CISG,¹¹² and the seller is not normally entitled to avoid the contract but only entitled to damages. The buyer's late payment can only be treated as a fundamental breach in very exceptional cases,

¹¹⁰ See *ante* fn. 88.

¹¹¹ CISG Article 54: 'The buyer's obligation to pay the price includes taking such steps and complying with such formalities as may be required under the contract or any laws and regulations to enable payment to be made.' Article 59: 'The buyer must pay the price on the date fixed by or determinable from the contract and this Convention without the need for any request or compliance with any formality on the part of the seller.'

¹¹² See fn. 3 Franco Ferrari; also refer to an award of International Chamber of Commerce, Award No.7585,1992 <http://cisgw3.law.pace.edu/cases/927585i1.html>.

e.g., when the buyer clearly refused to make payment, when the buyer is insolvent, or when the buyer has failed to make the payment after the expiry of an additional time fixed by the seller.¹¹³ In these circumstances, the buyer's delay in payment has developed into a fundamental breach and thus the seller is entitled to avoid the contract and claim damages.¹¹⁴

In the Chinese judgments, the Chinese tribunals normally hold the buyer's short delay in making payment as a non-fundamental breach of contract under the CISG, which does not entitle the seller to avoid the contract. In the *Australian raw wool case*,¹¹⁵ the buyer concluded three contracts with the seller for the purchase of Australian raw wool C.N.F. to be shipped before 15th November 1993. The buyer opened the L/C on 3rd November 1993. The seller asserted that the L/C was opened too late and then avoided the contract, sold the goods to a third party and claimed his loss of profit. Although in the contract there was no express term as to the time when the L/C should be opened, the seller claimed that according to the 'ChinaTex Raw Materials Trading Corporation's practice', the buyer should have opened the L/C fifteen days before the date of shipment, i.e., before 31st October 1993. The arbitrators declined to recognise the 'ChinaTex Raw Materials Trading Corporation's practise' as the practice provided in Article 9(2) of the CISG. The buyer was held to be only obliged to open the L/C within a reasonable time before shipment and thus the buyer did not open the L/C late. The arbitrators further explained that even if the buyer did open the L/C three days late, the buyer's delay did not amount to a

¹¹³ CISG Article 63(1): 'The seller may fix an additional period of time of reasonable length for performance by the buyer of his obligations.' Article 64(1): 'The seller may declare the contract avoided: (b) if the buyer does not, within the additional period of time fixed by the seller in accordance with paragraph (1) of Article 63, perform his obligation to pay the price or take delivery of the goods, or if he declares that he will not do so within the period so fixed.' See Supreme Court of Queensland, Australia, 17 November 2000 <http://cisgw3.law.pace.edu/cases/001117a2.html>. Schlechtriem p.297-298.

¹¹⁴ CISG Article 61.

¹¹⁵ Award of 23 April 1995 [CISG/1995/07] (*Australian raw wool case*).

fundamental breach and the seller was not entitled to avoid the contract, unless the buyer failed to open the L/C after the expiry of the additional time fixed by the seller. The seller's wrongful avoidance of contract was held to constitute a fundamental breach and the buyer was awarded damages for the price difference between the contract price and the market price at the time when the contract was avoided. From the judgment in this case, the Chinese tribunal's position was clear: the buyer's late payment is not generally treated as a fundamental breach and therefore the contract cannot be avoided based on the buyer's delay.

If the *Australian raw wool case* had been decided under the FECL, the result would probably have been the same. According to Article 29(2) of the FECL, the seller is only entitled to cancel the contract if the buyer fails to open the L/C within the agreed time in the contract and also fails to open the L/C within the additional reasonable time fixed by the seller.¹¹⁶ As mentioned before, a simple delay in performance does not automatically trigger a fundamental breach of contract under the FECL and the buyer is normally entitled to a second chance before a contract can be avoided.

In English international sales law, the terms as to the time of performance in the international sale of goods contract are normally treated as a condition of contract.¹¹⁷ Where a sale contract stipulates the time for opening the L/C, the buyer must open the L/C by the agreed time; and where a sale contract fails to specify the time for opening the L/C, the buyer must open the L/C within a reasonable time before the commencement of the shipment period.¹¹⁸ The buyer's failure to open the L/C on

¹¹⁶ FECL Article 29. See *ante* fn. 104.

¹¹⁷ *Trans Trust SPRL v Danubian Trading Co Ltd* [1952] 2 QB 297; See *ante* fn. 88; *Gutteridge and Megrah's Law of Banker's Commercial Credits*, H.C. Gutteridge, (8th ed. 2001) p.30-40.

¹¹⁸ *Pavia & Co SpA v. Thurmann-Nielsen* [1952] QB 84, CA: it was established by Lord Denning that the buyer is under an obligation to open the L/C before the first day of shipment period.

time entitles the seller to refuse to ship the goods,¹¹⁹ terminate the contract¹²⁰ and recover damages¹²¹. If the *Australian raw wool case* was decided under English law, the decision would depend upon whether the buyer did open the L/C late: if the buyer did open the L/C three days late as the seller claimed, the seller would have been entitled to terminate the contract and recover the damages on the price difference between the contract and the actual resale;¹²² and if the buyer did not open the L/C late as decided by the Chinese tribunal, the seller would not have been entitled to terminate the contract and he would have been liable for the buyer's damages suffered from the seller's unjustifiable termination of contract.

The difference between the CISG and English law as to the buyer's delay in making payment is substantial. The CISG does not consider such a breach to be serious enough to deprive the seller substantially from his contractual expectation, unless the delay goes beyond a reasonable period of time. English law presumes such a delay as a breach of conditions of contract, which entitles the seller to be discharged from the contract. In the fluctuating market of international trade, when it comes to judging which approach is better, it is immaterial which approach is more fair but which approach is more efficient for the contracting parties to make quick decisions. Whether the delay is beyond a reasonable time is a question of fact to be decided by circumstances and decisions can differ between jurisdictions or different courts of the same jurisdiction. The open textured definition of the fundamental breach in the CISG can potentially cause conflicting decisions. The English position

¹¹⁹ *Glencore Grain Rotterdam BV v Lebanese Organisation for International Commerce (The Lorico)* [1997] 2 Lloyd's Rep. 386.

¹²⁰ *Trans Trust SPRL v Danubian Trading Co Ltd* [1952] 2 QB 297.

¹²¹ SGA Section 50.

¹²² From the facts of this case, the seller's resale price was higher than the original contract price with the buyer. Therefore, the seller suffered no loss for the buyer's breach and the seller has no damage to recover. The seller's claim of his loss of profit would not be supported by English court because the *prima facie* market rule applies according to SGA Section 50(2).

is comparatively more certain in the sense that the seller can make quick decisions on whether to terminate the contract with confidence. In English law, if the parties do not wish the contract to be avoided by the breach of time, they can simply insert a non-rejection clause into the contract to restrict the remedy to damage only.

2.2.3 Defective performance of the contract

[a] Defective goods

Where the goods delivered to the buyer are defective, does the seller's breach amount to a fundamental breach or non-fundamental breach of contract and what remedies can the buyer claim from the seller under the CISG?

Under the CISG, whether the delivery of defective goods amounts to a fundamental breach depends upon whether the substantiality of the detriment caused by the defective performance is established according to Article 25 of the CISG.¹²³ The ascertainment of a substantial detriment is a matter of judicial discretion to be applied in each cases,¹²⁴ i.e., what factors need to be considered and the importance attributed to them are decided by the courts or arbitration tribunals.¹²⁵ The categorisation of a breach, judged by the seriousness of the defects in performance may vary significantly between jurisdictions or different courts of the same jurisdiction.¹²⁶ Nevertheless, some guidance can be concluded from the Articles of the CISG, some academic remarks of the CISG and analysis of related cases. Where

¹²³ Schlechtriem p. 294; CISG Advisory Council Opinion No. 5: The buyer's right to avoid the contract in cases of non-conforming goods or documents ['Opinion No. 5'] <http://www.cisg.law.pace.edu/cisg/CISG-AC-op5.html>: The CISG-AC is a private initiative supported by the Institute of International Commercial Law at Pace University School of Law and the Centre for Commercial Law Studies, Queen Mary, University of London. It is in place to support the understanding of the CISG and the promotion and assistance in the uniform interpretation of the CISG. The CISG-AC Opinions does not have binding effect on the contracting states of the CISG but only have instructional function as a source of reference.

¹²⁴ Schlechtriem p. 296.

¹²⁵ Schlechtriem p. 296; Opinion No. 5.

¹²⁶ Opinion No.5.

the parties have explicitly agreed on the importance of some specific features of the goods in a contract, non-conformity to these features can constitute a fundamental breach and entitle the injured buyer to avoid the contract.¹²⁷ Where the parties fail to clarify the importance of such features, the threshold to a fundamental breach in non-conformity is generally placed very high under the CISG. The delivery of defective goods is not generally regarded as a fundamental breach of contract provided that: any defects can be rectified by the seller, for example, by repair;¹²⁸ replacement goods can be provided within a reasonable time, which would not cause inconvenience or uncertain expense to the buyer;¹²⁹ or any loss can be remedied by damages or a reduction in price.¹³⁰ The purpose for which the goods are bought needs to be considered for the ascertainment of a fundamental breach in defective goods:¹³¹ where the goods are bought for the buyer himself, the decisive factor is whether the goods are improper for the buyer's intended use; where the goods are bought for a resale, the decisive factor is whether the non-conformity make the goods not resalable.¹³²

It should be noted that the buyer is not entitled to avoid the contract when the seller fails to cure a defect of the goods within the additional period of time fixed by the buyer, because such an approach for the avoidance of contract only applies in

¹²⁷ The parties are allowed to derogate from or vary the effects of Article 25 according to Article 6 of the CISG. The intent of the parties may be interpreted according to Article 8 of the CISG. See Opinion No.5.

¹²⁸ CISG Article 46(3).

¹²⁹ CISG Article 48(1); see Opinion No. 5 see fn. 123.

¹³⁰ CISG Article 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 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.' See fn. 3 Franco Ferrari.

¹³¹ Opinion No. 5: the attention is to be had to the issue whether the buyer can make use of the goods or process them differently without unreasonable expenses. See CISG Article 35.

¹³² Opinion No. 5.

circumstances of non-delivery but not in defective delivery.¹³³ Whether the seller's failure to cure within the additional time constitutes a fundamental breach depends upon whether the breach satisfies the test for a fundamental breach in Article 25 of the CISG, i.e., whether the delivery of the defective goods deprives the buyer's expected interest substantially on conclusion of the contract.¹³⁴ The justification for a high threshold for the fundamental breach in defective delivery is that the avoidance of contract is considered to be a remedy of last resort under the CISG and the injured party is not entitled to avoid the contract when other remedies are still available.¹³⁵

Under the CISG, where the defect of the goods constitutes a fundamental breach, the remedies that the buyer can claim include the avoidance of contract or the substitution of the goods together with damages.¹³⁶ Where the defect of the goods does not constitute a fundamental breach, the buyer can require the seller to repair the goods, reduce the price or compensate damages resulting from the breach.¹³⁷

The Chinese tribunals normally hold the seller's delivery of the defective goods as a non-fundamental breach of contract under the CISG and the buyer is not entitled to avoid the contract but only entitled to a price reduction, repair or substitution of the goods. The following two cases are given as examples.

In the *Leather gloves case*,¹³⁸ a contract was concluded for the purchase of 5000 dozen pairs of leather gloves C.I.F. to be paid by an irrevocable L/C. The weight of each package for 10 dozen pairs of gloves was agreed in the contract: initially as 16kg and then modified to 15kg per box. The documents that the seller tendered were rejected by the Bank of Germany because of an inconsistency between the

¹³³ CISG Article 49(1) (b); see Schlechtriem p.295.

¹³⁴ Schlechtriem p. 296.

¹³⁵ Ingeborg Schwenzer, 'Avoidance of the Contract in Case of Non-Conforming Goods (Art. 49(1)(a) CISG)', 25 *Journal of Law and Commerce*, (2005-06) 437-442

¹³⁶ CISG Articles 45, 46(1) (2).

¹³⁷ CISG Articles 45, 46(1) (3), 48, 50.

¹³⁸ Award of 26 November 1998 [CISG/1998/06] (*Leather Gloves case*).

documents and the L/C. The buyer urged the seller to ask the notifying bank to release the documents and promised that the payment would be made within 24 hours after the receipt of the goods. After receiving the goods, the buyer discovered that the goods were defective, i.e., the leather of the gloves was very thin and each box weighed less than 11kg. The buyer objected to these defects, refused to pay the agreed price and sold the goods at the price at a 30% discount, despite the seller's offer to exchange the goods and other possible mitigating measures. It was held by the arbitration tribunal that the seller's defective delivery did not amount to a fundamental breach because the seller agreed to exchange the goods and bear all the cost for it. The buyer's refusal to pay was held to be unjustifiable and to constitute a fundamental breach of contract. The buyer was held to be liable for the payment of price. In the meantime, due to the existence of some defects of the goods admitted by the seller, the buyer was allowed a price reduction of 30% of the contract price. It was clear in this case that the seller's delivery of defective goods was not held by the Chinese tribunal to constitute a fundamental breach when the substitution of the goods was available and the buyer was not entitled to avoid the contract but only entitled to a price reduction.

In the *Shaping machine case*,¹³⁹ the buyer bought two shaping machines, a JB102 and a JB105 together with some auxiliary equipment and other parts C&F from the seller. The thickness auto control system (JSW) of the JB102 and JB105 machines was not functional and the seller failed to resolve the problem for eight years since they were first tested. The arbitration tribunal held that the JSW thickness auto control system was an essential part of the shaping machine for producing quality products. The defects on such an essential feature of the machine and the seller's

¹³⁹ Award of 20 July 1993 [CISG/1993/10] (*Shaping machine case*).

failure to cure the defects for an unreasonable period of time amounted to a fundamental breach of contract. The injured buyer was held to be entitled to avoid the contract by returning the goods to the seller, a refund of the price paid and the recovery of damages resulting from the seller's breach.

If the FECL had been applied in the aforementioned cases, the result would have probably been the same. The FECL also hold a very high threshold for the ascertainment of a fundamental breach. In the '*Leather gloves case*', the offer of the seller to exchange the goods together with other remedies would exclude the buyer's right to avoid the contract under the FECL. The seller's defective delivery has not deprived the buyer's expected economic benefit according to Article 29 of the FECL. In the '*Shaping machine case*', the serious defects of the central feature of the shaping machines and the seller's failure to cure them within a reasonable time could also amount to a fundamental breach and entitle the buyer to avoid the contract.

If English law had been applied in these cases, the results could have been different from those of the CISG and the FECL. In the *Leather gloves case*, the buyer would have been entitled to terminate the contract despite the seller's offer to exchange the goods. Under English law, the perfect tender rule applies before the acceptance of the goods,¹⁴⁰ i.e., the description of the goods is treated as a condition of contract according to Section 13 of the SGA and that the goods did not conform to that description entitles the buyer to terminate the contract.¹⁴¹ The package weight in this case was particularly described in the contract after lengthy negotiation and modification. The conduct of the parties has shown that such description is essential for the contract and forms an integral part of the identity of the goods. The discount

¹⁴⁰ *Tradax Export S.A v European Grain & Shipping Co.* [1983] 2 Lloyd's Rep.100; Opinion No. 5; M Bridge 3.17 p. 81.

¹⁴¹ *Ashington Piggeries Ltd v Christopher Hill Ltd* [1972] AC 441; *The International Sale of Goods Law & Practise*, Michael Bridge (1st ed. 1999) p.81.

sale may be treated as a reasonable mitigating measure taken by the injured buyer and the buyer may be entitled to recover damages for the price difference between the value of the goods at the time of delivery and the value the goods would have had if the goods had satisfied the description of the contract.¹⁴² In the *Shaping machine case*, since the buyer accepted the goods, the buyer was only entitled to terminate the contract if the defects are regarded as sufficiently serious under English law.¹⁴³ Because the defects of the shaping machines were deemed to be sufficiently serious, the buyer would be entitled to terminate the contract, return the machines to the seller and recover the price paid together with other damages. Technically speaking, in circumstances of defective delivery, it is easier for the injured buyer to terminate the contract under English law than the CISG and FECL. The buyer should be more confident in terminating a contract under the perfect tender rule of English law than under the test for a strict substantial detriment of the CISG and FECL. The fundamental reason for such different legal positions between the CISG, FECL and English law is that the termination of contract is considered as the first resort in English law but as the last resort in the CISG and FECL.¹⁴⁴

[b] Defective documents

Where the documents tendered by the seller are defective, does the seller's breach amount to a fundamental breach or a non-fundamental breach of contract and what remedies can the buyer claim from the seller?

¹⁴² SGA Section 53.

¹⁴³ SGA Section 35(1); *The Hansa Nord* [1976] Q.B. (C.A) 44; Opinion No. 5.

¹⁴⁴ Ingeborg Schwenzer, 'Avoidance of the Contract in Case of Non-Conforming Goods (Art. 49(1)(a) CISG)', 25 *Journal of Law and Commerce*, (2005-06) 437-442.

Under the CISG, the seller is obliged to hand over the documents relating to the goods in the form required by the contract.¹⁴⁵ It is controversial under the CISG whether a seller's tender of non-conforming documents in documentary sales constitutes a fundamental breach and therefore entitles the buyer to avoid the contract. One view is that it depends upon whether the discrepancy deprives the buyer of his expected interest substantially from the conclusion of contract,¹⁴⁶ taking into account the possibility to cure the defects of documents by means of reasonable effort¹⁴⁷ and the possibility to use the goods for their intended purpose despite such defects.¹⁴⁸ That is to say, the defect in the documents does not amount to a fundamental breach if the defect can be rectified in time¹⁴⁹ or the goods can still be used for their intended purpose.¹⁵⁰ It should be noted that the buyer cannot avoid a contract based on the seller's failure to rectify the defects of documents after the expiry of the additional period of time fixed by the buyer. That is because Article 49(1) (b) of the CISG only applies to a non-delivery of goods but not in a defective delivery of the goods. This view maintains that the rule of strict compliance in documentary sales is not applicable under the CISG and the buyer is not entitled to reject any documents for slight defects. Nevertheless, it treats a commodity sale as exceptional, i.e., the seller is under a duty to tender the clean B/L timely and the defects of documents cannot normally be remedied unless the buyer is the end

¹⁴⁵ CISG Article 34: 'If the seller is bound to hand over documents relating to the goods, he must hand them over at the time and place and in the form required by the contract. If the seller has handed over documents before that time, he may, up to that time, cure any lack of conformity in the documents, if the exercise of this right does not cause the buyer unreasonable inconvenience or unreasonable expense. However, the buyer retains any right to claim damages as provided for in this Convention.'

¹⁴⁶ CISG Article 25.

¹⁴⁷ CISG Article 34.

¹⁴⁸ See fn. 3 Franco Ferrari; Opinion No. 5.

¹⁴⁹ Opinion No.5: e.g., the seller can cure the defects of an unclean B/L by buying the same goods with a clean B/L.

¹⁵⁰ e.g., where the buyer is the end user of the goods, the B/L with the shipment for one day late does not affect the buyer's intended use with the goods.

user.¹⁵¹ The other view is that in documentary sales such as C.I.F., the buyer has the right to reject the documents if there is any discrepancy between the tendered documents and the contract, even if that discrepancy is of little practical significance.¹⁵² This latter view applies the rule of strict compliance in documentary sales and holds the seller's delivery of defective documents as a fundamental breach of contract, which entitles the buyer to reject the defective documents and claim damages.

The examination of the Chinese cases has shown the Chinese tribunal's hesitation in deciding whether the seller's tender of defective documents constitutes a fundamental breach of contract entitling the buyer to avoid a contract under the CISG. In the *Hot-rolled plates case*,¹⁵³ the buyer purchased 7,500 tons (5% more or less) of hot-rolled steel plates C.N.F. from the seller and the payment was agreed to be made by an irrevocable L/C. The buyer delivered 7,402 tons of the goods and tendered the documents. The market was declining very quickly and the seller was notified by the confirming bank that the documents tendered were rejected by the issuing bank because of two discrepancies: the technical indicator recorded in the quality certificate required by the L/C was 'CU: 0.05 pctmax' but the certificate tendered was 'S (CU): 0.05 pctmax'; and the gross weight in the tendered shipping invoice was equal to the net weight, which should not be the case in general practice. Since the seller failed to receive payment by the L/C, he terminated the contract, re-sold the goods to a third party and claimed damages. The Chinese arbitration tribunal

¹⁵¹ Opinion No.5.

¹⁵² The Secretariat Commentary to Article 49 of the CISG reads: 'The rule that the buyer can normally avoid the contract only if there has been a fundamental breach of contract is not in accordance with the typical practice under c.i.f. and other documentary sales. Since there is a general rule that the documents presented by the seller in a documentary transaction must be in strict compliance with the contract, the buyers have often been able to refuse the documents if there has been some discrepancies in them even if that discrepancy was of little practical significance.'
<http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-49.html>.

¹⁵³ Award of 15 February 1996 [CISG/1996/10] (*Hot-rolled plates case*).

declined to make any comment on whether the issuing bank had the right to reject the documents for the inconsistencies between the tendered documents and the L/C. The seller's tender of the defective documents was held not to fall as a fundamental breach of contract under the CISG because the discrepancies were not serious enough to have deprived the buyer of his expected interest under the contract and the acceptance of defective documents would have done no harm to the buyer. It should be noted that the arbitrators did not look into the list of documents in the L/C exclusively but looked into the documents listed in the contract, and came to the conclusion that the statement of 'S (CU): 0.05 pctmax' in the quality certificate conformed to the terms of the contract. The buyer's rejection of the defective documents was held to be unjustifiable and the seller was held to be eligible to recover the damages for the difference between the original contract price and the substitute resale price together with interest. It was clear in this case that the rule of strict compliance in the documentary sale was not applied and the delivery of defective documents was held to be a non-fundamental breach of contract. In the author's view, the existence of the documentary discrepancies should have been judged upon the documents listed in the L/C exclusively but not based upon the documents listed in the contract as was decided in this case.

In the *Air purifiers case*,¹⁵⁴ where the documents tendered by the seller was rejected by the bank for the defects of some documents required by the L/C, the buyer's refusal to make payment was held to be justifiable because the presented documents must comply with the L/C. It should be noted that the seller argued that some documents the buyer claimed were not mentioned in the L/C but only mentioned in the contract. The Chinese tribunal held that the L/C is independent

¹⁵⁴ Award of 17 April 1996 [CISG/1996/19] (*Air purifiers case*).

from the contract and the seller should have fulfilled his obligation strictly in conformity with the contract. The buyer also rejected the goods because the goods delivered by the seller were also seriously defective. The Chinese arbitrators held that the seller's tender of defective documents and defective goods was a fundamental breach and the buyer was entitled to avoid the contract and recover the damages caused by the seller's breach. In the author's view, despite the rule of strict compliance being applied in this case, it was wrong for the Chinese tribunal to judge the documentary discrepancy based on the documents listed in the contract instead of the documents listed in the L/C. The seller should only be obliged to tender the documents required by the L/C rather than the contract after the L/C is opened and accepted. In practice, the banks would never consider the documents listed in the contract but only check the conformity of the documents required in the L/C.

The Chinese tribunals applied the CISG in the above two cases and also maintained that the application of Chinese contract law would not conflict with the application of the CISG. The applicable Chinese law was the FECL when both cases were decided. So it can be assumed that the Chinese tribunal would have made the same decisions if the FECL had been applied.

The decisions relating to the two preceding Chinese cases would appear very unsatisfactory to the English court. Firstly, in the *Air purifier case*, the arbitration tribunals were completely wrong for looking into the contract rather than the L/C exclusively when judging the conformity of the documents. The payment by means of the L/C means that the L/C is the only source for judging the compliance of the documents after the L/C is opened and accepted by the seller. Even if the buyer changed the required documents in the L/C, the seller's acceptance of such a L/C means that the contract of sale has been effectively varied by the agreement of the

parties and that the seller has waived his right of objection to such non-conformity. The seller must tender the documents required by the L/C only. Secondly, the rule of strict compliance is rigorously observed under English law. The non-conforming documents would be rejected, no matter how trivial the defect,¹⁵⁵ unless the buyer decides to accept the documents despite the discrepancies. The Chinese tribunal's acceptance of the non-conforming documents with so-called insufficient discrepancies in the *Hot-rolled plates case* would probably not have been permitted under English law and the buyer would have been entitled to reject the documents. In the documentary sale, it is hard to judge which discrepancy is sufficiently serious and which is not because the bank observing the rule of strict compliance would reject the non-conforming documents according to the incorporated UCP in the contract.¹⁵⁶ After comparison, the English position is more certain than the CISG in judging the buyer's right to reject the non-conforming documents. The application of the rule for strict compliance in documentary sale under English law ensures that the buyer can make quick decisions as to whether he has the right to reject the non-conforming documents. The buyer under the CISG would be very unsure in making such a decision due to the existence of some uncertain elements in judging the fundamental breach according to Article 25 of the CISG.

Conclusion

From the examination of the aforementioned Chinese cases, the categorisation of the breach of contract by the criteria of fundamental breach of the CISG, i.e., whether the breach deprives the injured party substantially of his expected interest from

¹⁵⁵ *Glencore v Bank of China* [1996] 1 Lloyd's Rep.135 at 153, 154.

¹⁵⁶ UCP is normally applied by the bank to examine the conformity of documents when the payment is made by the L/C.

concluding the contract, has caused difficulty and uncertainty in some circumstances. In international documentary sale, the observation of the time agreement and the conformity of the goods and documents are traditionally regarded by the contracting parties to be of the greatest value. The breach of the agreement as to time and descriptions does not *per se* constitute a fundamental breach under the CISG and the decisive factor is whether the breach has caused substantial detriment to the injured party according to Article 25 of the CISG. The ascertainment of the 'substantial detriment' as to the delay or the non-conformity is a matter of fact to be decided by judicial discretion, i.e., what factors need to be considered and what importance should be attributed to those factors are decided by individual national courts or arbitration tribunals. The outcomes may be significantly different between jurisdictions or different courts of the same jurisdiction. This problematic feature of the categorisation rule of the CISG would inevitably cause some uncertainty and unpredictability in its application for awarding remedies by the tribunals of the contracting states.

In circumstances of delayed performance, the Chinese tribunals judge the constitution of a fundamental breach by whether the delay has caused substantial detriment to the injured party, i.e., whether the delay goes beyond a reasonable period of time. For example, the seller's late delivery by one month in the *Shirts case* was held to be reasonable; the seller's late delivery by four months in the *Dried sweet potatoes case* was held to be unreasonable; and the buyer's delay in opening the L/C for three days in the *Australian raw wool case* was held to be reasonable. Why was the delay of three days or one month considered reasonable and the delay of four months considered unreasonable? The answer cannot be found in the Chinese judgements or the CISG, but can only be judged at the discretion of the tribunal

considering the facts of individual cases. So it is likely that a period of delay may be judged as a fundamental breach by some tribunals but judged as a non-fundamental breach by others. The flexibility in categorising a breach and awarding remedies leaves the injured party with inevitable uncertainty. It is very hard for the contracting party to make quick and accurate decisions as to whether it is justifiable to avoid the contract based on the other party's delay of performance. The CISG achieved its aim of uniformity by enforcing the performance of contract and preventing the avoidance of contract. The consequence for the adoption of such an approach is that the contracting parties will not take their obligations of timely performance seriously and therefore the remedy for a breach of time agreement is uncertain. The best advice for the contracting party is to clarify the consequence of a breach of time agreement explicitly in the contract, because the CISG allows the parties to derogate from or vary the effect of the provisions of the CISG.¹⁵⁷ In contrast, English law is much more certain regarding this issue. In international trade, the terms as to time are *prima facie* essential to the contract.¹⁵⁸ The breach of a time agreement in delivery or opening the L/C, no matter how slight the delay is or how little the consequence caused by the delay is, entitles the injured party to terminate the contract, unless the parties have agreed otherwise.¹⁵⁹

In circumstances of defective performance, i.e., by delivering defective goods or tendering defective documents, where the parties fail to stipulate the importance of some features of the goods or documents in their contract, the Chinese tribunals awarded the buyer's right of avoidance upon whether the defects cause substantial detriment as provided in Article 25 of the CISG. The delivery of defective goods or

¹⁵⁷ CISG Article 6.

¹⁵⁸ See fn.6 Schmittoff p.87; *The International Sale of Goods Law & Practise*, Michael Bridge (1st ed. 1999) p. 88; Chitty: 43-113, 43-271; Benjamin 18-267.

¹⁵⁹ SGA Section 15A does not apply to express terms, e.g., the time of delivery: the Law Commission Report; Benjamin 12-025; SGA Sections 11(3) and 61(1); *Bowes v Shand* (1877) 2 App.Cas.455.

the tender of defective documents is not generally treated as a fundamental breach even if the defects are serious, as long as the defects can be cured by the seller's repair or substitution without causing unreasonable delay, inconvenience or uncertain expenses to the buyer.¹⁶⁰ This is because the CISG stresses the performance of contract and encourages the remedy of specific performance rather than the avoidance of contract. English law emphasizes the termination of contract and encourages the injured party to terminate the contract and mitigate the loss by selling or buying substitute goods in the market straight after a contract is breached. The difficulty in judging the substantial detriment in defective delivery makes the CISG less certain and less efficient than English law. The advice for the contracting party is to specify the essential features of the goods and the consequences of the breach of these features by an express term: the avoidance of contract, specific performance or damages. By doing so, the high threshold of substantial detriment for the avoidance of contract is excluded as allowed under Article 6 of the CISG. In regard to the defects in the documents, the principle of strict compliance rigorously applied in English law entitles the buyer to reject the defective documents that are inconsistent with the L/C. Whether the tender of the non-conforming documents causes substantial detriment to the buyer in the contract is not an issue that the English courts need to consider. English courts thus have less chance to make the same mistakes as the Chinese tribunals in the *Hot-rolled plates case* and the *Air purifiers case*, in which the contract was examined to ascertain the conformity of the documents when the L/C was the means of payment. According to some scholars, the principle of strict compliance should be applied in the documentary sale to judge the right of rejection for the documentary defects under the CISG. Where the Incoterms

¹⁶⁰ CISG Article 48(1).

are incorporated in the contract, the parties should be assumed to have agreed that the buyer has the right to reject the documents even if the discrepancy between the documents and the L/C has little practical significance.

In circumstances of non-performance, i.e., non-delivery or non-payment, the CISG and English law are both very consistent in allowing the avoidance of the contract because the main purpose of the contract has failed.

It is not surprising to discover that the application of the categorisation rule of the breach of contract under the FECL makes no difference from the application of the CISG because the FECL was drafted based on the CISG and the Chinese courts normally interpret the FECL in the same way as the CISG even if there are some slight wording differences in some Articles.

From the proceeding comparison, it appears to the author that in international sales of goods, the application of English law is more predictable than the CISG in most cases. The emphasis on the performance of contract under the CISG makes it very difficult for a fundamental breach to be recognised. A contract can only be avoided if the test for substantial detriment is satisfied in Article 25 of the CISG. The predictability of the remedies for a breach as to whether the contract can be avoided is therefore very hard to achieve. The best advice for the contracting parties under the CISG is to stipulate in the contract as to the consequence of a breach of certain agreement to avoid potential uncertainties of the categorisation rule of the CISG.

CHAPTER 3

OPERATION OF THE RIGHT OF AVOIDANCE FOR BREACH OF CONTRACT

Introduction

In the international sale of goods, the avoidance of contract is regarded as the most serious remedy for breach of contract.¹ A contract can be ended when the aggrieved party exercises his right of avoidance and subsequently both parties are discharged from further performance of the contract subject to restitution and damages. In other words, the parties are released from their own unperformed obligations under the contract and from their obligation to accept the performance by the other party if made or tendered.² Given the serious consequence for the avoidance of contract, some means of limitation has been adopted by different countries to constrain the right of avoidance. If the aggrieved party does not avoid the contract according to the requirement of limitation, his right of avoidance may be lost. Thus, some knowledge of the avoidance rules under the applicable law is necessary for the contracting parties.

In this chapter, the author investigates the avoidance rules under the CISG, FECL and English law by comparing their similarities and differences. A number of Chinese cases are examined to see whether the application of the avoidance rules under the CISG has led to predictable decisions. Also, the FECL and English law are applied by the author in those Chinese decisions in order to find out whether the

¹ Different terminology is adopted in the avoidance rules of the three different regimes: 'avoidance' in the CISG, 'cancellation' in the FECL and 'termination' in English law.

² *Chitty on Contracts*, A. G. Chitty, (30th ed. 2008) ['Chitty'] 24-001.

application of these two alternative laws would have made any difference. In the conclusion of this chapter, the author analyses what has caused the unpredictability in the Chinese decisions if there are any, i.e., whether it is a problem of legislation or misunderstanding in application and how these problems can be resolved?

3.1 Comparison on the avoidance rules under the three regimes: CISG, FECL and English law

The avoidance rules for breach of contract under the three regimes are compared with regard to the following issues. [a] What are the relevant provisions of the avoidance rules under the three regimes? [b] Are they similar or different: if they are similar, what are their similarities and if they are different, what are their differences?

The study of these questions is helpful for exploring the operation of the right to avoid the contract, i.e., how the right of avoidance can be exercised or lost under the avoidance rules of these different regimes.³

3.1.1 *Relevant provisions of the avoidance rules under the three regimes*

In the CISG, Article 49 states the rules as to the buyer's right of avoidance whilst Article 64 states the rules as to the seller's right of avoidance. The construction of Articles 49 appears analogous to the construction of Article 64 in that they both contain two parts: the preconditions for the aggrieved party's right to avoid the

³ The ground for the right to avoid the contract is discussed in Chapter 2 of this thesis. Chapter 2 focuses on the interpretation of a concept, i.e. fundamental breach – a ground for the avoidance of contract. It illustrates the criteria and circumstances under which a breach of contract may constitute a fundamental breach to trigger the remedy of avoidance. Chapter 3 of this thesis goes further to explore the operation of the right to avoid the contract, i.e. how the right of avoidance can be exercised and when this right may be lost. The study of fundamental breach in Chapter 2 builds the foundation for the analysis of the right of avoidance in Chapter 3.

contract and the limitation on the right of avoidance.⁴ Article 49(1) of the CISG provides for the preconditions for the buyer's right of avoidance when a contract is breached by the seller:⁵ *'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.'*⁶ Article 49(2) of the CISG imposes some limitation on the buyer's right of avoidance: *'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.'* Article 64(1) of the CISG lays down the preconditions for the seller's right of avoidance when a contract is breached by the buyer: *'The seller may declare the contract avoided: (a) if the failure by the buyer to perform any of his obligations under the contract or this Convention amounts to a fundamental breach of contract; or (b) if the buyer does not, within the additional period of time*

⁴ *Commentary on the UN Convention on the International Sale of Goods (CISG)*, Müller-Chen, (2nd ed. 2005) ['Müller-Chen'] p.575.

⁵ *Ibid.*

⁶ See *ante* Chapter 2 'Categorisation of Breach of Contract – Ground for Avoidance for Fundamental Breach'.

*fixed by the seller in accordance with paragraph (1) of article 63, perform his obligation to pay the price or take delivery of the goods, or if he declares that he will not do so within the period so fixed.*⁷ Article 64(2) of the CISG imposes the limitation on the seller's right of avoidance: *'However, in cases where the buyer has paid the price, the seller loses the right to declare the contract avoided unless he does so: (a) in respect of late performance by the buyer, before the seller has become aware that performance has been rendered; or (b) in respect of any breach other than late performance by the buyer, within a reasonable time: (i) after the seller knew or ought to have known of the breach; or (ii) after the expiration of any additional period of time fixed by the seller in accordance with paragraph (1) of article 63, or after the buyer has declared that he will not perform his obligations within such an additional period.'* It should be noted that derogatory agreements are permitted under the CISG.⁸ According to Article 6 of the CISG, the parties can derogate from or vary the effect of Articles 49 and 64 by making an express clause in the contract to authorise the aggrieved party the right of avoidance under the agreed circumstances.⁹

Article 29 of the FECL lays out the circumstances under which an international sale contract can be cancelled: *'A party shall have the right to notify the other party that a contract is cancelled in any of the following situations: (1) if the other party has breached the contract, the expected economic interests for which the contract is concluded are seriously affected; (2) if the other party fails to perform the contract within the time limit agreed upon in the contract, and again fails to perform it within the reasonable period of time allowed for delayed performance...; or (4) if the*

⁷ Ibid.

⁸ Müller-Chen p.595.

⁹ CISG Article 6: *'The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.'*

contractually agreed conditions for the cancellation of the contract are present.' The FECL does not stipulate any restrictions on the right of avoidance as provided for in Articles 49(2) and 64(2) of the CISG.

Under English law, the remedy of termination is available either when a condition of contract is breached¹⁰ or when an innominate term of contract is repudiously breached, i.e., the nature and consequence of the breach goes to the root of a contract.¹¹ The consequence of the breach of conditions is clearly provided for in Section 11(3) of the SGA: '*a stipulation in a contract is a condition, the breach of which may give rise to a right to treat the contract as repudiated*'. There is no provision in the SGA dealing with the seller's loss of the right of termination for breach of contract by the buyer.¹² The loss of right to terminate the contract in the SGA only focuses on the buyer through his *acceptance*. In the sale of the goods, the buyer is entitled to a reasonable opportunity to examine the conformity of the goods when the seller tenders delivery.¹³ There are in principle three assumptions by which the buyer is deemed to have accepted the goods and thereby have lost his right of rejection.¹⁴ They are when the buyer expressly intimates his acceptance of the goods to the seller, when the buyer performs an action inconsistent with the ownership of the seller, or when the buyer retains the goods for a reasonable time without rejecting

¹⁰ The condition can be the expressly agreed by the parties or implied by law i.e. by s.13, 14, 15 of the Sale of Goods Act 1979. In English law, the terms of contract are classified as conditions, warranties and innominate terms. See *ante* 2.1.1.

¹¹ *Hong Kong Fir Shipping Co Ltd v Kawasaki Kisen Kaisha* [1962] 2 QB 26; *The Hansa Nord* [1976] QB 44; *Reardon Smith Lines Ltd v Hansen Tangen* [1976] 1 WLR 989. See *The Sale of Goods*, P.S. Atiyah, (11th ed. 2005) ['Atiyah'] p.91-94, 499.

¹² J. W. Carter, 'Party Autonomy and Statutory Regulation: Sale of Goods', 6 *Journal of Contract Law*, North Ryde NSW, Australia (1993) 93-122, at p.118.

¹³ SGA Section 34: '...Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he is bound on request to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract [and, in the case of a contract for sale by sample, of comparing the bulk with the sample].'

¹⁴ Atiyah p. 510.

them.¹⁵ Section 35 of the SGA states that: '(1) *The buyer is deemed to have accepted the goods... (a) when he intimates to the seller that he has accepted them, or (b) when the goods have been delivered to him and he does any action in relation to them which is inconsistent with the ownership of the seller... (4) The buyer is also deemed to have accepted the goods when after the lapse of a reasonable time he retains the goods without intimating to the seller that he has rejected them.*' The consequence for the buyer's acceptance is specified in Section 11(4) of the SGA that: '*the breach of a condition to be fulfilled by the seller can only be treated as a breach of warranty, and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is an express or implied term of the contract to that effect.*' Parallel to the concept of acceptance, there are some other general common law doctrines which are frequently applied to the contracts of international sale of goods, these being *affirmation, waiver and estoppel*.¹⁶ The difference between affirmation and acceptance is that the *affirmation* of contract requires the aggrieved party's knowledge of breach and of the right to terminate when a contract can be affirmed¹⁷ and the acceptance of the goods does not require such knowledge when the goods can be accepted.¹⁸ The common law doctrines of *waiver and estoppel*¹⁹ apply in the situation where the buyer with the knowledge of the facts and his right of

¹⁵ Atiyah p. 510.

¹⁶ Atiyah p. 507-508.

¹⁷ *Peyman v Lanjani* [1985] Ch 457. It is also held in this case that the party may lose his right of termination even if he does not know the facts or his rights, if he represents that he is affirming the contract by his words or conduct and the other party relies on his prejudice on that implied representation. See Atiyah p.507-508.

¹⁸ Atiyah p. 508.

¹⁹ Atiyah p. 134 'In modern decisions, no clear distinction appears to be drawn between waiver and estoppel'; See *Finagrain SA Geneva v P Kruse* [1976] 2 Lloyd's Rep.508. The doctrine of waiver is also addressed in Section 11(2) of SGA: 'Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition.'

termination²⁰ makes clear and unequivocal representations, either expressly or implicitly,²¹ that he will accept the goods or that he will not reject them based on the breach (e.g., late delivery); thus the buyer loses his right to reject the goods.²² The terminology of waiver is also addressed in Section 11(2) of the SGA: ‘*Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition*’.

3.1.2 Similarities of the avoidance rules under the three regimes

The avoidance rules of the three regimes have three main similarities. The avoidance of contract must be declared; the right of avoidance must be exercised within a reasonable time-limit; and the effects of avoidance include the discharge of further performance of the contract, damages or restitution.

[a] Declaration of avoidance

The breach of contract under the three regimes does not lead *ipso facto* to the avoidance of contract.²³ The existence of a repudiatory breach, e.g., by a fundamental breach or by the breaching party’s non-performance after the expiry of the additional time fixed, does not automatically bring a contract to an end.²⁴ According to the avoidance rules of any of the three regimes, the injured party who wishes to avoid the contract must communicate his decision to the breaching party.²⁵ If the injured

²⁰ The general view is that a party cannot be taken to have waived his rights which he did not know he had: see Atiyah p. 135. The leading case is *Procter & Gamble Philippine Manufacturing Corpn v Peter Cremer GmbH & Co (Manila)* [1988] 3 All ER 843.

²¹ *Bremer v Vanden Avenue-Izegem* [1978] 2 Lloyd’s Rep 109, 126.

²² Atiyah p. 134-137, 508.

²³ Müller-Chen p.514.

²⁴ Müller-Chen p.584.

²⁵ CISG Art.26: ‘A declaration of avoidance of the contract is effective only if made by notice to the other party.’ See Müller-Chen p.584. English law: *Vitol SA v Norelf Ltd* [1996] AC 800; *Contract law*, Ewan Mckendrick, (7th ed. 2007) [‘Mckendrick’] p.394-395. FECL Art.32: ‘Notices or agreements on

party fails to do so, he may be held to have lost his right of avoidance. The breaching party may therefore insist upon the performance of contract when a sudden change of market tends to favour him again.²⁶

[b] Limits on the right of avoidance within a reasonable time

The avoidance rules of the three regimes all impose a time-limit on the right to avoid the contract.²⁷ The injured party must make his decision as to whether to exercise his right of avoidance within a reasonable time under certain circumstances.²⁸ The injured party's failure to make a declaration to the effect of avoidance after the lapse of a time-limit deprives him of the right to avoid the contract.²⁹ The ascertainment of reasonable time is a matter of fact, depending upon the circumstances of each case.³⁰ In Article 49(2) and 64(2) of the CISG, the phrase of 'reasonable time' as a limit on the right of avoidance is used repeatedly. In Section 35(4) of the SGA, the buyer is deemed to have accepted the goods and lost his right to terminate the contract 'when *after the lapse of a reasonable time* he retains the goods without intimating to the seller that he has rejected them'.³¹ The FECL does not have an express provision as to a time-limit for the cancellation of contract, but the restriction of reasonable time can be implied by the application of good faith. Good faith is a general principle of

the modification or cancellation of contracts shall be made in writing.' The different forms of declaration for avoiding contract are analysed next in 3.1.3[a] Forms of avoidance.

²⁶ For example, the seller who failed to deliver the goods after the expiry of the additional time fixed by the buyer may change his mind and insist on the performance of contract after the sudden drop of the market.

²⁷ Müller-Chen p.666.

²⁸ It is when the goods have been delivered or when the price has been made. See CISG Articles 49(2) and 64(2). See Atiyah p. 508.

²⁹ See CISG Articles 49(2) and 64(2). SGA s. 35(4).

³⁰ SGA s. 59 'Reasonable time a question of fact: Where a reference is made in this Act to a reasonable time, the question what is a reasonable time is a question of fact.' *Fisher, Reeves & Co Ltd V Armour & Co Ltd* [1920] 3 K.B. 614, 624; *Long v Lloyd* [1958] 1 W.L.R. 753. Chitty 43-315.

³¹ SGA Section 35(4). SGA Section 35(5): 'The questions that are material in determining for the purposes of subsection (4) above whether a reasonable time has elapsed include whether the buyer has had a reasonable opportunity of examining the goods for the purpose mentioned in subsection (2) above'.

civil law applicable in China and is stipulated in Article 4 of the People's Republic of China General Principles of Civil Law (GPCL).³²

[c] Effects of avoidance

Despite the different terminology employed by the three regimes, i.e., 'avoidance' in the CISG, 'cancellation' in the FECL and 'termination' in English law, the injured party's election of such a right has similar effects on the contract. They are distinguished from rescission *ab initio*, which sets aside the contract retrospectively and prospectively and requires mutual restitution between the contracting parties.³³

The terms of 'avoidance', 'cancellation' or 'termination' of the avoidance rules under the three regimes operate with the prospective effect of the contract only. Both parties are discharged from further performance of the obligations under the contract and the breaching party is liable for any damages suffered by the other party resulting from his breach.³⁴ If a contract has been wholly or partly performed, the parties are bound to make restitution for any monies paid or any goods delivered.³⁵ It should be noted that the injured party is not bound to avoid the contract. The election of avoidance is a right, not an obligation of the injured party.³⁶ Therefore, he has the freedom to waive his right of discharge and treat the contract as continuing, e.g., by

³² GPCL Article 4: 'In civil activities, the principles of voluntariness, fairness, making compensation for equal value, good faith shall be observed.'

³³ *Contract Law*, Mindy Chen-Wishart, (2nd ed. 2008) ['Chen-Wishart'] p.515; Chitty 6-106, 24-001; *Photo Production Ltd v Securicor Transport Ltd* [1980] A.C. 827, 844.

³⁴ *Photo Production Ltd v Securicor Transport Ltd* [1980] A.C. 827, 844; Chitty 24-001, 24-047-048; Chen-Wishart p.515-516; Atiyah p.505-506. CISG Article 81: '(1) Avoidance of the contract releases both parties from their obligations under it subject to any damages which may be due. Avoidance does not affect any provision of the contract for the settlement of disputes or any other provision of the contract governing the rights and obligations of the parties consequent upon the avoidance of the contract. (2) A party who has performed the contract either wholly or in part may claim restitution from the other party of whatever the first party has supplied or paid under the contract. If both parties are bound to make restitution, they must do so concurrently.' FECL Article 34 'The modification, cancellation or termination of a contract shall not affect the rights of the parties to claim damages.'

³⁵ *Ibid.*

³⁶ CISG Articles 49 and 64 employ the term of 'may', FECL Article 29 called it a 'right'. *Hain SS. Co Ltd v Tate & Lyle Ltd* (1936) 41 Com. Cas. 350, 355, 363; *Vitol SA v Norelf* [1996] A.C. 800. See Chitty 24-001.

accepting the defective performance and consent himself with the remedy of damages only.³⁷

3.1.3 Differences of the avoidance rules under the three regimes

The avoidance rules of the three regimes have the following differences: the forms of avoidance, the loss of the right to avoid the contract and the buyer's dual rights to reject the goods and reject the documents.

[a] Forms of avoidance

The avoidance of contract is required in different forms under the avoidance rules of the three regimes. In the CISG, although a notice to the other party is required for a declaration of avoidance to become effective, the declaration is not subject to any particular formal requirements.³⁸ The notice can be given in writing, verbally or even by conduct, as long as it is clear and comprehensible to both parties.³⁹ It should be noted that China has declared a reservation on Article 11 according to Article 96 when adopting the CISG.⁴⁰ This states that a declaration of avoidance for breach of contract must be in or evidenced by writing when any contracting party has his place of business in China. Article 32 of the FECL also demonstrates China's position stating that the notice on the cancellation of contract must be in writing.

³⁷ Chitty 24-001.

³⁸ CISG Article 26.

³⁹ Müller-Chen p.584-585. This position can also be inferred from Articles 11 of the CISG. Article 11: 'A contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirements as to form. It may be proved by any means, including witness.'

⁴⁰ <http://www.cisg.law.pace.edu/cisg/countries/cntries-China.html>. Dong Wu, 'CIETAC's Practice on the CISG', *Nordic Journal of Commercial Law* (2/2005). CISG Article 96: 'A Contracting State whose legislation requires contracts of sale to be concluded in or evidenced by writing may at any time make a declaration in accordance with article 12 that any provision of article 11, article 229, or Part II of this Convention, that allows a contract of sale or its modification or termination by agreement or any offer, acceptance, or other indication of intention to be made in any form other than in writing, does not apply where any party has his place of business in that State.'

In contrast, English law holds a very flexible approach as to the form of termination for breach of contract. It was clarified by the House of Lords in *Vitol SA v Norelf Ltd* that the acceptance of repudiation requires no particular form.⁴¹ It is sufficient that any communication or conduct to the repudiating party clearly and unequivocally conveys the aggrieved party's intention to treat the contract as ended.⁴² The notification by the aggrieved party or any agent is not necessary. It is sufficient that the fact of election draws the repudiating party's attention.⁴³ Occasionally, the aggrieved party's inactivity, e.g., by his mere failure to perform, may also constitute the acceptance of repudiation, depending upon 'the particular contractual relationship and the particular circumstances of the case'.⁴⁴

[b] Loss of the right to avoid the contract

The avoidance rules of the three regimes adopt different means to restrain the aggrieved party's right to avoid the contract. The approach employed by the CISG is the time constrains, i.e., the buyer or seller must declare the contract avoided within a reasonable time, where the goods have been delivered or the price has been paid.⁴⁵ The right of avoidance is lost if the notice of avoidance is given beyond the limit of reasonable time.⁴⁶ Articles 49(2) and 64(2) of the CISG lay down the circumstances under which the aggrieved buyer and seller may lose their right of avoidance and by

⁴¹ [1996] AC 800. See Mckendrick p.394-395, Chen-Wishart p.514.

⁴² Ibid.

⁴³ Ibid. It is advised that the aggrieved party who wishes to accept the repudiation should draw that acceptance expressly to the attention of the repudiating party. Mckendrick p. 395.

⁴⁴ *Vitol SA v Norelf Ltd* [1996] AC 800; Mckendrick p. 395.

⁴⁵ Where the goods have not been delivered or where the price has not been paid, there is no time-limit for the exercising of the right to avoid the contract. See Müller-Chen p.586, 666, Harry M. Flechtner, 'Remedies Under the New International Sales Convention: The Perspective from Article 2 of the U.C.C.', *Journal of Law and Commerce* (1988) 53-108.

⁴⁶ The rationale behind the time-limit for the avoidance of contract is to prevent undue delay, unnecessary cost involved and the uncertainty as to the relationship of the parties and the status of the contract. See *Uniform Law for International Sales under the 1980 United Nations Convention*, John O. Honnold, (3rd ed. 1999) p.333.

what point in time the limit of reasonable time should start to count.⁴⁷ These two Articles are often known as ‘the most complicated rule of the entire Convention’ due to their complex construction and the difficulties involved in application.⁴⁸ Moreover, the CISG imposes a further time-limit for the buyer, who wishes to avoid the contract, based on the non-conformity of the goods in Article 39.⁴⁹ The buyer must examine the goods within a short period of time.⁵⁰ The buyer must then give notice to the seller specifying the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it.⁵¹ A failure to give such a notice deprives the buyer of the right to rely on the non-conformity of the goods.⁵² In other words, the buyer not only loses his right to avoid the contract based on a fundamental non-conformity, but also loses his right to recover any damages caused by the delivery of the defective goods.⁵³

⁴⁷ Tobias Plate, ‘The Buyer’s Remedy of Avoidance under the CISG: Acceptable from a Common Law Perspective?’, *Vindobona Journal of International Commercial Law and Arbitration* (2002) 57-82; Harry M. Flechtner, ‘Remedies Under the New International Sales Convention: The Perspective from Article 2 of the U.C.C.’, *Journal of Law and Commerce* (1988) 53-108.

⁴⁸ Enderlein, F. and Maskow, D., *International Sales Law* (1992), Article 49, para 6; Müller-Chen p.666.

⁴⁹ CISG Article 39: ‘(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. (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.’

⁵⁰ CISG Article 38: ‘(1) The buyer must examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances. (2) If the contract involves carriage of the goods, examination may be deferred until after the goods have arrived at their destination. (3) If the goods are redirected in transit or redispached by the buyer without a reasonable opportunity for examination by him and at the time of the conclusion of the contract the seller knew or ought to have known of the possibility of such redirection or redispach, examination may be deferred until after the goods have arrived at the new destination.’

⁵¹ CISG Article 39(1).

⁵² *Ibid.*

⁵³ There is one exceptional circumstance under which the buyer is not deprived of the right to rely on the non-conformity of the goods after his failure to notify the seller of the non-conformity within the time-limit. That is when the seller had the knowledge of non-conformity and did not disclose it to the buyer. Article 40 of the CISG: ‘The seller is not entitled to rely on the provisions of article 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.’ Article 44 of the CISG also stipulates another circumstance under which the buyer is still entitled to the remedy of price reduction or damages when he has a reasonable excuse for failure to give the notice of non-conformity. Article 44: ‘Notwithstanding the provisions of paragraph (1) of article 39 and paragraph (1) of article 43, the buyer may reduce the price in

In the FECL, there are no rules that expressly limit the aggrieved party's right to cancel the contract.⁵⁴ The time-limit for the right of avoidance may be implied through the application of the principle of good faith in the PRC General Principles of Civil Law (GPCL).⁵⁵ The aggrieved party can be obliged to make his decision regarding whether to cancel the contract within a reasonable time-limit. Nevertheless, due to the lack of precise legislation, the ascertainment of reasonable time can be called into question, e.g., the point at which the reasonable time-limit should start to count.

The means of limitation adopted by English law for restricting the parties' right of termination for breach of contract mainly includes two ways: one is the aggrieved party's own conduct and the other is the operation of the rule of law.⁵⁶ The aggrieved party's own conduct refers to the operation of some general common law principles, i.e., affirmation or waiver by estoppel. The aggrieved party may lose his right to terminate the contract by his own affirmation, that is when he knew both of the breach and his right to terminate and yet still decided to affirm the contract;⁵⁷ or by waiver, that is when he made a clear and unequivocal representation that he would not insist on strict performance of the original contract despite having the knowledge of all the facts and his right of termination.⁵⁸ The other means of limitation for the aggrieved party's right of termination is by the operation of law through

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.' There is a debate in the CISG regarding whether the time-limit for avoiding the contract based on the fundamental non-conformity should be longer than the time-limit for giving the notice for the non-conformity of the goods. The jurisdiction of contracting States of the CISG and scholars hold different views. A Swiss court thinks these two time-limits should be the same and an Italian court believes that the time-limit for avoiding the contract based on the fundamental non-conformity should be longer than the time-limit for notifying the non-conformity of the goods. See Ari Korpinen, 'On legal uncertainty regarding timely notification of avoidance of the sales contract' published on <http://www.cisg.law.pace.edu/cisg/biblio/korpinen.html>

⁵⁴ See the discussion in *ante* 3.1.2.

⁵⁵ See Article 4 of the GPCL.

⁵⁶ Chen-Wishart p.514-515.

⁵⁷ *Peyman v Lanjani* [1985] Ch 457; Atiyah p.508, Chen-Wishart p. 516-517.

⁵⁸ *Charles Rickards Ltd v Oppenheim* [1950] 1KB 616. Atiyah p.134, Chen-Wishart p.176-178, 514-515. See SGA s. 11(2).

acceptance.⁵⁹ When the seller tenders delivery of the goods, the buyer is entitled to a reasonable opportunity for examination of the goods.⁶⁰ The buyer loses his right to terminate the contract when he accepts or is deemed to have accepted the goods by intimating his acceptance to the seller, acting inconsistently with the ownership of the seller, or retaining the goods beyond a reasonable time without rejecting them.⁶¹ It is in contrast to the position of the CISG that where the aggrieved party's right to terminate the contract is lost by affirmation, waiver or acceptance, his right to damages would normally survive under English law.⁶² Even if there had been an unequivocal representation for waiving both rights of termination and damages, the aggrieved party can rarely be held to have lost his right to damages, unless the requirement of sufficient action in reliance is satisfied. For example, the defaulting party must have acted in reliance on the representation of the aggrieved party's waiver in such a way as to make it inequitable for the representation to be voided.⁶³

[c] Dual rights to reject the goods and reject the documents

Where the sale of goods is concluded on shipment terms, the contract may be avoided by the buyer by exercising two distinct rights of rejection: the rejection of

⁵⁹ SGA s.35.

⁶⁰ SGA s.34. The time for examination is normally not less than the time for the buyer to have a reasonable opportunity to examine the goods, or the time taken for the buyer to resell the goods together with an additional time for the sub-buyer to inspect and test the goods when the goods are resold. *Truk (UK) Ltd v Tokmakidis GmbH* [2000] 2 All ER (Comm) 594. See Atiyah p.518, Chitty 43-314-315.

⁶¹ SGA s. 35(1)(4).

⁶² *Ets. Soules & Cie. v International Trade Development Co. Ltd* [1980] 1 Lloyd's Rep. 129. *Benjamin's Sale of Goods*, Judah Philip Benjamin, (7th ed. 2006) ['Benjamin']19-150-151; Atiyah p.136.

⁶³ *Bremer Handelsgesellschaft mbH v Deutsche Conti- Handelsgesellschaft mbH* [1983] 1 Lloyd's Rep.689; *Bremer Handelsgesellschaft mbH v Bunge Corp.* [1983] 1 Lloyd's Rep. 476. See Benjamin 19-150.

goods and the rejection of documents.⁶⁴ The avoidance rule of the CISG in Article 49 only speaks of the buyer's right to avoid the contract against the seller's obligation to deliver the goods. It is not clear if the buyer's right of avoidance can be enacted if the seller does not fulfil his obligation to tender the documents.⁶⁵ Where the delivered goods conform perfectly to the contract and the tendered documents do not comply with the contract, it is controversial under the CISG as to whether the buyer is entitled to reject the documents. The CISG Advisory Council Opinion No. 5 holds that where the buyer is the last buyer in a string transaction and the goods can be used for the intended purpose, the buyer does not have the right to avoid the contract by rejecting the non-conforming documents.⁶⁶ It seems that the CISG does not presume the buyer's dual rights to reject goods and documents as being separate and independent from each other.

In the avoidance rule of the FECL, the buyer's right to cancel the contract only refers to the seller's breach of general contractual obligations. The buyer's right to cancel the contract due to the seller's failure to tender required documents is not mentioned by any Article of the FECL. Therefore, it is not clear in the FECL as to the relationship between the buyer's dual rights of rejection to cancel the contract.

In English law, the buyer's dual rights to reject the goods and reject the documents are generally held to be separate⁶⁷ and independent from each other.⁶⁸

⁶⁴ In the documentary sale, the seller has the duties to deliver the goods and to tender the proper shipping documents. His failure to deliver the goods or tender the documents entitles the buyer to avoid the contract. Benjamin 19-010, 19-144.

⁶⁵ Benjamin 19-144 fn. 90. It is noted that the seller's duty to tender the contractual documents is provided in Article 30 of the CISG. '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.'

⁶⁶ <http://www.cisg.law.pace.edu/cisg/CISG-AC-op5.html#ivb>.

⁶⁷ *James Finlay & Co. Ltd v Kwik Hoo Tong* [1929] 1 K.B. 400 at p.414. This case established the existence of the buyer's separate rights to reject the goods and to reject the documents. The Court of Appeal held that the seller is under the duty to deliver the goods and tender the documents conforming to the sale of contract. The seller's breach of either duty makes the seller liable to the buyer. See *Bills of Lading in Export Trade*, Charles Debattista (3rd ed. 2009) ['Debattista'] 9.26.

The buyer's reaction to one mode of performance, e.g., by accepting or rejecting the documents or the goods, does not affect his right to the other mode of performance. In contrast to the position of the CISG, the buyer under English law is entitled to reject the documents that do not conform to the contract, even if the goods are perfectly in compliance with the contract.⁶⁹ It should be noted that some constraints have been imposed on the buyer's dual rights of rejection by the Court of Appeal in the leading case *Panchaud Freres*.⁷⁰ The buyer may lose his right to terminate the contract under the doctrine of estoppel through his own conduct. Where the buyer accepts the documents with the noticeable defects that justify the rejection of documents, he is estopped from rejecting the goods or the documents and claiming damages on the same ground. Where the buyer accepts the goods with the noticeable defects that justify the rejection of goods, he is also estopped from rejecting the documents or the goods and claiming damages on the same ground. However, the buyer is not estopped from rejecting the goods and claiming damages on any ground other than the noticeable defects reflected in the documents.

⁶⁸ The buyer's two rights to reject the documents and reject the goods are independent. See *Twei Tek Chao v British Traders and Shippers Ltd* [1954] 2 QB 459. The buyer has two independent rights of rejection: the right to reject the documents arises when the documents are tendered, and the right to reject the goods arises when they are delivered. The buyer's acceptance of the goods does not estop his right from rejecting the documents, given the defects in the documents were hidden on tender. The buyer should still be entitled to the right of damages for having been deprived of the opportunity to reject the defective documents when the documents were tendered. See *Bergerco USA v Vegoil Ltd* [1984] 1 Lloyd's Rep 440. The buyer's acceptance of documents on tender does not preclude his right to reject the goods on arrival, given the defects of the goods are not shown in the accepted documents. See Debattista 9-27.

⁶⁹ Benjamin 19-147.

⁷⁰ *Panchaud Freres SA v Etablissements General Grain Co* [1970] 1 Lloyd's Rep 53. See Debattista 9-35-42. The SGA only represents the old fashion of sale of goods. The loss of right to reject in Section 35 of the SGA through acceptance only refers to the sale of goods and does not refer to the documentary sale.

3.2 Examination of the consistency of the avoidance rules applied by the Chinese tribunals under the CISG in comparison with the FECL and English law

This section investigates some Chinese cases decided by the Chinese tribunals under the avoidance rule of the CISG. The effect of application is examined with regard to whether the avoidance rule of the CISG has been working consistently in these Chinese cases. The issues to be analysed are as follows: *[a] Where the seller delivers defective goods, by what point in time must the buyer have examined the goods and what is the consequence if the buyer fails to object to the non-conformity of the goods within the agreed time-limit? [b] Where the goods are sold on shipment terms, whether the buyer has dual rights to avoid a contract by rejecting the non-conforming goods and rejecting the non-conforming documents? What is the relationship between the buyer's dual rights of rejection?*

The examination of these questions covers some of the most controversial issues arising out of the application of the avoidance rule of the CISG. If the result of application is predictable in the Chinese decisions, it means the avoidance rule of the CISG has been working effectively. The avoidance rules of the FECL and English law are also applied by the author in the same Chinese cases to ascertain if the outcomes would have been different under these alternative laws. *[i] Where the application of the avoidance rule of the CISG is predictable, would the application of the FECL or English law also be predictable? [ii] Where the application of the CISG is not predictable, would the application of the FECL or English law be more predictable?* If the result of application is not as predictable under the avoidance rules of certain regimes, the author will look into the cause of such unpredictability and how these can be resolved.

3.2.1 *Where the seller delivers defective goods, by what point in time must the buyer have examined the goods and what is the consequence if the buyer fails to object to the non-conformity of the goods within the agreed time-limit?*

Under the CISG, there is a strict time-limit for the buyer to examine the goods and give a notice of non-conformity to the seller if the delivered goods are defective. According to Article 38 of the CISG, the buyer has an obligation to examine the goods ‘*within as short a period as is practicable in the circumstances*’. The buyer is also required by Article 39 of the CISG to give the seller a notice of non-conformity ‘*within a reasonable time after he has discovered it or ought to have discovered it*’.⁷¹ The buyer’s failure to give a notice of non-conformity within such a time-limit may lead to a severe consequence, i.e., the deprivation of his right to rely on the non-conformity of the goods.⁷² That is to say, the buyer would not only lose his right to avoid the contract,⁷³ but also lose his right to any damages resulting from the non-conformity of the goods. There are two exceptional circumstances provided for under the CISG when the buyer may escape from these consequences. Firstly, it is when the buyer can prove that the seller knew or could not have been unaware of the lack

⁷¹ The contracting parties may have a separate agreement in the contract as to the time-limit when the buyer should examine the goods and give the notice of non-conformity. Such an agreement is permitted by CISG Article 6 and it prevails over Articles 38 and 39 of the CISG. CISG Article 6: ‘The party may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of its provisions.’

⁷² CISG Article 39.

⁷³ Under the CISG, the buyer’s entitlement to the avoidance of contract only arises when the seller’s delivery of defective goods constitutes a fundamental breach, i.e., the defects substantially deprive the material interest of the buyer from concluding the contract according to Article 25 of the CISG. The seller’s failure to cure the defective goods within the additional period of time fixed by the buyer does not make the seller’s defective delivery fundamental breach and therefore the buyer is not entitled to avoid the contract by this approach according to Article 49(1)(b) of the CISG.

of non-conformity, which he failed to disclose to the buyer.⁷⁴ However, it is not easy for the buyer to find sufficient evidence to prove this in practice. And secondly, if the buyer can prove that he had an appropriate reason for failing to give the required notice of non-conformity, the buyer is entitled to the remedy of price reduction or damages.⁷⁵ Whether the buyer's reason is acceptable is at the tribunal's discretion. It is hard to believe that a court would accept such a reason easily in order for the buyer to avoid the consequences. Thus, under the CISG, when the buyer fails to examine the goods and give a notice of non-conformity to the seller within a reasonable time-limit, the consequence is serious and it is unlikely that such a consequence can be avoided.

The ascertainment of time-limit for the buyer's examination and notification of non-conformity is an important issue under the CISG. In the transaction of international trade, the goods are very often resold or redirected to sub-buyers before the buyer had a reasonable opportunity to examine the goods. Under these circumstances, the ascertainment of time-limit can become complex. However, the CISG allows some leeway for the buyer to defer examination. Article 38 of the CISG provides for two cases in which the time-limit for the examination of the goods may be deferred: *'(2) If the contract involves carriage of the goods, examination may be deferred until after the goods have arrived at their destination. (3) If the goods are redirected in transit or redispached by the buyer without a reasonable opportunity for examination by him and at the time of the conclusion of the contract the seller knew or ought to have known of the possibility of such redirection or redispach, examination may be deferred until after the goods have arrived at the new destination.'* In both these cases, the constraint of reasonable time for the notification

⁷⁴ CISG Article 40.

⁷⁵ CISG Article 44.

of non-conformity only begins when the goods have reached their final destination and after the buyer has had an opportunity to discover any defects in the goods.

It is open to question as to how much time is reasonable for the buyer's examination and notification of non-conformity where there is no express term agreed in the contract as to a time-limit for such examination. It is one of the most litigated matters in the CISG.⁷⁶ The Advisory Council Opinion No. 2 holds that a reasonable time should vary dependent upon the circumstances supported in each case. Given the absence of guidance from the CISG, the contracting states of the CISG have different preferences as to the interpretation of a reasonable time-limit. For example, the tribunals of some old members of the Uniform Law on the International Sale of Goods (ULIS)⁷⁷ are more demanding on the buyer than the tribunals with the history in their domestic law to require the notice of non-conformity to be given within a reasonable time.⁷⁸

The decisions of the Chinese tribunals have shown some unpredictability regarding the ascertainment of a time-limit for a buyer's obligation of examination and notification, especially when the resale or redispaching of the goods is involved. The Chinese tribunals hold conflicting views regarding whether the buyer's resale of the goods without examination represents his acceptance of the goods and the loss of his right of objection to the non-conformity of the goods.

The Chinese tribunal in the *Cysteine case*⁷⁹ held the buyer's resale to a third party as an action inconsistent with the seller's title to the goods and therefore the buyer

⁷⁶ CISG Advisory Council Opinion No. 2: Examination of the Goods and Notice of Non-Conformity Article 38 and 39 <http://www.cisg.law.pace.edu/cisg/CISG-AC-op2.html>.

⁷⁷ The ULIS is one of the antecedents to the CISG: <http://www.cisg.law.pace.edu/cisg/text/antecedents.html>. The ULIS is stricter with the time-limit for the buyer's duty of examination than the CISG. If the goods were redispached by the buyer, their examination could have been deferred until they arrived at the new destination only if they were redispached without transshipment: <http://www.cisg.law.pace.edu/cisg/biblio/bianca-bb38.html>.

⁷⁸ CISG Advisory Council Opinion No. 2.

⁷⁹ Award of 20 February 1994 [CISG/1994/03] (*Cysteine case*).

lost his right to any damages resulting from the non-conformity of the goods. In this case, the buyer purchased 5,000 kg of Cysteine from the seller C.N.F. Hamburg and the payment was agreed to be made by an irrevocable L/C payable on sight. The inspection clause in the contract clearly stipulated that the goods should be re-inspected by the local office of the China Commodities Inspection Bureau (CCIB) at the port of destination. In addition, the parties agreed that the buyer was entitled to claim compensation for the non-conformity of the goods within ninety days after the goods were unloaded with the support of an inspection certificate issued by the CCIB. The inspection clause also stated that if the inspection could not be completed within the stipulated period, the buyer would be further entitled to extend the period of a claim, provided that prior notice was given to the seller. The buyer received the goods in early August 1990. Without initially arranging for the goods to be inspected in Hamburg, the buyer resold 2,000 kg of the goods to a Swiss client and 3,000 kg to a French client. It was not until December 1990 that the buyer submitted some samples for inspection to be taken by the SGS office at Antwerp in Belgium, after the buyer's clients complained about the quality of the goods and subsequently claimed compensation from the buyer. It was held by the Chinese tribunal that the buyer did not follow the requirement of inspection as provided under the contract. Despite the buyer's claim that there was no branch of the CCIB in Hamburg, the tribunal held that the buyer should have arranged for alternative local agency to inspect the goods in Hamburg within the agreed time-limit after they had been received. The buyer's objection to the quality of the goods with the inspection certificate issued in December 1990 was clearly beyond the time-limit of ninety days agreed in the contract. Furthermore, although the receipt of the goods by the buyer was not held to imply the acceptance of the goods, the resale of the goods without the

seller's knowledge to a third party, who had used part of the goods for testing, was regarded as an action inconsistent with the seller's title to the goods. Therefore, the buyer was held to have lost his right to object to or rely on the non-conformity of the goods to claim damages.

It was clear that the Chinese tribunal made their decision in the *Cysteine case* based on two key findings. Firstly, the buyer raised his objection to the quality of the goods without the required supporting inspection certificate and beyond the time-limit agreed under the contract. It seems to the author that the parties' agreement regarding the issue of an inspection certificate within ninety days, after the arrival of the goods, transformed the buyer's physical obligation of objecting to the non-conformity of the goods into a documentary 'certificate final' obligation. In other words, the buyer can only raise an effective objection if he can produce a certificate issued by the agreed inspection agency within the agreed period. The buyer's failure to perform such an obligation cost him the loss of the right to reject the non-conformity of the goods. Secondly, the buyer's action by resale, without the seller's knowledge and the sub-buyer's use of part of the goods for testing, were inconsistent with the seller's title to the goods. Thereafter, the buyer was deemed to have accepted the goods by the Chinese tribunal. The results of these two findings prevented the buyer from relying upon the non-conformity of the goods according to Article 39 of the CISG. The buyer's claim of damages resulting from the non-conformity of the goods, i.e., the discount of 50% of the resale price compensated to the sub-buyer was dismissed by the Chinese tribunal.

In contrast, the Chinese tribunal in the *Jasmine aldehyde case*⁸⁰ held that the buyer's resale of the goods before examination did not represent his acceptance of

⁸⁰ Award of 23 February 1995 [CISG/1995/01] (*Jasmine aldehyde case*).

those goods and therefore the buyer did not lose his right to rely on the non-conformity of the goods. In this case, the buyer concluded a contract with the seller for the sale of 10,000 kg of jasmine aldehyde to be delivered C.I.F. US \$21/kg with a total value of US \$210,000 from Shanghai to New York. The goods were shipped from Shanghai on 30th September 1992, arrived in New York on 27th November 1992 and unloaded on 30th November 1992. Then, the goods were immediately delivered to the buyer's customer who rejected the goods on 4th December 1992. On the same day, the buyer notified both the seller and the insurer's American agent of the damage to the goods. According to the report issued by the inspection agent appointed by the insurer, the damage to the goods was caused by high temperature in transit. The buyer proved that after the contract was concluded and prior to shipment, he had sent two faxes to the seller. In these two faxes, the buyer requested the seller to pay particular attention to the control of temperature in transit and the assurance of a direct shipping route as the quality of jasmine aldehyde can deteriorate in high temperature. The seller did not object to these additional requests and assured the buyer that he would be adhered to them. The Chinese tribunal held that the seller's reply constituted a separate agreement with regard to the temperature of the goods in transit and a direct shipping route. Thus, the seller was held to have failed to perform the agreement because the goods were not kept at the proper temperature; nor was the shipping route direct. In the 'Evaluation of Damaged Cargo and Indemnity Agreement' made by the three parties (the seller, the buyer and the insurer) on 28th May 1993, the damaged cargo was valued at US \$40,000 and the loss was valued at US \$170,000. The insurer agreed to indemnify the buyer to the sum of US \$110,000; the seller agreed to pay the buyer US \$60,000 under a separate arrangement and the buyer agreed to bear any other loss or damage. In the separate compensation

agreement signed by the seller and the buyer, the seller agreed to remunerate the buyer to the sum of US \$60,000, in which US \$20,000 was to be paid in cash before 15th August 1993 with an additional US \$40,000 in the form of commissions and rebates against future trading. However, the seller subsequently claimed that these two agreements should be made null and void as they were made under the pressure of the insurance company at the time. The seller also claimed that the buyer did not raise any objection to the quality of the goods within a reasonable time-limit according to Article 38 of the CISG and that the buyer's resale to a third party without the seller's knowledge constituted his acceptance of the goods.

In the author's view, the resolution of the *Jasmine aldehyde case* highlights three important issues. The first issue is whether the buyer examined the goods and gave the notice of non-conformity within a reasonable time as required in Articles 38 and 39 of the CISG, given the fact that no precise time-limit was agreed in the original contract. As previously mentioned, the ascertainment of 'reasonable time' is one of the most litigated matters under the CISG.⁸¹ The tribunals of the contracting states have different preferences regarding the interpretation of reasonable time. In the *Jasmine aldehyde case*, the buyer's examination of the goods within seven days of delivery may be held to fall within a reasonable period by some tribunals but not by others. Also, another question which may be raised is as to whether the buyer was qualified to defer examination of the goods until their arrival at the final destination caused by the redirection of the goods to the sub-buyer. In the author's view, Article 38(3) should not be applicable in this case because the seller had no knowledge of the redirection of the goods. Considering all these related elements, the Chinese tribunal held that the buyer's objection to the non-conformity of the goods beyond

⁸¹ CISG Advisory Council Opinion No. 2.

seven days after the receipt of the goods fell within the scope of reasonable time under the CISG. Therefore, the buyer was entitled to damages caused by the non-conformity of the goods.

The second issue is whether the buyer's resale to his sub-buyer without the seller's knowledge constituted the buyer's acceptance of the goods. The buyer's resale to a third party was held to be consistent with the seller's title to the goods and therefore did not constitute acceptance of the goods. The buyer was entitled to the damages resulting from the non-conformity of the goods caused by the seller's failure to fulfil the agreed transport arrangements.

The third issue is whether the indemnity agreement made between the three parties (the seller, the buyer and the insurer) and the mutual indemnity agreement made between the seller and the buyer were valid. The Chinese tribunal confirmed the validity of these two agreements. Therefore, the seller was obliged to pay the buyer the damages of US \$60,000 as per compensation agreement. Due to the seller's lack of commitment to indemnify the buyer for damages of US \$40,000 against commissions on future trading as originally agreed, the Chinese tribunals held that the seller must pay the buyer the damages of US \$60,000 in cash.

From the discussion above, the Chinese tribunals clearly had some difficulties in ascertaining the limit for reasonable time for the examination of the goods. It was uncertain in the *Cysteine case* and the *Jasmine aldehyde case* as to whether the buyer's resale of the goods should be treated as an action inconsistent with the seller's title to the goods. Also, it was uncertain as to whether the buyer's resale without prior examination of the goods constituted the buyer's acceptance of the goods, which deprived the buyer of his right to rely on the non-conformity. The outcomes of these two cases were conflicting. The arbitrators in the *Cysteine case*

held the buyer's resale as an action inconsistent with the seller's title to the goods. Therefore, the buyer was deemed to have accepted the non-conforming goods. The buyer was held to have lost his right to rely on the lack of conformity of the goods. Nevertheless, the arbitrators in the *Jasmine aldehyde case* looked the opposite view. It is unfortunate that there is no record available for the author to find out the reason how either of these decisions was reached. In the author's opinion, the generation of such conflicting views stems from the absence of instruction in the CISG as to how the reasonable time-limit for the examination of the goods in Articles 38 and 39 should be interpreted and at what point the acceptance of the goods by the buyer should become operational when the goods have been resold by the buyer without examination. Given the harshness of the consequence of a buyer's failure for timely examination, it is important to call for a clear unified instruction to clarify this area of the CISG.

If the aforementioned Chinese cases were decided under the FECL, it would be very hard to predict what decisions the Chinese tribunals would have made, due to the lack of provisions to address these issues. As mentioned before, the FECL does not have any article which stipulates the buyer's obligation to examine the goods or restricts the buyer's right to terminate the contract. The limit of reasonable time for the buyer to examine the goods and give the notice of non-conformity may only be implied by the application of the general principle of good faith in the GPCL. Nevertheless, how such a reasonable time should be interpreted and ascertained in different cases is not clear. From the perspective of legislative history, the FECL was drafted as part of China's preparation to adopt the CISG.⁸² The author maintains that if the FECL had been applied, the Chinese tribunal would probably have interpreted

⁸² See *ante* 1.1.

the principle of reasonable time-limit for the examination and acceptance of the goods in the same way as the CISG and reached the same decisions as those in the cited cases.⁸³

If English law had been applied in the above two Chinese cases, the result could probably have been different. English law has gone through several amendments with regard to the buyer's right to examine the goods and the buyer's loss of the right to reject the goods through his act of acceptance. It is specified in Sections 34 and 35 of the SGA and English case law.⁸⁴ The buyer's resale or delivery of the goods to his sub-buyer is the most common type of act regarded as 'inconsistent with the ownership of the seller'.⁸⁵ However, the fact of resale or delivery on its own is not absolute in ascertaining the buyer's acceptance. Section 35(6)(b) of the SGA states that the buyer is not deemed to have accepted the goods *merely* because of the fact of resale or delivery under a sub-contract.⁸⁶ Whether the buyer's delivery of the goods under the sub-contract constitutes the acceptance of the goods should depend upon

⁸³ It is noticed that the Contract Law of the People's Republic of China (CCL) which has replaced the FECL has very similar provision to Articles 38, 39 and 40 of the CISG in respect of the time-limit for the buyer's obligation of examination and the consequence for the buyer's failure to examine the goods and give the notification of non-conformity. Article 158 of the CCL: 'Where the parties have agreed upon an inspection period, the buyer shall notify the seller of any non-compliance in quantity or quality of the subject matter within such inspection period. Where the buyer delayed in notifying the seller, the quantity or quality of the subject matter is deemed to comply with the contract. Where no inspection period is agreed, the buyer shall notify the seller within a reasonable period, commencing on the date when the buyer discovered or should have discovered the quantity or quality non-compliance. If the buyer fails to notify within a reasonable period or fails to notify within two years, commencing on the date when it received the subject matter, the quantity or quality of the subject matter is deemed to comply with the contract, except that if there is a warranty period in respect of the subject matter, the warranty period applies and supersedes such two year period. Where the seller knows or ought to know the non-compliance of the subject matter, the buyer is not subject to the time limits for notification prescribed in the preceding two paragraphs.'

⁸⁴ SGA Section 34: '...Unless otherwise agreed, when the seller tenders delivery of goods to the buyer, he is bound on request to afford the buyer a reasonable opportunity of examining the goods for the purpose of ascertaining whether they are in conformity with the contract [and, in the case of a contract for sale by sample, of comparing the bulk with the sample].'

⁸⁵ Atiyah p.515-516.

⁸⁶ SGA s. 35 '(6) The buyer is not by virtue of this section deemed to have accepted the goods merely because – ... (b) the goods are delivered to another under a sub-sale or other disposition.' The delivery of the goods to the sub-buyer can be deemed to constitute the buyer's acceptance if it is combined with some other circumstances, e.g., when *restitutio in integrum* is no longer possible. See Chitty 43-312. The buyer may also be deemed to have accepted the goods by a resale when he sold the goods on and delivered them to the sub-buyer with the full knowledge of the non-conformity of the goods and his right of rejection under the original contract. See Benjamin 20-111.

whether the buyer had a reasonable opportunity for examination of the goods as provided in Section 35(1)(b) of the SGA.⁸⁷ Also, whether the buyer has had a reasonable opportunity for examination of the goods is material for judging whether a reasonable time has elapsed.⁸⁸ Where the goods are sold for resale, the reasonable time to express rejection is normally the time taken for the buyer to resell the goods together with an additional period of time for the sub-buyer to both inspect and ascertain if they are fit for purpose.⁸⁹ In determining the reasonable time, the seller's conduct⁹⁰ or custom⁹¹ may also be considered.⁹²

If the *Cysteine case* were decided under English law, whether the buyer's resale of the goods to sub-buyers constituted the buyer's acceptance depends upon whether the buyer had a reasonable opportunity to examine the goods. The inspection clause in the contract stipulated that the goods must be inspected by the local office of CCIB at the port of destination and that the buyer must claim any compensation for the non-conformity of the goods within ninety days after the goods being unloaded together with the CCIB inspection certificate. As reasonable examination must take place within the period of ninety days from the date of unloading, the buyer's resale of the goods and his objection to the quality after 4 months from unloading clearly went beyond the agreed period. The buyer would have lost his right to reject the

⁸⁷ SGA Section 35(1) 'The buyer is deemed to have accepted the goods subject to subsection (2) below – (a) when he intimates to the seller that he has accepted them, or (b) when the goods have been delivered to him and he does any act in relation to them which is inconsistent with the ownership of the seller. (2) Where goods are delivered to the buyer, and he has not previously examined them, he is not deemed to have accepted them under subsection (1) above until he has had a reasonable opportunity of examining them for the purpose – (a) of ascertaining whether they are in conformity with the contract, and (b) in the case of a contract for sale by sample, of comparing the bulk with the sample.'

⁸⁸ SGA s.35(5) 'The questions that are material in determining for the purpose of subsection (4) above whether a reasonable time has elapsed include whether the buyer has had a reasonable opportunity of examining the goods for the purpose mentioned in subsection (2) above.'

⁸⁹ *Truk (UK) Ltd v Tokmakidis GmbH* [2001] 1 Lloyd's Rep. 534, 551. See Chitty 43-315.

⁹⁰ E.g. the seller's acquiescence for the seller's request of the extension of time. *Farnworth Finance Facilities Ltd v Attryde* [1970] 1 W.L.R. 1053.

⁹¹ *Sanders v Jameson* (1848) 2 C. & K. 557.

⁹² Chitty 43-315.

goods but should still have been entitled to claim damages under English law.⁹³ Also, the buyer's loss on 50% of the resale price as the damage suffered from the non-conformity of the goods would probably have been recoverable.

Under English law, the judgment of the *Jasmine aldehyde case* would probably have been the same as the Chinese decision but based on different reasoning. The buyer's resale of the goods would have been held to be inconsistent with the ownership of the seller. Nevertheless, the resale and delivery of the goods to the sub-buyer would not have been deemed to be the buyer's acceptance of the goods because the buyer did not have a reasonable opportunity to examine the goods until the goods had been delivered to the buyer's sub-buyer for seven days from unloading. The buyer's objection to the non-conformity on the same day as the goods reached his sub-buyer should fall within the reasonable time of examination. The buyer should be entitled to damages of US \$60,000 as promised by the seller.

In the author's view, the approach of English law is more predictable and consistent in ascertaining the reasonable time-limit for the buyer's examination of the goods and the consequence of the buyer's failure to raise any objection as to the conformity of the goods. The amended SGA combined with the interpretation of long-established English case law has shown the benefit of certainty, which is absent from the CISG.

3.2.2 Where the goods are sold on shipment terms, whether the buyer has dual rights to avoid the contract by rejecting the non-conforming goods and rejecting the non-conforming documents?

⁹³ Under English law, even if the buyer's right to terminate the contract based on the non-conformity of the goods is lost by his act of acceptance, his right to damages is not normally affected. *Ets. Soules & Cie. v International Trade Development Co. Ltd* [1980] 1 Lloyd's Rep. 129. Benjamin 19-150-151; Atiyah p.136. See *ante* 3.1.3 [b].

What is the relationship between the buyer's dual rights of rejection?

The seller's obligations to deliver the goods and tender the documents are both clearly identified in Article 30 of the CISG. When it comes to the buyer's right to avoid the contract, some doubts have occurred as to the buyer's right to reject the documents on the grounds that Article 49 of the CISG only refers to the buyer's right to avoid the contract by rejecting the goods. It is not clarified in the CISG as to whether the buyer can avoid the contract by rejecting the non-conforming documents and what the relationship is between the buyer's rights to reject non-conforming goods and to reject the non-conforming documents. It can be inferred from Article 30 that the buyer should have the right to avoid the contract by rejecting the non-conforming documents. However, the relationship between the buyer's dual rights of rejection is a crucial issue. It is especially important when only one mode of performance of the seller (e.g., the delivery of goods) complies with the contract whilst the other mode of performance of the seller (e.g., the tender of documents) does not comply with the contract. Under such circumstance, whether the buyer is entitled to accept one mode of performance and reject the other depends upon the relationship between the buyer's dual rights of rejection. Unfortunately, this issue is not clear in the CISG.

The Chinese cases have shown that some uncertainty exists in the relationship between the buyer's dual rights of rejection. In some cases, when neither the tendered documents nor the delivered goods conform to the contract, the Chinese tribunals have recognised the buyer's two separate rights to avoid the contract, which is by rejecting the non-conforming documents and by rejecting the non-conforming goods. In some other cases, when the goods are conforming and the documents are

not conforming to the contract, the Chinese tribunals has upheld that the buyer would not be entitled to avoid the contract based on the conformity of the goods, but the tribunals has refused to answer the question as to whether the buyer is still entitled to avoid the contract by rejecting the non-conforming documents.

The Chinese tribunal in the *Air purifiers case* recognised the buyer's dual rights of rejection to avoid the contract when the tendered documents and the delivered goods were both fundamentally defective.⁹⁴ In this case, the buyer bought three automatic purifiers from the seller to be delivered from New York to Shenzhen, China by road and air. The packaging of the goods was specified in the contract to satisfy the requirements of the international transportation. Payment was agreed to be made by an irrevocable L/C totalling US \$167,000: 90% of the L/C amount payable upon the presentation of the required documents after the goods arrived at the buyer's place of business, and 10% of the L/C amount payable upon the presentation of a quality confirmation certificate issued by the buyer after the goods had been inspected or ninety days from the date the goods arrived at the buyer's place of business. The goods arrived at Shenzhen on 5th January 1994. On 17th January 1994, the representatives of the seller and the buyer inspected the goods jointly and signed an Inspection Memorandum confirming the poor packaging and the wrong models of purifiers delivered. On 18th January 1994, the bank notified the buyer that the documents that the seller had tendered were not in compliance with the L/C and asked the buyer as to whether he would accept the non-conforming documents. The buyer declined and rejected the non-conforming documents. On 2nd March 1994, an inspection certificate was issued by the CCIB confirming the serious defects of the goods including the poor packaging, which was unsuitable for international

⁹⁴ Award of 17 April 1996 [CISG/1996/19] (*Air purifiers case*).

transportation and the incorrect diameters of the air pipes in the purifiers. On 15th March 1994, the buyer declared the contract avoided and claimed damages. However, the seller claimed that the defects of the goods were curable and not serious enough to constitute a fundamental breach. Based on the Inspection Memorandum and the Inspection Certificate, the Chinese tribunal confirmed that the seller's delivery of the non-conforming goods amounted to a fundamental breach and the buyer was entitled to reject the goods. The seller's failure to tender the quality certificate and some other documents required by the contract was also held to constitute a fundamental breach of contract, which entitled the buyer to reject the documents.⁹⁵ The buyer's exercising of his dual rights of rejection was held to be justified. The buyer's avoidance of contract was held to have been declared within a reasonable time as required by Articles 39, 26, and 49(2)(b)(i) of the CISG. The Chinese tribunal held the seller responsible for the cost incurred for the disposal of the goods, together with the buyer's inspection and L/C losses.

It was evident that the buyer's dual rights to reject the documents and reject the goods were identified and confirmed by the Chinese tribunal in *Air purifiers case*. Whether the buyer was entitled to avoid the contract by rejecting the documents depended upon whether the inconsistency of the documents constituted a fundamental breach of contract. Whether the buyer was entitled to avoid the contract by rejecting the goods depended upon whether the non-conformity of the goods constitutes a fundamental breach of contract. A contract may be avoided by the buyer's exercising of either of these two rights. They were identified as two separate rights to be judged upon the seller's two modes of performance.

⁹⁵ In the decision of *Air purifiers case*, whether the Chinese tribunal should judge the conformity of the tendered documents against the contract or the L/C is discussed in *ante* 2.2.3 [b].

In the *Leather gloves case*, where the seller's delivery of non-conforming goods was not serious enough to qualify for the buyer's rejection to avoid the contract, the question as to whether the seller's tender of the non-conforming documents entitled the buyer to avoid the contract by rejecting the defective documents was not mentioned by the Chinese tribunal in the judgment.⁹⁶ In this case, the buyer bought 5,000 dozens of leather gloves C.I.F. to be delivered from Shanghai to Hamburg. It was agreed that the total price of US \$45,375 would be paid by an irrevocable sight L/C. After the sample goods were inspected and confirmed by the buyer, the goods were shipped from Shanghai on 25th March 1995. After the seller tendered the documents for payment, the Bank of Germany rejected the documents due to the inconsistency between the documents and the L/C. The goods arrived at Hamburg on 29th April 1995. The buyer urged the seller to ask the notifying bank to release the documents and promised to make the payment within 24 hours of receipt of the goods. On 30th May 1995, the seller completed the bank procedure, released all the documents and the buyer took delivery of the goods. However, on the same day, the buyer refused to accept the goods or make payment due to some defects found in the goods. While the weight of each package for 10 dozen pairs of gloves was agreed in the contract as 15kg per box, each package delivered by the seller weighed less than 11kg. Despite the seller's offer to exchange the goods, the buyer unilaterally sold the goods at a discount price to mitigate his loss. The Chinese tribunal did not hold the defects of the goods as serious enough to constitute a fundamental breach and thus entitle the buyer to reject the goods and avoid the contract.⁹⁷ The buyer's action to avoid the contract was held to be unjustifiable and that action amounted to a

⁹⁶ Award of 26 November 1998 [CISG/1998/06] (*Leather gloves case*).

⁹⁷ Whether the discrepancy of the quality defects should have been held to constitute the fundamental breach of contract in this case is discussed in *ante* 2.2.3[a].

fundamental breach of contract. The buyer was held to be responsible for the payment of the price and the seller's damages.

In this decision, the issue as to whether the seller's tender of defective documents gave the buyer the right of rejection to avoid the contract was ignored by the Chinese tribunal. In the absence of some relevant facts, this raises some doubts for the author. What inconsistencies of the documents tendered by the seller caused them to be rejected by the Bank of Germany? After the buyer accepted the documents outside of the L/C under a separate agreement with the seller, had the buyer lost his right to reject the non-conformity of the documents? If some serious defects of documents were hidden and not noticeable in the documents tendered by the seller, the buyer could still have had the right to reject the defective documents and to avoid the contract after he accepted the documents before taking delivery of the goods, in spite of the fact that the non-conformity of the goods was not serious enough to qualify for the right of rejection. Unfortunately, neither of these questions was addressed and answered by the Chinese tribunal.

From the analysis of these two cases, the Chinese tribunals clearly had some hesitation in recognising the relationship between the buyer's dual rights to reject the goods and reject the documents. It was doubtful in these Chinese decisions whether these two rights of rejection could be exercised separately and independently from each other under the CISG. The answer in the *Air purifiers case* appeared to be positive. The buyer was held to be entitled to avoid the contract by the exercising of two separate rights of rejection, i.e., by rejecting the non-conforming documents and by rejecting the non-conforming goods. In contrast, the answer in the *Leather gloves case* appeared to be negative. When the buyer's right of rejection to one mode of the seller's performance, i.e., the delivery of goods, was not justified, it was disregarded

as to whether the buyer would be still eligible to reject the other mode of performance, i.e., the tender of documents. The fundamental cause of the unpredictability of the Chinese tribunals' position stems from the absence of a clarification under the CISG as previously mentioned. The Chinese tribunals had to rely upon their own understanding. Therefore, the judgments of individual tribunals would inevitably result in unpredictable decisions.

If the aforementioned cases had been decided under the FECL, the results would probably have been the same. As mentioned before, the buyer's right to cancel the contract only refers to the seller's breach of general contractual obligation under Article 29 of the FECL. The buyer's dual right to cancel the contract by rejecting the documents and rejecting the goods were not clarified under the CISG at all. In the author's view, given the legislative history, that the FECL was based upon the CISG and the similar legislative status between these two laws, it is doubtful that the application of the FECL would have made any difference than that of the CISG.

If English law had been applied in these cases, the decisions would have been predictable. The relationship between the buyer's dual rights of rejection is clear under English law.⁹⁸ The exercising of the buyer's dual rights to reject the goods and reject the documents is generally held to be separate and independent from each other.⁹⁹ In the *Air purifiers case*, the outcome of the application of English law would have been similar to that of the Chinese decision. Under English law, the seller is obliged to deliver the goods conforming to the contractual descriptions, the sample and to be of satisfactory quality.¹⁰⁰ The seller's delivery of non-conforming

⁹⁸ See *ante* 3.1.3 [c].

⁹⁹ *James Finlay & Co. Ltd v Kwik Hoo Tong* [1929] 1 K.B. 400 at p.414; *Twei Tek Chao v British Traders and Shippers Ltd* [1954] 2 QB 459. See *ante* 3.1.3 [c].

¹⁰⁰ SGA s. 13, 14, 15.

goods with serious defects in this case entitled the buyer to reject them.¹⁰¹ Where payment was agreed to be made upon presentation of the documents under the L/C, the seller's failure to tender the quality certificate required by the L/C constituted a breach of condition and entitled the buyer to reject the non-conforming documents.¹⁰² In the *Leather gloves case*, the application of English law would have been different from that of the CISG. Under English law, the buyer's delivery of defective goods that are inconsistent with the quality description agreed in the contract should constitute a breach of condition and entitle the buyer to reject the goods.¹⁰³ Even if the non-conformity of the goods is not serious enough to breach a condition of the contract to justify the rejection of the goods, the buyer should still be entitled to terminate the contract by rejecting the non-conforming documents when the defects of the documents justify the right of rejection.¹⁰⁴ The buyer's acceptance of documents on tender with hidden defects should not preclude his right to reject the documents later when the buyer has learned of such defects in the documents upon delivery of the goods.¹⁰⁵ Unfortunately, such important reasoning regarding the buyer's dual rights of rejection was ignored in the judgment of the *Leather gloves case*.

Conclusion

From the discussion above, neither of the questions raised by the author above has been answered consistently by the Chinese tribunals. This unpredictability is mainly caused by the lack of clarity of the avoidance rule under the CISG. The

¹⁰¹ Ibid.

¹⁰² *The Hansa Nord* [1976] 1 QB 44, 70B. Debattista 9-11.

¹⁰³ SGA s. 11(3), 13.

¹⁰⁴ *The Hansa Nord* [1976] 1 QB 44, 70B; *Twei Tek Chao v British Traders and Shippers Ltd* [1954] 2 QB 459.

¹⁰⁵ Debattista 9-21.

interpretations of individual tribunals without a unified guidance from the CISG have led to conflicting decisions.

The first question raised was *where the seller delivers defective goods, by what point in time must the buyer examine the goods and what are the consequences if the buyer fails to raise any objection as to the non-conformity of the goods?* The avoidance rule of the CISG only provides for the buyer's obligation to examine the goods within a reasonable time and the consequence of the buyer's examination beyond the time-limit, which is to deprive the buyer of the right to rely on the non-conformity of the goods. There is no further explanation as to how to assess the reasonable time-limit and how to ascertain the buyer's loss of the right to reject goods, especially when the buyer has resold the goods. The Chinese decisions have shown serious unpredictability in judging the buyer's loss of the right to avoid the contract. In the *Cysteine case*, the buyer's resale without examining the goods was held as an action inconsistent with the seller's ownership, which constituted the buyer's acceptance and the loss of the buyer's right to reject the goods and avoid the contract. In contrast, in the *Jasmine aldehyde case*, the buyer's resale was held to be an action not inconsistent with the seller's ownership and not to constitute the buyer's acceptance of the goods. The buyer did not lose his right to reject the goods and avoid the contract by his action of resale. In contrast, English law has developed comprehensive rules as to the buyer's loss of the right to terminate the contract. The buyer is not deemed to have accepted the goods merely based upon his action of resale. Whether the buyer has accepted the goods by resale under English law depends upon whether the buyer had a reasonable opportunity to examine the goods. It should be noted that the time taken for the buyer to resell the goods, together with an additional period for the sub-buyer's inspection and testing, is normally taken into

account when ascertaining a reasonable time for rejection of the goods. The potential for the decisions made under English law based on the facts of these two cases are likely to be predictable.

The second question raised was *where the goods are sold on shipment terms, whether the buyer has dual rights to avoid the contract by rejecting any non-conforming goods and rejecting any non-conforming documents and what is the relationship between the buyer's dual rights of rejection*. The avoidance rule of the CISG only refers to the avoidance of contract by rejection of the goods. The avoidance of contract by rejecting the documents and the relationship between the buyer's dual rights to reject the goods and reject the documents are not addressed in the CISG. As a result, some conflicting decisions have been made in the Chinese cases as to the relationship between the buyer's dual rights of rejection. In the *Air purifier case*, the Chinese tribunal appeared to hold the buyer's dual rights to reject the non-conforming goods and reject the non-conforming documents as two separate rights, where the non-conformity of the goods and the non-conformity of the documents both constituted a fundamental breach of contract. In the *Leather gloves case*, the Chinese tribunal did not appear to regard the buyer's dual rights of rejection to be separate or independent from each other. Where the non-conformity of the goods was not considered to qualify for rejection, the buyer was not entitled to avoid the contract, regardless of whether the non-conformity of the documents entitled the buyer to avoid the contract by rejecting the defective documents. By contrast, under English law, the buyer's dual rights of rejection are generally regarded as separate and independent. The buyer's potential right to terminate the contract by rejecting the non-conforming documents would have been considered by the English court and

may well have led to different conclusion from that of the Chinese tribunal in the *Leather gloves case*.

With regard to all the issues raised, the application of the FECL would not have made any difference from the application of the CISG in the Chinese decisions. It was due to the legislative history of the FECL as previously discussed. There is no provision in the FECL to address either of the issues raised above.

In the author's view, the clarification of the avoidance rule of the CISG is the best solution that would lead to predicable judgments by individual tribunals of contracting states. The achievement of this aim has to rely on the effort of the United Nations Commission on International Trade Law (UNCITRAL) and the cooperation of the contracting states of the CISG, depending upon how determined they are to achieve the unified application of the CISG.

CHAPTER 4

DAMAGES FOR BREACH OF CONTRACT

Introduction

In the international sale of goods, once a contract is breached, damages are one of the most common remedies that the injured party claims from the breaching party. The injured party would require the breaching party to remedy the damages resulting from the breach of contract. Therefore, the knowledge of the damage rules under the applicable law is crucial to the interests of the contracting parties. An effective damage rule should offer the contracting parties with a predictable outcome. In other words, it should be clear to the contracting parties about what damages are recoverable and when they are recoverable.

The purpose of this chapter is to find out whether Article 74 of the CISG, as the basic damage rule has proven to be effective in China. The predictability of the Chinese judgments in granting damages is examined because the predictability is an important criterion for judging the effectiveness of a law. English law and the PRC Foreign-Related Economic Contract Law (FECL) are compared with the CISG in order to see which regime works more consistently.

The first section of this chapter examines the relevant provisions of the damage rules under these three regimes to illustrate their similarities and differences. The second section of this chapter analyses some Chinese cases to assess the consistency of the categorisation of the compensable losses and the predictability of the awarded damages in different circumstances by the Chinese tribunals. English law is also analysed in the study to see whether it would have provided more predictable results,

had it been applied in place of the CISG. The author will consider the judgments made in the Chinese cases reviewed here and assess if any unpredictability that have arisen may have been better served under an alternative regime.

4.1 Comparison on the damage rules under the three regimes: CISG, FECL and English law

In this part, the author looks into the damage rules under the CISG, FECL and English law with regard to the following aspects: [a] What are the relevant provisions of the damage rules under the three regimes? [b] Are they similar or different? If they are similar, what do they have in common; and if they are different, what are the differences?

Firstly, this chapter begins with a quotation of the relevant provisions of the three regimes under discussion. In general, the damage rule consists of two main concepts: the principle of full compensation and the limitation of damages.¹ Under the principle of full compensation, the author compares the categorisation of compensable losses between the CISG, FECL and English law. Under the limitation of damages, the author compares the causation and foreseeability tests of the CISG with the causation and remoteness tests of the SGA. The comparison of the foreseeability test and the remoteness test is focused on the following aspects: which party's foreseeability or contemplation is material for limiting the breaching party's liability;² when the loss must be foreseeable or contemplated; what degree of probability is required for the breaching party to foresee or contemplate such a loss; what degree of knowledge the breaching party needs to have to be liable for the loss

¹ See *Commentary on the UN Convention on the International Sale of Goods (CISG)*, Peter Schlechtriem, (2nd ed. 2005) ['Schlechtriem'] p.746.

² The 'contemplation' is the word that is used in the remoteness test of English law; and the 'foreseeability' is the word used in the foreseeability test of the CISG and the FECL.

resulting from his breach; and what is the object of the foreseeability or contemplation.³

4.1.1 Relevant provisions of the damage rules under the three regimes

Article 74 of the CISG is the basic rule for calculating damages under the CISG.⁴ The first part of Article 74 states that: '*Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach*'. This is generally considered as a reflection of the principle of full compensation despite the precise wording of 'full compensation' not being explicitly mentioned in this Article.⁵ The second part of Article 74 states that: '*Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of the contract*'. This specifies the foreseeability rule as a method to limit the breaching party's liability under the CISG.

Article 19 of the FECL is the rule for assessing the damage before the CISG was adopted by China.⁶ It appears similar to Article 74 of the CISG: '*The liability of a party to pay compensation for the breach of a contract shall be equal to the loss*

³ *Remedies for Breach of Contract - a Comparative Account*, G. H. Treitel, (1988) ['Treitel'] p.150-162.

⁴ Schlechtriem p.746.

⁵ *ibid*; AC Opinion No.6 <http://cisgw3.law.pace.edu/cisg/CISG-AC-op6.html>; Article 7.4.1 of UNIDROIT Principles of International Commercial Contracts uses the precise wording of 'full compensation': 'The aggrieved party is entitled to *full compensation* for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance of cost or harm'.

⁶ The PRC Foreign-related Economic Contract Law validated from 1st July 1985 to 30th September 1999 and has been replaced by Contract Law of the People's Republic of China (CCL) since 1st October 1999.

suffered by the other party as a consequence of the breach. Such compensation may not exceed the loss which the party responsible for the breach ought to have foreseen at the time of the conclusion of the contract as a possible consequence of a breach of contract.' The first part of Article 19 of FECL, like the first part of Article 74 of the CISG, reflects the principle of full compensation. The second part of Article 19 of the FECL, like the second part of Article 74 of the CISG reflects the foreseeability rule. The reason for such similarity arises from the legislative background of the FECL,⁷ and the FECL was drawn up based on the draft of the CISG to prepare China for the ratification of the CISG.⁸ Despite the existence of some minor differences, e.g., by omitting the provisions of '*loss of profit*' and '*in light of the facts and matters of which he then knew or ought to have known*', these provisions were normally implied by the Chinese tribunals when applying Article 19 of the FECL.⁹ Thus, the comparison of the damage rules under the three regimes in this chapter is only between the CISG and English law because there is no substantive difference between Article 74 of CISG and Article 19 of FECL.

Sections 50(2), 51(2), 53(2) and 54 of the Sale of Goods Act 1979 (SGA) are the counterpart of Article 74 of the CISG in English law. Sections 50(2), 51(2) and 53(2) lay down the basic rule for calculating damages, i.e., the principle of full compensation and the remoteness test. Section 50(2) regulates the seller's damages resulting from the buyer's non-acceptance: '*the measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the buyer's breach of contract*'. Section 51(2) regulates the buyer's damages resulting

⁷ See the history background of the FECL introduced in *ante* 1.1.

⁸ See Fan Yang, 'The application of the CISG in the Current PRC Law and CIETAC Arbitration Practice' http://www.njcl.utu.fi/2_2006/Article4.htm.

⁹ Article 113 of the Contract Law of PRC (CCL) revised the Article 19 of FECL and made up the spelling difference from '*loss of profit*' by adding the '*including the interests receivable after the performance of the contract*' despite the omission of '*in the light of the facts and matters of which he then knew or ought to have known*'.

from the seller's non-delivery: *'the measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the seller's breach of contract'*. Section 53(2) regulates the remedy for the breach of warranty: *'the measure of damages for breach of warranty is the estimated loss directly and naturally resulting, in the ordinary course of events, from the breach of contract'*. The statement of the *'damage is the ... loss ... resulting from the ... breach of contract'* reflects the principle of full compensation, despite the simpler wording compared with Article 74 of the CISG. The statement of *'directly and naturally resulting in the ordinary course of events'* is the provision of the remoteness test as a limitation to the principle of full compensation. Section 54 further provides that the buyer or the seller can also recover the loss of interest and special damages,¹⁰ i.e., *'Nothing in this Act affects the right of the buyer or the seller to recover interest or special damages in any case where by law interest or special damages may be recoverable, or to recover money paid where the consideration for the payment of it has failed'*.

4.1.2 Similarities of the damage rules under the three regimes

[a] Principle of full compensation

The damage rules under the three regimes all contain the principle of full compensation. Following the Anglo-American rule of strict liability, a defaulting party is obliged to be liable for all the losses arising from his breach of contract,

¹⁰ e.g., for unusual loss arising from special circumstances known to the seller, or in particular circumstances the loss of profit under a resale: see *Benjamin's Sale of Goods*, Judah Philip Benjamin, (7th ed. 2006) ['Benjamin'] 17-001.

irrespective of his fault.¹¹ The purpose is to put the aggrieved party, as far as money can do, in the same financial position as if the breach had never occurred and the contract had been properly performed.¹² The aggrieved party has the right to be fully compensated for all the disadvantages resulting from the other party's breach and for his loss of the benefit from the bargain¹³. The suffered loss and the loss of profits are both compensable under the principle of full compensation in the three regimes.¹⁴

[b] Limitation of damages

Different methods have been adopted by the CISG, FECL and SGA to limit the breaching party's liability on the grounds that the principle of full compensation places too heavy a burden on the breaching party.¹⁵ The main limitation methods under the CISG and the FECL are the foreseeability test and the mitigation rule, whilst the main limitation methods under English law are the remoteness test and the mitigation rule.¹⁶

¹¹ Treitel p.346. The only exception of liability is the claimant's contributory negligence or force majeure because the causation between the breach and the damage is broken by such interruptions. The CISG: see Articles 79 and 80 and Schlechtriem p.746. The English position: see *Chitty on Contracts*, A. G. Chitty, (30th ed. 2008) ['Chitty'] 26-037-038; Benjamin 16-051; *Lambert v Lewis* [1982] A.C. 225 HL; *Beoco Ltd v Alfa Laval Co Ltd* [1995] Q.B. 137. The force majeure clause is treated by the English court with scepticism and it is rarely successfully claimed by the defaulting party, unless the event falls precisely within such a clause. See *The Marine Star* [1994] 2 Lloyd's Rep.629.

¹² *Robinson v Harman* (1848) 1 Ex 850, 855 per Parke B; AC Opinion No.6 see *ante* fn.5; Chitty 26-001; Treitel p.82.

¹³ See Treitel p.82; Farnsworth, 'Damages and Specific Relief', 27 *American Journal of Comparative Law* (1979) 247-253.

¹⁴ The loss of profits is explicitly specified in Article 74 of the CISG. It is omitted in the provision of Article 19 of FECL but the Chinese tribunals always treat the loss of profit as a normal recoverable damage. Under English law, the lost profit is generally treated as special damages recoverable under s.54 of the SGA subject to the remoteness test. e.g., *H. Parsons (Livestock) Ltd v Uttley, Ingham & Co Ltd* [1978] Q.B.791, 802-803; *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 K.B. 528.

¹⁵ Treitel chapter VI: several principal techniques developed by some other different legal systems are the following: fault, foreseeability, causation, judicial discretion, mitigation, certainty and specific limitations (e.g., injured feelings, non-payment of money and failure to make title to land).

¹⁶ See David McLAUCHLAN, 'Some Issues in the Assessment of Expectation Damages Under English law, presentation on the Conference of Contract Damages: Domestic and International Perspectives', 28-29 June 2007. The claimant is entitled to recover his loss of bargain subject to the rules on remoteness test and mitigation of damage and this principle is commonly referred as the

(i) Causation

The three regimes all require causality between the defendant's breach of contract and the claimant's loss,¹⁷ but the requirement of causation only plays a subsidiary role, i.e., it is not the main method used for limiting the breaching party's liability. Under the CISG and the FECL, the breach, as the occurrence of a harmful event is in principle sufficient enough for claiming damages (*condition sine qua non*, the 'but for' rule).¹⁸ It is immaterial whether the breach is the direct or indirect cause of the loss for the recovery of damages under the CISG.¹⁹ The question of whether the loss is compensable is decided by the foreseeability rule in the second part of Article 74 of the CISG.²⁰ In English law, the requirement of causation is often ignored and confused with the remoteness test.²¹ Thus, when it comes to the recovery of certain loss, the English court would normally ignore whether the loss is directly or indirectly caused by the breach, but only consider whether the damage falls within the reasonable contemplation of the breaching party when the contract is concluded.²²

Robinson v Harman principle. The mitigation rule is provided in Article 77 of the CISG. It is not covered in this chapter but is discussed in Chapter 5 of the thesis.

¹⁷ Article 74 of the CISG: '...loss...as a consequence of the breach...'; sections 50(2), 51(2) and 53(2) of the SGA: 'damage is the...loss...resulting from the ...breach of contract'; Article 19 of the FECL: '...loss...as a consequence of the breach'. None of the CISG, FECL or English law has identified a formal test for the causation test, thereby potentially leaving some uncertainty in its ascertainment. The determination of causation in English law relies on 'the court's common sense' and that in the CISG is left under the tribunal's discretion. See *Galoo v Bright Grahame Murray* [1994] 1 W.L.R. 1360.at 1374-1375; See *McGREGOR On Damages*, McGREGOR, (17th ed. 2003) ['McGregor']: 6-125; See Chitty 26-032.

¹⁸ Schlechtriem p.759.

¹⁹ Schlechtriem p.759; Fritz Enderlein, Dietrich Maskou, 'International Sales Law' ['Fritz'] <http://cisgw3.law.pace.edu/cisg/biblio/enderlein.html>.

²⁰ Schlechtriem p.759.

²¹ Chitty 26-032; McGregor 6-125; Benjamin 16-049. The separate existence of causation is made particularly clear by *Monarch S. S. Co. v Karlshamns Oljefabriker* [1949] A.C. 196. The causation plays an important role in tort under English law.

²² Treitel p169.

(ii) Foreseeability test and remoteness test

The means of limiting the breaching party's liability is the foreseeability test as provided in Article 74 of the CISG and Article 19 of the FECL. The means of limitation under English law is the remoteness test as provided in Sections 50(2), 51(2), 53(2) of the SGA.²³ It is widely believed that English law has adopted the foreseeability test as a result of the civil law through the test of remoteness in the leading case of *Hadley v Baxendale*,²⁴ subject to some changes.²⁵ The 'natural' result is the counterpart of the 'foreseeable' consequence.²⁶ The SGA is the codification of *Hadley v. Baxendale* and the phrase of 'directly and naturally resulting in ordinary course of events'²⁷ is the counterpart of the provision of 'foresaw or ought to have foreseen...as a possible consequence' in Article 74 of the CISG. It is not so clear whether the foreseeability test in the CISG originated as a civil law concept or resulted from the influence of the common law.²⁸ The foreseeability test of the CISG and the FECL and the remoteness test of English law have similarities in the following aspects: *whose foreseeability or contemplation matters for the limitation of the recoverable damages, when the loss must be foreseeable or contemplated by the breaching party, and what degree of knowledge the breaching party needs to have for being held to be liable for the loss resulting from his breach.*

Firstly, in both the foreseeability test and the remoteness test under the three regimes, it is the breaching party rather than the injured party whose foreseeability or contemplation limits the amount of the recoverable damages. Article 74 of the CISG

²³ Mitigation is another main means adopted by the CISG, FECL and English law for limiting the recovery of damages. It is discussed in Chapter 5 of this thesis.

²⁴ (1854) 9 Ex. 341. The foreseeability rule was described as a 'sensible rule' in this case, although the foresight or foreseeability was not explicitly referred to by the judges.

²⁵ e.g., the exclusion of 'fraud' from French law. Under English law, the liability of contract is strict liability, irrespective of the fault of the parties: Treitel p.151.

²⁶ See Treitel p.151.

²⁷ SGA: s. 50(2), s. 51(2), s. 53(2).

²⁸ See Treitel p.153.

stipulates that it is ‘the party in breach’. Article 19 of the FECL specifies that it is ‘the party responsible for the breach’. English law does not give explicit guidance in the SGA but illustrates the issue in the case law.²⁹ In *Victoria Laundry*, the court clearly stated that what was foreseeable depended upon the knowledge ‘possessed by the parties or, at all events, by the party who later commits the breach’.³⁰ Although in *Hadley v Baxendale*,³¹ the court referred to ‘the contemplation of both parties’, what the court really tried to emphasize was that the contemplation by the injured party is not enough to satisfy the test for remoteness. The logic behind such similar provisions under the three regimes is the reciprocal allocation of business risk, i.e., the defendant only undertakes the responsibility for the consequence of his breach for the promise commensurate with his knowledge appropriate to the circumstances and the claimant takes the risk of any other consequences.³²

Secondly, in both the foreseeability test and the remoteness test under the three regimes, the breaching party’s foreseeability or contemplation is judged by the time when the contract was made. Article 74 of the CISG and Article 19 of the FECL provide that it is ‘at the time of the conclusion of the contract’. This issue is not clearly identified in the SGA but has been clarified in English case law. In *Hadley v Baxendale*, the court explicitly referred to ‘the time when the contract was made’ as the time when the loss should fall within the contemplation of the parties.³³ In *Victoria Laundry*,³⁴ it was held that the defendant’s actual knowledge of the special circumstances, which makes him liable for the exceptional losses, must have been had by the defendant ‘at or before the making of the contract’. Also, these similar

²⁹ See Treitel p.159.

³⁰ *Victoria Laundry*, see *ante* fn.14.

³¹ (1854) 9 Ex. 341, 354.

³² See Chitty 26-051.

³³ (1854) 9 Ex.341, 355.

³⁴ *Victoria Laundry* see *ante* fn.14.

positions under the three regimes are based on the reciprocal allocation of risk.³⁵ It is only fair for the defendant before entering the contract to be offered an opportunity to decide whether to take the risk of certain loss and charge proportionately to that degree of any extra responsibility.³⁶

Thirdly, in the foreseeability and the remoteness test under the three regimes, the degree of knowledge that the breaching party needs to have for being liable for the loss resulting from his breach include both objective knowledge and subjective knowledge, despite the phrasing of the CISG, FECL and SGA appearing differently. The ‘objective knowledge’ is the facts and matters that a reasonable man ought to have known in the ordinary course of things.³⁷ The ‘subjective knowledge’ is the facts and matters that the breaching party actually knew at the time when the contract was concluded.³⁸ The party should be liable for the loss resulting from his breach if he knew or ought to have known the facts or matters on conclusion of the contract. Article 74 of the CISG provides that the foreseeability must be established ‘in the light of the facts and matters of which he then *knew or ought to have known*’. Article 19 of the FECL only specifies the objective knowledge as ‘the loss which the party responsible for the breach *ought to have foreseen*’, but the Chinese tribunals may also apply the breaching party’s subjective knowledge for judging the recoverable damage in their judgments. In the SGA, the objective knowledge falls within the scope of ‘directly and naturally ... in the ordinary course of events’ as provided in Sections 50(2), 51(2) and 53(2). The subjective knowledge is provided for in Section 54 of the SGA stating that the breaching party is liable for special damages resulting

³⁵ Chitty 26-051.

³⁶ *Sale of Goods*, Michael Bridge (2nd ed. 1997) [‘Michael Bridge’] p.542 and Treitel p.159

³⁷ Djakhongir Saidov ‘Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods’ <http://cisgw3.law.pace.edu/cisg/biblio/saidov.html> (‘Djakhongir Saidov’); *Hadley v. Baxendale* (1854) 9 Ex.341, 355.

³⁸ *Ibid.*

from his breach if he had actual knowledge of the special circumstances on the conclusion of the contract.³⁹ This has been comprehensively discussed in *Hadley v Baxendale*.⁴⁰ The objective knowledge is normally based upon the experience of the party as the ‘merchant’, taking the circumstances of individual cases into account.⁴¹ The subjective knowledge is not very easy to ascertain and therefore may lead to potential uncertainty.⁴² It depends upon ‘some knowledge and acceptance by one party of the purpose and intention of the other in entering into the contract’⁴³ In other words, the breaching party is only liable for the loss when he was actually informed of the special circumstances and he expressly accepted such a risk at the time of contract.⁴⁴ The breaching party’s mere knowledge of an unusual loss at the time of contract is not generally accepted to be sufficient to hold the party liable if he can prove that either he did not wish to or a reasonable man in the same position would not have accepted the risk of such a loss.⁴⁵ In *The Achilles*,⁴⁶ the House of Lords adopts a new approach of remoteness test in contract, i.e., the agreement centred test. It requires the court to identify the ‘common expectation’ of the parties, ‘objectively assessed, on the basis of which the parties are entering into their contract’,⁴⁷ i.e.,

³⁹ See Benjamin 16-046.

⁴⁰ (1854) 9 Ex.341, 355. Two limbs of the rules are distinguished in *Hadley v Baxendale*: The defendant is liable for the loss which (1) any reasonable person in his position could have contemplated (2) a reasonable person with the same knowledge of the special circumstances as the defendant had could have contemplated. Two kinds of losses are referred to in the rule of *Hadley v Baxendale*: (1) losses ‘arising naturally’ (2) losses which ‘may reasonably be supposed to have been in the contemplation of the parties’.

⁴¹ Djakhongir Saidov: see *ante* fn. 37.

⁴² The mechanism for judging the actual knowledge is provided by Article 8 of the CISG, referring to the ‘statements’ and ‘other conduct’ of the party (Article 8(2)) and together with the interpretation of ‘statements and conducts’ (Article 8(3)). Such method can serve as the important indicators of the knowledge that the breaching party had at the contracting time: Djakhongir Saidov: see *ante* fn. 37.

⁴³ *Ibid.* See Treitel, p.156; *Weld-Blundell v. Stephens* [1920] A.C.956, 980: In deciding whether a fact is considered as having been known, a right balance has to be ascertained in relying on the available sources. The proportion of each source of the information contributed to the formation of the party’s knowledge has to be assessed and the specific circumstances of particular case should be decisive.

⁴⁴ Djakhongir Saidov: see *ante* fn. 37.

⁴⁵ See Chitty 26-063-063A; Cf. *Robophone Facilities Ltd v Blank* [1966] 1 W.L.R. 1428,1437,1448; *Koufos v. C. Czarnikow Ltd* [1969] 1A.C. 350 at 385.

⁴⁶ *Transfield Shipping Inc v Mercator Shipping Inc (The Achilles)* [2008] UKHL 48.

⁴⁷ *Ibid.* Lord Walker of Gestingthorpe at [78].

what the parties would ‘reasonably have considered the extent of the liability they were undertaking’.⁴⁸ This approach assists certainty of the remoteness test by identifying the parties’ intention as a whole against its commercial background and it prevents the uncertainty of the old ‘external rule of policy’ approach in determining how likely or usual a loss must be for it to be recoverable.⁴⁹

4.1.3 Differences of the damage rules under the three regimes

[a] Principle of full compensation: the categorisation of compensable losses

Article 74 of the CISG and Article 19 of the FECL only describe an obscure concept of full compensation and fail to define the compensable loss in greater detail.⁵⁰ The lack of the provision for categorising the compensable losses leaves some uncertainty in ascertaining what losses are recoverable under the CISG or the FECL.⁵¹ The SGA lays down the rules for damages by the circumstances of *the seller’s non-delivery*,⁵² *defective delivery*,⁵³ *delayed delivery*⁵⁴ and *the buyer’s non-acceptance*.⁵⁵ The compensable losses are generally categorised by the different protected interest in English case law, i.e., the expectation interest, reliance interest and performance

⁴⁸ Ibid. Lord Hoffmann at [23].

⁴⁹ Adam Kramer, ‘Case Comment – The new test of remoteness in contract’, *Law Quarterly Review* (2009) 408.

⁵⁰ There is a view that there is a literal categorisation of losses in Article 74 of the CISG: actual losses (the decrease of the assets which existed at the contracting time) and loss of profit (the increase of the assets which was prevented by the breach of contract): Schlechtriem p.752 and Djakhongir Saidov: see *ante* fn. 37.

⁵¹ This is a reason why some contracting states of the CISG are holding conflicting decisions as to whether some losses are covered by Article 74. See *ante* 4.2.

⁵² SGA s.51

⁵³ SGA s.53

⁵⁴ The SGA does not have express provisions for the assessment of the damages when the seller fails to deliver the goods by the fixed date or when the buyer takes delivery late. This circumstance would probably fall within the general provision of s. 53(2) of the SGA: See Benjamin 17-038.

⁵⁵ SGA s.50

interest etc.⁵⁶ The expectation interest is the interest that the claimant would have benefited from the proper performance of the contract and was prevented from doing so by the defendant's breach of contract.⁵⁷ The reliance interest is the expenditure that the claimant reasonably incurred by reliance on the promised performance.⁵⁸ The performance interest is the interest existing in the performance of the contract and it is 'not readily measurable in terms of money'.⁵⁹ The discussion of the different compensable losses in this chapter is based upon the categorisation of the protected interest, the same as the method adopted by English law, i.e., the expectation loss, the reliance loss and the consequential loss. The expectation loss is normally the claimant's primary or direct loss,⁶⁰ arising from his loss of expectation interest.⁶¹ The reliance loss and the consequential loss are both based on the loss of reliance interest and the difference between them at the time of occurrence, i.e., the reliance loss occurs before the breach of contract and the consequential loss occurs after and as the result of the breach of contract.⁶² The reliance loss is the expenditure that the claimant spent in gaining the benefit in reliance on the performance of contract by the defendant and that is lost as the result of the defendant's breach.⁶³ The purpose for claiming the reliance loss is not to recover the expectation losses, but to revert the situation as if the contract had never existed. The claimant would not normally claim

⁵⁶ Chitty 26-002, 26-003.

⁵⁷ Chitty 26-002.

⁵⁸ *Ibid.* It is noticeable that under English law it is not clear whether the claimant is allowed to recover his damages in respect of both expectation interest and reliance interest, and how far he can recover such damages.

⁵⁹ *Att.-Gen. v Blake* [2001] 1 A.C. 268, 282; Chitty 26-003. It is argued by some scholars that the wider recognition of the performance interest would undermine some basic rules of the current law, e.g., mitigation.

⁶⁰ Schlechtriem p.753.

⁶¹ See Treitel p.82-88, Relationship between expectation, reliance and restitution p.88-105; Schlechtriem p.746. The expectation loss entails the compensable losses, such as the price differences, the loss of profit and the loss of interest. It is further discussed in 4.2 of this chapter.

⁶² The reliance loss entails the losses, such as the expenses wasted for buying materials and making products, delivering the goods in vain or preserving or storing the goods, booking space with the carrier, opening and amending L/C and inspecting goods etc. See *ante* 4.2.

⁶³ Chitty 26-072; Schlechtriem p.746

such a loss unless he cannot prove the loss of profit or when the contract is actually unprofitable.⁶⁴ The consequential loss goes beyond the expectation loss. It is normally suffered through the specific arrangements made by the claimant when the contract was concluded.⁶⁵

[b] Limitation of damages: the foreseeability test and the remoteness test

The foreseeability test of the CISG and FECL and the remoteness test of English law are distinguished by the following aspects: *what degree of probability is required for the breaching party to foresee or contemplate the loss resulting from his breach and what must be foreseen or contemplated by the breaching party at the time of contract.*⁶⁶

The *degree of probability* is the criterion used to ascertain the possibility that the loss resulting from a breach of contract falls within the foreseeability or the contemplation of the breaching party or a reasonable man in the same position.⁶⁷ The function of the degree of probability is to control the capacity of the defendant's foresight or contemplation by law: if the capacity is set too high (in other words, the degree of probability is set too low), the defendant would be liable for a consequence that a reasonable man would not have been liable for and it would impair the function of the remoteness rule, which is to limit the defendant's liability. The degree

⁶⁴ Treitel p.82-88: Relationship between expectation, reliance and restitution p.88-105. See also Chitty 26-072-077

⁶⁵ Schlechtriem p.753, 767. Chitty 26-078. The consequential loss entails the compensable losses, such as the buyer's liability to sub-buyer, the seller's storage and transportation expenses before resale, the repair cost and the litigation expenses. For further discussion, see *ante* 4.2.

⁶⁶ Treitel p.150-162.

⁶⁷ See Chitty 26-059.

of probability required by English law⁶⁸ is higher than the CISG and the FECL.⁶⁹ English law requires the degree to be ‘*as a probable result*’,⁷⁰ of the breach of contract and the CISG and the FECL requires the degree to be ‘*as a possible consequence*’ of the breach of contract.⁷¹ The higher degree of probability was extensively discussed by House of Lords in the *Heron II*⁷² and a variety of phrases were used by the judges to interpret the English standard: ‘not unlikely’⁷³, ‘not unlikely to occur’⁷⁴, ‘a real danger’ or ‘a serious possibility’⁷⁵. The ‘possible consequence’ in the foreseeability test of the CISG and the FECL appears easier to be contemplated than the ‘probable result’ in the remoteness test of English law. There is an increased likelihood that the defaulting party will be held liable for the loss resulting from his breach under the CISG and the FECL than under English law. In the author’s view, the broadness for liability under the CISG exposes the breaching party to less protection and decreases the effect of the foreseeability rule as a means for limiting the breaching party’s liability.

⁶⁸ Sections 50(2), 51(2) and 53(2) of the SGA do not give any guidance but English common law provides persuasive authorities.

⁶⁹ Jacob S. Ziegel, ‘Report to the Uniform Law Conference of Canada on Convention on Contracts for the International Sale of Goods’ <http://cisgw3.law.pace.edu/cisg/text/ziegel25.html>; E. Allan Farnsworth, ‘Damages and Specific Relief’, 27 *American Journal of Comparative Law* (1979) 247-253; Franco Ferrari, ‘Comparative Ruminations on the Foreseeability of Damages in Contract Law’, 53 *Louisiana Law Review*, (March 1993) 1257-1269; Arthur G. Murphey, Jr., ‘Consequential Damages in Contracts for the International Sale of Goods and the Legacy of Hadley’, VII.(a), 23 *Wash. J. Int’l L. & Econ.*, 1989, 415-474.

⁷⁰ *Hadley v Baxendale* (1854) 9 Ex.341, 355.

⁷¹ Article 74 of the CISG; Article 19 of the FECL.

⁷² *Koufos v. C. Czarnikow Ltd* [1969] 1 A.C. 350 (*The Heron II*); This case departed from the language used in the Act, the word ‘directly’ was not used and the focus was placed on ‘reasonable contemplation’ of the parties.

⁷³ *Ibid.* at 383 Lord Reid used the words of ‘not unlikely’ to denote a degree of probability considerably less than an even chance but nevertheless not very unusual and easily foreseeable.’ See also his statement at 388: ‘a very substantial degree of probability’.

⁷⁴ *Ibid.* at 406: Although Lord Morris thought it was unnecessary to use any particular phrase, he used ‘not unlikely to occur’ with ‘liable to result’ as an alternative. Lord Hodson accepted these phrases. ([1969] 1 A.C. at 410-411), but Lord Reid, rejected this phrase, p.388.

⁷⁵ Lord Lords Pearce and Upjohn adopted the words ‘a real danger’ or ‘a serious possibility’. The *Victoria Laundry* case also accepted ‘a real danger’ or ‘a serious possibility’ (at 540). These words were rejected by Lord Reid (at 390) who also rejected the phrase of ‘foreseeable as a real possibility’ (at 385). These words were accepted by House of Lords in *Bank of Nova Scotia v Hellenic Mutual War Risks Association (Bermuda) Ltd* [1992] 1 A.C. 233, 267.

The *object* of the contemplation in the remoteness test under English law is described as the *loss* in the SGA.⁷⁶ The ‘loss’ in the SGA is further interpreted by English case law as to type or kind of loss but not as to extent or quantification of loss,⁷⁷ except for the loss of profit. That is to say, in general, all the claimant needs to prove for recovering his loss resulting from the breach of contract is that the defendant contemplated or ought to have contemplated such a type of loss at the time of contract and the claimant does not need to prove the defendant’s contemplation as to extent or quantity of the loss. The recovery of the loss of profit is treated as an exceptional case in English law. There is a ceiling for a recoverable loss of profit, i.e. the normal profit that could be reasonably contemplated by the defendant at the time of contract. If the claimant demands an exceptional profit, he must prove the defendant’s actual knowledge and acceptance of the risk of such a special profit at the time of contract.⁷⁸ By comparison, it is not so clear under the CISG and the FECL as to what is the object of the breaching party’s foreseeability in the foreseeability test and scholars hold differing opinions of these matters. From the provision of Article 74 of the CISG, the possibility of the loss should be considered as one object of the breaching party’s foreseeability. Some scholars believe that the quantification of the loss should be excluded from the object of the breaching party’s foreseeability because the process of valuing loss is not subject to the foreseeability test, which only applies to limit the recovery of ‘further damages’ i.e., other items of loss.⁷⁹ However, other scholars believe that both type and extent of the loss should

⁷⁶ SGA 1979: Sections 50(2), 51(2) and 53(2).

⁷⁷ See Chitty 26-058; *H. Parsons (Livestock) Ltd v Uttley, Ingham & Co Ltd* [1978] Q.B.791, at 811

⁷⁸ *Victoria Laundry*: see *ante* fn.14: the defendant was only held liable for the normal business profit instead of the exceptional profit which he did not know and had no reasons to know.

⁷⁹ See Article 74 and Article 75, Article 76: ‘as well as any further damages recoverable under Article 74’; Treitel, p.161.

be considered as the object of the breaching party's foreseeability.⁸⁰ These differing opinions as to the object of the foreseeability test may well lead to predictable judgments with regard to what the claimant needs to prove to recover his loss as a result of the defendant's breach when brought before the jurisdictions of the different contracting states to the CISG. Therefore, English law is comparatively more advantageous in avoiding such unnecessary confusion than either the CISG or the FECL.

4.2 Examination of the consistency of the Chinese cases under the CISG in comparison with English Law

The People's Republic of China has adopted the whole legislative concept of the CISG.⁸¹ This background makes the Chinese cases ideal for testing the effect of the damage rule of the CISG on the grounds that its application is not influenced by an alternative domestic legal culture.

The author examines the predictability of the Chinese decisions in the following aspects: (1) *Whether the compensable losses categorised by the Chinese tribunals were consistent across Chinese cases?* (2) *With regard to the different categories of compensable losses: [a] Would the aggrieved party be able to recover his expectation losses consistently, that is can he recover his loss of the price difference between the contract price and the market price, the loss of profit in resale and any resulting loss of interest? [b] Would the aggrieved party be able to recover his reliance losses consistently: can he recover his loss for issuing and amending the Letters of Credit (L/C) and recover his loss for inspecting goods? [c] Would the aggrieved party be able to recover his consequential losses consistently, that is can*

⁸⁰ Djakhongir Saidov: see *ante* fn. 37: II 2(e); Schlechtriem p.766.

⁸¹ See *ante* 1.1.

the buyer recover any compensation paid to his sub-buyers and his loss incurred for repairing the defects of the goods and also can the aggrieved party recover his litigation losses from the breaching party? The consistency as to the application of the foreseeability test by the Chinese tribunals is examined in the discussion of each damage.

The examination of the predictability of the Chinese decisions regarding the above aspects can show whether the damage rule of the CISG is effective, i.e., whether the application of the CISG ensures that predictable damages are granted to the aggrieved party by the Chinese tribunals. If the decisions are predictable, it means that the damage rule of the CISG has been effective; if the decisions are not predictable, the damage rule of the CISG may be defective or some misunderstanding could exist in the application of the CISG by the Chinese tribunals. The author will investigate what has caused any unpredictability and how any problems can be resolved. On the grounds that the damage rule of the FECL does not have any substantive difference from the CISG as shown in the first section of this chapter, the application of the FECL would probably have resulted in the same outcome. Thus, the author will not apply the damage rule of the FECL in the Chinese judgments in the discussion from this point. Due to the existence of some substantive differences in the damage rules between the CISG and English law, the English damage rule is applied by the author to the Chinese cases to examine the predictability of the possible results under English law. *[a] If damages had been awarded consistently under the CISG, would the English position have been the same? [b] If damages had been awarded inconsistently under the CISG, would the application of English law have led to more predictable outcome?*

As mentioned in the first section of this chapter, the reader needs to bear in mind that Article 74 of the CISG provides an obscure concept of the principle of full compensation and does not clarify the categorisation of any compensable losses. The foreseeability test designed to limit the recoverable damage in Article 74 is also a very flexible instrument with ‘inevitably imprecise’⁸² and ‘heuristic’⁸³ characteristic. The uncertainty of these elements existing in the damage rule of the CISG demands the exploring of competent judges.⁸⁴ While this uncertainty may not be a problem for creative common law judges,⁸⁵ they can cause confusion to Chinese judges who are traditionally obliged to apply laws but not to interpret laws.⁸⁶

4.2.1 The categorisation of compensable losses by the Chinese tribunals

The categorisation of the compensable losses in the Chinese cases appears inconsistent throughout the author’s investigation. For example, in some cases, the losses were categorised by directness as direct loss and indirect loss;⁸⁷ in some cases, the losses were categorised by actual loss and non-actual loss;⁸⁸ and in some other cases, the losses were simply awarded item by item without any categorisation.⁸⁹

⁸² Farnsworth, (1979) 27 *Am J Comp L* 247, 253.

⁸³ Schlechtriem p.763.

⁸⁴ E.g., the object of the foreseeability (i.e., the type or the extent of the loss), the ascertainment of the probability of foreseeability and the degree of the defendant’s knowledge.

⁸⁵ Even so, the potential inconsistent interpretations by different courts without the unified guidance from UNCITRAL (United Nations Commission on International Trade Law) might still impair the aim of the unification of the CISG.

⁸⁶ In China, the judges are only entitled to apply and not entitled to interpret laws. The power of interpreting law belongs to the Chinese Supreme Court. In the internal rules of some courts, the judge can be demoted if the judgment made by him is overruled by a higher court. The Chinese judges are normally very reluctant to apply the laws creatively or illustrate the rationale of their judgments.

⁸⁷ E.g., Award of 18 September 1996 [CISG/1996/01] (*Lanthanide compound case*); Award of 17 October 1996 [CISG/1996/47] (*Tinplate case*); Award of 31 December 1997 [CISG/1997/37] (*Lindane case*).

⁸⁸ E.g., Award of 7 January 2000 [CISG/2000/06] (*Cysteine case*); Award of 10 October 1996 [CISG/1996/45] (*Petroleum coke case*).

⁸⁹ E.g., Award of 8 April 1999 [CISG/1999/21] (*New Zealand raw wool case*).

None of the Chinese cases categorised the compensable losses by the type of protected interest like English law.

It was misleading for the Chinese tribunals to categorise the compensable losses by direct loss and indirect loss. This is because directness is the criterion for the causation test, which has not been adopted by the CISG as a means for limiting recoverable damages.⁹⁰ In other words, the recovery of damages should not be decided by whether the damages are the direct or indirect consequence of the breach but by whether the damages satisfy the foreseeability test required by Article 74 of the CISG. The consideration of the directness in categorising the compensable losses is not only unhelpful in judging what loss is recoverable, but also misleading in a sense that it regards the causation test as a criterion to justify whether damages are recoverable. It should be noted that the foreseeability test was not mentioned in the decisions of many cases in which the categorisation of losses was based on whether the losses were directly caused by the breach of contract.⁹¹ It is doubtful as to whether the causation test or the foreseeability test was applied in the awarding of the damages. The lack of a proper categorisation of compensable losses in the Chinese cases stems from the obscure concept of the principle of full compensation in Article 74 of the CISG. The Chinese tribunals had to create their own criteria to categorise the compensable losses. In consequence, the unpredictability of the categorisation is unavoidable until a clarification is issued from the CISG.

In English law, the compensable losses have been consistently categorised by English courts on the basis of the protected interest, such as the expectation interest or the reliance interest. The compensable losses are normally categorised as the

⁹⁰ See *ante* 4.1.2[b](i).

⁹¹ e.g., Award of 18 September 1996 [CISG/1996/01] (*Lanthanide compound case*); Award of 17 October 1996 [CISG/1996/47] (*Tinplate case*). However, in one case (*Lindane case* [CISG/1997/37]) the foreseeability test was expressly applied despite the categorisation of compensable losses by directness.

expectation loss, the reliance loss or the consequential loss. The recovery of certain loss depends upon whether the remoteness test is satisfied, i.e., whether the loss falls within the reasonable contemplation of the breaching party at the time of contract. In practice, the requirement of causation between the loss and the breach of contract is normally ignored and taken over by the remoteness test.⁹² Thus, in English law the categorisation of the compensable losses does not affect the recovery of damages. The inconsistent categorisation of compensable losses faced by the Chinese tribunals in applying the CISG is not a problem for English law.

4.2.2 An examination of the consistency of compensable losses decided by the Chinese tribunals

[a] The recovery of expectation losses

(i) Loss on price difference

Can the aggrieved party, e.g., an unpaid seller or buyer facing the non-delivery of goods, make a substitute transaction by re-selling or re-buying in the market and recover his loss on the price difference between the original contract and the substitute transaction; or where the substitute sale has not been made, can he recover the price difference between the original contract and the current price prevailing at the place where the delivery should have been made and at the time when the delivery should have been made?

The answers to these questions depend upon whether the loss on the price difference is the compensable loss covered by Article 74 of the CISG. As mentioned in the first section of this chapter, although the compensable losses are not clearly

⁹² See Chitty 26-032, McGregor 6-125, Benjamin 16-049. Treitel p.169: the English courts would simply apply the remoteness test without discussing the 'directness' or 'causation' at all.

defined in Article 74, the loss on the price difference, as one of the aggrieved party's expectation losses, should be recoverable under the principle of full compensation.⁹³

It should be noticeable that the recovery of damages on the price difference in Article 74 is similar in form to the recovery of damages for any price difference in Articles 75 and 76.⁹⁴ Nevertheless, there is a radical difference in the prerequisite of the application: the condition for the application of Articles 75 and 76 is the avoidance of contract whereas the application of Article 74 does not have such a requirement.⁹⁵

In the Chinese cases, although the loss on the price difference was often awarded to the aggrieved party, the Articles applied by the tribunals were not so consistent. Often, Article 75 was incorrectly applied in circumstances where the contract was not avoided.⁹⁶ For example, in the *New Zealand raw wool case*, the buyer failed to open the L/C and the market fell, the seller then resold the goods to a third party to mitigate his loss before formally informing the buyer that the contract was avoided based upon the buyer's breach. The seller claimed the price difference together with interest between the original contract and the actual sale. The arbitrators held the buyer responsible for the seller's loss on the price difference calculated based on

⁹³ The recovery of such losses is also subject to the foreseeability test and the substitute transaction must be reasonable.

⁹⁴ Article 75 of the CISG: 'If the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods, the party claiming damages may recover the difference between the contract price and the price in the substitute transaction as well as any further damages recoverable under Article 74'. Article 76 (1) of the CISG: 'If the contract is avoided and there is a current price for the goods, the party claiming damages may, if he has not made a purchase or resale under Article 75, recover the difference between the price fixed by the contract and the current price at the time of avoidance as well as any further damages recoverable under Article 74. If, however, the party claiming damages has avoided the contract after taking over the goods, the current price at the time of such taking over shall be applied instead of the current price at the time of avoidance.'

⁹⁵ The International Sales Convention Advisory Council (CISG-AC) is a private initiative supported by the Institute of International Commercial Law at Pace University School of Law and the Centre for Commercial Law Studies, Queen Mary, University of London. The CISG-AC is in place to support the understanding of the CISG and the promotion and assistance in the uniform interpretation of the CISG. http://cisgw3.law.pace.edu/cisg/CISG-AC-op6.html#*. Their opinions play a suggestive but not binding role to the interpretation of the CISG.

⁹⁶ Award of 8 April [CISG/1999/21] (*New Zealand raw wool case*); Award of 1 February 2000 [CISG/2000/01] (*Silicon and manganese alloy case*).

Article 75 of the CISG due to the buyer's fundamental breach by failing to open the L/C. Nevertheless, the seller's claim for interest on the resale price difference was not supported by the arbitrators because the seller was on error when declaring the avoidance of contract. The seller was found to be 'guilty' of reselling the goods before the avoidance of contract according to Article 75 of the CISG. In the author's view, the issue that the arbitrators failed to take into account was that Article 74 should have been applied and not Article 75. According to Opinion No.6 of the CISG Advisory Council (Opinion No.6),⁹⁷ under Article 74 of the CISG the seller is entitled to claim damages on the price difference without having to avoid the contract first. In this case, the misuse of Article 75 by the Chinese tribunal did not affect the seller's recovery of the damages on the price difference but only affected the recovery of the interest. It is clear that the Chinese arbitrators misunderstood the different assumptions of Articles 74 and 75.

In the *Oxidized aluminum case*, where the seller failed to deliver the goods and the market rose, the buyer claimed damages on the difference between the contract price and the current market price, although the contract was not avoided.⁹⁸ In this case, Article 74 was correctly applied by the arbitrators despite the fact that Articles 75 and 76 were also cited as supporting the decision. The author believes that the application of Articles 75 and 76 in this case was unnecessary because the contract was not avoided by the buyer.

These two Chinese cases have shown strong evidence that the prerequisite of Article 74 has not been correctly differentiated from that of Articles 75 and 76 by the Chinese tribunals. The CISG Advisory Council has clarified this issue in Opinion No.6 which states that: 'If there has been a breach of contract and then the aggrieved

⁹⁷ http://cisgw3.law.pace.edu/cisg/CISG-AC-op6.html#*

⁹⁸ Award of 24 April 1997 [CISG/1997/09] (*Oxidized aluminum case*).

party enters into a reasonable substitute transaction without first having avoided the contract, the aggrieved party may recover damages under Article 74, that is, the difference between the contract price and the substitute transaction'.⁹⁹ It should be noted that these two cases were both decided before Opinion No.6 was issued. It will become clear in future cases what influence the CISG Opinion No.6 is going to have on the Chinese tribunals in their understanding and application of the CISG.

By comparison, English law does not have this problem. The recovery of damages on the price difference does not require the termination of contract according to Sections 50(3), 51(3), 53(3) of the SGA. If English law had been applied in those two Chinese cases, the aggrieved party would have been entitled to the difference between the contract price and the substitute transaction or the current market price, irrespective of whether the contract had been terminated or not. Under English law, where there is no available market or the *prima facie* market rule is not applicable, the basic damage rule provided in Sections 50(2), 51(2), 53(2) of the SGA and the rule for assessing special damage in Section 54 of the SGA would apply instead.¹⁰⁰ It should be remembered that the basic damage rule should only be considered after the *prima facie* market rule.¹⁰¹ Hence, compared with the CISG, the application of English law would have led to more predictable results.

(ii) Loss of profit

⁹⁹ Opinion No.6 is adopted by the CISG-AC at its spring 2006 meeting in Stockholm, Sweden. http://cisgw3.law.pace.edu/cisg/CISG-AC-op6.html#*.

¹⁰⁰ See Benjamin 17-002, 17-007, 17-021: SGA Section 51(2) should apply, where the parties ought, at the contracting time, to have contemplated that the *prima facie* rule would not compensate the buyer's loss if the seller fails to deliver the goods (*Thompson (W L) Ltd v Robinson (Gunmakers) Ltd* [1955] Ch.177); where the application of the *prima facie* market rule would compensate the buyer 'more than his true loss' (*Bence Graphics International Ltd v Fasson UK Ltd* [1998] Q.B.87); or where the buyer agreed to accept the goods at lower price than market price after the seller's breach (*Pagnan (R.) & Fratelli v Corbisa Industrial Agropacuaria* [1970] 1 W.L.R. 1306).

¹⁰¹ See Benjamin 17-002, 17-021.

Can the aggrieved buyer claim his loss of profit in the resale in the circumstances of the seller's non-delivery, delayed delivery or defective delivery?

The answer is clearly identified in Article 74 of the CISG. As mentioned in the first section of this chapter, the buyer's loss of profit as one of his expectation losses, resulting from the seller's breach of contract, should be recoverable under the principle of full compensation even if it were not explicit in Article 74.¹⁰² The recovery of the loss of profit is also subject to the foreseeability test and the mitigation rule.

However, the loss of profit has not been granted consistently by the Chinese tribunals. The cause of such unpredictability arises from the uncertainty in the understanding of two aspects of the loss of profit: *what degree of probability* should be applied in assessing whether a profit would have been made and *what amount* that profit should be.¹⁰³ The reason for these uncertainties stems from the lack of clear interpretations of Article 74 of the CISG.

In the Chinese cases, although the loss of profit was often awarded by the Chinese tribunals, the reasoning of some judgments has not been very convincing and the amount of the granted loss of profit has been random.¹⁰⁴ For example, in the '*Kidney beans case*',¹⁰⁵ where the market was rising and the seller's request for a higher price was rejected by the buyer, the seller failed to deliver the goods and the

¹⁰² One of the reasons why the 'loss of profit' is specially emphasized in Article 74 is because for ideological reasons some countries do not recognise the loss of profit or limit it with special conditions to be satisfied: see Schlechtriem p. 746. Article 44 of the CISG specifies the circumstance under which the loss of profit is not claimable. It is when the seller did not know the non-conformity of the goods or any right or claim of a third party related to the goods and the buyer fails to notify the seller of these defects within the reasonable time after the buyer becomes aware or ought to have become aware of them, even if the buyer has reasonable excuses for not doing so. See CISG Articles 38, 39, 40, 41, 42, 43, 44.

¹⁰³ Schlechtriem p.759; See fn. 19 Fritz : It is not clear 'whether the injured party is entitled to recover the loss of profit he actually suffered, the extent of profit he could have expected, or an average profit to be expected at a certain time in certain place', and 'which period of time the loss of profit can be measured.'

¹⁰⁴ One of the reasons why the author calls the amount 'random' is because the Chinese tribunal did not give any persuasive reasoning for the figure of the loss of profit granted to the buyers.

¹⁰⁵ Award of 27 June 1997 [CISG/1997/18] (*Kidney beans case*).

buyer claimed his lost profit, which would have been made in the resale contract, i.e. the difference between the original contract price and the resale price. Although the validity of the resale was not verified by the Chinese tribunal, the seller's non-delivery was held to constitute the fundamental breach of contract and 'the seller should therefore pay a reasonable compensation to the buyer'. The arbitration tribunal came straight to grant 10% of the contract price as the amount to cover the buyer's loss of profit without explanation.

Two issues need to be addressed as to the decision in the *Kidney beans case*: *what degree of probability was applied by the Chinese tribunal in judging whether the loss of profit would have been made or not, and why 10% of the contract price was allowed as a reasonable amount for the loss of profit*. There was no clear answer to these questions. The facts confirmed by the arbitrators included that the seller's non-delivery constituted the fundamental breach and that the buyer informed the seller of the resale at the time of contract despite the arbitrators' doubt as to the existence of the actual resale contract. To judge whether the loss of profit should have been granted, Article 74 of the CISG should be applied as it is the basic damage rule of the CISG. Whether the buyer's loss of profit in the resale can be recovered should depend upon whether the foreseeability test in Article 74 is satisfied, i.e., whether the seller foresaw or ought to have foreseen the buyer's loss of profit at the time of contract, given the facts and matters that he knew or ought to have known, as a possible consequence of his breach of contract. In the decision of this case, the buyer's recovery of a portion of his loss of profit was simply based on the seller's fundamental breach, i.e., non-delivery and the seller's foreseeability of such a loss at the contracting time was not considered. In the author's opinion, the degree of probability applied by the Chinese tribunal in justifying whether the lost profit would

have been made was quite low in this case. Given the seller's liability for the buyer's loss of profit, it can be inferred that the seller must have been held to have foreseen the loss of a profit as a possible consequence of his breach of contract when he was notified of the resale at the time of contract, despite the fact that sub-contract had not been proven by the buyer. With regard to the second question, there is insufficient evidence available for the author to clarify why the Chinese tribunals awarded 10% of the contract price in compensation and whether such compensation was reasonable. The same issue has also been raised in other cases.¹⁰⁶ The lack of reasoning in the Chinese cases makes it uncertain regarding whether the granted margins of the loss of profit were reasonable on the grounds that it was the normal business profit foreseeable by the seller at the time of contract or they were only some random figures awarded by accident.

In the author's view, the specific emphasis of the 'loss of profit' in Article 74 has not helped Chinese tribunals to make clear and convincing judgments. Considering the uncertain elements in the calculation of the loss of profit, the uniform instructions from UNCITRAL are necessary. There is a view that the general law of evidence of the *lex fori* should be adopted to resolve this problem and the tool of reasonable certainty should be applied. Where there is no sufficient degree of certainty, the assessment of damages should be at the court's discretion.¹⁰⁷ The author does not prefer the application of the national *lex fori* because the purpose of the CISG for unification would be impaired by such a method. Also, it would have the potential to

¹⁰⁶ In the Award of 29 March 1999 [CISG/1999/14] (*Flanges case*), the tribunal awarded 15% of contract price as the margin rate for the loss of profit that the buyer is entitled to. In the Award of 31 January 2000 [CISG/2000/09] (*Clothes case*), 20% of sale price was awarded to the buyer as the loss of profit for the seller's breach by delivering defective goods. In the Award of 26 October 1993 [CISG/1993/12] (*Frozen beef case*), 10% of the contract price was held to be the margin rate for the loss of profit caused by the seller's failure to provide some goods.

¹⁰⁷ Friedrich Blasé and Philipp Höttler, Remarks on the Damages Provisions in the CISG, Principles of European Contract Law (PECL) and UNIDROIT Principles of International Commercial Contracts (UPICC) <http://cisgw3.law.pace.edu/cisg/biblio/blase3.html>.

cause the loss of profit to be ascertained differently by contracting states of the CISG.¹⁰⁸

By comparison, English law is far more sophisticated. The loss of profit is recoverable as an expectation loss by English case law. The *degree of probability* and *the ascertainment of the amount* of the loss of profit have both been clarified in determined cases. The SGA specifies a general rule for the measurement of damages and English case law has developed the specific rule in individual circumstances.

When the seller breaches the contract by non-delivery, *the degree of probability* applied in assessing the loss of profit depends upon *whether there is a sub-sale contract and whether there is an available market*. *Where there is a sub-sale contract and there is an available market*, the buyer is not normally entitled to claim the loss of profit on the price difference between the original contract and the sub-sale contract,¹⁰⁹ but is only entitled to claim the price difference between the original contract with the seller and the substitute transaction with another supplier. However, if the buyer has resold the very same goods in a sub-sale,¹¹⁰ then the buyer can claim the loss of profit despite the presence of an available market, subject to the seller's reasonable contemplation.¹¹¹ *Where there is a sub-sale contract and there is no available market*, the buyer's loss of profit is the measure of damages subject to the seller's reasonable contemplation that the buyer bought the goods with a view to

¹⁰⁸ The aim of the CISG is stated in the preamble of the CISG: 'the removal of legal barriers in international trade and promote the development of international trade'.

¹⁰⁹ *Williams Bros v Ed T Agius Ltd* [1914] A.C.510.

¹¹⁰ For example, the delivery date is the same as the original sale contract or the goods have been appropriated in the sub-contract with the same name of the ship as in the original contract.

¹¹¹ The seller should have contemplated or ought to have contemplated (e.g., the buyer is a trader) at the contracting time that the buyer was or probably was buying for resale and the buyer could only perform his duty under the sub-sale by delivering the very same goods to his sub-buyers. (*Re R and H Hall Ltd and WH Pim (Junior) & Co's Arbitration* [1928] All E.R.Rep.763,766,767,769 HL): See Chitty 43-432; McGregor 20-025; Benjamin 17-029.

resell.¹¹² *Where there is no available market and no sub-sale contract*, it becomes a question of the loss of a chance to make a profit. It depends upon whether the buyer can prove with a balance of probabilities that had the seller not breached the contract, the buyer would have been able to sell the goods and would have made a profit.¹¹³ The English court has adopted the means of the ‘*all-or-nothing*’ balance of probabilities.¹¹⁴ If there is more than a 50% chance on the balance of probabilities and that can be proven, then the buyer is entitled to all the profits available in the market in that it is not an issue of loss of a chance but a provable loss of profit.

The English case law has also developed a rule for *ascertaining the amount of loss of profit*. Only a reasonable amount of the loss of profit in a normal sub-contract can be recovered. If the amount of the profit in the sub-contract is too high, it can be adjusted by the English court to a reasonable amount.¹¹⁵ *In circumstances of non-delivery*, the buyer is only entitled to the normal business profit unless he can prove the seller’s actual knowledge of the exceptional profit.¹¹⁶ *In circumstances of delayed delivery*, the seller is not normally liable for the buyer’s loss of profit caused by the delay in the resale unless the seller contemplated or ought to have contemplated such a resale.¹¹⁷ *In circumstances of defective delivery*, the seller is only liable for the buyer’s loss of profit if he contemplated or ought to have contemplated the buyer’s

¹¹² E.g., *Frank Mott & Co Ltd v Muller & Co (London)* (1922) 13 L.L.Rep. 492; *Patrick v Russo-British Grain Export Co Ltd* [1927] 2 K.B. 535, 541; Cf. See Chitty 43-435.

¹¹³ See Chitty 26-042; See Benjamin 16-050: *Allied Maples Group Ltd v Simmons and Simmons* [1995] 1 W.L.R. 1602, C.A. (not a sale of goods case).

¹¹⁴ See *Remedies for torts and breach of contract*, A. S. Burrows, (3rd ed. 2004) p.53-63.

¹¹⁵ *Household Machines Ltd v Cosmos Exporter Ltd*. [1928] All E.R. Rep. 763, at 767,768,773.

¹¹⁶ *Victoria Laundry*: see *ante* fn.14; SGA 1979 s. 54 ‘special damages’. The decision of *Victoria Laundry* was also confirmed in *Transfield Shipping Inc v Mercator Shipping Inc (The Achilleas)* [2008] UKHL 48, The House of Lords held that the claimant could only be awarded damages for loss of the normal profit rather than for loss of the lucrative charter on the grounds that the latter was too remote. Taking into account the type of contract and its commercial background, the court took the view that the intention of the parties at the time of entering the contract was not to make the charterers undertake the risk of sudden market fluctuations (see *ante* p.109-110). In the case of *Golden Strait Corporation v Nippon Yusen Kubishiki Kaisha (The Golden Victory)* [2007] 1 CLC 352 HL, the House of Lords held that the most important principle for assessment of damages is that the damages should reflect the loss suffered.

¹¹⁷ See Chitty 43-441.

intention to use his goods for profit-making and also he must have the knowledge of which category of use the buyer intended for his profit-making.¹¹⁸ The amount of liability that the seller has for the buyer's loss of profit is also subject to the buyer's obligation of mitigation.¹¹⁹

If the *Kidney beans case* had been decided under English law, the judgment would have been different, depending upon whether there was an available market or not.¹²⁰ If there was an available market, the buyer would not normally be entitled to the loss of profit on the price difference between the original contract and the resale contract.¹²¹ The buyer would only be entitled to the price difference between the original contract and the substitute sale, unless the buyer can prove that he had resold the very same goods in the sub-contract. If there was no available market, then the buyer's loss of profit, i.e., the price difference between the original contract and the sub-contract, would be the measure of the damages.¹²² Because the buyer informed the seller of the resale at the time of contract, the loss of profit in the resale should have fallen within the seller's reasonable contemplation and therefore, the seller should be liable for that loss. As to the amount of the loss of profit, the buyer should only be entitled to his normal business profit unless he can prove the seller's actual knowledge of the exceptional profit.¹²³ The ascertainment of the amount of the loss of profit is at the court's discretion. It is noticed that the mechanism of English case law has made the SGA very adaptive to development in the business world. The

¹¹⁸ See Chitty 43-441; *Bunting v Tory* (1948) 64 T.L.R.353.

¹¹⁹ *Cullinane v British 'Rema' Manufacturing Co Ltd* [1954] 1 Q.B.292.

¹²⁰ The Chinese arbitrators did not discuss whether there was an available market in the *Kidney beans case*.

¹²¹ *Williams Bros v Ed T Agius Ltd* [1914] A.C.510.

¹²² *Frank Mott & Co Ltd v Muller & Co (London)* (1922) 13 L.L.Rep. 492; *Patrick v Russo-British Grain Export Co Ltd* [1927] 2 K.B. 535, 541; Cf. See Chitty 43-435.

¹²³ *Victoria Laundry*: see *ante* fn.14; SGA 1979 s. 54 'special damages'.

position of English law is more certain than the CISG in judging the recovery of the loss of profit.

(iii) Loss of interest

Where the buyer failed or delayed in making payment, can the seller claim his loss of use of the money, e.g., the interest he could have gained ('normal interest') or interest charges for the loan he took out from the bank which could have been avoided had the money been paid back in time ('loan interest')? Can the period of the interest count from the time when the payment was supposed to be made to the time when it was actually made?

Under the CISG, the recovery of the loss of 'normal interest' is not only available as the expectation loss under the principle of full compensation in Article 74, but also specifically provided for by Article 78.¹²⁴ According to Article 78, the unpaid seller is entitled to the interest on 'the price' or 'any other sum' 'in arrears',¹²⁵ that the buyer owes 'without prejudice to any claim for damages recoverable under Article 74'. Unlike the normal damages covered by Article 74 of the CISG, the foreseeability test is not required for the recovery of interest loss in Article 78. The author infers that the loss of 'normal interest' is treated specially in the CISG, i.e., the buyer is assumed to have foreseen such a loss resulting from his breach and therefore, the seller is discharged from proving the buyer's foreseeability at the time of contract. The ascertainment of the recoverable interest rate should be under the tribunal's discretion. However, the seller's loss of 'loan interest' does not fall within the definition of 'interest' in Article 78 and is only recoverable if the requirement of

¹²⁴ Article 78: 'If a party fails to pay the price or any other sum that is in arrears, the other party is entitled to interest on it, without prejudice to any claim for damages recoverable under Article 74.'

¹²⁵ The phrase of any other sum in arrears includes the price difference, the loss of profit and some additional expenditure that the aggrieved party occurred resulting from the breach.

the foreseeability test in Article 74 is satisfied. The seller can only recover his loan interest loss if he can prove the buyer's actual knowledge of such a loan and that the buyer's delay in payment would cause the seller to suffer the interest loss when the contract was made. *The period of interest* should count from the time when the payment should have been made to the time when it was actually made.

In the Chinese cases, the seller's *loss of 'normal interest'* is generally upheld and the seller's *loss of 'loan interest'* is normally dismissed by the tribunals because the seller fails to prove the buyer's foreseeability of such a loss on conclusion of the contract. For example, in the *Lacquer handicraft case*,¹²⁶ the arbitrators supported the seller's loss of normal interest under Article 78 and dismissed the seller's loss of loan penalty interest under Article 74 because the buyer had no knowledge of any loan when the contract was made. In the *Lentils case*,¹²⁷ the seller's claim of normal loan interest loss was upheld on the grounds that the buyer, as an international trading company, should have foreseen such damage in light of the fact that the seller was also a trading company. The seller's claim of penalty loan interest was dismissed because it could not be foreseen by the buyer at the time of contract. It should be noticed that in this case, there was no consideration as to whether the seller could recover his normal interest loss which would have been gained had the payment been made on time. In the author's view, the arbitrators awarded the seller's loss of normal loan interest to cover his loss of normal interest.

In the *Leather Gloves case*, the seller's claim of the interest on the payment that the buyer failed to make was dismissed by the tribunal although the seller's request for the payment of the goods was supported.¹²⁸ There was no explanation for this decision when awarding the case. This would appear to be a wrong decision by the

¹²⁶ Award of 6 August 1996 [CISG/1996/35] (*Lacquer handicraft case*).

¹²⁷ Award of 18 December 1996 [CISG/1996/56] (*Lentils case*).

¹²⁸ Award of 26 November 1998 [CISG/1998/06] (*Leather Gloves case*).

Chinese tribunal. The seller's loss of normal interest should have been awarded according to Article 78 of the CISG and the buyer should have foreseen such a loss for the seller if the goods were not paid for on time.

The English position is different from the CISG in this respect. The loss of interest is not traditionally recoverable by means of general damages.¹²⁹ It is left open for the parties to make their own arrangement in the contract and the court would enforce such an arrangement.¹³⁰ Also, the English court occasionally infers such an agreement by the course of dealing between the parties¹³¹ or by a relevant trade usage¹³². However, there is one common law exception to this general rule.¹³³ When the second rule of *Hadley v Baxendale* is satisfied,¹³⁴ i.e., when a reasonable man with the same knowledge of the special circumstances as the defendant could be expected to foresee such a loss, then special damages can be awarded, such as any interest charges or other expenses incurred by the seller in obtaining finance from another source as the result of the buyer's late payment.¹³⁵ Indeed, the seller needs to prove the buyer's contemplation at the time of contract that his delay or failure to pay would cause the seller to borrow the same amount of money from an alternative source and thus incur the interest charges. The object of the contemplation the seller needs to prove is only the type of loss, which is interest charges, and not the actual amount of the interest loss. The reasonableness of the interest rate is at the court's discretion. If the seller wishes to claim an exceptionally high interest rate, he would need to prove the buyer's actual knowledge of this interest rate and his acceptance of

¹²⁹ *London, Chatham and Dover Railway Co v South Eastern Railway Co* [1893] A.C. 429. It was confirmed by HL in *President of India v La Pintada Compania Navegacion SA* [1985] A.C. 104.

¹³⁰ See Chitty 26-169.

¹³¹ *Re Anglesey* [1901] 2 Ch.548.

¹³² *Ikin v Bradley* (1818) 8 Taunt. 250.

¹³³ This rule was created by CA in *Wadsworth v Lydall* [1981] 1 W.L.R.598, and expressly approved by HL in *President of India v La Pintada Compania Navegacion SA* [1985] A.C. 104, at 125-127

¹³⁴ (1854) 9 Ex. 341.

¹³⁵ The currency loss caused by late payment has been held to fall within this principle. *President of India v Lips Maritime Corp.* [1988] A.C. 395, 410-412.

the risk involved. The recovery of special damages is also confirmed by Section 54 of SGA.

In conclusion, the CISG and English law differentiates from each other in the recovery of the loss of *normal interest*. While the CISG categorises the interest loss as the normal damage, English law treats it as the special damage. According to Article 78 of the CISG, the buyer is assumed to have foreseen the seller's loss of interest resulting from his non-payment or late payment at the contracting time and the seller can recover such a loss without proving the buyer's foreseeability as required by Article 74. Under English law, the seller can only recover his loss of interest if he can prove the buyer's reasonable contemplation of such a special damage when the contract was concluded. Considering the burden of proof placed on the seller, it seems that it is harder for the seller to recover his interest loss under English law than under the CISG. The court has to face more uncertainties in ascertaining the special damage than in ascertaining the normal damage. The recovery of the interest loss under English law can be theoretically less predictable than under the CISG.

[b] The recovery of reliance losses

(i) Loss for issuing and amending the L/C

In circumstances of non-delivery or in circumstances of the defective delivery of goods that are eventually rejected, can the buyer recover his expenses incurred for opening or amending the L/C?

The answer to this question depends upon whether such wasted expense as a reliance loss is covered by the principle of full compensation in Article 74 of the

CISG. A loss for issuing or amending the L/C is generally recognised as a recoverable reliance loss subject to the foreseeability test.

The compensation of the L/C loss has been consistently awarded by the Chinese tribunals. In the *Isobutyl alcohol case*, where the seller failed to deliver the goods and tender the documents required by the L/C, the buyer claimed his L/C losses including the interest on the deposit paid for opening the L/C. The buyer's claim of the L/C cost and interest incurred was upheld by the tribunal.¹³⁶ Whether the buyer's L/C loss was foreseen by the seller was not mentioned in the decision of this case, but Article 74 was explicitly applied. Therefore, it can be inferred that the foreseeability test must have been applied to reach the decision of this case.

In the *Lindane case*,¹³⁷ where the seller failed to deliver some goods, the buyer claimed his L/C loss, his liability to the sub-buyer and his sub-buyer's L/C loss. The buyer's L/C loss and his liability to the sub-buyer were both upheld by the Chinese tribunal. It was held that the seller's non-delivery constituted a fundamental breach which entitled the buyer to recover damages according to Article 45 of the CISG. The buyer's L/C loss and his liability to the sub-buyer were the damages resulting from the seller's non-delivery and 'it was reasonably foreseeable by the seller' at the time of contract by Article 74 of the CISG. Therefore, the seller should be liable for the buyer's losses. Nevertheless, the buyer's claim of his sub-buyer's L/C loss was dismissed by the tribunal on the grounds that the buyer's recovery of the liability to his sub-buyer should include the sub-buyer's L/C loss. In the author's view, the Chinese tribunal made the correct decision because the compensation of the buyer's liability to his sub-buyer and the sub-buyer's L/C loss would have resulted in double recovery.

¹³⁶ Award of 7 July 1997 [CISG/1997/20] (*Isobutyl alcohol case*).

¹³⁷ Award of 31 December 1997 [CISG/1997/37] (*Lindane case*).

It should be noted neither of the injured buyers in these two cases claimed their expectation losses, i.e., the loss on the price difference between the contract and the market or their loss of profit. Therefore, the Chinese tribunal in neither case had an opportunity to explore the relationship between the recovery of the expectation loss and the recovery of the reliance loss.

In comparison, in the *Horsebean case*, where the seller failed to deliver the goods, the buyer bought the substitute goods and claimed the difference between the contract price and the substitute sale price and his expenses for issuing and modifying the L/C and for inspecting goods.¹³⁸ The buyer's claim for the expectation loss on the price difference was upheld and the L/C loss was dismissed on the grounds that the L/C loss was the buyer's normal expenditure that would be borne by the buyer in his performance of contract. In the author's view, the real reason why the tribunal dismissed the buyer's claim of the L/C loss is for preventing the double recovery of both expectation loss and reliance loss although it was not stated in the decision of this case. The author will return to the issue of double recovery in the discussion of the recovery of inspection loss.

English law is also very consistent in awarding the injured buyer the L/C loss. The buyer can normally recover his L/C loss, as long as the remoteness test can be satisfied,¹³⁹ i.e., the loss fell within the seller's reasonable contemplation as a 'probable' result of the breach at the time of contract.¹⁴⁰ However, there is an exceptional case in which the buyer cannot recover his L/C loss. This is when the seller can prove that the contract made between both parties is not going to be profitable for the buyer, i.e., the buyer would not have been able to recoup his cost of

¹³⁸ Award of 7 May 1997 [CISG/1997/12] (*Horsebean case*).

¹³⁹ Although the recovery of such a reliance loss is not normally subject to the reasonableness test, the expenditure unreasonably incurred would not normally pass the remoteness test.

¹⁴⁰ *Hadley v Baxendale* (1854) 9 Ex.341, 355.

performance, even if the seller had performed his contractual obligation in full.¹⁴¹ In other words, the buyer cannot recover his L/C loss, if the contract can be proven to be unprofitable to him by the seller.

(ii) Inspection loss

Can the buyer recover his loss for inspecting goods which had already incurred before the seller eventually failed to deliver the goods or before the seller delivered the defective goods?

The inspection loss, as another type of reliance loss, should be covered by the principle of full compensation of Article 74 of the CISG, subject to the foreseeability test.

The Chinese cases have shown some confusion in awarding the buyer's inspection loss. In the aforementioned *Horsebean case*,¹⁴² while the buyer's claim of the L/C loss was dismissed as a normal business expense in the performance of contract, the buyer's claim of an inspection loss was upheld with the buyer's recovery of the price difference between the contract and the substitute sale.¹⁴³ The confusing point is that if the disapproval of the L/C loss was for avoiding a double recovery of both expectation loss (i.e., the loss on the price difference) and the reliance loss (i.e., the L/C loss), why was another reliance loss (i.e., the inspection loss) approved to generate another double recovery? These decisions appear conflicting. In the *Isobutyl alcohol case*, where the seller failed to deliver the goods, the buyer's claim of both his inspection loss and his L/C loss was upheld by the

¹⁴¹ See Chitty 26-073; *C.C.C. Films (London) Ltd v Impact Quadrant Films Ltd* [1985] Q.B. 16; *C & P Haulage v Middleton* [1983] 1 W.L.R. 1461 This point is expressly confirmed in *Cullinane v. British 'Rema' Manufacturing Co Ltd* [1954] 1 Q.B. 292.

¹⁴² For the facts of this cases, see *ante* 4.2.2[b](i).

¹⁴³ Award of 7 May 1997 [CISG/1997/12] (*Horsebean case*). The buyer's loss of inspection fee was only partly awarded because the inspection expenses claimed were also for the buyer's some 'other goods'.

tribunal.¹⁴⁴ It was regrettable that the buyer did not claim his expectation loss. Therefore, it is impossible to compare this case with the *Horsebean case* to establish the position of the Chinese tribunal. Nevertheless, it is apparent that the inspection loss was recognised by the Chinese tribunal as a recoverable loss under Article 74 of the CISG, despite the existence of the confusing relationship between the recovery of expectation loss and the recovery of reliance loss. The cause of this confusion arises from the obscure principle of full compensation in Article 74 and the lack of a clear and uniform interpretation from UNCITRAL.

English law considers the inspection loss as a reliance loss and the rule for the compensation of inspection loss is similar to the rule for the L/C loss as discussed previously, i.e., the recovery of the L/C loss should be subject to the tests for profitability and remoteness. Also, it is not clear under English law as to whether the buyer can recover the damages for both his 'expectation interest' and 'reliance interest' and to what extent these can be both recovered.¹⁴⁵ This position of English law is demonstrated by the conflicts in case law. In the *Cullinane v British 'Rema' Manufacturing Co Ltd*,¹⁴⁶ the majority of the judges in the Court of Appeal ruled that the buyer was entitled to recover either his wasted reliance expenditure or his loss of expected profits but not both. Morris L. J. disagreed and maintained that both the buyer's expectation loss of net profits and net capital expenditure should be recoverable, as long as there is no overlapping under the different heads of claim. However, the other judges in the case disagreed with this view. The decision of the

¹⁴⁴ Award of 7 July 1997 [CISG/1997/20] (*Isobutyl alcohol case*): the foreseeability test was assumed to be applied without being expressly mentioned because Article 74 of the CISG was cited in this case.

¹⁴⁵ See Chitty 26-002, 43-451, 43-454; McGregor 20-073; Benjamin 17-070.

¹⁴⁶ [1954] 1 Q.B.292, 308. The buyer (claimant) bought a clay-pulverising machine with a warranty of a certain rate and the machine failed to do so. The buyer claimed the damages for his *net capital loss* (i.e., the price paid for the machine, the cost of its housing and ancillary plant and interest, deduct the actual residual value of the machine and plant at the time of the claim) and his *net loss of business profit* for a period of three years up to the hearing of the case instead of the estimated useful life ten years of the plant (i.e., the estimated net profit after deducting the interest on capital, depreciation, maintenance and other expenses).

Cullinane is confusing in its concern to avoid double recovery. It is noted that the Court of Appeal in a later case, that is *Anglia v Reed*,¹⁴⁷ followed the *Cullinane* case and held that the claimant must choose to claim either the wasted expenses or the loss of profits, but not both. By comparison, in a case not concerned with the sale of goods, that is *George Mitchell (Chesterfield) Ltd v Finney Seeds Ltd*,¹⁴⁸ where a farmer bought defective seeds, which resulted in crop failure, the House of Lords concluded that all the costs incurred in the cultivation of the defective seeds and the net profit, which the farmer would have expected to make for successful crops, should be recovered.

It appears to the author that there is one circumstance that the *Cullinane* case has omitted, that is the recovery of consequential losses. The claimant should be entitled to recover both his expectation loss and his consequential loss (that is a post-breach loss upon the reliance interest), e.g., the buyer's net profit loss and his compensation to the sub-buyer. It is the extra loss that should not have been incurred but has actually incurred. The recovery of these two losses would not conflict in that by the recovery of both these losses, the buyer is placed in the same situation as that of a properly performed contract. Consequential loss is not a normal business expense that the buyer should undertake for profit-making. The relationship between the recovery of the expectation loss and the reliance loss is an issue remains unresolved by both of the CISG¹⁴⁹ and English law.

¹⁴⁷ *Anglia Television Ltd v Reed* [1972] 1 Q.B. 60 (This is not a sale of goods case).

¹⁴⁸ [1983] 2 A.C. 803 at 812.

¹⁴⁹ In a US case *Delchi Carrier S.p.A. v. Rotorex Inc.*, 71 F.3d 1024, 1030 (2d Cir. 1995), the district court approved the buyer of his loss of profit but disapproved his consequential damages for the purpose of avoiding double recovery including the expenses for storage and shipping to return the defective goods to manufacturer. The Second Circuit court overruled this decision and held that awarding such consequential damages that the buyer actually incurred in no way creates a double recovery and instead furthers the purpose of giving the injured party damages 'equal to the loss' as provided in Article 74 of the CISG. <http://cisgw3.law.pace.edu/cases/951206u1.html>. This case is also discussed in Larry A. DiMatteo, Lucien Dhooge, Stephanie Greene, Virginia Maurer and Marisa

[c] The recovery of consequential losses

(i) Buyer's liability to his sub-buyer

Where a seller failed to deliver the goods or he delivered defective goods to a buyer who had resold the goods to his sub-buyer, can the buyer recover his loss from the seller for any compensation that the buyer is liable to pay to his sub-buyer?

The buyer's liability to his sub-buyer, as a consequential loss, should be recoverable under the principle of full compensation in Article 74, subject to the foreseeability test and the mitigation rule.¹⁵⁰

The Chinese tribunals have been very generous in awarding the buyer damages for such a consequential loss. The seller is normally assumed to have foreseen the buyer's liability to the sub-buyer as a possible consequence of his breach at the time of contract, provided that the seller knew that the buyer was a trading company.¹⁵¹ In some cases, the Chinese tribunals held the seller liable to such a loss without mentioning the foreseeability test. For example, in the *Lanthanide compound case*,¹⁵² the buyer's claim of loss for the liability to the sub-buyer was upheld because the seller knew of the existence of the sub-buyer. In the *Tinplate case*,¹⁵³ the buyer's claim of his liability to the sub-buyer was also covered simply on the grounds that the seller knew the buyer as a trading company. There are two possible reasons as to why the foreseeability test was not mentioned in these two cases. The first possible reason is that the foreseeability test was implicit in the ruling by the Chinese

Pagnattaro, 'The Interpretive Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence', 34 *Northwestern Journal of International Law and Business*, (Winter 2004) 299-440.

¹⁵⁰ In practice, the consequential loss is more tended to be limited by the foreseeability test and the mitigation rule than any other losses: AC Opinion No.6, see *ante* fn.5 para. 6.2; Schlechtriem p.758.

¹⁵¹ E.g., Award of 25 October 1994 [CISG/1994/13] (*High tensile steel bars case*); Award of 31 December 1997 [CISG/1997/37] (*Lindane case*).

¹⁵² Award of 18 September 1996 [CISG/1996/01] (*Lanthanide compound case*).

¹⁵³ Award of 17 October 1996 [CISG/1996/47] (*Tinplate case*).

tribunals on the grounds that the buyer's liability to the sub-buyer should fall within the seller's foreseeability. The seller in the *Tinplate case* knew that the buyer was a trading company. Also, the seller knew that the buyer bought the goods for the purpose of resale and the buyer would have to accept any liability to his sub-buyer if the seller failed to deliver the goods. The seller in the *Lanthanide compound case* knew at the time of contract that the buyer had resold the goods to the sub-buyer. Therefore, the seller must have foreseen any liability that the buyer may have to the sub-buyer if there was a breach of contract. If the author's speculation is right, the omission of foreseeability in these two cases would be understandable. The second possible reason is that the Chinese tribunals failed to consider the foreseeability test and they came to their decisions by accident. If that were the case, it would be a fundamental error because the foreseeability rule is the means by which the breaching party's liability can be limited under Article 74. This omission in the judgment is against the damage rule of the CISG and leaves the injured buyer in a very vulnerable situation.

The reasoning of some Chinese cases is also worth of re-consideration. The author will analyse the reasoning applied in the following two cases.

In the *Kidney beans case*,¹⁵⁴ the buyer's claim of his liability to the sub-buyer was dismissed by the Chinese arbitrators because the seller could not foresee such a loss on the grounds that the sub-contract was not made before the conclusion of the original contract, despite the fact that the buyer informed the seller of the possibility of a resale at the time of contract. In the author's view, the main issue in this case was not when the sub-contract was made, but the degree of the breaching party's knowledge in the foreseeability test, i.e., what degree of knowledge the seller needs

¹⁵⁴ Award of 27 June 1997 [CISG/1997/18] (*Kidney beans case*).

to have to lead to his foreseeability of the buyer's liability to the sub-buyer. Apparently, the Chinese arbitrators did not accept that the seller's mere knowledge of the sub-sale was an acceptance of any risk of liability for the buyer's resale of the goods. The burden of proof should be placed on the seller to prove that he or a reasonable man in his position would not accept the risk of such a loss when he was informed of the possible resale at the time of contract. Therefore, the time at which the resale contract was made is an irrelevance. In the author's view, the Chinese tribunal did not appreciate what was the critical issue of this case and their judgment was based upon the wrong criteria. This is further evidence that illustrates the Chinese tribunal's lack of understanding of Article 74 of the CISG and in consequence that nature of the foreseeability test.

In the *Flanges case*,¹⁵⁵ the seller only delivered part of the goods and those delivered were defective. The buyer mitigated his loss by selling the goods to his sub-buyer at a reduced price and claimed from the seller for the compensation paid to his sub-buyer, his loss of profit together with other expenses incurred. The Chinese tribunal only upheld a portion of the buyer's compensation to the sub-buyer under Articles 38 and 39 of the CISG.¹⁵⁶ The reason given was that the buyer failed to examine and object to the quality of the goods within the agreed time limit of the contract. In the author's view, whether the seller is liable for the buyer's loss against

¹⁵⁵ Award of 29 March 1999 [CISG/1999/14] (*Flanges case*).

¹⁵⁶ Article 38 of the CISG: '(1) The buyer must examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances. (2) If the contract involves carriage of the goods, examination may be deferred until after the goods have arrived at their destination. (3) If the goods are redirected in transit or redispached by the buyer without a reasonable opportunity for examination by him and at the time of the conclusion of the contract the seller knew or ought to have known of the possibility of such redirection or redispach, examination may be deferred until after the goods have arrived at the new destination.' Article 39 of the CISG: '(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. (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.'

his sub-buyer should depend upon whether the foreseeability test in Article 74 of the CISG was satisfied; and whether the seller is fully or partially liable for such compensation should depend upon whether the amount of the compensation is reasonable at the court's discretion. Thus, if the buyer's loss of compensation to his sub-buyer fell within the seller's foreseeability at the time of contract and the amount of compensation claimed is reasonable, then the seller should be fully liable. As was confirmed by the Chinese tribunal that the buyer failed to examine and object to the quality of the goods, the buyer should have lost his right for any damages caused by the non-conformity of the goods.¹⁵⁷ The Chinese tribunal should not have awarded any of the buyer's damages to his sub-buyer as a result of the non-conformity for the same reason. In the author's view, there may be two reasons as to why the buyer managed to claim back a portion of his liability against the sub-buyer after it was confirmed that he should have lost the right of objection. These two reasons are that the Chinese tribunal either took the seller's negligence in selling defective goods into account, or was influenced by the concept of share liability between the contracting parties in reaching their decision in this case. This would suggest that the Chinese tribunals made a fundamental error. The liability of contract in the CISG should be a strict liability and the fault of the parties should be disregarded.¹⁵⁸ The liability of contract should only be borne by the breaching party and not shared with the injured

¹⁵⁷ Articles 39, 40 of the CISG. There are two exceptional circumstances provided by the CISG under which the seller should still be liable for the damage caused by the non-conformity of the goods. These two circumstances are when the seller knew or could not have been unaware the lack of conformity which he did not disclose to the buyer (Article 40 of the CISG) and when the buyer has a reasonable excuse for his failure to give the required notice (Article 44 of the CISG). Neither of the circumstances of these two Articles was mentioned in the decision of the *Flanges case*. Therefore, the author assumes that these circumstances did not exist in the facts of this case. CISG Article 40: 'The seller is not entitled to rely on the provisions of article 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.' CISG Article 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.'

¹⁵⁸ Treitel p.346.

party. It appears to the author that the Chinese tribunal did not handle the relationship of these issues properly in their decision.

By comparison, English law is very consistent in judging the compensation of consequential loss. In circumstances of the seller's non-delivery or defective delivery of the goods, Sections 51(2) and 53(2) of the SGA provide for a general rule for the assessment of damages. English common law has developed specific rules for calculating the buyer's damages for his liability to the sub-buyer. If the aforementioned Chinese cases had been decided under English law, then the recovery of any consequential loss would have been subject to the tests for *causation*, *remoteness and reasonableness*. The establishment of *causation* between the buyer's liability to his sub-buyer and the seller's breach would have been judged by the court's common sense.¹⁵⁹ However, the buyer's failure to take reasonable mitigating action may break the causal chain,¹⁶⁰ e.g., the buyer failed to buy substitute goods in the market to perform the sub-sale contract. Thus, the damages claimed by the sub-buyer against the original buyer were as a result of the lack of mitigating action by the original buyer and not by any breach of contract by the original seller.¹⁶¹ Also, the recovery of the buyer's liability against the sub-buyer is subject to the *remoteness test*. The buyer needs to prove that such a loss was within the seller's reasonable contemplation, i.e., the seller contemplated or ought to have contemplated at the time of contract that the buyer would have to compensate his sub-buyer if the seller breaches the contract.¹⁶² The buyer does not have to prove the seller's actual contemplation of the exact amount of the loss, but only the type of loss which may be

¹⁵⁹ *Galoo v Bright Grahame Murray* [1994] 1 W.L.R. 1360.at 1374-1375 CA.

¹⁶⁰ *Lambert v Lewis* [1982] A.C. 225 HL; *Beoco Ltd v Alfa Laval Co Ltd* [1995] Q.B. 137.

¹⁶¹ Hence, the English court would always examine first whether the buyer has tried to mitigate the loss, e.g., by finding substitute goods when he knew or ought to have known of the breach and the buyer's failure to do so would deprive him of the right to claim his liability to a sub-buyer from the seller.

¹⁶² SGA 1979 s. 54 provides the buyer's right of such recovery as 'special damages'.

incurred under these circumstances. The amount of the recoverable damage for the buyer's liability to sub-buyers is also subject to the *reasonable test*, i.e., it is at the discretion of the court as to what is considered a reasonable amount. The recovery of such a consequential loss does not have a ceiling based upon the expected profitability of the contract.¹⁶³ That is to say, the buyer can still recover such a loss even if the contract made with the seller has proven to be unprofitable. In English law, when the seller is liable for the buyer's loss of profit in the sub-contract,¹⁶⁴ the seller is normally held to be liable for the buyer's liability against the sub-buyer and any costs incurred in defence against the sub-buyer.¹⁶⁵ If the same Chinese cases had been decided under English law, the buyer may have had less probability to recover his liability to the sub-buyer. That is because the degree of probability required in the remoteness test under English law is stronger than that of the foreseeability test under the CISG.

(ii) Repair loss

When the seller delivered defective goods and the buyer decided to accept the goods, is the buyer entitled to recover his losses incurred for repairing the goods or for his failed attempts involved?

The buyer's repair loss should be covered by the principle of full compensation in Article 74 of the CISG. In general, the buyer should be able to recover his repair loss, as long as the foreseeability test is satisfied and the cost of repair is reasonable. There is only one exception to this rule. It is provided in Article 48 of the CISG stating that when the seller is willing to cure the defect of the goods and the buyer is

¹⁶³ Chitty 26-078.

¹⁶⁴ *Re R and H Hall Ltd and WH Pim (Junior) & Co's Arbitration* [1928] All E.R.Rep.763, at 767, 769, HL(non-delivery); *Hydraulic Engineering Co Ltd v McHaffie Goslett & Co* (1878) 4 Q.B.D. 670 (defective delivery).

¹⁶⁵ *Agius v Great Western Colliery Co* [1899] 1 Q.B. 413, 420.

expected to accept the seller's offer according to trade usage, the buyer is excluded from repairing the goods himself and recovering those costs.¹⁶⁶ The CISG requires the seller's consent to the buyer's repair as a precondition for the buyer's recovery of his repair cost. In other words, the buyer is only entitled to repair the defects of the goods and recover his repair cost if the seller has waived his right of repair. This rule reflects one of the essential features of the CISG, which is to enforce the performance of the contract before the termination of that contract is considered.

Under the CISG, the seller is deemed to have a greater right to cure the defects of the goods than the buyer. However, the Chinese tribunals have been inconsistent in dealing with this relationship. This is illustrated in the following three cases.

In the *Clothes case*,¹⁶⁷ the buyer's repair cost was awarded in full after the arbitrators found that the goods delivered did not comply with the quality description in the contract. The issue of whether the seller was requested to rectify any defects in the goods before the buyer repaired them was not addressed by the tribunal.

In the *Gear processing machine case*,¹⁶⁸ the buyer asked the seller to repair the defect of the goods, but the seller did not respond. The buyer then organised for the repair of the goods and claimed his cost from the seller. The buyer agreed to bear 50% of the repair cost and claimed the other 50% of the repair cost, i.e., the labour expenses. The Chinese tribunal considered the buyer's claim of the labour expenses was reasonable and the award was made.

In a second *Clothes case*,¹⁶⁹ the goods delivered by the seller were defective and the buyer informed the seller that he would attempt to resell the defective goods at the best price achievable. The seller agreed to this request. The goods were

¹⁶⁶ Schlechtriem p.754.

¹⁶⁷ Award of 18 April 1995 [CISG/1995/06] (*Clothes case*).

¹⁶⁸ Award of 4 July 1997 [CISG/1997/19] (*Gear processing machine case*).

¹⁶⁹ Award of 31 January 2000 [CISG/2000/09] (*Clothes case*).

eventually resold by the buyer for the same price as originally agreed in the sub-contract after he completed some repair work. The buyer then claimed the repair cost from the seller. Although the full amount of the repair cost claimed by the buyer was held to be reasonable, only 70% of the cost was awarded by the Chinese tribunal, on the grounds that the buyer failed to consult the seller before any repair work was done. The tribunal did not regard the seller's consent to the buyer's resale at the best price achievable as the seller's consent to the buyer's repair. As stated earlier, the seller should have the priority to cure the defect of the goods before the buyer's own repair. A failure by the buyer to follow this course of action should preclude him from claiming the repair loss according to Article 48 of the CISG and therefore any claim should be dismissed. Nevertheless, 70% of the buyer's repair loss was approved by the arbitrators. In the author's view, the fact that the seller's fault in delivering defective goods may have been a consideration in the award. If that was the case, a fundamental error has been made because the CISG applies strict liability of contract, irrespective of the fault of the contracting parties. In the author's view, the seller's consent to the buyer's resale at the best price achievable should have been regarded as the seller's waiver of his right to cure any defects of the goods. Therefore, the buyer should have the right to repair the goods and claim the repair cost. Because the full amount of the repair cost was considered to be reasonable by the tribunal, the buyer should have been awarded that amount.

By comparison, English law has a very different position from the CISG. Specific performance is considered an exceptional remedy for the breach of contract and damages is the primary remedy.¹⁷⁰ A claim of specific performance would normally be dismissed when an award of damage is adequate to remedy the injured

¹⁷⁰ Michael Bridge p. 559-560.

party's loss.¹⁷¹ This position is adopted to prevent the undermining of some basic rules of English law such as that of mitigation.¹⁷² Specific performance is only granted on rare occasions such as when the goods are unique and replacement or alternatives are not available.¹⁷³ Where the warranty of the goods is breached or where the buyer elects to treat the breach of a condition of contract as the breach of a warranty, the buyer may claim damages according to the *prima facie* market rule. The damage amounts to 'the difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had fulfilled the warranty' according to Section 53 of the SGA. When the conditions of the goods, e.g., the descriptions of the goods, are breached by the seller, the buyer is entitled to reject the defective goods and buy substitute goods in the market. The buyer's damage is measured by the *prima facie* market rule, which has the same effect as the seller's non-delivery, i.e., 'the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered' according to Section 51(3) of the SGA. Where there is no available market, the basic rule for damages in Sections 51(2) or 53(2) of the SGA applies, i.e., the buyer's damage is measured by the loss directly and naturally resulting, in the ordinary course of events, from the seller's breach of contract. If the goods have been repaired by the buyer, the buyer can recover any repair costs that bring the goods up to the contractual standard.¹⁷⁴ The recovery of the repair costs is subject to the tests for causation, remoteness and reasonableness and not subject to the test for the profitability of the contract. It is apparent that English law does not have the same

¹⁷¹ Treitel p.73.

¹⁷² See Chitty 26-003; 27-003; 27-020.

¹⁷³ Ulrich Drobnig, 'General Principles of European Contract Law', *Petar Sarcevic & Paul Volken eds., International Sale of Goods: Dubrovnik Lectures*, Oceana (1986), Ch. 9, 305-332, available at <http://www.cisg.law.pace.edu/cisg/biblio/drobnig.html>.

¹⁷⁴ *Minster Trust Ltd v Traps Tractors Ltd* [1954] 1 W.L.R. 963, 988-989; *Mondel v Steel* (1841) 8 M. & W. 858, 872.

problem as the CISG with regard to the confusing relationship between the buyer's right of repair and the seller's priority to cure the defects of the goods prior to repair.

(iii) Litigation loss

Can the aggrieved party (seller or buyer) recover his loss on the expenses associated with litigation against the defaulting party as a consequential loss under Article 74 of the CISG?

This question has caused considerable academic controversy and resulted in many inconsistent judgments under the CISG.¹⁷⁵ The damages at issue involve extrajudicial expenses¹⁷⁶ and litigation expenses¹⁷⁷. The focus of the debate is whether such damages should be covered as a substantive issue under Article 74 of the CISG or as a procedural issue under national law.

The Chinese cases have demonstrated serious unpredictability in their outcomes that reflect the different interpretation of Article 74 by the tribunals. In some cases, Article 74 was invoked for awarding the claimant's arbitration loss, e.g., attorney's fees, travelling and investigation cost;¹⁷⁸ and in other cases, the national procedural rule was applied by enforcing the Arbitration Rules of China International Economic and Trade Arbitration Commission (CIETAC).¹⁷⁹ The compensation of the litigation loss measured by different rules has turned out with very different results. For example, some decisions made by applying some previous CIETAC arbitration rules

¹⁷⁵ Schlechtriem p.757; AC Opinion No.6, see *ante* fn.5 para.5; The UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods:

A/CN.9/SER.C/DIGEST/CISG/74 [8 June 2004]

<http://daccessdds.un.org/doc/UNDOC/GEN/V04/555/63/PDF/V0455563.pdf?OpenElement>.

¹⁷⁶ E.g., cost of debt collection by agent or lawyer.

¹⁷⁷ E.g., attorney's fees and court or arbitration fees.

¹⁷⁸ E.g., Award of 12 February 1999 [CISG/1999/08] (*Chrome plating machine case*); Award of 12 February 1999 [CISG/1999/09] (*Nickel plating machine case*).

¹⁷⁹ E.g., Award of 25 November 1996 [CISG/1996/02] (*Chromium ore case*); Award of 6 March 1997 [CISG/1997/01] (*Men's shirts case*); Award of 30 June 1999 [CISG/1999/30] (*Peppermint oil case*); Award of 31 December 1999 [CISG/1999/32] (*Steel coil case*); Award of 29 January 2000 [CISG/2000/08] (*Steel bottle case*).

had a limit for the amount of the recoverable arbitration loss, i.e., not more than 10% of the total amount awarded to the winning party,¹⁸⁰ and some decisions made by applying Article 74 of the CISG did not have such a limit.

The existence of such unpredictability stems from the absence of a clear unified interpretation of the CISG. The AC Opinion No.6 has a very persuasive argument. The view here is that the recovery of litigation loss should be a procedural issue governed by *lex fori* and not a substantive issue governed by the CISG.¹⁸¹ The Opinion held that to achieve the aim of uniformity,¹⁸² the general principles of the CISG should take precedence over private national law. The principle of full compensation under Article 74 of the CISG appears to cover the litigation loss. The basis for the recovery of damages here is the *breach of contract*. Then an unequal situation incurs, that is only the winning claimant is entitled to the recovery of litigation loss when the defendant has breached the contract and the winning defendant is not entitled to the recovery of litigation loss when the claimant did not breach the contract.¹⁸³ Such a situation would cause disparity in the recovery of damages between the contracting parties and it is against the principle of equity, one of the essential principles of the Convention. Hence, the compensation of litigation loss should not be governed by Article 74 of the CISG but should be governed by the private procedural rule.¹⁸⁴ In the author's opinion, it is unfortunate that the

¹⁸⁰ Article 59 of the Arbitration Rules of CIETAC in the versions of 1994, 1995, 1998, 2000 <http://www.cietac.org.cn/shiwu/zhongcaishiwu.asp?type=sw5> (Chinese version of 1994, 1995, 1998); http://www.cietac.org.cn/english/rules/rules_3.htm (English version of 2000) The 2005 version deleted such amount limit and replaced it with 'reasonableness' test at the tribunal's discretion in Article 46(2) <http://www.cietac.org.cn/english/rules/rules.htm>.

¹⁸¹ <http://cisgw3.law.pace.edu/cisg/CISG-AC-op6.html>

¹⁸² See Article 7(1) and the preamble of the CISG.

¹⁸³ For example, a defendant seller who won the case by successfully invoking a force majeure clause in the contract cannot claim his litigation loss from the claimant buyer by Article 74 because the buyer did not breach the contract.

¹⁸⁴ In *UNITED STATES Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co. Inc* (Federal Circuit Court of Appeals [7th Circ.] 19 November 2002): the court dismissed the claimant's attorney's fee as a loss compensable in Article 74 because the parties are supposed to bear their own legal

contracting states of the CISG are not bound to the Opinions of the CISG Advisory Council, although it is thought by some scholars to be the ‘most authoritative citations to the meaning of the Convention that one can find’.¹⁸⁵ The inconsistent judgments in the Chinese cases were all made before the AC Opinion No.6 was issued. It is worth considering how the Chinese tribunals would react to the views in Opinion No.6 in any future cases.

The litigation loss of the CISG is called the award of costs under English law. The general rule is that the unsuccessful party pays for the costs of the successful party.¹⁸⁶ In fact, the point to make is not whether English law or Article 74 of CISG is more reasonable in respect of which party should undertake the litigation loss, but that English law has the advantage in that there is only one rule to follow. The difficulty that the contracting states of the CISG have to face is the existence of two possible applicable rules, i.e., the CISG and private national law.

Conclusion

The application of Article 74 of the CISG by the Chinese tribunals has not led to predictable judgments. As discussed before, although some damages were consistently awarded,¹⁸⁷ most were inconsistent in the determination of Chinese

expenses under ‘American rule’ and left it open whether certain pre-litigation expenditures might be recoverable under Article 74 in the USA. <http://cisgw3.law.pace.edu/cases/021119u1.html>

¹⁸⁵ Kritzer, ‘Guide to Practical Applications of the United Nations Convention on Contracts for the International Sale of Goods’, Kluwer, 1989, p.2.

¹⁸⁶ The Civil Procedure Rules 1998 Part 44.3(2)(a): ‘(2) If the court decides to make an order about cost - (a) the general rule is that the unsuccessful party will be ordered to pay the costs of the successful party...’. *Dredging and Construction Co Ltd v Delta Civil Engineering Ltd* (2000) 68 Con LR 87. See also *Arbitration Law*, Robert Merkin (3rd ed. 2005) London: LLP: 18.79 and 18.82. Harry Flechtner and Joseph Lookofsky: *Viva Zapata! American Procedure and CISG Substance in a U.S. Circuit Court of Appeal*, 7 *Vindobona Journal of International Commercial Law and Arbitration* (2003) 93-104.

¹⁸⁷ E.g., the loss of interest and the L/C related losses.

decisions.¹⁸⁸ By comparison, English law has been more predictable in most circumstances. It is undeniable that some uncertain areas of the CISG have caused confusion for the Chinese tribunals.¹⁸⁹ Nevertheless, the blame cannot be all laid on the legislative skills of the CISG because the legislation of the SGA is no more advanced. The strength of English law is the common law mechanism, which adapts the SGA with flexibility to the development of international trade. For example, the absence of categorisation of compensable losses in Article 74 has caused confusion in the Chinese cases. Neither does the SGA have the explicit categorisation of compensable losses. Nevertheless, this problem has been resolved by the introduction of protected interests in English case law. Similarly, the remoteness rule in the SGA is no more manipulative than the foreseeability rule in the CISG. However, English case law has developed the remoteness rule and made it a practical tool that enables English courts to determine the compensation of different damages. Arising from the lack of authoritative guidance, many Chinese tribunals simply tend to quote Article 74 of the CISG without exploring the substantive content, i.e., the proper categorisation of the compensable losses and the foreseeability test. Also, there is a concern that in some cases the foreseeability test was replaced by the causation test as a means of limiting the liability of the breaching party.¹⁹⁰

In the author's opinion, to resolve these problems, it is insufficient to ensure that judges are more competent or to refer matters to alternative legislations as has been recommended by some scholars.¹⁹¹ The adoption of these two approaches would

¹⁸⁸ E.g., the loss on price difference, the loss of profit, the inspection loss, the buyer's liability to sub-buyer, the repair loss and litigation loss.

¹⁸⁹ E.g., the categorisation of compensable loss and protected interest, the object of the foreseeability test and the ascertainment of the degree of knowledge.

¹⁹⁰ Award of 18 September 1996 [CISG/1996/01] (*Lanthanide compound case*); Award of 17 October 1996 [CISG/1996/47] (*Tinplate case*).

¹⁹¹ The Principles of European Contract Law or UNIDROIT Principles of International Commercial Contracts have been suggested by some scholars to be applied to interpret the CISG to achieve a

probably do more harm than good and result in even more conflicting interpretations of the CISG. An effective clarification from UNCITRAL is a logical solution to resolve all the problems and to achieve a uniform application of the CISG. The documents like AC Opinions are very useful instruments, but they would be more effective if all the contracting states of the CISG were bound by them.

It is accepted that some inconsistent judgments were caused by the Chinese tribunals themselves, e.g., by their misunderstanding of the CISG. In some cases, the foreseeability test was confused with the causation test; in other cases, the fault of the contracting party was taken into account;¹⁹² and in further cases, the discretion of the tribunals was not properly applied.¹⁹³ In the author's opinion, the solution to these problems has to rely on the progress of the development of Chinese tribunals and the guidelines issued by the UNCITRAL. Also, it appears that the Chinese tribunals need more assistance than any other contracting states from UNCITRAL. This situation stems from the short legislative history of the Chinese international trade law and the immaturity in the development of legal theory in China. The guidelines from UNCITRAL will give a better understanding of the context of the CISG and in doing so enable the Chinese tribunals to be more consistent in their judgments.

The adoption of the CISG should be seen as a starting point as more work needs to be done to promote uniformity in its interpretation by the contracting states. This analysis of the circumstances surrounding the application of the CISG makes it more understandable with regard to why the UK has deliberated for so long as to whether to join the CISG. The existence of substantive differences between English law and

uniform understanding. The author is strongly against this opinion because there are some fundamental distinctions between these two legislations.

¹⁹² E.g., Award of 18 April 1995 [CISG/1995/06] (*Clothes case*).

¹⁹³ A variety of margins to the loss of profits were awarded by some arbitrators without persuasive reasoning and evidences. e.g., Award of 29 March 1999 [CISG/1999/14] (*Flanges case*), Award of 31 January 2000 [CISG/2000/09] (*Clothes case*), Award of 26 October 1993 [CISG/1993/12] (*Frozen beef case*).

the CISG calls for caution before any action is taken. The damage rule of English law has shown that it can be utilised with assurance, whereas the same cannot be said for that of the CISG. That is a reason why English law is appreciated by many international traders, who have incorporated English law into their contracts because of its predictability in application.

CHAPTER 5

MITIGATION OF THE LOSS FOR BREACH OF CONTRACT

Introduction

The starting place for the assessment of damages under the CISG is the principle of full compensation provided in Article 74: the aggrieved party is entitled to all losses resulting from the breach of the other party.¹ It is accepted that this places too heavy a burden on the party in breach and therefore alternative means have been introduced to limit this liability under the different legal systems. These are fault, foreseeability, causation, judicial discretion, mitigation and certainty of damages.² The tools of limitation adopted by the CISG are foreseeability³ and mitigation⁴. The foreseeability test has been addressed in Chapter 4 and the mitigation rule here.

The mitigation rule is, for some scholars: a ‘fundamental principle of the law of damages’.⁵ It requires the aggrieved party to take reasonable measures to prevent and minimise the loss resulting from the breach of the defaulting party. The aggrieved party’s failure to do so will result in a reduction of damages from the full damages which the breaching party should have been liable⁶ according to Articles 45(1)(b),

¹ This principle goes back to the famous formulation in *Robinson v Harman* (1848) 1 Ex 850 that the contracting party suffering losses should be put, as far as money can do, in the same position as if the contract had been properly performed. See Harvey McGregor QC ‘The Role of Mitigation in the Assessment of Damages’ presented in Birmingham Contract Damages Conference 28-29 June 2007.

² *Remedies for Breach of Contract-a Comparative Account*, G. H. Treitel, (1988) [‘Treitel’] Chapter VI.

³ CISG Article 74.

⁴ CISG Article 77.

⁵ *Sale of Goods*, Michael G. Bridge (2nd ed. 1997) [‘Michael Bridge’] p. 546.

⁶ Victor Knapp, *Bianca-Bonell Commentary on the International Sales Law*, Giuffrè: Milan (1987) [‘Victor Knapp’] p.559-567, also available at <http://cisgw3.law.pace.edu/cisg/biblio/knapp-bb77.html>.

61(1)(b)⁷ and 77 of the CISG. The sum to be reduced is equivalent to the amount by which the loss should have been mitigated. The purpose of the mitigation rule is to prevent the injured party from anticipating a loss as the result of a breach of contract by the other party, awaiting the increase of the loss passively, and then suing for damages.⁸

In the first section of this chapter, the mitigation rule of the CISG is compared with the mitigation rules of English law and the FECL.⁹ Their similarities and differences are examined. In the second section of this chapter, the Chinese cases decided under the CISG are critically examined to see whether Article 77 has been applied effectively. In particular, where the CISG has been consistently applied by the Chinese tribunals, if English law had been applied, would the result have been different? Where the CISG has not been consistently applied, would English law have worked more consistently? Finally, the question is addressed as to which regime offers the most predictability.

5.1 Comparison on the mitigation rules under the three regimes: CISG, FECL and English Law

In this part, the mitigation rules of the three regimes are compared with regard to the following questions: *[a] What are the relevant provisions under the three regimes? [b] Are they similar or different: if they are similar, what do they have in common and if they are different, what are the differences?* This examination starts with the

⁷ CISG Articles 45(1) (b) and 61(1) (b): 'If the seller (buyer) fails to perform any of his obligations under the contract or this Convention, the buyer (seller) may claim damages as provided in Articles 74 to 77.'

⁸ Victor Knapp, see *ante* fn. 6; *Remedies for torts and breach of contract*, A. S. Burrows, (3rd ed. 2004), p.122; *British Westinghouse Co v Underground Ry* [1912] A.C. 673 at 689.

⁹ The People's Republic of China Foreign-Related Economic Contract Law.

citation of the relevant provisions of the mitigation rules under the different regimes and then their similarities and differences are compared.

5.1.1 Relevant provisions of the mitigation rules under the three regimes

Article 77 is the mitigation rule of the CISG. Article 77 begins by specifying the injured party's duty to mitigate his loss: *'A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach.'* This is followed by the consequence for the injured party's failure to mitigate his loss: *'If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated'*.

Article 22 of the FECL reflects the mitigation rule of the old Chinese international sale contract law.¹⁰ Article 22 begins by stating the injured party's duty of mitigation: *'A party which suffers losses resulting from a breach of contract by the other party shall promptly take appropriate measures to prevent the losses from becoming severer.'* This is followed by outlining the sanction for the injured party's failure of mitigation: *'If the losses are aggravated as a result of its failure to adopt appropriate measures, it shall not be entitled to claim compensation for the aggravated part of the losses.'*

¹⁰ This rule was valid from 1st July 1985 to 30th September 1999. The CISG has become effective in China since 1st January 1988.

The heading of the mitigation of damages under English law may refer to three rules: *the avoidable loss, the avoided loss and the cost of mitigation*.¹¹ The *avoidable loss* corresponds to Article 77 of the CISG and it is the most important aspect of the mitigation rule. The injured party should take reasonable measures to mitigate his loss resulting from the breach of contract but he cannot recover his avoidable loss, which is the loss that could have been avoided or minimised by the injured party's reasonable measures.¹² This principle has been made by Lord Haldane in *British Westinghouse Electric and Manufacturing Co. Ltd v Underground Electric Ry.*¹³ 'imposes on a plaintiff the duty of taking all reasonable steps to mitigate the loss consequent on the breach and debars him from claiming any part of the damages which is due to his neglect to take such steps.' This rule is closely associated with the *prima facie* market rules in Sections 50(3) and 51(3) of the Sale of Goods Act 1979 (SGA).¹⁴ They specify in cases of damages for non-acceptance and damages for non-delivery that: '*Where there is an available market for the goods in question the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted (or delivered) or (if no time was fixed for acceptance or delivery) at the time of the refusal to accept (or deliver).*' This is the *prima facie* rules for measuring the recoverable damages for the breach of contract based on the mitigation rule of the *avoidable loss*.¹⁵ The injured party is required to act immediately upon the breach of contract by selling or buying the goods in a

¹¹ *McGREGOR On Damages*, McGREGOR, (17th ed. 2003) ['McGregor'] p.217; *Chitty on Contracts*, A. G. Chitty, (30th ed. 2008) ['Chitty'] 26-101; *Benjamin's Sale of Goods*, Judah Philip Benjamin, (7th ed. 2006) ['Benjamin'] 16-052; Michael Bridge see *ante* fn. 5 p.547.

¹² See McGregor p.217; Chitty 26-101.

¹³ [1912] A.C. 673 at 689. The statement of this leading case is regarded as the most authoritative expression of the mitigation rule in McGregor 7-014. See also *Owners of the Front Ace v Owners of (the Vicky I)* [2008] EWCA Civ 101.

¹⁴ Benjamin 16-052.

¹⁵ Benjamin 16-052.

substitute transaction subject to an available market.¹⁶ The other two aspects of the English mitigation rule, the avoided loss and the cost of mitigation, do not correspond to the mitigation rules in Article 77 of the CISG and Article 22 of the FECL. These are discussed later in the discussion of the mitigation rules of the three regimes.

5.1.2 Similarities of the mitigation rules under the three regimes

The mitigation rules under the three regimes have similar features: the nature of the mitigation rule; the reasonableness of the mitigating measures; the reimbursement of the relevant mitigating expenses; and the burden of proof.

[a] Nature of the mitigation rule

The nature of mitigation is not the injured party's obligation but an option. The injured party has the right to choose whether to mitigate his loss or not, despite the word of duty being commonly used.¹⁷ Article 77 of the CISG provides that the injured party 'must take measures as are reasonable...to mitigate the loss resulting from the breach'. Although the word of 'must' is adopted, the mitigating action is not enforceable and the injured party can make his decision in his own interest.¹⁸ If the injured party decides not to mitigate his loss resulting from the breach of contract, the breaching party is not entitled to demand the injured party's mitigation,¹⁹ or the

¹⁶ Ibid. Where is no available market, the basic rule of assessing damages in Sections 50(2), 51(2) or the special damages in Section 54 would apply instead, although the *prima facie* market rule would apply first: see Benjamin 17-002, 17-007, 17-021 and Chapter Two of this thesis: 2.2.1(1).

¹⁷ Michael Bridge, see *ante* fn. 5 p.547; McGregor 7-017; *Commentary on the UN Convention on the International Sale of Goods (CISG)*, Peter Schlechtriem, (2nd ed. 2005) ['Schlechtriem'] p.788; Djakhongir Saidov 'Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods' <http://cisgw3.law.pace.edu/cisg/biblio/saidov.html> ('Djakhongir Saidov') II.4.(a).

¹⁸ Schlechtriem p.788.

¹⁹ Djakhongir Saidov, see *ante* fn. 17 II.4 (a).

injured party's liability to pay any damages.²⁰ However, the failure of mitigation will prevent the injured party from recovering the loss that could have been avoided by his mitigating action. Article 22 of the FECL specifies the consequence for the failure of mitigation that the aggrieved party: 'shall not be entitled to claim compensation for the aggravated part of the loss'. Under English law, the mitigation is called a 'loose' duty because it is not actionable or owed to anybody by the injured party.²¹ Pearson L.J. declared in *Darbishire v Warran*²² that the claimant is at liberty to make good the loss but not at the expense of the defendant. In other words, the injured party is under no contractual duty to mitigate his loss but he is not entitled to charge the breaching party by the means of damages for the sum greater than what he reasonably needs.²³

[b] Reasonableness of mitigating measures

Under the three regimes, the measures taken by the injured party to mitigate his loss only need to be reasonable. Article 77 of the CISG requires those measures to be 'reasonable in the circumstances'. The criterion is the conduct of a prudent person in the same position as the injured party taking into account any relevant trade usage.²⁴ The injured party may be required to preserve perishable goods or sell them under

²⁰ Schlechtriem p.788.

²¹ McGregor 7-017.

²² [1963] 1 W.L.R. 1067 CA.

²³ Refer to the citation in McGregor 7-017. Sir John Donaldson M.R. emphasized this point in *The Solholt* [1983] 1 Lloyd's Rep. 605, CA that "A plaintiff is under no duty to mitigate his loss, despite the habitual use by the lawyers of the phrase 'duty to mitigate'. He is completely free to act as he judges to be in his best interest." However, the defendant is 'only liable for such part of the plaintiff's loss as is properly caused by the defendant's breach of duty' not for 'all loss suffered by the plaintiff in consequence of his so acting'.

²⁴ Schlechtriem p.790; CISG Article 9: '(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves. (2) The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which they parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.'

Article 77 as provided by Articles 85 to 88 of the CISG, even if there is no contractual obligation for him to take such measures.²⁵ Article 22 of FECL uses the word of ‘appropriate’ and it is normally applied with the same meaning as ‘reasonable’ by the Chinese tribunals. In English law, whether the injured party has acted reasonably is a question of fact, not a matter of law.²⁶ The ascertainment of reasonableness depends upon the circumstances of concrete cases.²⁷ The standard is what an injured party is expected to do ‘in the ordinary course of business’.²⁸ The injured party does not need to mitigate his loss resulting from the breach of contract by risking his own money,²⁹ endangering his commercial reputation,³⁰ injuring innocent persons,³¹ or sacrificing any of his property or rights.³²

[c] Reimbursement of the relevant mitigation expenses

The law covering the reimbursement of mitigation expenses includes the rules for the *avoidable loss, the avoided loss and the loss of mitigation* and these are similar under the three regimes.

²⁵ Schlechtriem p.790.

²⁶ McGregor 7-016, 7-065.

²⁷ Refer to McGregor: ‘The criterion of reasonableness and the standard of reasonableness’ 7-064-067; ‘Illustrative decisions’ 7-068-082.

²⁸ *Dunkirk Colliery Co v Lever* (1878) 9 Ch.D. 20, CA, at 25. It was also approved by Lord Haldane in *British Westinghouse Electric and Manufacturing Co. Ltd v Underground Electric Ry* [1912] A.C. 673 at 689; McGregor 7-066.

²⁹ *Lesters Leather and Skin Co v Home and Overseas Brokers* (1948) 64 T.L.R. 569, CA: the claimant buyer was held not to be bound to mitigate his loss of profit for rejecting the non-merchantable goods delivered to a UK port by risking his own money to buy substitute goods available in India. See also *Jewelowski v Propp* [1944] K.B.510; Benjamin 16-062; McGregor 7-072.

³⁰ *Finlay v Kwik Hoo Tong* [1929] 1K.B. 400, CA: the claimant who bought from the defendant August goods, actually shipped in September, despite the Bill of Lading (B/L) stating August, is not obliged to mitigate his loss by forcing the goods on his sub-buyers (where the B/L was the conclusive evidence of the date of shipment in sub-sale contract) because enforcing their legal rights against their sub-buyer would have injured their commercial reputation.

³¹ *Banco de Portugal v Waterlow* [1932] A.C. 452; McGregor 7-080; Benjamin 16-52

³² *Elliott Steam Tug Co. v Shipping Controller* [1922] 1 K.B. 127 at 120-141; McGregor 7-078; Benjamin 16-52. For more illustrations as to what is not required for the claimant in mitigation, see McGregor 7-071-082.

With regard to the *avoidable loss* rule under the CISG, the breaching party may claim a reduction in the avoidable loss, which should have been mitigated by the injured party according to Article 77. Under the FECL the injured party is not entitled to claim the compensation for the avoidable part of the loss according to Article 22. Under English law, when the seller fails to deliver the goods, the buyer must go to the market with reasonable speed and buy equivalent goods, when there is an available market. The seller is only liable for the damages on the price difference between the contract price and the market price at the time of non-delivery according to Section 51(3) of SGA. Also, he is not liable for the buyer's loss of profit in the sub-sale contract when the buyer fails to mitigate such a loss. The same rule applies in circumstances of non-acceptance according to Section 50(3) of the SGA. Where there is an available market, the seller is only entitled to damages on the price difference between the contract price and the market or current price at the time when the goods ought to have been accepted and he is not entitled to claim the total price of the goods from the buyer.

With regard to the *avoided loss*, where the injured party has taken reasonable mitigating measures and has successfully avoided or minimised his loss resulting from the breach of contract, he cannot claim any losses which he has already avoided.³³ That is because the injured party has never suffered the loss. Therefore, the requirements of the damage rules cannot be satisfied as outlined in the foreseeability test of the CISG and FECL,³⁴ the remoteness test of English law and the requirement of factual causation between the breach and the loss. The English position is clearly illustrated in the leading case of *British Westinghouse Co v*

³³ McGregor p.217, 264; Chitty 26-101, 26-115; Michael Bridge, see *ante* fn. 5 p.547.

³⁴ CISG Article 74 and FECL Article 19; *The International Sale of Goods Law & Practice*, Michael G. Bridge (1st 1999) p.105.

*Underground Ry.*³⁵ Where the injured party gains some benefits from the breach of contract or where he has avoided more losses than that is required by law, his benefit will be deducted to that extent from the damages recoverable from the breaching party.³⁶

With regard to *the loss of mitigation* where the injured party has taken reasonable measures to mitigate his loss resulting from the breach of contract, he can recover his loss incurred in the course of mitigation.³⁷ Such a loss is recoverable as a consequential loss subject to the foreseeability test of both the CISG and FECL together with the remoteness test of English law.³⁸ Also, the injured party can recover the loss incurred in mitigation, where the mitigating measures taken have in themselves led to a greater loss than it would have been, had the mitigating action not been taken, as long as that loss incurred for mitigation was reasonable.³⁹

[d] Burden of proof

The burden of proof is imposed on the breaching party according to the mitigation rules of all the three regimes. It is the breaching party's responsibility to prove that the loss resulting from the breach of contract could have been avoided by the injured party's mitigating action. Under the CISG, the breaching party needs to prove that 'the conditions for the availability of the defence exist',⁴⁰ i.e., the existence of the obligation to mitigate the loss and the extent of that obligation in the different

³⁵ [1912] A.C. 673; see also McGregor 7-089 and Michael Bridge see *ante* fn.34 p.105.

³⁶ *ibid.*

³⁷ McGregor p.217; Chitty 26-101, 26-120; Michael Bridge, see *ante* fn.5 p.553; Schlechtriem p.792 para.11.

³⁸ CISG Article 74, FECL Article 19, SGA Sections 50(2) and 51(2). Schlechtriem p.792; CISG Advisory Council Opinion No. 6: 'The aggrieved party is entitled to additional costs reasonably incurred as a result of the breach and of measures taken to mitigate the loss.' <http://cisgw3.law.pace.edu/cisg/CISG-AC-op6.html>. For further discussion see Chapter 4 of the thesis.

³⁹ *The Elena d'Amico* [1980] 1 Lloyd's Rep. 75; McGregor 7-084; Benjamin 16-058. Schlechtriem p.753: 'cost incurred in failed attempts to remedy the defective goods can also be claimed'.

⁴⁰ Schlechtriem p.793.

circumstances.⁴¹ Article 22 of the FECL has the same position. Under English law, the issue of burden of proof has also been clarified: the breaching party needs to prove that the injured party as a reasonable man ought to have taken certain measures to mitigate his loss.⁴²

5.1.3 Differences of the mitigation rules under the three regimes

The mitigation rules under the three regimes have some differences in their basic principles, the scope of their application and the time for mitigation.

[a] Basic principle of the mitigation rules

The basic principle of the mitigation rule under the CISG is that of good faith. One of the criteria for judging the reasonableness of the mitigating measures is what could be reasonably expected under the same circumstances from a party in good faith. It is noted that good faith is only a general principle of interpretation rather than substantive law,⁴³ as provided for in Article 7(1) of the CISG.⁴⁴ The duty of mitigation is considered to express good faith in international commerce.⁴⁵ Although the FECL does not have an explicit provision of good faith, it is often implied as a basic principle of the mitigation rule by the Chinese tribunals in their judgments.⁴⁶

However, the principle of good faith is not generally recognised by English contract

⁴¹ Ibid.

⁴² *Roper v Johnson* (1873) L.R. 8 C.P. 167. It was also confirmed by the House of Lords in *Garnac Grain Co v Faure & Fair-clough* [1968] A.C. 1130 at 1140 See Benjamin 16-052, McGregor 7-019, Michael Bridge, see *ante* fn.5 p.547.

⁴³ Francis Reynolds, 'Some Reservations about CISG' *L.Q.R.* (April 2003) ['Francis Reynolds'] p.291.

⁴⁴ CISG Article 7(1): 'In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.'

⁴⁵ Schlechtriem p.787.

⁴⁶ In the Contract Law of the People's Republic of China which has replaced FECL, Article 6 expressly stipulates good faith as a basic principle of Chinese contract law: 'the parties shall observe the principle of honesty and good faith in exercising their rights and performing their obligations.'

law.⁴⁷ The general view under English law is that the right of contract will be strictly exercised,⁴⁸ and the parties are assumed to be able to manage their own interests.⁴⁹ The principle of good faith in the CISG, which is designed to lead to a ‘romantic’⁵⁰ and ‘desired’ result are considered by some English scholars as a source of uncertainty.⁵¹ That is probably the reason why the larger commodity traders, who need their contract to be strict and with less flexibility, prefer the application of English law to the CISG.⁵²

[b] Applicable scope of the mitigation rules

The scope of the mitigation rule is applied differently under the three regimes. Under the CISG and the FECL, the injured party’s duty of mitigation lies alongside his right of damages and is restricted to that right only.⁵³ The injured party’s failure to mitigate does not affect any other remedies available to him, e.g., by requiring the specific performance of contract from the breaching party, as long as the domestic law authorises a broad approach of requiring performance.⁵⁴ For example, the seller

⁴⁷ It is noted that the marine insurance contract is an exception. The utter most good faith is recognised as a principle in the marine insurance contract law.

⁴⁸ In *White & Carter (Councils) Ltd v. McGregor* [1962] A.C. 413, 420, Lord Reid has a famous statement to its effect by citing the uncertainty that might arise if courts had to decide this issue.

⁴⁹ Francis Reynolds, see *ante* fn.43 p.291: There is an exception for this view where the implied contract terms equity or statute have intervened.

⁵⁰ Francis Reynolds, see *ante* fn.43 p.291.

⁵¹ Treitel p.74.

⁵² Francis Reynolds, see *ante* fn.43 p.292; Steven Gee and Charles Debattista, ‘An English sale of goods Act that will be suitable for the worldwide market’, *Lloyd’s List* (8 December 2004) p. 6.

⁵³ CISG Article 77 and FECL Article 22; Schlechtriem p.788.

⁵⁴ CISG Article 28: ‘If, in accordance with the provisions of this Convention, one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgement for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by this Convention.’ The American delegate’s proposal to apply the mitigation rule to the reduction of damages ‘or a corresponding modification or adjustment of any other remedy’ in Article 77 was rejected because the wording was too vague and broad although it was sound to some extent. It is noticeable that the UK delegate supported the American proposal. <http://cisgw3.law.pace.edu/cisg/text/link77.html>. See also Schlechtriem p.789; Treitel p.73; see also ‘The Secretariat Commentary on 1978 Draft Article 73’. The Secretariat Commentary was made on the 1978 Draft of the CISG and it is not the Official Text. 1978 Draft Article 73 was almost the same as Article 77 of the CISG. The Secretariat Commentary on 1978 Draft Article 73 is therefore regarded by some scholars as the most authoritative and the closest counterpart to an official Commentary of

may still require the buyer to take delivery of or pay for the goods even if the seller has failed to mitigate his loss on a falling market by selling the goods to other available buyers.⁵⁵ Alternatively, the buyer may require the seller to deliver, substitute, repair,⁵⁶ or reduce the price of the goods,⁵⁷ after the buyer has failed to mitigate his loss in a rising market by buying substitute goods from another supplier when the contract is breached. The fundamental reason for such difference is that the CISG and the FECL emphasize the performance of contract, which is a primary remedy for the breach of contract.⁵⁸ So even if the injured party fails to mitigate his loss, he is still entitled to require specific performance from the breaching party to achieve the same result as the recovery of full damages.⁵⁹ However, the principle of good faith in Article 7(1) of the CISG should prevent the injured party from doing this,⁶⁰ but it is not completely clear under the CISG what the consequences are for the breach of this principle. Also, the definition of good faith may be interpreted differently by the contracting states of the CISG.

By comparison, under English law, damage is the primary remedy for the breach of contract and specific performance is discretionary.⁶¹ Normally, the English court would not grant the remedy of specific performance whenever damage is considered an adequate remedy.⁶² The injured party's failure of mitigation would exclude him from claiming specific performance. The *prima facie* market rule in Sections 50(3) and 51(3) of the SGA requires the action of mitigation to be taken immediately after

CISG Article 77. <http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-77.html>; Victor Knapp 2.8, see *ante* fn.6.

⁵⁵ CISG Article 62.

⁵⁶ CISG Article 46.

⁵⁷ CISG Article 50.

⁵⁸ Francis Reynolds, see *ante* fn.43 p.294.

⁵⁹ Schlechtriem p.789; *Uniform Law for International Sales under the 1980 United Nations Convention*, John O. Honnold, (3rd ed. 1999) ['Honnold'] p.459 § 419.3(3) 'Mitigation and the Right to Require Performance'.

⁶⁰ Treitel p.74.

⁶¹ Michael Bridge, see *ante* fn.5 p. 559-560.

⁶² Treitel p.73.

the contract is breached by selling or buying the goods in the market. The only damage that the injured party can recover is the difference between the contract price and the market or current price at the time of breach. The breaching party is not liable for any exaggerated loss, which could have been avoided by the injured party's mitigation.

[c] By what point in time the duty of mitigation arises

The time when the injured party becomes obliged to mitigate his loss resulting from the breach of contract is provided for differently under the three regimes. The object of mitigation under the CISG and the FECL is called the mitigation of 'loss', whereas under English law it is called the mitigation of 'damages'.⁶³ Under Article 77 of the CISG and Article 22 of the FECL, the injured party is obliged to prevent and mitigate his loss,⁶⁴ i.e., not only by minimising the extent of the loss after it has occurred but also by preventing the loss from occurring.⁶⁵ In English law, the injured party is normally only obliged to mitigate his damage when he discovers or ought to have discovered that the contract was breached.⁶⁶

If an anticipatory breach of contract occurs, the time at which the duty of mitigation arises are provided for differently under the mitigation rules of the three regimes. Under the CISG and the FECL, the injured party may breach his duty of mitigation by unreasonably keeping the contract open and by delaying the avoidance

⁶³ Michael Bridge, see *ante* fn.34 p.105.

⁶⁴ Schlechtriem p.788.

⁶⁵ Schlechtriem p.787-788.

⁶⁶ *Toepfer v Warinco* [1978] 2 Lloyd's Rep. 569, 578. In case of defective performance, as soon as the claimant discovers the defects, he is under the duty of mitigation to stop using the goods by either making it safe or replacing it. The claimant cannot recover any damage from the defendant which arises after he discovered the defects but could have been reasonably avoided by remedial measures. Some latitude is normally allowed to be given after the claimant knows or ought to have known the breach, i.e., a reasonable time, depending upon the circumstances for the claimant to decide how to mitigate: *C. Sharpe & Co. Ltd v Nosawa & Co.* [1917] 2 K.B. 814, 821; Treitel p.117; Benjamin 16-053; Chitty 26-109.

of contract, i.e., by refusing to accept the anticipatory repudiation.⁶⁷ However, there is some controversy regarding this issue under the CISG. The prevalent view is that the injured party is obliged to accept the anticipatory repudiation and mitigate his loss before the performance of contract is due according to the principle of good faith in Article 7(1) of the CISG.⁶⁸ Other hold the view that the injured party has an option to decide whether to accept the anticipatory repudiation or not and in consequence, he is not obliged to mitigate his loss until the performance is due according to Article 72(1) of the CISG.⁶⁹ Under English law, the injured party is under no obligation to accept the anticipatory breach of contract. It is an option for him either to accept the anticipatory repudiation and discharge the breaching party from further performance of contract, or to continue to treat the contract as binding until the due date for performance.⁷⁰ Where the injured party decides to accept the anticipatory repudiation, he then becomes obliged to take mitigating action within a reasonable time after his acceptance. Where the injured party decides to reject the anticipatory repudiation, he will only be obliged to mitigate his loss when the performance is due under the contract.⁷¹

If the actual breach of contract occurs, e.g. by non-delivery or non-acceptance, the time when the injured party is obliged to terminate the contract and mitigate his loss by a resale is provided for differently under the three regimes. In principle, under the CISG or the FECL, when the contract is breached, the injured party is not obliged to avoid the contract and he is still entitled to the performance of the contract,

⁶⁷ Michael Bridge, see *ante* fn.34 p.105. The principle of good faith in Article 7(1) of the CISG may also be invoked for such an offence.

⁶⁸ Secretariat Commentary, see *ante* fn.54.

⁶⁹ Honnold p.457; CISG Article 72(1): 'If prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach of contract, the other party may declare the contract avoided.'

⁷⁰ *Fercometal SARL v Mediterranean Shipping Co. SA* [1989] A.C. 788. Benjamin 16-080-082; McGregor 7-020-022.

⁷¹ *Ibid.*

as long as he has an acceptable reason for delaying the avoidance of contract, or when a substitute sale was not reasonable or possible during that time.⁷² Under English law, the injured party is bound to act immediately upon the breach of contract, i.e., by terminating the contract and buying or selling the goods if there is an available market.⁷³ Then the *prima facie* market rule measures the recoverable damages based upon the market or current price at the time of breach.⁷⁴ Even if there is no available market, the injured party still has a duty to take reasonable mitigating action to minimise his loss.⁷⁵

5.2 Examination of the consistency of the mitigation rule applied by the Chinese tribunals under the CISG in comparison with English law

This session discusses some determined Chinese cases in which the mitigation rule of the CISG was applied in order to assess as to whether this rule has been applied consistently in those decisions. The issues to be discussed include: [a] *Where the contract is breached, the injured party should mitigate his loss or require specific performance from the breaching party and whether the injured party's failure of mitigation would restrict his claim of specific performance?* [b] *At what point in time should the mitigating action be taken by the injured party when an anticipatory breach of contract occurs? Should this occur at the time of anticipatory breach or at the time when the performance is due under the contract?* [c] *What should be considered reasonable mitigating measures?*

⁷² Schlechtriem p.792.

⁷³ Benjamin 16-052; Chitty 26-110.

⁷⁴ SGA Sections 50(3), 51(3).

⁷⁵ Benjamin 16-052, 077-078.

These questions cover some of the most controversial issues of the mitigation rule under the CISG. If the application of the mitigation rule of the CISG under the Article 77 provides predictable outcomes in the Chinese cases, it can be considered effective. As previously mentioned, the application of the mitigation rule of the FECL and CISG both has the same outcomes. Therefore, the author will not discuss the application of the FECL. Also, because some substantive differences exist between the mitigation rules of the CISG and English law, it is considered worthwhile to establish what the outcomes would be under English law. This comparison will focus upon the following aspects. *[a] If there has been predictable judgments under the CISG, would the same apply under English law. [b] Conversely, if the judgments have not been predicable under the CISG, would the same apply under English law?*

5.2.1 *Where a contract is breached, should the injured party mitigate his loss or require specific performance from the breaching party and whether the injured party's failure of mitigation would restrict his claim of specific performance?*

Under the CISG, the injured party's duty of mitigation applies only to the remedy of damages but not to that of specific performance. A controversial issue is often raised under the CISG: *when a contract is breached, should the injured party mitigate his loss and claim damages, or require the performance from the breaching party; and where the injured party fails to mitigate his loss, is he still entitled to recover his full loss by claiming specific performance from the breaching party instead of claiming damages regardless of his failure of mitigation?*

It is important to address this issue so as to establish whether damages or specific performance is the primary remedy because this impacts upon the consequence for the breach of contract. If damages prevail over specific performance, then the injured party needs to mitigate his loss resulting from the breach immediately, once a contract is breached. Otherwise, the mitigation rule would apply and he would not be able to recover the avoidable loss, which could have been mitigated, even if he chooses to claim specific performance instead of damages. If specific performance prevails over damages, once the contract is breached, the injured party should be aware that if there is still possibility for the breaching party to perform the contract, then he would need to require specific performance. Also, he cannot mitigate his loss by making a substitute sale in the market until the performance of contract becomes impossible or the performance is refused by the breaching party.

The Chinese tribunals have not demonstrated consistency in dealing with these issues. In some cases, the remedy of specific performance was held to be subject to the mitigation rule.⁷⁶ In other cases, the injured party's entitlement to mitigation was held to be subject to the requirement of specific performance from the breaching party.⁷⁷

In *Hang Tat v. Rizhao*,⁷⁸ a contract was concluded for the sale of frozen PTO shrimp C&F Florida, the USA. The seller guaranteed that the quality of the goods met the US sanitation and health standards. Also, the seller agreed that if the goods were not given right of entry to the US by the US Food and Drug Administration ('FDA'), he would refund the payment and compensate for the cost of freight together with any other related expenses for return of the goods. In fact, the goods

⁷⁶ China 17 December 1999 Rizho Intermediate People's Court, Shandong Province (*Hang Tat v. Rizhao*) and Award of 11 April 1997 [CISG/1997/05] (*Silicon metal case*).

⁷⁷ *Silicon metal case*, see *ante* fn. 76; Award of 31 January 2000 [CISG/2000/09] (*Clothes case*).

⁷⁸ *Hang Tat v. Rizhao*, see *ante* fn.76.

were seized and the FDA demanded them to be destroyed because of the problem of decay. The buyer shipped the goods back and asked the seller to refund the payment. Because the seller and the buyer could not reach an agreement as to whether the seller should refund the payment first or the buyer should tender the Bill of Lading (B/L) first, the goods were left with the shipping agent for over a year. They were finally sold by the Qingdao Customs Investigation Bureau when the value of the goods was approaching zero. The money was confiscated by the National Treasury because no party claimed ownership of the goods. The buyer sued the seller and claimed a refund of the price paid together with other damages. The Chinese tribunal supported the buyer's claim for the refund of the payment but held the buyer liable for 70% of the loss of the value of the goods on the grounds that the buyer had failed to mitigate his loss by preserving the goods properly. In this case, the Chinese tribunal applied the mitigation rule to the claim of specific performance, i.e., a refund of the cost of the goods. However, the buyer's failure of mitigation by preserving the goods properly cost him 70% of the value of the goods deducted from the original price to which he was initially entitled.

In the *Silicon metal case*,⁷⁹ the quality and quantity of the goods delivered did not comply with the contract. The seller had forged the inspection certificate and had obtained the payment through the Letter of Credit (L/C). The buyer received the goods and asked the seller to substitute the defective goods. After the seller refused to respond this request, the buyer mitigated his loss by reselling the goods at a lower price. The Chinese tribunal held that the buyer was entitled to mitigate his loss by this resale at a discounted price. The seller was required to return the price the buyer overpaid and compensate for the buyer's loss of profit for reselling the defective

⁷⁹ See *ante* fn. 76.

goods at a lower price. It was clear that the Chinese tribunal held the buyer entitled to mitigate his loss when he claimed specific performance from the seller. The buyer's claim of specific performance, i.e., the refund of the overpaid price, was held to be subject to the mitigation rule, i.e., by the discounted resale.

In these two cases, both arbitration tribunals held the claim of specific performance by the buyer to be subject to the mitigation rule. When the buyer in *Hang Tat v. Rizhao*⁸⁰ failed to mitigate his loss, his claim of specific performance, i.e., the refund of the full price reduced by a sum equivalent to the avoidable loss, which could have been mitigated by his proper preservation of the goods. When the buyer in the '*Silicon metal case*'⁸¹ mitigated his loss by a discounted resale, he claimed and won back both his overpaid price and his loss of profit.

By comparison, in some other cases, the Chinese tribunals have held that the remedy of specific performance prevails over the remedy of damages and the mitigation rule does not apply to a claim of specific performance. In the *Clothes case*,⁸² where the clothes delivered by the seller were found to be defective, the buyer mitigated his loss by repairing the goods in his own factory and selling the clothes for the original price as agreed in the sub-contract. The buyer claimed the damage for the repair cost from the seller. The Chinese arbitrators did not deny the fact that the buyer had the right to mitigate his loss, but ordered the buyer to stand 30% of the repair cost on the grounds that the buyer had not consulted the seller prior to carrying out the repair. In this case, Article 48 of the CISG was applied and the seller was held to have the priority to cure the defect in his performance after the delivery of the goods. The seller's right to cure was held to have been deprived by the buyer's own

⁸⁰ See *ante* fn.76.

⁸¹ *ibid.*

⁸² *Clothes case* fn. 77.

mitigating action, i.e., by repairing the clothes himself.⁸³ Apparently, the Chinese tribunal in this case considered the buyer's consultation on the seller's specific performance was a precondition of the buyer's mitigating action.

In the *High carbon tool steel case*,⁸⁴ where the buyer failed to open the L/C by the contractual date, the seller mitigated his loss by reselling the goods to another customer at a lower price. The seller claimed this price difference between the contract and the substitute sale. The Chinese tribunal held that the seller must stand the loss of 50% of this price difference for his failure to give the buyer that proper notice prior to resale.

In the author's opinion, in the above two cases, it is clear that the Chinese tribunal held the injured party's mitigation to be subject to the requirement of specific performance from the breaching party. The injured party's failure to require the specific performance cost him the reduction by a considerable amount of the damages to which they would have been originally entitled.⁸⁵

In all four cases discussed above, it is apparent that the Chinese tribunals hold conflicting views with regard to whether specific performance should be subject to the mitigation rule or *vice versa*.

What could be the fundamental cause of this confusion? The two conflicting views stem from two very different remedies for the breach of contract under the CISG: damage and specific performance. Damage is the traditional remedy of the common law under which the remedy of specific performance is rarely granted,

⁸³ Article 48(1) of the CISG: '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 retains any right to claim damages as provided for in the Convention.'

⁸⁴ Award of 31 December 1996 [CISG/1996/58] (*High carbon tool steel case*).

⁸⁵ The principle of sharing the loss is often applied to the Chinese decision. The author disagrees about the application of such a principle. In the author's view, if the injured party should not mitigate his loss, he should undertake all the loss related to his improper mitigation; if the injured party should mitigate his loss and he does it properly, the breaching party should be liable for all the loss related.

unless the normal sanction of damages is considered inadequate, e.g., when the goods sold are unique.⁸⁶ Specific performance is the traditional remedy for the breach of contract in the countries with planned economies where both contracting parties would have deviated from their planned tasks if the performance of contract is not enforced.⁸⁷ The divergence between countries with market economies and those with planned economies is so enormous that the CISG could not achieve a compromise and has had to rely on specific performance being made subject to individual domestic law as laid out in Article 28 of the CISG.⁸⁸ That is to say: for countries in which specific performance is an exceptional remedy for the breach of contract, damages prevail over specific performance and the Articles related to specific performance in the CISG do not apply;⁸⁹ for countries in which specific performance is the primary remedy for the breach of contract, the Articles related to specific performance would apply. However, it is not clear under the CISG, where specific performance is a normal remedy, whether specific performance prevails over damages and whether a claim of specific performance is subject to the mitigation rule.⁹⁰ As mentioned earlier, some scholars believe that the mitigation rule in Article 77 of the CISG applies to only the remedy of damages;⁹¹ and other scholars maintain that the mitigation rule should apply to other remedies such as specific performance.⁹²

⁸⁶ Ulrich Drobnig, 'General Principles of European Contract Law', *Petar Sarcevic & Paul Volken eds., International Sale of Goods: Dubrovnik Lectures*, Oceana (1986), Ch. 9, 305-332, available at <http://www.cisg.law.pace.edu/cisg/biblio/drobnig.html>.

⁸⁷ *Ibid.*; Article 28 of the CISG see fn. 54; SGA section 52(1) 'In any action for breach of contract to deliver specific or ascertained goods, the court may, if it thinks fit, on the plaintiff's application, by its judgment or decree direct that the contract shall be performed specifically, without giving the defendant the option of retaining the goods on payment of damages.'

⁸⁸ *Ibid.*

⁸⁹ e.g. Articles 46, 50 and 62 of the CISG.

⁹⁰ See *ante* 5.1.3 [b].

⁹¹ Schlechtriem p.788.

⁹² Honnold p.459.

Some scholars hope that the injured party will observe the principle of good faith in Article 7(1)⁹³ and mitigate his loss even if specific performance is claimed. Nevertheless, the CISG does not clarify what the consequences are if the principle of good faith was breached. There is nothing to stop the injured party from escaping his duty of mitigation by claiming specific performance to enhance his own interests. Hence, the contracting parties are strongly advised to draft a specific term in their contract that deals with the relationship between the mitigation rule and specific performance when the CISG is the applied law.⁹⁴ For example, if the parties wish the mitigation rule to apply in the claim of specific performance, it should be clearly specified in the contract that Article 77 applies to specific performance.⁹⁵ The drafted terms could be worded that: ‘If the claimant fails to mitigate his loss, the party in breach may claim a reduction of damage by an amount equivalent to that which should have been mitigated, or claim a corresponding modification or adjustment to the remedy of specific performance’. If the parties do not wish the mitigation rule to apply to the claim of specific performance, this should be clearly stated in the contract. The drafted terms could read ‘If the claimant fails to mitigate his loss, the party in breach may claim a reduction in damages only and no corresponding modification or adjustment should be made when the remedy of specific performance is claimed.’

Under English law, specific performance is an exceptional remedy and would only be granted when damage is not adequate for compensating for the loss of the injured party. The mitigation rule prevails over the remedy of specific performance.

⁹³ None of the Chinese cases that the author has found mentioned the principle of good faith when the mitigation rule in Article 77 was applied.

⁹⁴ Jeffrey S. Sutton, ‘Measuring Damages Under the United Nations Convention on the International Sale of Goods’, *50 Ohio State Law Journal* (1989) 737-752.

⁹⁵ This is allowed by the CISG in Article 6: ‘The parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of its provision.’

Thus, once a contract is breached, the injured party is obliged to mitigate his loss immediately by selling or buying in the market and he is only entitled to the price difference between the contract and the market or the current price at the time of breach. This is called the *prima facie* market rule and is provided for in Sections 50(3) and 51(3) of the SGA. The confusion as to whether the mitigation rule should be applied to the remedy of specific performance is not an issue for English law.

However, there is a principle which was concluded in the *White and Carter (Councils) Ltd v McGregor*, a non-sale of goods case.⁹⁶ In this case, the House of Lords held that the claimant had no duty to mitigate his loss where a debt was claimed in return for the claimant's performance of his obligation, unless the claimant had no legitimate interest in performing his side of the contract or his performance needed the co-operation from the defendant. That is to say, if the injured party had no legitimate interest in performing the contract or if the cooperation from the other party was needed for the performance of contract, the injured party still had the duty of mitigation. It is not clarified under English law whether this principle would apply in a sale of goods case.⁹⁷ In a sale of goods contract, the seller's delivery of the goods needs the co-operation of the buyer in taking delivery. Therefore, the seller cannot take advantage of the principle demonstrated in the *White and Carter* case and in consequence he still has the duty of mitigation.⁹⁸

If English law had been applied in aforementioned cases, the first two cases would probably have arrived at the same result whereas the latter two would probably have come to a different conclusion. The claimant would not have been

⁹⁶ [1962] A.C. 413 at 431.

⁹⁷ Benjamin 16-059; Djakhongir Saidov see *ante* fn. 17 II 4 (c).

⁹⁸ *Clea Shipping Corporation v Bulk Oil International Ltd (The Alaskan Trader)* [1984] 1 All E.R. 129 at p.133; Benjamin 16-059.

required to share the liability for their proper mitigating action as damages are the primary remedy for the breach of contract under English law and the mitigation rule applies to the claim of specific performance in a dispute in the international sale of goods.

5.2.2 *When a breach of contract is anticipated, at what point in time should mitigation occur: at the time of the anticipatory breach or when performance is due under the contract?*

Under the CISG, there are conflicting views regarding the time at which the duty of mitigation should arise when a breach is anticipated. Is the injured party obliged to accept the repudiation of the party in breach and must therefore mitigate his loss when he accepts the anticipatory repudiation? Alternatively, is the injured party entitled to reject the anticipatory repudiation and therefore only obliged to mitigate his loss when the performance is due under the contract?

The answer to these questions is important because the time for the assessment of damages is dependant upon the time when mitigation should take place.⁹⁹ If the injured party is not bound to accept the anticipatory breach, he can decide the time when to accept the anticipatory repudiation with a favouring market. The period of time for him to make the decision starts from the date of anticipatory breach to the date when the performance of contract is due. His duty of mitigation would only arise after his acceptance. The damages would be assessed at the point in time when he decides to accept the anticipatory repudiation and terminate the contract. Alternatively, if the injured party is bound to accept the anticipatory repudiation, the

⁹⁹ 'The timing of the non-breaching party's mitigation efforts is crucial to the ultimate calculation of damages owed.' Larry A. DiMatteo, Lucien Dhooge, Stephanie Greene, Virginia Maurer and Marisa Pagnattaro, 'The Interpretive Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence' VI.2.C <http://www.cisg.law.pace.edu/cisg/biblio/dimatteo3.html>.

breaching party's unilateral repudiation would terminate the contract and the injured party would be bound to mitigate his loss at the time of anticipatory breach. Damages would be assessed at the point of time when the anticipatory breach occurs.

The Chinese tribunals recognise the principle of good faith in contract law¹⁰⁰ and they generally support the view that the time when the duty of mitigation arises is when the anticipatory breach occurs and not when the performance is due under the contract.

In the *Compound fertilizer case*,¹⁰¹ the seller informed the buyer before the date of performance that he could not deliver the 20,000 tons of compound fertilizer for the price of \$3,320,000 as agreed in the contract. This was because the seller's suppliers had failed to deliver the goods to the seller. Unfortunately, the buyer had already resold the goods to two sub-buyers for the total price of Chinese currency RMB 34,000,000.¹⁰² The buyer did not buy substitute goods for his sub-buyers and claimed his loss of net profit RMB 1,800,600, i.e., the anticipated gross profits with expenses deducted. The seller argued that this loss was caused by the buyer's failure to mitigate by buying substitute goods in the market to fulfil his sub-contracts. The Chinese tribunal held that the buyer had made an effort to mitigate his loss by trying to find the substitute goods after the seller's anticipatory breach occurred, although his effort did not succeed because of the problems of season and price. The buyer's claim for the loss of net profit was upheld. Based on the decision in this case, it can be inferred that the Chinese arbitrators held that the buyer was obliged to mitigate his loss when the anticipatory breach of contract occurred. It was considered important that the buyer could show that he had made an effort to mitigate his loss when the breach was anticipated. If the Chinese arbitrators had not taken this view, they could

¹⁰⁰ See *ante* 5.1.3[a].

¹⁰¹ Award of 30 January 1996 [CISG/1996/05] (*Compound fertilizer case*).

¹⁰² The exchange rate between the USD and RMB was not given in the facts of the case.

have supported the buyer's claim for his loss of profit by simply dismissing the seller's claim for the buyer's failure to mitigate his loss because the buyer was not obliged to do so until the performance was due.

In the *Caffeine case*,¹⁰³ the seller could not deliver the goods because of the problem of manufacturer. He informed the buyer of his anticipatory breach before the delivery date of the contract and asked the buyer to purchase substitute goods from other sources. The buyer bought the substitute goods before the date of the seller's delivery and claimed his loss for the difference between the original contract price of \$7.45/kg and the substitute contract price of \$13.8/kg. Subsequently, the market price fell rapidly after the buyer had bought the substitute goods. The seller claimed that the buyer was not entitled to buy the substitute goods before the delivery date and the buyer was only entitled to the difference between the original contract price of \$7.45/kg and the market price of \$9.03/kg on the date of delivery under the contract. The Chinese tribunal dismissed the seller's argument and held that the buyer's substitute purchase before the contractual delivery date was reasonable. It was confirmed that the buyer had the right to take reasonable measures to mitigate his loss when the seller informed him prior to the delivery date of his inability to deliver the goods.¹⁰⁴ However, because the buyer could not provide sufficient evidence to prove the existence of the substitute purchase, the buyer's claim of the difference between the contract price and the substitute sale price was dismissed. Then, the author would believe that the buyer should be awarded the difference between the contract price \$7.45/kg and the market price around \$13.8/kg at the time when the contract was terminated by the buyer's acceptance of the seller's anticipatory breach, which was also the time when the buyer's mitigating action, i.e.

¹⁰³ Award of 29 March 1996 [CISG/1996/15] (*Caffeine case*).

¹⁰⁴ This assertion also reflects the nature of the mitigation rule as mentioned in 5.1.2 of this chapter that the mitigation is an option and a right of the injured party.

by a substitute purchase, should have been taken. However, the Chinese tribunal ascertained the market price not by the time when the anticipatory breach was accepted but by the time when the goods should be delivered under the contract. The author believes that it was a wrong decision. The assessment of damage in this case should have been based on the time when the contract was terminated and the mitigation should have been taken, i.e., at the time when the anticipatory breach was accepted rather than when goods should have been delivered. The decision of this case clearly conflicts with the general view of the Chinese tribunals that the injured party should mitigate his loss at the time of anticipatory breach, rather than when the performance is due under the contract.

The cause of the conflicting views of the Chinese tribunals in the above two cases is that the CISG has not clarified the time when the duty of mitigation arises in the circumstance of anticipatory breach.¹⁰⁵ The principle of good faith in Article 7(1) requires the injured party to prevent and minimise the loss before the performance of contract is due.¹⁰⁶ That is to say, the injured party is obliged to mitigate his loss when the anticipatory breach occurs. Article 72(1) defines the acceptance of the anticipatory breach only as an *option* of the injured party, i.e., the injured party is entitled to decide whether to accept the anticipatory breach and when to mitigate his loss up until the performance is due. Therefore, the time for the assessment of damages is held to be different depending upon the tribunal's preference.

A typical illustration of these conflicting views is the examples given in the two examples given in two literatures: Example 73A in the Secretariat Commentary¹⁰⁷ and Example 77A in Professor John O. Honnold's book.¹⁰⁸ In Example 73A, the

¹⁰⁵ See *ante* 5.1.3[c].

¹⁰⁶ See *ante* fn.44.

¹⁰⁷ Secretariat Commentary see *ante* fn. 54.

¹⁰⁸ Honnold p.457.

buyer who refused to avoid the contract and to buy substitute goods when facing an anticipatory breach on a rising market was held to have failed to mitigate his loss and was only entitled to the difference between the original contract price and the market price at the time of anticipatory breach, instead of the time at which the performance was due. In contrast, in Example 77A, a seller who refused to avoid the contract and refused to sell the goods by a substitute sale when facing an anticipatory breach of contract on a falling market was held not to be obliged to accept the anticipatory repudiation. Instead, he was entitled to the difference between the original contract price and the market price when the performance was due and not when the anticipatory breach occurred according to Article 72(1) of the CISG.¹⁰⁹

Considering the uncertainty of the CISG arising from these two conflicting views, the parties are strongly advised to clarify in advance how the mitigation rule of the CISG should be interpreted and applied by an express term in their contract.¹¹⁰ For example, if the parties prefer the mitigation to be undertaken at the time of an anticipatory breach, a term could be drafted as follows: ‘The injured party is obliged to mitigate his loss when an anticipatory breach occurs. The breaching party may claim a reduction in damages or a corresponding modification and adjustment of specific performance in the amount by which the loss should have been mitigated on the date of anticipatory breach.’ If the parties prefer the mitigation to be undertaken only when the performance is due, a term could be drafted as follows: ‘The injured party has the option to decide whether to accept an anticipatory breach of contract or not. If the injured party decides to accept it, he is obliged to mitigate his loss at the time of the anticipatory breach and his failure to mitigate entitles the breaching party

¹⁰⁹ See *ante* 5.1.3[c].

¹¹⁰ Jeffrey S. Sutton, ‘Measuring Damages Under the United Nations Convention on the International Sale of Goods’, 50 *Ohio State Law Journal* (1989) 737-752.
<http://cisgw3.law.pace.edu/cisg/biblio/sutton.html>.

to claim a reduction in damages or a corresponding modification and adjustment of specific performance in the amount by which the loss should have been mitigated based on the date of anticipatory breach. If the injured party decides to reject the anticipatory breach, he is obliged to mitigate his loss when the performance is due. Failure to mitigate entitles the breaching party to claim a reduction in damages or a corresponding modification and adjustment of specific performance in the amount by which the loss should have been mitigated based on the performance date under the contract.’

As outlined in the first session of this chapter,¹¹¹ by comparison, under English law, when the anticipatory breach occurs in circumstances of non-delivery or non-acceptance, the injured party is entitled to either accept the repudiation or to continue treating the contract as binding until the date for performance is due under the contract.¹¹² The duty of mitigation would only arise when the anticipatory repudiation is accepted by the injured party or when the performance is due and if the anticipatory repudiation is rejected by the injured party.¹¹³ The injured party is under no obligation to act ‘reasonably’ in exercising his options.¹¹⁴ Where he decides to accept the anticipatory repudiation, he is obliged to mitigate his loss within a reasonable time after his acceptance of the goods. The assessment of damage is based upon the market price of the goods at a time by which they ought to have been resold or re-bought,¹¹⁵ rather than on the date of repudiation or the date when the

¹¹¹ See *ante* 5.1.3[c].

¹¹² *Ferrometal SARL v Mediterranean Shipping Co. SA* [1989] A.C. 788. Benjamin 16-080-082; McGregor 7-020-022. The American position is different from English law. The general American common law principle of damages is that ‘Relief ought not to include damages for loss that could have been avoided’: Farnsworth, ‘Damages and Specific Relief’, 27 *Am. J. Comp. L.* (1979) at 251, available at <http://www.cisg.law.pace.edu/cisg/biblio/farns.html>.

¹¹³ *Ibid.*

¹¹⁴ *Tredegar Iron and Coal Co. (Ltd) v Hawthorn Bros & Co.* (1902) 18 T.L.R. 716 at 716-717; Benjamin 16-059.

¹¹⁵ *Melachrino v Nickoll and Knight* [1920] 1 K.B. 693 at 697; *Kaines (U.K) Ltd v Osterreichische* [1993] 2 Lloyd’s 2 Lloyd’s Rep. 1 at 11, 12; Benjamin 16-081.

repudiation was accepted. However, if the market fell after the seller accepted the repudiation, the seller must resell the goods immediately and he would not be able to recover any price difference between when he should have resold the goods and when he actually did.¹¹⁶ Where the injured party refuses to accept the anticipatory repudiation, he is only obliged to mitigate within a reasonable time after the date for performance is due.¹¹⁷ Where there is an available market, the assessment of damages should be normally based upon the market price on the date of delivery.¹¹⁸ The market price at the time of repudiation until the date for performance is irrelevant because the mitigation rule would not apply until the date of the occurrence of the breach.¹¹⁹

If English law had been applied in the *Compound fertilizer case*,¹²⁰ the result would probably have been different from the Chinese decision. The buyer would only have been entitled to the difference between the original contract price and the market price within a reasonable time after the seller's anticipatory breach of contract was accepted.¹²¹ If the market price of the goods was rising after the buyer accepted the anticipatory breach,¹²² the buyer should re-purchase the goods immediately and the only damages to which he would be entitled are those of the price difference between the original contract price and the market price on the date when he accepted the anticipatory breach.¹²³ The net profit loss suffered by the buyer between the original contract price and sub-sale contract price could only be recovered if there was no available market for the buyer to buy the substitute goods

¹¹⁶ *Melachrino v Nicholl and Knight*, see ante fn. 115.

¹¹⁷ *White and Carter (Councils) Ltd v McGregor*, see ante fn. 96.

¹¹⁸ *Tredeggar Iron and Coal Co. (Ltd) v Hawthorn Bros & Co.* see ante fn.114 at 716; *Tai Hing Cotton Mill Ltd v Kamsing Knitting Factory* [1979] A.C. 91 at 102, 104; Benjamin 16-081-082.

¹¹⁹ *White and Carter (Councils) Ltd v McGregor*, see ante fn. 96; *Tredeggar Iron and Coal Co. (Ltd) v Hawthorn Bros & Co.* see ante fn.114.

¹²⁰ Award of 30 January 1996 [CISG/1996/05] (*Compound fertilizer case*).

¹²¹ See ante fn. 115.

¹²² This circumstance was not clarified in the facts of the case.

¹²³ *Melachrino v Nicholl and Knight*, see ante fn. 115.

available and the seller knew or ought to have known that the buyer bought the goods with a view for resale at the time of contract.¹²⁴

If English law had been applied in the *Caffeine case*, even if the buyer could not prove the existence of the sub-sale contract, he would have been entitled to his loss based on the difference between the original contract price and the market price when he ought reasonably to have re-bought the substitute goods after the anticipatory breach was clearly accepted by the buyer. Unlike the Chinese tribunals, the calculation of damages would have not been based upon the market price when the delivery was due under the contract.¹²⁵

5.2.3 Reasonableness of mitigation: what the reasonable mitigating measures are?

The mitigation rule under the CISG requires the injured party to act reasonably to mitigate his loss resulting from the breach of contract by the other party.¹²⁶ Article 77 states that the mitigating measures need to be ‘reasonable in the circumstances’. This poses the question: what are the reasonable mitigating measures for the breach of contract in international sale of goods?

The Chinese tribunals could consider the following as reasonable mitigating measures that the injured party could take: the preservation of the goods; the disposal of the goods;¹²⁷ the repair of the goods;¹²⁸ the sale of the goods including re-selling¹²⁹ or re-buying;¹³⁰ or the sourcing of alternative goods. It is worth noting that

¹²⁴ E.g. *Frank Mott & Co Ltd v Muller & Co (London)* (1922) 13 L.I.L.Rep. 492; *Patrick v Russo-British Grain Export Co Ltd* [1927] 2 K.B. 535, 541; Chitty 43-435.

¹²⁵ *Melachrino v Nickoll and Knight*, see *ante* fn. 115 at 697; *Kaines (U.K) Ltd v Osterreichische* [1993] 2 Lloyd’s 2 Lloyd’s Rep. 1 at 11, 12; Benjamin 16-081.

¹²⁶ See *ante* 5.1.2[b].

¹²⁷ Award of 6 June 1991 [CISG/1991/03] (*Cysteine monohydrate case*).

¹²⁸ Award of 18 April 1995 [CISG/1995/06] (*Clothes case*).

¹²⁹ Award of 8 April [CISG/1999/04] (*Australian raw wool case*).

the Chinese tribunals have been very consistent in their judgments as to whether the measures taken by the injured party are reasonable mitigating measures.

The *Cysteine monohydrate case*¹³¹ is a case in which the injured buyer was held to have failed to take a reasonable mitigating measure. Where the goods delivered by the seller were defective, the seller agreed to substitute the goods if they could be sent back to Shenzhen as agreed in the sale contract, although neither party could agree who should pay for the freight. Instead, the buyer sent the goods back to Hong Kong and named a third party as the consignee of the B/L, who went bankrupt before taking delivery. The goods remained in Hong Kong for over three years and then the buyer claimed a refund of the price, the freight, the storage charges and the interest on all costs. In this case, the buyer's preservation of the goods in Hong Kong for over three years was not held by the Chinese arbitrators as a reasonable mitigating measure. Therefore, the loss incurred for the storage charge in Hong Kong was not recoverable. Furthermore, the arbitrators alleged that this loss could have been avoided by taking reasonable mitigating measures, e.g. by transporting the goods back to Shenzhen, reselling the goods, or making the seller as the consignee of the B/L for taking delivery of the returned goods. In this case, the Chinese tribunal correctly ascertained the reasonableness of the mitigating measures: the buyer's preservation action was unreasonable because it did not mitigate but augmented the loss resulting from the seller's breach of contract.

The *Chrome-plating machines production-line equipment case*¹³² is a case in which the seller's storage cost was held to be recoverable as a reasonable mitigating measure. When the buyer failed to open the L/C, the seller preserved the goods for a

¹³⁰ Award of 10 August 2000 [CISG/2000/04] (*Silicon metal case*).

¹³¹ See *ante* fn. 127.

¹³² Award of 12 July 1996 [CISG/1996/28] (*Chrome-plating machines production-line equipment case*).

short period and then sold them to another buyer. The seller claimed the price difference between the original contract price and the substitute sale price. He also claimed for the storage costs and the interest on those costs. The buyer refused to pay for the storage costs on the grounds that they could have been avoided if the seller had resold the goods immediately after the buyer's failure to open the L/C at the time agreed under the contract. The Chinese tribunal made the final decision based on the confirmation of two facts. Firstly, it was confirmed that the goods were not in common use and they were specially manufactured to satisfy the special requirements of the buyer's end user. Secondly, it was confirmed that the buyer never avoided the contract in writing before the arbitration hearing. Based upon these two facts, the Chinese arbitrators held that the seller's action of storing the goods before the resale was a reasonable mitigating measure after the buyer's breach of contract. The loss caused by the storage was not an avoidable loss as claimed by the buyer. Instead, it is the costs incurred for mitigating the loss resulting from the buyer's breach. In this case, the Chinese tribunal correctly identified that the seller had taken reasonable mitigating measures.

If English law had been applied in these two Chinese cases, the outcomes would have been the same. As mentioned in the first section of this chapter,¹³³ in English law, the reasonableness of mitigation is a question of fact and not of law¹³⁴ and the criterion of the reasonableness is no higher than what the injured party is expected to do in the ordinary course of business.¹³⁵ The storage loss in the *Cysteine monohydrate case* would also be treated as an avoidable loss, which was not recoverable because the buyer did not take reasonable mitigating action. The only

¹³³ See *ante* 5.1.2[b].

¹³⁴ McGregor 7-016, 7-065.

¹³⁵ *Dunkirk Colliery Co v Lever* (1878) 9 Ch.D. 20, CA, at 25. It was also approved by Lord Haldane in *British Westinghouse Electric and Manufacturing Co. Ltd v Underground Electric Ry* [1912] A.C. 673 at 689; McGregor 7-066.

loss that the buyer can recover under English law is the price difference between the value of the goods at the time of delivery and their value, had they fulfilled the warranty of the goods as provided for in Section 53(3) of the SGA.¹³⁶ The seller's storage loss in the *Chrome-plating machines production-line equipment case*¹³⁷ would also have been recoverable as a mitigation loss, i.e., the costs incurred for mitigating the loss resulting from the buyer's breach of contract. The recovery of the seller's storage costs would have been treated as a consequential loss and would have been subject to the tests for remoteness, reasonableness and causation.¹³⁸

Conclusion

The Chinese tribunals have not been consistent in their judgments with regard to the two issues under discussion. The main cause of this unpredictability arises from the conflicts within the CISG itself. For the purpose of compromise, the CISG has managed to draw upon a variety of conflicting domestic legal instruments together. The concurrence of damages and specific performance in the CISG as discussed in this chapter is an example of a compromise designed to nationalise conflicting remedies for the breach of contract. The mitigation rule is a means of limitation in the assessment of damages under the CISG. It is against this background that the author has raised the issues under discussion.

The first question raised was *whether the injured party should mitigate his loss or require specific performance from the other party after a contract is breached and whether the injured party's failure of mitigation restricts his right to require specific*

¹³⁶ Section 53(3) of the SGA: 'In the case of breach of warranty of quality such loss is prima facie the difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had fulfilled the warranty.'

¹³⁷ Award of 12 July 1996 [CISG/1996/28].

¹³⁸ Chitty: 26-078; SGA section 50(2): 'Damages for non-acceptance: the measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the buyer's breach of contract.' For details, see *ante* Chapter 4.

performance? From the examination of the previous Chinese cases, the answer to this question is not clarified under the CISG. Article 48(1) of the CISG entitles the seller to repair any defects of the goods after the date for delivery. According to this, the injured buyer is obliged to request the seller's specific performance before taking his own mitigating action. Article 7(1) of the CISG requires the buyer to observe the principle of good faith and mitigate his loss even if he could claim specific performance instead of damages. Article 77 of the CISG provides that the buyer's failure of mitigation only restricts his right of damages and does not affect his right to require specific performance. A combination of these Articles has resulted in a difficult situation: after a contract is breached, the injured party is obliged to require the specific performance from the breaching party and take his own mitigating action, but his failure of mitigation would not affect his claim of specific performance. Thus, by claiming the specific performance of contract, the injured party would receive the same result as the recovery of full damages despite his failure of mitigation. The conflict of the CISG in this respect has confused the Chinese tribunals with regard to whether the claim of specific performance should be subject to the mitigation rule. That was the main reason why the Chinese judgments were unpredictable.

The second question raised was *when the mitigation should be taken in the circumstance of an anticipatory breach – at the time of the anticipatory breach or when the performance is due?* Article 72(1) of the CISG identifies the mitigation as the injured party's option, i.e., either he can accept the anticipatory repudiation and mitigate his loss after his acceptance or he can reject the anticipatory repudiation and only mitigate his loss when the performance is due under the contract. Article 7(1) of the CISG requires the injured party to observe the principle of good faith and mitigate his loss when the anticipatory breach occurs. This conflict within the CISG

has caused the Chinese tribunals' confusion in deciding when the mitigating action should be taken and how the damages for the breach of contract should be calculated.

The third question raised was *what are reasonable mitigating measures?* This issue has been consistently handled in the Chinese cases. Reasonable mitigating measures are readily distinguishable from the unreasonable.

By comparison, under English law, the answers to the above three questions are certain and thus predictable. The primary remedy for the breach of contract under English law is the termination of contract and the awarding of damages.¹³⁹ The mitigation rule plays a crucial role in the awarding of damages. Once a contract is breached, the claimant is obliged to sell or buy immediately in the market to mitigate his loss. The *prima facie* market rule in Sections 50(3) and 51(3) of the SGA calculates the recoverable damages based upon the difference between the contract price and the market price at the time of the breach of contract. The loss caused by the injured party's failure of mitigation is not recoverable under English law. Where there is an available market, the time for mitigation is normally the time of breach. Where there is no available market, the calculation of damages is based upon the estimated loss directly and naturally resulting, in the ordinary course of events, from the breach of contract.¹⁴⁰ There is some latitude in what is considered to be a reasonable time before mitigation comes into force.¹⁴¹ Specific performance is a discretionary remedy and can only be granted to the injured party in unusual circumstances. The injured party under English law does not have to face the complications that arise under the CISG. He cannot claim the specific performance of contract whenever damage is available. Under English law, in the circumstances

¹³⁹ Francis Reynolds see *ante* fn.43 p. 294.

¹⁴⁰ The details of the calculation of damage based on Sections 50(2) and 51(2) of the SGA is discussed in Chapter 4 of this thesis.

¹⁴¹ *C. Sharpe & Co. Ltd v Nosawa & Co.* [1917] 2 K.B. 814, 821; Treitel p.117; Benjamin 16-053.

of anticipatory breach, the time for mitigation depends upon whether the anticipatory breach is accepted by the injured party. Where it is accepted, the time for mitigation is the reasonable time after his acceptance. Where it is refused, the time for mitigation is the time when the performance is due. It is the injured party's choice to decide whether to accept or reject the breaching party's anticipatory repudiation of the contract. There is no principle of good faith for the injured party to observe under the English sale of goods contract law. Thus, when the anticipatory breach of contract occurs in English law, there is no confusion as to whether the mitigation should be taken and how the damages will be calculated at the time of mitigation.

In conclusion, the mitigation rule of the CISG has some defects, which have resulted in some confusion for the Chinese tribunals. The resolution of these problems has to rely on the study of the CISG cases and a uniform interpretation of the Articles of the CISG. The United Nations Commission on International Trade Law¹⁴² has organised nine CISG Advisory Council Opinions to be issued to interpret some problematic Articles of the CISG. Although the Opinions of this Council are not binding on the contracting states of the CISG, they are helpful instruments for the interpretation and application of the CISG in a more uniform and robust way. The author looks forward to another Opinion to be issued by the Advisory Council shortly, which will clarify some of the conflicting issues of the mitigation rule under the CISG as raised in this chapter.

¹⁴² It is the organisation which prepares the CISG.

CHAPTER 6

SPECIFIC PERFORMANCE FOR BREACH OF CONTRACT

Introduction

Specific performance is the principal remedy for the breach of contract under the CISG. Where a contract is in default, the injured party has the right to require the breaching party to perform his obligations under the contract. Specific performance requires the seller's delivery, repair or substitution of the goods and the buyer's payment or taking delivery of the goods together with any other contractual obligations.¹ The injured party can only demand the avoidance of contract and claim of damages in limited circumstances under the CISG. For example, when a fundamental breach of contract occurs,² when the defaulting party fails to perform the contract after the expiry of any additional period of time fixed by the aggrieved party or when the defaulting party fails to rectify any severe defect by his subsequent performance.³

The purpose of this chapter is to investigate whether the specific performance rule of the CISG has been applied consistently by the Chinese tribunals and therefore has led to predictable judgments in the Chinese cases. The specific performance rules of the FECL and English law are compared with the CISG to see which regime leads to more consistent and predictable judgments.

¹ CISG Articles 46 and 62.

² CISG Article 49.

³ CISG Articles 48 and 49.

The first section of this chapter examines the relevant provisions of the specific performance rules of the three regimes by comparing their similarities and differences. The second section of this chapter investigates some Chinese judgments with regard to two raised issues. The author applies the specific performance rule of English law to the Chinese cases in order to see if the application of this alternative law would have made any difference. Finally, in conclusion, the author attempt to establish what has caused any unpredictability and whether there are any potential problems when the judgments have been unpredictable.

6.1 Comparison on the specific performance rules for breach of contract under the three regimes: CISG, FECL and English law

The specific performance rules under the three regimes are examined in this section with regard to the following respects: [a] What are the relevant provisions of the three regimes? [b] What are their similarities and differences? A discussion of these issues would help to understand why the remedy of specific performance has different significance in the three regimes.

6.1.1 Relevant provisions of the specific performance rules under the three regimes

The CISG grants both the seller and the buyer the remedy of requiring the performance of contract when either party is in breach. Article 46 provides for the buyer's remedy to require the seller's specific performance when the seller is in breach of a contract. Article 46(1) specifies the precondition for the buyer's claim of specific performance that the buyer must not resort to a remedy that is inconsistent with his claim of specific performance: *'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.' An inconsistent remedy may include a claim for damages, a price reduction or the avoidance of contract. Articles 46(2) and 46(3) specify the different forms of the buyer's request for the seller's specific performance and under what circumstances the buyer is entitled to each of those forms of the seller's specific performance. Article 46(2) states that: *'If the goods do not conform with the contract, the buyer may require delivery of substitute goods only if the lack of conformity constitutes a fundamental breach of contract and a request for substitute goods is made either in conjunction with notice given under article 39 or within a reasonable time thereafter.'* Article 46(3) states that *'If the goods do not conform with the contract, the buyer may require the seller to remedy the lack of conformity by repair unless this is unreasonable having regard to all the circumstances. A request for repair must be made either in conjunction with notice given under article 39 or within a reasonable time thereafter.'* Article 62 stipulates the seller's remedy of requiring the buyer's specific performance and the precondition for the seller's claim: *'The seller may require the buyer to pay the price, take delivery or perform his other obligations, unless the seller has resorted to a remedy which is inconsistent with this requirement.'* Article 28 of the CISG restricts the granting of specific performance subject to national law: *'If, in accordance with the provisions of this Convention, one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgement for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by this Convention.'* While the phrase used in Articles 46 and 62 is 'require performance', the phrase used in Article 28 is 'specific performance'. The rephrasing is a compromise made between the civil law countries

and the common law countries to satisfy the interest of a common law system for the purpose of unification.⁴ Common law speaks of ‘specific performance’ and civil law talks about ‘require performance’.⁵

The remedy of specific performance is not spelt out in the FECL, but the claim of specific performance is normally upheld by the Chinese tribunals and applied as if under the CISG.⁶ It is because specific performance is covered as one of ‘other reasonable remedial measures’ provided in Article 18 of the FECL: *‘If a party fails to perform the contract or its performance of the contractual obligations does not conform to the agreed terms, which constitutes a breach of contract, the other party is entitled to claim damages or demand other reasonable remedial measures. If the loss suffered by the other party cannot be completely made up after the adoption of such remedial measures, the other party shall still have the right to claim damages.’*

In English law, only the buyer’s request for the seller’s performance of contract is categorised as a specific performance claim. Where the buyer fails to pay for the goods, the seller maintains the right of action against the buyer for payment, but such an action is not traditionally regarded as a claim for specific performance.⁷ Thus, the discussion of the specific performance rule under English law in this chapter is restricted to the buyer’s action against the seller’s performance. Section 52 of the SGA specifies the buyer’s right to require the seller’s specific performance subject to the following limitations: *‘(1) In any action for breach of contract to deliver specific*

⁴ *The International Sale of Goods Law & Practice*, Michael G. Bridge (1st 1999) p.99.

⁵ *Ibid.* p.100.

⁶ It is mainly due to the drafting history of the FECL. The FECL was drafted based on the CISG. More details can be found in *ante* 1.1.

⁷ *Chitty on Contracts*, A. G. Chitty, (30th ed. 2008) [‘Chitty’] 27-005. SGA Section 49: ‘Action for price (1) Where, under a contract of sale, the property in the goods has passed to the buyer and he wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action against him for the price of the goods. (2) Where, under a contract of sale, the price is payable on a day certain irrespective of delivery and the buyer wrongfully neglects or refuses to pay such a price, the seller may maintain an action for the price, although the property in goods has not passed and the goods have not been appropriated to the contract.’

or ascertained goods, the court may, if it thinks fit, on the plaintiff's application, by its judgment or decree direct that the contract shall be performed specially, without giving the defendant the option of retaining the goods on payment of damages.' The goods must be *'identified and agreed on at the time a contract of sale is made [and includes an undivided share, specified as a fraction or percentage, of goods identified and agreed on as aforesaid]'*⁸ or *'identified in accordance with the agreement after the time a contract of sale is made'*.⁹

6.1.2 Similarities of the specific performance rules under the three regimes

Under the three regimes, where a contract is breached by the seller, the buyer all has the right to require the seller to perform the contract. The buyer's entitlement to require the seller to deliver the goods is a form of specific performance that all three regimes have in common.¹⁰ Also, there is a similar limitation imposed on a buyer's request for the seller's delivery: the buyer must not resort to a remedy that is inconsistent with his claim of specific performance, e.g., by avoiding the contract or claiming damages.¹¹

6.1.3 Differences of the specific performance rules under the three regimes

⁸ SGA Section 61(1).

⁹ *Re Wait* [1927] Ch 606, at 630, per Atkin L.J. Chitty 43-471.

¹⁰ CISG Art.46, FECL Art.18, SGA s.52(1).

¹¹ CISG Art.46(1), see *Commentary on the UN Convention on the International Sale of Goods (CISG)*, Peter Schlechtriem, (2nd ed. 2005) ['Schlechtriem'] p.537; English case: *Meng Leong Development Pte. Ltd v Jip Hong Trading Co. Pte. Ltd* [1985] A.C. 511, see *Benjamin's Sale of Goods*, Judah Pilip Benjamin, (7th ed. 2006) ['Benjamin'] 17-096. Article 18 of the FECL made the remedy of specific perform and the remedy of damages as two options between which the claimant is only entitled to one. The only exception is when the remedy of specific performance is not adequate to compensate the claimant's loss, the claimant can claim the extra damages suffered.

The specific performance rules of the three regimes differ in three main aspects: the scope of their application, the limits imposed on the remedy of specific performance, the significance of the role of specific performance and the court's discretion.

[a] Scope of application

The scope of the application of the specific performance rules in the three regimes has some significant differences. Firstly, despite the differing terminologies under the three regimes, specific performance is a broader concept under the CISG and the FECL than under English law.¹² Under the CISG and the FECL, the specific performance rules embrace both the buyer's right to require the seller's performance of contract and the seller's right to require the buyer's performance.¹³ Under the SGA, the specific performance rules generally refer only to the buyer's request of the seller's delivery.¹⁴

Secondly, under the specific performance rules of the SGA, the precondition of the buyer's request for the seller's delivery is that the goods must be specific or ascertained, i.e., '*identified and agreed on at the time a contract of sale is made [and includes an undivided share, specified as a fraction or percentage, of good identified and agreed on as aforesaid]*'¹⁵ or 'identified in accordance with the agreement after the time a contract of sale is made'.¹⁶ In contrast, the specific performance rules of the CISG and the FECL do not require the goods to be specific.¹⁷

Thirdly, the forms of specific performance that the claimant may resort to are more varied in the CISG and FECL. Under these regimes, the buyer is not only

¹² *The International Sale of Goods Law & Practice*, Michael G. Bridge (1st 1999) p.100.

¹³ CISG Articles 49 and 62; FECL Article 18.

¹⁴ The phrase used in Section 52 of the SGA is 'on the plaintiff's application' under the heading of 'Buyer's remedies'. The 'plaintiff' here indicates the buyer only.

¹⁵ SGA Sections 52 and 61(1).

¹⁶ *Re Wait* [1927] Ch 606, at 630, per Atkin L.J. See also Chitty 43-471; Benjamin 17-097.

¹⁷ CISG Article 46(1) and FECL Article 18.

entitled to require the seller to deliver the goods, but also entitled to require the seller to repair any defective goods or to provide substitute goods where the lack of conformity constitutes a fundamental breach of contract.¹⁸ Also, the injured seller can require the buyer's performance by asking for payment or acceptance of the goods.¹⁹ In contrast, the only form of specific perform provided for by the SGA is the buyer's entitlement to require the seller to deliver the specific or ascertained goods.²⁰

[b] Limits on the remedy of specific performance

The limits imposed on the remedy for specific performance are different under the three regimes. In the CISG, there are three main restrictions imposed on a claim for specific performance. These are resorting to an inconsistent remedy, impediments and good faith as outlines below.

Firstly, the claimant can only require specific performance if he has not resorted to a remedy which is inconsistent with the claim of specific performance.²¹ The inconsistent remedies under the CISG include the avoidance of contract, price reduction and damages.²² The inconsistent remedy of price reduction is covered by Article 18 of the FECL as a type of 'other reasonable remedial measures'. However, the remedy of price reduction is not available to business-buyers in English law.²³

¹⁸ CISG Article 46(2)(3), Schlechtriem p.536-537; FECL Article 18.

¹⁹ CISG Article 62; FECL Article 18.

²⁰ SGA Section 52(1).

²¹ CISG Articles 46(1) and 62; *Commentary on the Draft Convention on Contracts for the International Sale of Goods* prepared by the Secretariat, UN (hereinafter, "Secretariat Commentary"). The commentary on Article 42 of the 1978 draft of the CISG is roughly equivalent to Article 46 of the CISG. <http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-46.html>.

²² CISG Articles 46(1), 49, 64, 50, 74; Schlechtriem p.537.

²³ The remedy of price reduction is only available to consumer-buyers in English law as provided in SGA Part 5A, despite some scholars arguing that a general remedy of price reduction can be implied from Sections 30 and 53 of the SGA: Peter A. Piliounis, 'The Remedies of Specific Performance, Price Reduction and Additional Time (Nachfrist) under the CISG: Are these worthwhile changes or additions to English Sales Law?', *12 Pace International Law Review* (Spring 2000) 1-46 ['Peter A. Piliounis'].

Secondly, under the CISG and FECL, the claimant is not entitled to require the performance of the breaching party if the non-performance is caused by force majeure or the claimant's own act or omission,²⁴ as this breach breaks the causation between the breach and damages. However, the force majeure clause is treated with scepticism by the English court and it is rarely upheld unless the impediment fits precisely in such a clause.²⁵

Thirdly, under the CISG, where the seller refuses to deliver the goods, the buyer maintains his right to require the seller to deliver the goods without the obligation to avoid the contract and to purchase replacement goods, as long as it is to his advantage to do so.²⁶ The only limitation imposed on the buyer's claim of specific performance is the principle of good faith.²⁷ The position of the FECL is similar to the CISG. Good faith is often applied by the Chinese tribunals as a basic principle of contract law, although it is not explicit in the FECL.²⁸ In contrast, the principle of good faith is not generally recognised by English contract law.²⁹ Under English law,

²⁴ CISG Article 79: '(1) A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.' '(3) The exemption provided by this article has effect for the period during which the impediment exists.' Article 80: 'A party may not rely on a failure of the other party to perform, to the extent that such failure was caused by the first party's omission.' See also Schletriem p. 538. FECL Article 24: 'If a party is prevented from performing all or part of its obligations owing to force majeure, it shall be relieved of all or part of its obligations. If a party cannot perform its obligations within the contractually agreed time limit owing to force majeure, it shall be relieved of the liability for delayed performance during the after-effect period of the event. Force majeure means an event that the parties could not have foreseen at the time of conclusion of the contract, both parties being unable to either avoid or overcome its occurrence and consequences. The scope of force majeure may be specified in the contract.'

²⁵ *The Marine Star* [1994] 2 Lloyd's Rep.629; Chitty 26-037-038; Benjamin 16-051; *Lambert v Lewis* [1982] A.C. 225 HL; *Beoco Ltd v Alfa Laval Co Ltd* [1995] Q.B. 137.

²⁶ Schletriem p.539.

²⁷ CISG Article 7(1): 'In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of *good faith* in international trade.'

²⁸ In the Contract Law of the People's Republic of China which has replaced FECL, Article 6 expressly stipulates good faith as a basic principle of Chinese contract law: 'the parties shall observe the principle of honesty and good faith in exercising their rights and performing their obligations.'

²⁹ It is noted that the marine insurance contract is an exception. The utter most good faith is recognised in the marine insurance contract law. English law believes that the right of contract can be exercised strictly and the parties are assumed to be able to look after themselves. *White & Carter*

the buyer is under the strict obligation to mitigate his loss by buying substitute goods in the market and his damage is '*prima facie to be ascertained by the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered or (if no time was fixed) at the time of the refusal to deliver*'.³⁰ Under English law, the buyer has to prove the inadequacy of damages, i.e., damages are insufficient to compensate for his loss as a result of the seller's non-delivery and this loss can only be fully remedied by the seller's specific performance.³¹ The awarding of specific performance is at the court's discretion.³²

[c] Significance of the role of specific performance and the court's discretion

The remedy of specific performance plays different roles in the remedial system of the three regimes. Under the CISG and FECL, specific performance is the primary remedy for the breach of contract. There is no requirement as to whether the goods must be specific, ascertained or identified under the contract.³³ In contrast, under English law, damage is the primary remedy for breach of contract and specific performance is an exceptional remedy.³⁴ The granting of specific performance is only available to the buyer on his application under limited circumstances: when damage is inadequate to compensate for his loss as a result of the seller's breach and the goods must be specific or ascertained.³⁵ Hence, it is likely that specific

(Councils) Ltd v. McGregor [1962] A.C. 413, 420, Lord Reid has a famous statement to its effect by citing the uncertainty that might arise if courts had to decide this issue.

³⁰ SGA Section 51(3).

³¹ *Remedies for Breach of Contract - a Comparative Account*, G. H. Treitel, (1988) ['Treitel'] p.73; *The Sale of Goods*, Michael. G. Bridge, 1997 p. 559-560; Peter A. Piliounis.

³² SGA Section 52(1).

³³ CISG Articles 46 and 62; Peter A. Piliounis.

³⁴ Francis Reynolds, 'Some Reservations about CISG' *L.Q.R.* (April 2003) ['Francis Reynolds'] p.291.

³⁵ SGA Sections 52(1) and 61(1).

performance would be granted more frequently under the CISG and FECL than under English law.³⁶

Under the CISG, there is a limit of enforceability for the granting of specific performance, i.e., a court is not bound to enter a judgment for specific performance unless the court would do so under its own national law.³⁷ If specific performance is the normal remedy for breach of contract under the national law of the contracting states, the option rests with the buyer to require the specific performance from the seller and the buyer does not have to resort to litigation.³⁸ If specific performance is an exceptional remedy under the national law, the buyer has to apply to the court for the seller's specific performance and then the award is at the court's discretion.³⁹ Under the FECL, the granting of specific performance is not of limited enforceability because it falls into the category of 'other reasonable remedial measures' as provided for in Article 18 and it is treated by the Chinese tribunals as the normal remedy for breach of contract. Under English law, the awarding of specific performance is of limited enforceability in that it is regarded as an exceptional remedy that is subject to the court's discretion.⁴⁰ The court has the authority to make the judgment as to whether the remedy of specific performance is enforceable, whilst taking into account the circumstances of individual cases, e.g., whether the goods are specific or ascertained.⁴¹ Damages are normally considered to be adequate for compensating for any loss resulting from the breach of contract and the application of specific performance is rarely upheld.⁴²

³⁶ Peter A. Piliounis.

³⁷ CISG Article 28; Schletriem p538.

³⁸ Peter A. Piliounis.

³⁹ Ibid.

⁴⁰ SGA Section 52; Peter A. Piliounis.

⁴¹ *Re Wait* [1927] Ch 606, at 630, per Atkin L.J.

⁴² See fn. 34 Francis Reynolds; Treitel p.73; *Re Wait* [1927] Ch 606, at 630.

6.2 Examination of the consistency of the specific performance rule applied by the Chinese tribunals under the CISG in comparison with English law

In this section, the author examines some decided Chinese cases to see whether the application of the specific performance rule of the CISG has led to predictable judgments. Of those Chinese cases that have been reported, there was an insufficient number to ascertain whether there was consistency in the judgments related to the seller's right of specific performance against the buyer for payment. Under English law, the seller's action for the payment of the goods is not classified as a claim of specific performance. Therefore, the examination of the Chinese cases in this section focuses only on the buyer's right to require the seller to perform the contract. The issues to be discussed are as follows. *[a] Where the seller fails to deliver the goods, can the buyer require the delivery of goods from the seller when the goods are not ascertained or specific? [b] In circumstances of defective delivery, can the buyer require the seller to repair the goods or can the buyer only claim damages?*

If these questions were consistently answered by applying the CISG, it means that the specific performance rule of the CISG has proven to be effective in these respects. If the answers were inconsistent, it shows that there might be either a lack of clarity in the CISG itself, which has led to misunderstandings in the application of the CISG. Should the latter be the case, the causality of the inconsistency will be explored and resolutions will be offered. As shown in the first section of this chapter, the provision of the specific performance rule of the FECL is similar to that of the CISG. The application of the FECL would not make any difference from the application of the CISG. Therefore here, the author only applies English law to the Chinese cases in an effort to show any differences in outcomes. *[a] Where the*

answers under the CISG were predictable, would the application of English law also have led to consistent decisions? [b] Where the answers under the CISG were not consistent, would the application of English law have led to predictable decisions?

6.2.1 Where the seller fails to deliver the goods, can the buyer require the delivery of the goods from the seller when the goods are not ascertained or specific?

Under the CISG, where the seller fails to deliver the goods, the buyer is entitled to require the seller to deliver the goods regardless of whether the goods are specific and ascertained or not. The specific performance rule of the CISG does not have the requirement of specific or ascertained goods.⁴³ In the determined cases, the Chinese tribunals have consistently upheld the buyer's claim of requiring the defaulting seller to perform the contract and they have disregarded whether the goods were ascertained and specific or not. The following two cases are examples of this.

In the *Rolled aluminium case*,⁴⁴ a Chinese buyer concluded two contracts No.072 and No.069 with an American seller to buy rolled aluminium C&F. In the contracts, the buyer agreed to open the L/C by 22nd October 1990. The seller agreed to deliver the rolled aluminium under contract No.072 and deliver the associated aluminium parts under contract No. 069 within seven weeks of notification of the opening of the L/C. The buyer opened the L/C by the agreed date. The delivery of rolled aluminium was found to have serious defects. The specification of the aluminium agreed in contract No.072 was 0.0125 +/- 0.0001 inches thick whilst that of the delivered goods was 0.0118 inches. Also, the seller refused to deliver the aluminium parts

⁴³ CISG Article 46(1).

⁴⁴ Award of 30 October 1991 [CISG/1991/04] (*Rolled aluminium case*).

under contract No.069. The buyer sourced the rolled aluminium elsewhere to substitute for the contract No.072 and to mitigate his loss suffered from the seller's breach. The buyer claimed damages for the price difference between the substitute purchase and the contract price, but required the seller to deliver the aluminium parts as agreed under contract No.069. The Chinese arbitrators held the seller's delivery of defective goods as a fundamental breach of contract No.072. The buyer was held to be entitled to return the defective goods to the seller, receive a refund of the original purchase price and recover the damages for the price difference together with other actual expenses. Also, the Chinese tribunal supported the buyer's claim of specific performance, i.e., by requiring the seller to deliver the aluminium parts under contract No.069.

It should be noticed that the goods, which the seller failed to deliver against contract No.069, were not specific or ascertained, and nor were they unique. The goods could be easily purchased elsewhere on the open market. However, this was not taken into account in the judgment because the uniqueness of the goods was not considered under the specific performance rule of the CISG. The buyer could require the defaulting seller to deliver the goods no matter how easily available they were on the open market.

In the *Scrap steel case*,⁴⁵ a seller and a buyer signed a contract on 1st January 1993 for the purchase of 20,000 tons of scrap steel at the price of US \$142/mt C.I.F. ZhangJiaGang (a port in China). The shipment was to be completed by the end of February 1993 and the buyer would open the L/C within twenty days of the contract being signed. The buyer opened the L/C as agreed. Subsequently, the seller asked that the time of delivery to be put back to 20th May 1993 and the terms of the L/C to

⁴⁵ Award of 27 July 2000 [CISG/2000/03] (*Scrap Steel case*).

remain valid until 10th June 1993. The buyer agreed, amended the L/C and made a pre-payment of US \$326,000 as requested by the seller. However, the seller failed to deliver the goods despite the flexibility shown by the buyer. The buyer filed an initial arbitration application in March 1994 demanding the seller to deliver the goods. The buyer's claim was upheld by the initial arbitration tribunal. Nevertheless, the seller still refused to deliver the goods after this first arbitration award was made. Five years later, in 1999, the buyer filed a further arbitration application to require a refund of the pre-payment of \$326,000 with interest. He also filed for the loss of profit totalling \$284,000, i.e., around 10% of the total contract price together with other legal fees. In the final award made on 27th July 2000, the arbitration tribunal upheld the buyer's claim of the refund of the pre-payment with interest and legal fees. Nevertheless, the buyer's claim for the loss of profit was dismissed on the grounds that 'the Arbitration Tribunal finds no legal and factual grounds for the calculation method alleged by [Buyer]'.

The *Scrap steel case* is a typical example of a buyer's option between the remedy of specific performance and that of damages when the goods are not ascertained. It is clear from this case that, due to no requirement of uniqueness or ascertainment of the goods under the CISG, there is little incentive for the buyer to purchase substitute goods when he has the easier option of recovering his loss by claiming the seller's specific performance as in the first arbitration trial held in 1994. According to the CISG, the arbitration tribunal upheld the buyer's claim of requiring the seller to deliver the goods despite the fact that substitute goods could be purchased on the open market. However, when the seller still refused to deliver the goods after the initial award was made, there seemed to be no other way for the buyer to recover his loss but by claiming a refund of the payment and damages caused by the seller's non-

delivery. When the second arbitration application was filed in 1999, in conjunction with the first arbitration award in 1994, the buyer had not made any effort to purchase substitute goods in the market. When it comes to the calculation of damages, i.e., the loss of profit, the arbitration tribunal would have to decide at what point in time the market price was relevant so as to assess the amount of damages. Their choices were: when the seller refused to deliver the goods on 20th May 1993; when the first arbitration decision was made in 1994; or when the second awarding was made in 2000. This is a complex question to answer. According to Articles 75 and 76 of the CISG, the measurement of damages should be based upon the point in time when the contract was avoided. This begs the question: when was the contract avoided and does this correspond to when the contract should have been avoided? Should the buyer have avoided the contract earlier based upon the principle of good faith or should the buyer have waited for five years to claim his loss of profit? The remedy of specific performance is regarded as a principal remedy for the breach of contract and there is no requirement of uniqueness or ascertainment of the goods under the CISG. In consequence, it would be difficult for the Chinese tribunal to judge when the contract should have been avoided and upon what point in time the market price should be calculated.⁴⁶

The difficulties stem from the uncertainty of the CISG with regard to two matters: the relationship between the remedy of specific performance and damages; and whether the claim of specific performance is subject to the mitigation rule in those countries where specific performance is the normal remedy for the breach of contract.⁴⁷ Some scholars would suggest that the buyer would observe the principle of good faith by buying substitute goods on the open market, even if he could claim

⁴⁶ See *ante* 4.2.2 [a] (ii) and 5.2.1.

⁴⁷ See *ante* 5.2.1.

the remedy of specific performance. Nevertheless, the CISG does not clarify what the consequence is when the principle of good faith is breached. There is nothing to stop the buyer from evading his duty of mitigation by claiming the seller's specific performance to enhance his own interests. The *Scrap steel case* is a typical example of this situation. The buyer waited for five years for the seller's specific performance without trying to mitigate his loss by making a substitute purchase. The best solution for the parties to prevent this uncertain situation is to make it clear in the contract what course of action will be taken: should the mitigation rule or specific performance come into force when the CISG is the applicable law.⁴⁸ Without such clarity in the contract, the Chinese tribunal in the *Scrap steel case* could probably not ascertain the market price at the time of the avoidance of contract. Instead, the arbitrators found a quick solution to this problem by dismissing the buyer's claim of loss of profit on the grounds that there was no sound legal and factual evidence for the calculation of such a loss. This decision does not make it clear as to what the Chinese tribunal's position was regarding this uncertain situation.

If the aforementioned two cases were determined under English law, the decision would probably have been different. English law regards specific performance as an exceptional remedy and imposes strict limitations on the granting of such a remedy.⁴⁹ The buyer can only apply for the seller's specific performance, i.e., by requesting the seller to deliver the goods, when the goods are specific or ascertained,⁵⁰ and when damages are not adequate to compensate the buyer's loss, e.g., when the goods are unique and cannot be purchased in the market.⁵¹ Where there is an available market

⁴⁸ Ibid.

⁴⁹ See *ante* 6.1.3 [b][c].

⁵⁰ SGA Sections 52 and 61(1); *Re Wait* [1927] Ch 606, at 630, per Atkin L.J.; Chitty 43-471; Benjamin 17-097.

⁵¹ Ulrich Drobnig, 'General Principles of European Contract Law', *Petar Sarcevic & Paul Volken eds., International Sale of Goods: Dubrovnik Lectures*, Oceana (1986), Ch. 9, 305-332, available at

for the buyer to purchase substitute goods, damages are considered to be adequate to compensate for the buyer's loss. The buyer is expected to go to the market place as soon as possible and purchase substitute goods to mitigate his loss. His recoverable damages are *prima facie* ascertained by the difference between the contract price and the market price or current price of the goods when the goods ought to have been delivered, or if no time was fixed, at the time of the seller's refusal to deliver.⁵²

If English law had been applied in the *Rolled aluminium case*, under contract No. 072, the incorrect thickness of the rolled aluminium would have breached the condition of the contract, i.e., the description of the goods.⁵³ Such a breach would have entitled the buyer to terminate the contract and claim a refund of the payment and damages amounting to the difference between the substitute purchase and the contract price. Under contract No. 069, since the aluminium parts were readily available, the buyer's claim against the seller's delivery would not have been upheld. The only damages the buyer could have recovered from contract No. 069 was the difference between the contract price and the price current at the time the goods ought to have been delivered, i.e., seven weeks after the opening of the L/C was notified.⁵⁴

If English law had been applied in the *Scrap steel case*, the decision would have been very different. The buyer's claim for the seller's delivery of the goods as laid out in the initial arbitration application would not have been upheld by English court.

<http://www.cisg.law.pace.edu/cisg/biblio/drobnig.html>. *The Sale of Goods*, P.S. Atiyah, (11th ed. 2005) p.561; *Behnke v Bede Shipping Co Ltd* [1927] 1KB 649. *Société des Industries Metallurgiques SA v Bronx Engineering Co Ltd* [1975] 1 Lloyd's Rep 465: the Court of Appeal refused to grant specific performance of a machine manufactured by the defendant seller, although it cost £270,000, weighed over 200 tons and would only be bought in the market with a nine to twelve months of delivery time. *CN Marine Inc v Stena Line* [1982] 2 Lloyd's Rep. 336: a buyer of a ship was not *prima facie* entitled to a decree of specific performance and the mere inconvenience to the buyer or the possibility of remote loss still did not justify such a decree. The buyer had to prove the ship was of peculiar importance to the buyer, e.g. the design was specially suited to the buyer's needs.

⁵² SGA Section 51(3).

⁵³ SGA Section 13.

⁵⁴ SGA Section 51(3).

The goods that the seller failed to deliver were not ascertained or specific goods as they could be purchased readily on the open market. Damages are the only remedy the buyer could rely upon in English law. Instead of waiting for five years for the seller's refusal to deliver the goods, the buyer would have been awarded a refund of the price and the difference between the contract price and the market or current price when the goods should have been delivered, i.e., on 20th May 1993. The English court would not have had to face the difficulty of ascertaining the buyer's damages and dismissing the buyer's claim for loss of profit because there were no sound legal or factual grounds. The application of English law would have put the parties in a much more certain and predictable situation. In the international sales of goods under English law, certainty and efficiency are given greater importance than justice. The fundamental cause of this divergence is that the CISG emphasizes the performance of contract whilst English law emphasizes the termination of contract.⁵⁵ As a result, although the application of these two legal systems both appear to result in predictable decisions, although the applied rationale and the actual damages the parties can recover are totally different.

6.2.2 *In terms of defective delivery, can the buyer require the seller to repair and substitute the goods or can the buyer only claim the damages?*

Under the CISG, where the goods delivered by the seller are defective, the buyer is entitled to require specific performance from the seller in two ways: repair or substitution. The buyer has the right to require the seller to remedy the lack of conformity by repair unless it is unreasonable, having regard for all the

⁵⁵ See fn. 34 Francis Reynolds p.294.

circumstances.⁵⁶ Where the non-conformity constitutes a fundamental breach of contract, the buyer is entitled to request the seller to substitute the goods.⁵⁷

In the Chinese cases, the buyer's claim for repair or substitution of the non-conforming goods was consistently supported by the Chinese tribunals. The remedy of specific performance was often given priority over the remedy of damages. In other words, the buyer was expected to request the seller's repair or substitution first, and if this was not forthcoming he could then resort to damages.⁵⁸

In the *Clothes case*,⁵⁹ the clothes delivered by the seller were not fit for purpose and the seller admitted the defects and agreed with the buyer's proposal to sell the goods at a discounted price. Consequently, the buyer repaired the goods, he resold the goods at the same price as originally agreed in the resale contract and then claimed the repair cost as the damages suffered from the seller's breach. The Chinese tribunal did not deny the agreement between the seller and the buyer on the mitigation of the loss, but ordered the buyer to stand 30% of the repair cost due to his failure to gain the seller's permission to repair the defective goods. The Chinese tribunal maintained that the seller should have had the option to repair the goods according to Article 48(1) of the CISG and the buyer's act of repairing the goods deprived the seller of that right.⁶⁰ The seller's agreement of the buyer's proposal to resell the goods at a discounted price was not held to constitute a waiver of the

⁵⁶ CISG Article 46(3).

⁵⁷ CISG Article 46(2).

⁵⁸ The main reason for it is because the delivery of defective goods is not generally regarded as the fundamental breach of contract so long as the defects can be remedied by repair or substitution. The buyer is therefore not entitled to avoid the contract and claim damages: detailed discussion in Chapter 2: Categorisation of the Breach of Contract 2.2.3[a] Defective goods.

⁵⁹ Award of 31 January 2000 [CISG/2000/09] (*Clothes case*). For Further details of this case, see *ante* 5.2.1.

⁶⁰ CISG Article 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 retains any right to claim damages as provided for in this Convention.'

seller's right to repair the goods. Apparently, the Chinese tribunal of this case held that the remedy of specific performance would take precedence over the remedy of damages and the buyer could only claim damages when his claim of specific performance was refused by the seller. The buyer's own repair, without the seller's approval, cost him 30% of the repair cost, which should have been reimbursed by the seller in the form of damages. In contrast, in the *Shaping machine case*, where the shaping machine that the seller delivered was seriously defective, the buyer was awarded a refund of the total payment, the return of the goods to the seller together with other damages, as the seller had failed to repair the equipment for over a period of eight years.⁶¹ Apparently, the buyer's request for the seller's repair and the lapse of an unreasonable period of time for the repair to be carried out made the buyer eligible for the recovery of all the damages caused by the seller's breach.

Under English law, the remedy of repair or replacement of the goods is not available to the business buyers but only to the consumer who is not under discussion here.⁶² Where the seller delivers defective goods, then rejection and damages are the only remedies that the buyer can resort to.⁶³ If the *Clothes case* had been decided under English law, the buyer's damages would have been based upon the repair cost necessary for bringing the goods up to the standard of those under contract subject to the tests for causation, remoteness and reasonableness. Since the repair cost was held to be reasonable, i.e., 'within the average labour fee in Germany', the buyer would have been entitled to recover all of the repair cost as damages.⁶⁴ In the *Shaping machine case*, the essential defects of the goods constituted a breach of condition of contract, i.e., the description of the goods. This would have entitled the buyer to

⁶¹ Award of 20 July 1993 [CISG/1993/10] (*Shaping machine case*). For the facts of this case, see *ante* 2.2.3 [a].

⁶² SGA Part 5A.

⁶³ For the details as to the calculation of damages, see *ante* 4.2.2 [c] (ii).

⁶⁴ SGA Section 53(2).

reject the goods and receive a refund of any payment together with reasonable damages resulting from the seller's breach. The damages should have been measured by the *prima facie* market rule with the same effect as the seller's non-delivery, i.e., 'the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered'.⁶⁵ If there was no available market, the buyer's loss should have been measured by 'the estimated loss directly and naturally resulting, in the ordinary course of events, from the breach of warranty'.⁶⁶ If English law had been applied, the buyer would not have needed to wait for the seller's failure to repair the goods for a period of eight year to qualify for the remedy of damages. The application of English law would have put the buyer in a much more certain and predictable position.

Conclusion

In respect of the two issues raised under discussion, the application of the specific performance rules of the three regimes has all resulted in predictable decisions, despite the different rationales underpinning these decisions. Also, there was disparity both in the amount of damages awarded and the reasoning behind the awards.

The main cause of the divergence of both rationale and recoverable damages is that the remedy of specific performance has different significance under the remedial systems of the three regimes. When enforcing the performance of contract, the CISG and FECL have to sacrifice the certainty and predictability of the parties' financial outcomes. A great deal of time has to pass before the failure of the remedy of

⁶⁵ SGA Section 51(3).

⁶⁶ SGA Section 53(2).

specific performance can qualify for the recovery of damages.⁶⁷ The avoidance of contract and the remedy of damages are discouraged as an action of resort for the injured party to pursue. The remedy of specific performance always has priority in the remedial procedure when the breach of contract occurs. In the *Clothes case*, the buyer's mitigating action of repairing the goods, without first giving the seller that opportunity cost the buyer 30% of his recoverable losses.⁶⁸ The sequencing in the remedial procedure caused difficulty in ascertaining the time when the contract should have been avoided and the time at which damages should be calculated. This is probably why in the *Scrap steel case*,⁶⁹ the Chinese tribunal avoided this difficulty by dismissing the buyer's claim for loss of profit because of the lack of evidence of that loss. If the Chinese tribunal had attempted to pinpoint the time when the contract should have been avoided, it is doubtful that the ascertainment of this timing would have been consistent across the decisions of these cases.⁷⁰ In contrast, under English law, specific performance is treated as an exceptional remedy for breach of contract and is subject to strict limitations. The termination of contract and the remedy of damages are regarded as the first resort. The injured buyer is required to go to the market and buy substitute goods to mitigate his loss at the time when a breach of contract occurs. His recoverable damages are *prima facie* and calculated on the current or market price at the time of breach. The construction in English remedial system ensures the efficiency in the estimation of the injured party's damages when the breach of contract occurs.

⁶⁷ Award of 20 July 1993 [CISG/1993/10] (*Shaping machine case*).

⁶⁸ Award of 31 January 2000 [CISG/2000/09] (*Clothes case*).

⁶⁹ Award of 27 July 2000 [CISG/2000/03] (*Scrap steel case*).

⁷⁰ See *ante* 5.2.1: the author discusses the detailed advice for avoiding the inconsistencies in dealing with the relationship between specific performance and mitigation and in calculating recoverable damages.

It is undeniable that there are very different approaches to the remedy of specific performance between the CISG and English law. To some extent, this mirrors the differences in civil and common law practice. In the author's view, this could be a major contributory factor as to why the UK has not adopted the CISG.

CHAPTER 7

CONCLUSION

The CISG is the world's most influential instrument for providing uniformity in the rules governing international trade. It covers over three-quarters of the global trade and has been adopted by seventy-three states including most of the major trading nations. Despite the apparent success of the CISG, the predictability in the interpretation and application of this system has proved to be a real problem in China. Given the importance of certainty in resolving international trade disputes, this is clearly not satisfactory.

This chapter summarises the author's examination of the remedial rules of the CISG, the Chinese tribunals' difficulties in applying these rules and the author's proposals as to how to resolve these uncertainties of the CISG. Also, the predictability of the judgments made under the remedial rules of the FECL and English law are compared with those of the CISG. Although the FECL is not as complex as the CISG, they share many concepts, many aspects of content and structures. The author did not find any substantial difference between the application of the remedial rules of the FECL and those of the CISG.¹

7.1 Summaries: remedies for breach of contract in the international sale of goods under the CISG and English law

¹ See *ante* 1.1.

7.1.1 Categorisation of breach of contract – ground for the right of avoidance based on fundamental breach

In categorising a breach of contract, the Chinese tribunals found it difficult to ascertain the criterion that applied to a fundamental breach, which is the ground for the aggrieved party to avoid the contract because this deprives him of his material interests. A breach of any clauses as to the time of performance and the description of goods or documents in the international sale of goods is not automatically regarded as a fundamental breach under the CISG. In the circumstances of delayed performance and defective performance, the Chinese tribunals reached inconsistent decisions as to what extent a delay or a defect should amount to a fundamental breach of contract. It was only under the circumstance of non-performance that the Chinese tribunals consistently agreed to accept that a fundamental breach of contract had occurred and awarded the injured party the right of avoidance.

The Chinese tribunals' difficulty in establishing whether a breach of clauses applying to time and descriptions amount to a fundamental breach stems from the CISG's emphasis on the performance of contract. A breach of delivery time or a breach of any clauses that describe the goods or non-compliance in documentation are not normally considered to be serious enough to cause substantial detriment to the material interests of the aggrieved party and to qualify for the avoidance of the contract. For such a breach to be deemed as fundamental or not is dependent upon the extent of any delay and the seriousness of any non-compliance, taking into account the circumstances of related cases. Without uniform guidance from United Nations Commission on International Trade Law (UNCITRAL) that defines what should be considered as an unreasonable delay or at what point non-compliance becomes unreasonable, unpredictability in judgments is inevitable. At present, the

only way for the contracting parties to avoid these uncertainties is to specify in the contract what consequences of any breach in time and what kind of non-compliance will be deemed unreasonable. They should also state whether such breaches permit the avoidance of contract or restitution by damages.² Such agreements are permitted by the CISG and normally prevail over the general categorisation rules of the CISG.³

In contrast, under English law, the breach of contract is categorised as a breach of conditions, warranties and innominate terms. The time of performance and the description of the goods or documents are traditionally regarded as essential conditions of the contract in the international sale of goods. A breach of terms as to time and description entitles the aggrieved party to terminate the contract and claim damages resulting from the breach. The application of English law would have led to predictable categorisation of these breaches of contract.⁴

7.1.2 Operation of the right of avoidance for breach of contract

In awarding the right to avoid the contract, the Chinese tribunals found it difficult to justify some aspects of the avoidance rule of the CISG, i.e., how to ascertain the reasonableness of a time-limit for the examination of the goods, the buyer's loss of the right to reject defective goods in circumstances of his resale, and the relationship between the buyer's dual rights to reject defective goods and to reject defective documents. The Chinese tribunals made inconsistent decisions as to whether the buyer's resale of the goods without examination constituted the buyer's acceptance of the goods.⁵ It was questioned as to whether the buyer's action of resale was inconsistent with the seller's ownership and deprived the buyer of his right to avoid

² See *ante* 2.2.2 and 2.2.3.

³ CISG Article 6: 'The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.'

⁴ See *ante* 2.2.2 and 2.2.3.

⁵ See *ante* 3.2.1.

the contract by rejecting the goods. The buyer's dual entitlements to reject non-conforming goods and to reject non-conforming documents were recognised as separate and independent rights by some Chinese tribunals but denied by others.⁶

The main cause of this unpredictability in the Chinese judgments arises from the uncertainties in the avoidance rule of the CISG. Due to the limited development of Chinese legislative history, the Chinese tribunals often have difficulties in securing predictable decisions when judgments have to be made which are at the court's discretion.⁷ The Chinese Supreme Court is normally the institution that provides unified legislative interpretations for all lower courts to follow. Given the nature of the CISG as an international convention, the Chinese Supreme Court has been reluctant to interfere with individual tribunals' application of the CISG. Thus, without uniform, legislative guidance from the Chinese Supreme Court, UNCITRAL or the CISG, individual Chinese tribunals have had no alternative but to interpret and apply the avoidance rules as they saw fit. Therefore, it is inevitable that conflicting interpretations will arise in the application of the avoidance rule.

In contrast, under English law, the buyer's resale of the goods to his sub-buyer is not deemed to constitute his acceptance of the goods.⁸ The buyer's entitlements to reject non-conforming documents and non-conforming goods are regarded as two separate and independent rights.⁹ English law has developed comprehensive rules to justify the buyer's loss of his right to terminate a contract. Whether the buyer has accepted the goods by his action of resale depends upon whether the buyer had a reasonable time to examine the goods. The time taken for the buyer to resell the goods together with an additional period of time for the sub-buyer to inspect and test

⁶ See *ante* 3.2.2.

⁷ See *ante* 1.1.

⁸ See *ante* 3.2.1.

⁹ See *ante* 3.2.2.

the goods is normally taken into account when ascertaining the reasonable time for the buyer to make his decision to reject the goods. The application of English law would have led to predictable decisions in the Chinese cases.

7.1.3 Damages for breach of contract

Despite a few consistent decisions in awarding damages for breach of contract,¹⁰ most decisions by the Chinese tribunals were unpredictable when applying the CISG.¹¹ In some cases, the Chinese tribunals confused the foreseeability test with the causation test as the main means to limit the breaching party's liabilities.¹² In some cases, the contracting party's fault was wrongly taken into account to justify the amount of recoverable damages.¹³ In other cases, there appeared to be no sound rationale upon which their judgments were based.¹⁴

The confusion in applying the damage rule of the CISG by the Chinese tribunals was caused mainly by the lack of clarification in the CISG. In Article 74, there is no categorisation of the compensable losses and there is an absence of any detailed interpretations of the foreseeability test. Without guidance from UNCITRAL together with the legislative inexperience of the Chinese domestic legal system, the Chinese tribunals tend to quote Article 74 of the CISG and avoid exploring the contents of this Article in their judgments.¹⁵ Therefore, it is inevitable that individual

¹⁰ E.g. the loss of interest and the L/C related losses. See *ante* 4.2.2.

¹¹ E.g. the loss on price difference, the loss of profit, the inspection loss, the buyer's liability to sub-buyer, the repair loss and litigation loss. See *ante* 4.2.2.

¹² See *ante* 4.2.1.

¹³ See *ante* 4.2.2 [c][i].

¹⁴ See *ante* 4.2.2 [a][ii].

¹⁵ For some socio-economic and political reasons, the Chinese judiciary emphasizes uniformity and objects to the court's discretion. The judges are only entitled to apply but not to interpret laws. The power of interpreting law belongs to the Chinese Supreme Court. In the internal rules of some courts, some judges may be even demoted if their judgments have been reversed by the higher courts. Based on this background, the Chinese judges are very reluctant to explore some substantive contents of CISG which has contributed to some erroneous application of the CISG to some extent.

tribunals will misunderstand and, in consequence, misuse the damage rule of the CISG when ascertaining recoverable damages.

In contrast, English law has developed comprehensive rules to categorise the compensable losses based upon protected interests.¹⁶ The categorisation of compensable losses and any decision to award damages are likely to be predictable. Compared with the foreseeability test of the CISG, English courts have developed the remoteness test as a practical tool to determine the compensation of losses. English law and its common law counterpart have shaped the SGA so that it has sufficient flexibility to adapt to the development of international trade.

7.1.4 Mitigation of the loss for breach of contract

In applying the mitigation rule of the CISG, Chinese tribunals were unable to decide upon two issues consistently: firstly, whether the aggrieved party's claim of specific performance should be subject to the mitigation rule;¹⁷ and secondly, in circumstances of an anticipatory breach, whether the aggrieved party should take his mitigating action when the anticipatory breach occurs or when the performance is due.¹⁸

The main cause of these inconsistencies arises from the conflicts within the CISG.¹⁹ For the purpose of compromise, the CISG has drawn upon a variety of conflicting legal instruments from different legal systems. The concurrent remedies for damages and specific performance are typical example of this compromise made between the civil law and common law practices of the countries under the CISG. It was inevitable that the coexistence of these two remedies under the same law, as

¹⁶ See *ante* 4.2.1.

¹⁷ See *ante* 4.2.1.

¹⁸ See *ante* 4.2.2.

¹⁹ See *ante* 5.2.1.

principal remedies for breach of contract, would lead to difficulties. The application of the mitigation rule, as one important means to restrict recoverable damages will always conflict with the aggrieved party's entitlement of specific performance. Furthermore, the uncertain nature of the mitigation rule, i.e., as an option or an obligation of the aggrieved party, is a further cause of confusion for the Chinese tribunals as to when the mitigating action should be taken and at what point in time the calculation of damages for the breach of contract should be based upon.

In contrast, the application of English law would have led to predictable judgments in this area. With regard to the first question raised above as to the relationship between specific performance and the mitigation rule, the mitigation rule plays the dominant role in the ascertainment of damages in English law and the remedy of specific performance is only applied in limited circumstances and at the court's discretion.²⁰ When a contract is breached, the aggrieved party is obliged to sell the goods or buy alternative goods immediately in the market to mitigate his loss. The *prima facie* market rule calculates the recoverable damages based on the market price when a contract was breached. Only when there is no available market is the calculation of damages based upon the estimated loss directly and naturally resulting, in the ordinary course of events, from the breach of contract. With regard to the second question raised above, it is the aggrieved party's choice to decide whether to accept or to reject the breaching party's anticipatory repudiation under the circumstances of an anticipatory breach.²¹ In other words, where the aggrieved party accepts the anticipatory breach, his time of mitigation has to be within a reasonable time after his acceptance; where the aggrieved party refuses the anticipatory breach, his time of mitigation is the time at which the performance was due. Good faith is not

²⁰ See *ante* 5.2.1.

²¹ See *ante* 5.2.2.

a principle that is generally observed under English contract law. Therefore, under the CISG, there is no confusion as to when the aggrieved party should accept the anticipatory breach based upon the principle of good faith.

7.1.5 Specific performance for breach of contract

In awarding the remedy of specific performance under the CISG, the Chinese tribunals have consistently held that the buyer is entitled to require the seller to deliver the goods regardless of whether the goods were ascertained or specific.²² Also, the buyer's claim for repair or substitution of any non-conforming goods has been consistently upheld by the Chinese tribunals and the buyer's remedy of specific performance has prevailed over the remedy of damages.²³

The enforcement of specific performance under the CISG has led to the sacrifice of certainty and predictability in the financial outcome of any claim for the contracting parties.²⁴ In other words, the aggrieved party has to wait for the defaulting party to perform his duty under the contract first and then claim the remedy of damages when the claim of specific performance fails. The consequence of such a remedial procedure is that it will inevitably cause difficulties for ascertaining the time when the contract should have been avoided and thus at what point in time the calculation of damages should be based upon. In the author's view, this is probably why some Chinese tribunals tended to dismiss the buyer's claim of damages for the reason of insufficient evidence, e.g., the buyer's claim for the loss of profit, when the seller has failed to deliver the goods.²⁵ Due to the emphasis on the continuing performance of the contract, it is very difficult for the Chinese tribunals to

²² See *ante* 6.2.1.

²³ See *ante* 6.2.2.

²⁴ See *ante* 6.2.1 and 6.2.2.

²⁵ Award of 27 July 2000 [CISG/2000/03] (*Scrap steel case*). See *ante* 6.2.1.

identify the time when a contract should have been avoided and therefore when damages should have been calculated. If the Chinese tribunals had tried to identify the time at which damages should be calculated, it is doubtful that the ascertainment of that timing and the resulting damages would have been predictable at the discretion of the different tribunals.

In contrast, the application of the specific performance rules under English law would have led to predictable decisions with different recoverable damages from those under the CISG.²⁶ Under English law, specific performance is an exceptional remedy and only available when the remedy of damages is not sufficient to compensate the aggrieved party's loss. When a contract is breached, the injured party is required to mitigate his loss instantly by buying substitute goods on the market. His recoverable damage is *prima facie* calculated and based on the current or market price at the time of breach. The construction of the English remedial system ensures efficiency in the parties' financial outcome and the consistency in the calculation of the recoverable damages. Therefore, the English court does not have to face the same difficulty as the Chinese tribunals in ascertaining the time when the contract should have been avoided and at what point in time the damages should have been calculated, after the aggrieved party's claim of specific performance failed.

7.2 Final comments

In brief, the problem of unpredictability in the interpretation and application of the CISG in China is mainly caused by a lack of clarity in particular areas of the legislation, which leads to misunderstanding in its application.²⁷ An ideal solution to this problem is for UNCITRAL to issue an official interpretation with binding effects

²⁶ See *ante* 6.2.1 and 6.2.2.

²⁷ E.g., the categorisation of the compensable losses. See *ante* 4.2.1.

on all the contracting states of the CISG.²⁸ The Advisory Opinions issued by the CISG Advisory Council are very useful instrument that provides unification of the various interpretations of the CISG, but as they are not binding, not all the contracting states enforce those Opinions.²⁹ This ideal solution is not easily achievable on the grounds that most countries would prefer to maintain some flexibility in their application of the CISG for their own interests.

In the author's view, to ensure predictable remedies for breach of contract in the international sale of goods under the CISG, international traders should incorporate express clauses in their contracts stipulating the consequences for breach of certain terms of contract to avoid any dispute arising from some uncertainties of the CSIG.³⁰ For example, if the parties require predictable remedies for the breach of terms as to time and descriptions of the goods or documents, they should incorporate a clause in their contract stating whether such breaches permit the avoidance of contract or restitution by damages.³¹ If the parties wish to avoid the uncertainty of recoverable damages under Article 74, they can incorporate a liquidated damages clause into the contract, which will amount to a contractual exclusion of Article 74 of the CISG.³² In

²⁸ See *ante* 3.2.1, 4.2.2[a](ii), 4.2.2[b](ii) p.135, 4.2.2[c](iii).

²⁹ <http://www.cisg.law.pace.edu/cisg/CISG-AC-op.html>

³⁰ There are some uncertainties in the interpretation of Art.74 of the CISG, eg the degree of probability in the foreseeability test. See *ante* 2.2.2, 2.2.3, 5.2.1, 5.2.2, 6.2.1, 6.2.2. These uncertainties can be avoided by including a liquidated damage clause in the contract. The court should give effect to this clause as commercial certainty should be given more weight in the international sale of goods contracts. *Philips Hong Kong Ltd v Attorney-General of Hong Kong* (1993) 61 BLR 41.

³¹ See *ante* 2.2.2 and 2.2.3.

³² This is allowed by Article 6 of the CISG that the parties can exclude the application of this Convention, derogate from or vary the effect of any of its provisions. See *ante* 2.1.1 p.13. Marcus S. Jacobs and Yanming Huang 'A Rebuttal of Dr Bruno Zeller's Commentary: The CISG and The Opting Out Clause Pursuant to Article 6 A Corrective Reply' 20(10) *Mealey's Intl. Rep.* 17 (2005). Mr Huang and Jacobs's argument is that by including a liquidated damage clause in the contract, the parties have impliedly opted out of the damage regime of the CISG through Art.6 with the consequence that the agreed sum is determined by Chinese domestic law. Mr Zeller argues that the liquidated damage clause can impliedly opt out of the damage rule of the CISG, but has no effect of applying Chinese domestic law. The author agrees with Mr. Zeller's view. In the case of *Philips Hong Kong Ltd v Attorney-General of Hong Kong* (1993) 61 BLR 41, the Privy Council stressed that certainty is important in commercial contracts and liquidated damages clauses enable the parties to know with a reasonable degree of certainty, the extent of their liability and the risks they would run as a result of entering the contract. The House of Lords in the case of *Dunlop Pneumatic Tyre Co Ltd v*

addition, some drafts of specific clauses suggested by the author earlier in this thesis are worthy of consideration.³³ For example, the contracting parties are strongly advised to draft specific terms in their contract that deal with the relationship between the mitigation rule and specific performance when the CISG is the applied law.³⁴ If the parties wish the mitigation rule to apply in the claim of specific performance, it should be clearly specified in the contract that Article 77 applies to specific performance.³⁵ The drafted terms could be worded that: *'If the claimant fails to mitigate his loss, the party in breach may claim a reduction of damage by an amount equivalent to that which should have been mitigated, or claim a corresponding modification or adjustment to the remedy of specific performance'*. If the parties do not wish the mitigation rule to apply to the claim of specific performance, this should be clearly stated in the contract. The drafted terms could read: *'If the claimant fails to mitigate his loss, the party in breach may claim a reduction in damages only and no corresponding modification or adjustment should be made when the remedy of specific performance is claimed.'*

Considering the uncertainty of the CISG arising from the two conflicting views as to the point in time when the injured party should mitigate his loss when a breach of contract is anticipated, the parties are strongly advised to clarify in advance how the mitigation rule of the CISG should be interpreted and applied by express terms in their contract.³⁶ For example, if the parties prefer the mitigation to be undertaken at the time of an anticipatory breach, a term could be drafted as follows: *'The injured party is obliged to mitigate his loss when an anticipatory breach occurs. The*

New Garage & Motor Co Ltd [1915] AC 79 set out the guidelines for the courts to consider when deciding whether a clause is a liquidated damages clause or a penalty clause.

³³ See *ante* 5.2.1, 5.2.2.

³⁴ See *ante* 5.2.1.

³⁵ This is allowed by the CISG in Article 6: 'The parties may exclude the application of this Convention or, subject to Article 12, derogate from or vary the effect of its provision.'

³⁶ See *ante* 5.2.2.

breaching party may claim a reduction in damages or a corresponding modification and adjustment of specific performance in the amount by which the loss should have been mitigated on the date of anticipatory breach.’ If the parties prefer the mitigation to be undertaken only when the performance is due, a term could be drafted as follows: *‘The injured party has the option to decide whether to accept an anticipatory breach of contract or not. If the injured party decides to accept it, he is obliged to mitigate his loss at the time of the anticipatory breach and his failure to mitigate entitles the breaching party to claim a reduction in damages or a corresponding modification and adjustment of specific performance in the amount by which the loss should have been mitigated based on the date of anticipatory breach. If the injured party decides to reject the anticipatory breach, he is obliged to mitigate his loss when the performance is due. Failure to mitigate entitles the breaching party to claim a reduction in damages or a corresponding modification and adjustment of specific performance in the amount by which the loss should have been mitigated based on the performance date under the contract.’*

In conclusion, consistency in the application of the CISG internationally is an ideal but difficult target to achieve due to the wide variety of interests that have to be served and the restrictions borne out of the divergent legal cultures of each participating state. However, to strive for such an ideal and to seek for alternative solutions by proposing clear contractual terms is far better than simply to accept unpredictable or bad practices. This thesis has concentrated upon some difficulties encountered in international trade with China and the author’s proposals on how to resolve them. It is hoped that by furthering this discussion on the CISG and its relationship to Chinese practice will draw the attention of legislators, tribunals and

international traders. This is with a view to bringing more clarity and with that more certainty into that the operation of the CISG in Chinese international trade.

‘磨刀不误砍柴功!’

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