

The Termination Regime in CISG

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Abstract. The United Nations Convention on Contracts for the International Sale of Goods(CISG) was designed to solve the international commercial disputes of sale of goods.Obligations and remedies are provided for both parties according to this statute.The termination regime is a vital part in contract theory no matter in the common law system or in the civil law system,because breach of contract by one party could not be prevented all the times in the variable market situation.This article focus on demonstration of the termination regime in CISG including examination of legal right to termination,how to exercise the right,and the consequences of termination.

General Introduction of Termination in CISG

Termination is one-side right of a party to avoid contracts.The correct party only needs to make a declaration of avoidance according to CISG termination system.If one party to a contract breaches the agreement,the other party could utilize such legal right without gaining permission of the breaching party.Termination as the remedy is regarded as the last resort in the scheme of remedies which include other remedies like price reduction and the award of damages.[1]Since termination is the last resort for parties where there are harsh consequences,strict requirements and restrictions of the regime are necessary.In CISG the basic and most important requirement for parties to exercise the right of termination is “fundamental breach”.A simple breach of contract does not qualify the innocent party to terminate contract.[2]If a simple breach occurs,the innocent party cannot terminate the contract immediately,he/she has to provide a period time of performance for the beaching party,after this extended time is violated,the innocent party could be entitled to avoid the contract.In another words,this *ultima ratio* remedy does not mean that the aggrieved parties have to exercise other remedies before they resort to termination remedies.[3]Once a fundamental breach occurs,the aggrieved party is entitled to terminate the contract without permission of the other party.

According to CISG stipulations,there are four different circumstances that the avoidance could be available:①where the buyer has the right of termination,which means the seller breaches the contract fundamentally(Art49);②where the seller is entitled to avoid the contract resulting from the buyer’s fundamental breach of contract(Art64);③ where there is an anticipatory breach constituting a fundamental breach,either the seller or the buyer can terminate contracts(Art72);④ where an installment sale is involved,the innocent party could terminate the whole or part of the contract(Art73).[4]According to equity rules,both sellers and buyers should have equal rights to protect their own interests by bringing the contract to an end.

The two basic key rules under CISG to qualify an avoidance--- Fundamental breach and the extended time for performance

Fundamental Breach

From descriptions of both Art49(1)(a) and Art69(1)(a) in CISG, it is not difficult to perceive that the fundamental breach is a vital criteria provided for sellers and buyers to judge whether there is a right of avoidance.If a breach of contract made by one party would substantially deprive the innocent party of gaining what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person in the same situation would not have foreseen the serious results caused by the breach, then such breach of contract can be called a fundamental breach.The two decisive elements in concept of fundamental breach are obvious:the first is “substantially”,the

second is “unforeseen” or “unforeseeability” which means the breach of contract is not foreseeable and a reasonable person of the same kind in the same circumstances would not have foreseen that result. [5]

“Substantially” means that if a party does not perform or incorrectly perform his contractual duties, the aggrieved party planning to claim a fundamental breach must have mainly lost his/her interest according to the contract. [6] Once requirement of “fundamental mainly lost” is satisfied, the innocent party can declare the contract avoided no matter whether the breaching party is intentionally to breach the contract or not. “Unforeseen” or “unforeseeability” means that the detrimental result of the breach would not be foreseen by the breaching party or cannot be foreseeable by any reasonable person in the same circumstances, even there is a material infringement. Fundamental breach can be established when these two key elements are satisfied at the same time.

However, definition of fundamental breach in Art25 is abstract and includes some uncertain terms, which leave difficulties to apply this provision. [7] For example, what is the criteria of “substantial deprivation”---to what extent the court could decide that the breach of contract deprives the aggrieved party of the substantial interest under the contract; and in what situations a reasonable person could not foresee the result of his/her breach of contract---how to define “the reasonable person”, and so on. Art25 does not offer a list of any examples constituting a fundamental breach. In Chinese contract law there is a list of events contributing to a fundamental breach. Those situations could be regarded as the right of termination. Beside this, there is a reported case in Germany coping with fundamental breach, it only concluded whether a fundamental breach had actually occurred without analysis of what defects the shoes had. However, degree of the defects is the key issue to justify the buyer’s right to avoidance of the contract. [8] Although there are some international cases illustrating some aspects of fundamental breach, such as the application of the rule of time limitation which shows whether the breach of time is fundamental, no sufficient cases are available to provide a definite application of the two components of fundamental breach. In my opinion, if there is some ambiguity in determining whether the breach is fundamental, common law cases which deal with the criteria of fundamental breach could be used to help solve the problem since the requirements of the CISG is essentially similar with common law system in this field.

According to Australian contract theory, the intention of parties is the key principle to determine whether there is a right of termination. The intention of parties can be perceived through three ways---expressly by the contract, by common law or by statute. We will focus on the requirements of common law. *Hongkong Fir* case illustrated that if breach of condition or breach of an intermediate term with serious consequences could be proved, the aggrieved party was entitled to terminate the contract. [9] A fundamental breach is deemed as sufficiently serious. [10] Both *Associated Newspapers* case and *Tramways* case proved how to test the essentiality of terms in contract “the test of essentiality is...that the promise is of such importance to the promisee that he could not have entered into the contract unless he had been assured of a strict or a substantial performance of the promise...and that this ought to have been apparent to the promisor...If the innocent party would not have entered into the contract unless assured of a strict and literal performance of the promise, he may in general treat himself as discharged upon any breach of the promise, however slight”. [11] The essential meaning of this statement in some extent is similar to that of fundamental breach provided in CISG. A party would not enter into a contract if he could not gain the benefits (apparent to both parties) fixed at the time when the contract was concluded. Then such benefits are deemed as fundamental condition of the contract.

Another less confused issue is “unforeseeability”. The problem, that whether profits gained according to the contract are foreseeable or not, can be judged by both party if there are specific provisions in their contract. This is the principle of autonomy of will. Where there is an absence of such autonomous will, international customs (usages) could be used to estimate the future profits that the aggrieved party would gain if without such breach. If such international customs (usages) are still absent, courts would decide according to the specific situations. This requires judges to consider the real will of both parties when they entered into the contract, and to estimate the foreseeable benefits by being a reasonable person in that situation to foresee. The foreseeable benefits generally include net

profit margin and other foreseeable charges such as penalty / compensation / damages. Penalty / compensation / damages are required to be disclosed to both parties when contract was concluded. Nobody should bear obligation against the future unforeseeable loss. All these judgements should be depended on the principle of fairness and justice.

Breach of extended time

Under CISG, not all situations of non-performance[12] or late performance will lead to right of termination. The innocent party firstly has to offer the breaching party with an extended period of time for performance unless the late performance is a fundamental breach. After the extended time lapses, the innocent party is entitled to terminate the contract. These means that where there is a fundamental breach, no matter performance is late or not, the innocent party definitely gets rights to terminate contract. And where there is no fundamental breach, non-performance and late performance do not permit the aggrieved party to terminate contract immediately and consequentially. In the situation of non-performance or late performance, the aggrieved party must provide the breaching party with an extended period of time for performance. Once the breaching party lose performance within the extended period offered by the innocent party, then the innocent party is entitled to avoid contract.

Test of right of avoidance---whether there is a legal right existing to terminate contract

Termination made by agreement between the parties

CISG respects the intention of contracting parties according to the principle of autonomy of will. It regulates in Art29(1) that the contracting parties could terminate or modify the original contract by the mere agreement of the parties. If the market situation has changed and at the same time both parties change their minds to refuse performing, then they have freedom to terminate contract. This is a peaceful bilateral way to bring contracts to the end by an agreement. Such bilateral-way aims to respect a freely market.

In Australian contract theory books and Chinese contract books, we could perceive that autonomous intention of parties is also important, namely the first step to check whether a contract can be terminated.

If such bilateral agreement cannot be concluded to terminate a contract, then one-side termination is necessary to protect the innocent party.

The specific stipulations which provide for both the buyer and the seller with right to termination

Both buyers and sellers can avoid the contract by providing evidence that the breach is fundamental(Art25). This is one-side termination.

Buyer's right to termination (central article--49)

CISG provides four main circumstances giving rise to the right to termination by buyer: non-delivery of the goods, delivery of non-conforming goods, late delivery and neglect of other duties. [13] Once the non-performance is fundamental breach, the buyer has right to terminate contract. The installment sales situation could be separately regarded as non-performance or delivery of non-conforming goods which amount to a fundamental breach.

a. Non-delivery of Goods

Actual non-performance or announced non-performance constitutes a fundamental breach according to Art49(1)(a)&(b). But if only a minor parts or non-substantial parts of the contract are not finally performed, such as one of several deliveries is not performed, there is no fundamental breach. [14] When the seller does not deliver the goods within the additional grace period fixed by the buyer according to Art47 or Art48(2), or the seller declares he will not deliver within the period so fixed, the buyer is entitled to avoid the contract[Art49(1)(b)]. The test of fundamental breach is not required under the situation with an additional time for performance. [15] In this situation, any failure to deliver

the goods by the seller, even an insignificant breach, may qualify the buyer to avoid the contract under Art49(1)(b). [16]

b. Delivery of Non-confirming Goods

Where there is a non-confirming delivery, buyer only can require seller to deliver substitute goods when lack of fundamental breach(Art46). In this situation an additional period of time may be fixed by buyer to offer seller more time to repair or remedy the non-confirming goods. If seller still does not repair or remedy the delivery during the extended period of time offered by buyer, then the buyer is entitled to avoid contract. Therefore delivery of non-confirming goods is not automatically inducing a termination.

c. Late Delivery

Late delivery does not automatically become a fundamental breach. Buyer cannot declare a contract avoided only by providing evidences of late performance without further evidences demonstrating that the late performance breaches the contract fundamentally or the seller lose performance during extended period of time.[17] In the cases that parties regard "time" as essential part, or in the cases that contractual subjects are seasonal goods, then "time" is the root of the contract and should not be breached. [18] If this essential element "time" is breached, there will be a fundamental breach since this kind of late performance deprives the aggrieved party of what he expected when the contract was concluded.

Another similar situation is stipulated in the INCOTERMS. A German court decision showed the term "time" in itself does not lead a simple delay into a fundamental breach.[19] It depends on whether the time is the fundamental issue in the contract.[20] If the time for performance is essential, even a short delay should entitle the buyer to terminate contract.

In order to determine whether the time is essential or not, in my opinion, Australian rules could be used as supplementations to help court to solve the issue. In Australian contract theory, the nature of the contract and the nature of the term in contract should be examined.[21] The time in commercial contracts generally are presumed to be the essence.[22]

If "time" is not fundamental issue in the contract and the seller has failed to deliver the goods on time, buyer can set an additional time for seller to perform(Art47). If seller still lose performance under the additional time, then the buyer gains right to avoid contract.

d. Neglect of Other Duties

Other duties mentioned in CISG, such as marking the goods for their identification, arranging for the carriage of the goods or offering all relevant information(Art32), are difficult to be deemed as fundamental elements in contract. Rare cases regard breach of such additional duty as fundamental breach. [23] However, some cases have demonstrated that if the seller had infringed resale restrictions or valid exclusive sales agreements or re-import restrictions, breach of such statements could be regarded as fundamental breach.[24]

The seller's right to termination (central article--64)

Similar to the buyer's right to termination, CISG also provides three main circumstances giving rise to the right to termination by seller: non-delivery or non-payment of the goods, late performance and neglect of other duties. A delay of delivery made by seller is usually considered more likely to be a fundamental breach, while a delay of payment made by buyer is regarded as not so fundamental. [25]

a. Non-delivery or Non-payment of the Goods and Late Performance

In the situations that buyer does not take delivery or pay the price to seller or perform lately (or other obligations under contract): ① if such behaviors constitute fundamental breach, the seller is entitled to avoid contract[Art64(1)(a)]; ② if such behaviors are not fundamental breach, the seller cannot avoid contract directly. He/She must offer buyer additional extended period of time to perform. When buyer fails to commit performance during the limited period, the seller can terminate contract[Art64(1)(b)].

b. Neglect of Other Duties

Buyer is required to examine the goods delivered by sellers within a reasonable time, otherwise the buyer will lose right to avoid the contract[Art39(1)]. If buyer forgets to examine commodities in the

reasonable time, seller can take advantages to release himself from the obligations in this situations even the goods delivered by himself are defective.

Anticipatory Breach and installment contract (central articles—72&73)

Regime of anticipatory breach protects observant party against the party who loses his creditworthiness or capability of performance. Now we do not discuss the right of suspension, we focus on the right of termination. “The criteria for early avoidance of the contract under Art72 are harsher than those for temporary suspension under Art71.” [26] If prior to the date of performance, it is clear that one of the parties will commit a fundamental breach, the other party may declare the contract avoided. In another words, if anticipatory breach is a fundamental breach, the innocent party is entitled to avoid contract. The fundamental breach must be “clear” and not be merely “apparent”. [27] The character of “clear” could be judged from two respects: ① the breaching party declared he would not perform the substantial obligations; or ② it is clear the party will fundamentally breach the contract. This second respect could be perceived from many facts, such as lack of ability to perform contract/insolvency or in bankruptcy proceeding/in civil or criminal litigation/undergoing credit crisis or crisis of creditworthiness/in debt/deficient conduct in preparing to perform or in performing the contract and so on.

Similar to Art72, Art73 stipulates right to avoidance in installment contracts. Right to avoid the deliveries already made (include deliveries made in the past and current deliveries) or future deliveries is permitted in CISG if the right is utilized within a reasonable time when fundamental breaches occurs in an installment sale.

Conclusion

When there is a breach of contract, the first step is to examine whether an agreement is concluded to terminate the contract. If no such bilateral agreement is provided, the innocent party can utilize statute right to terminate the contract (details stated in 3.2).

Restrictions—when exercising the right to termination

According to what we discussed above, the aggrieved party is entitled legally to terminate contact. However they also need to pay attention to the restrictions which would exclude the innocent party from exercising the right to termination.

Notice

According to termination regime in CISG, contractual termination does not automatically happen when there is a right to termination. Only when notice containing clear intention to declare contract avoided is informed, a declaration of avoidance is effective and enforceable. This is just one-side obligation, which means the party who want to avoid contract is required to provide a notice of avoidance to the counterparty; while the counterparty has no obligation to give further notice to make it clear that he has already received the notice of avoidance from the innocent party. The words, such as “cancel, annul, off, at an end, no longer binding” and so on, usually indicate intentions of termination. A notice comprising of such vocabularies could be regarded as a “clear notice”. Both writing and oral forms are acceptable.

Time Limitation

Art49(2) and Art64(2) stipulate a reasonable time for buyer or seller to exercise their right to termination. When seller or buyer does not perform central obligation, the counterparty only can terminate contract during a reasonable period of time after he/she is aware of the deficiency of delivery. Some experiential cases illustrate that such time frame should not be too long. If no special circumstances exist, five weeks are reasonable, and more than two months are regarded as unreasonably long. [28]

Restitution of goods

Buyer loses right to declare contract avoided if it is impossible for him/her to make restitution of the goods substantially in the condition that he/she received. This further regulation restricts buyer to exercise the right of avoidance. Compared to this restriction, seller is not required by statute to undertake such responsibility of restitution because restitution of price (money) is feasible. However, if impossible restitution of commodities is not due to the buyer's fault, he/she can be excluded from obligation of restitution and can terminate contract. Restitution is a special character of CISG, since it is one of rare rules in CISG which are not adopted by UNIDROIT Principles and the Lando Principles of European Contract Law. [29]

Conclusion

Notice, time limitation and restitution are the important restrictions in CISG to balance the interests of both side parties. They aimed to judge disputes according to principles of fairness and justice.

Consequences of Termination

Once effective termination occurs, first and foremost, both parties are released from the contractual obligations as if the contract was never concluded (Only the dispute settlement resolutions are still valid). The innocent party is entitled to claim compensations. Beside these, both parties are bound to return the goods or price to the counterparty. If the dispute is still unresolved, settlements or other jurisdictions provisions survive to resolve the problem.

Conclusion

Rules of fundamental breach and additional extended period of time are the most basic parts in termination regime. They give both party the right to termination. At the same time, according to the principle of fairness and justice, the exercise of termination regime should be restricted effectively in order to protect both parties' interests. Therefore the rules of fundamental breach, additional extended period of time and restrictions are the mainly content in termination regime. Since this regime absorbs the essence of both the civil law and common law theory, we could in some extent reference to the domestic practices in these countries when there are ambiguities in elaboration of rules of CISG.

Footnotes

[1] Koji Takahashi, 'Right to Terminate (Avoid) International Sales of Commodities' (2003) *Journal of Business Law* 102 at 122 <<http://www.cisg.law.pace.edu/cisg/biblio/takahashi.html#iii>> accessed on 29 March 2014.

[2] & [3] & [4] & [6] & [7] & [13] & [14] & [17] & [18] & [19] & [20] & [23] & [24] & [28] * [29] Ulrich Magnus, 'The Remedy of Avoidance of Contract Under CISG---General Remarks and Special Cases' 25 *Journal of Law and Commerce* 423 at 424; 424; 425; 425; 425; 433; 433; 434; 434; 434; 434; 435; 436; 428; 428.

[5] & [15] & [16] & [26] & [27] Jianming Shen, 'Declaring the Contract Avoided: The U.N. Sales Convention in the Chinese Context' (1997) 10 *New York International Law Review* at 12; 19; 19; 22; 22 <<http://www.cisg.law.pace.edu/cisg/biblio/shen.html#2a1>> accessed on 15 March 2014.

[8] Andrew Babiak, 'Defining 'Fundamental Breach' Under the United Nations Convention on Contracts for the International Sale of Goods' (1992) 6 *Temple International and Comparative Law Journal* 113 at 125 <<http://www.cisg.law.pace.edu/cisg/biblio/babiak.html#77>> accessed on 15 March 2014.

[9] & [10] & [11] & [21] & [22] J W Carter, Elisabeth Peden & G J Tolhurst, *Cases and Materials on Contract Law in Australia* (5th ed, 2007) at 295; 670; 675; 686; 686;

[12] Non-performance here includes two incidents: "the party actually does not perform" and "the party declare he/she will not perform within the extended time".

[25]Michael G. Bridge, 'Issues Arising Under Articles 64, 72, and 73 of the United Nations Convention on Contracts for The International Sale of Goods' 25 *Journal of Law and Commerce* 405 at 409.

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- 4.Strub G.M, 'The Convention on the International Sale of Goods: Anticipatory Repudiation Provisions and Developing Countries'(1989) 38 *International and Comparative Law Quarterly* 475 at 494.
- 5.<http://www.cisg.law.pace.edu/cisg/guides.html> accessed on 15 March 2014.