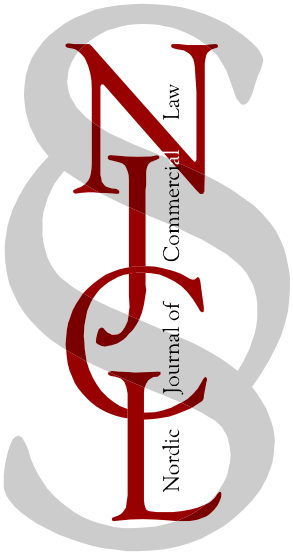

CAVEAT EMPTOR: ARE DECISIONS MORE FAVOURABLE TO THE SELLER ON MATTERS RELATING TO LETTERS OF CREDIT?

An Examination of CIETAC Decision of 4 June 1999

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1. INTRODUCTION

The People's Republic of China (PRC) has long been a source of much speculation for economists and trade pundits; with its staggering population of 1,296,500,000[2] it has become a force to be reckoned with. It is with China's accession to the World Trade Organization (WTO) on December 11, 2001 that one can assess the impact and volume of trade that has taken place over the past 5 years. To put this in perspective, worldwide China is ranked third overall in merchandise import and exports in 2004.[3] Also, in 2004 in the area of merchandise trade[4] which consists of Agricultural products, Fuels and Mining products, and Manufactured products, China commanded a 6.46% share in the world's total exports and 5.88% share in the world's total imports.[5]

With these figures in mind, we now turn to the legal implications of this trade. It is evident to any lawyer that with such vast amounts of transactions being conducted everyday, legal disputes are almost certain to follow. The United Nations Convention on Contracts for the International Sale of Goods 1980, (hereinafter referred to as 'CISG' or 'Convention'), has been in effect in China since January 1, 1988, and governs all international sale of goods transactions between contracting Member States.[6] This is important given that China's largest trading partners are: the United States, the European Union,[7] and the Republic of Korea. The United States, Korea, and most of the European Union Member States are contracting States under the CISG.

While most scholarly material written on the CISG focuses on the decision making of national courts, this article will instead examine a decision made by the Chinese International Economic and Trade Arbitration Commission (CIETAC).[8] CIETAC is one of the largest and most important arbitration institutions in China, with over 200 disputes reported involving the application of the CISG. Many contracting parties choose arbitration as their preferred method of dispute resolution because of its advantages: efficiency of speed, low costs, and internationally binding decisions under the 1958 New York Convention.[9]

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2 Taken from World Trade Organization database data from March 2004 http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=CN

3 http://stat.wto.org/CountryProfile/WSDBCountryPFView.aspx?Language=E&Country=CN

4 The share in world total exports and imports of merchandise. Breakdown by main commodity group: Agricultural products refer to food and raw materials, Fuels and Mining products include ores and other minerals; fuels and non-ferrous metals. Manufactures refer to iron and steel, chemicals, other semi-manufactures, machinery and transport equipment, textiles, clothing and other consumer goods.

5 Supra 2

6 The People's Republic of China has made an Article 95 CISG declaration and is therefore not bound by Article 1(1)(b) CISG. See: http://www.cisg.law.pace.edu/cisg/countries/cntries-China.html

7 Except the United Kingdom, Ireland, and Portugal

8 Formerly established under the name Foreign Trade Arbitration Commission (1956) renamed CIETAC in 1988. See: http://www.cietac.org.cn/english/introduction/intro_1.htm

9 The New York Convention 1958 (Convention on the Recognition and Enforcement of Foreign Arbitral Awards) has been acceded to by 135 countries as of May 1, 2005

This article examines what is considered one of the most important issues under the CISG, that of fundamental breach. In order for a buyer or seller to avoid the contract, they must prove that the breach in question is fundamental in order to justify abandoning their contractual obligations. Although there are many reasons why an innocent party might try to avoid the contract, this writer will focus on CIETAC decision of 4 June 1999 (*Industrial Raw Materials case*), which dealt with *inter alia* documentary letters of credit. We will look at the rules regarding documentary credits as established by the Uniform Customs Practice for Documentary Credits of the ICC (UCP 500), and the need for strict compliance. Following this, we will briefly examine the criteria needed to establish fundamental breach under Article 25 CISG. This article will then present an analysis of CIETAC decision of 4 June 1999 (*Industrial Raw Materials case*), to determine if the Arbitration Tribunal arrived at a decision that is conducive to uniform interpretation of the CISG. In this case, the reader will have to bear in mind the seriousness of the breach and whether it justifies avoidance of the contract. Was the decision more favourable to the seller? How would a reasonable person in the trade involved regard this situation? In addition, should the buyer have been entitled to some form of remedy for the seller's breach of his contractual obligations? Finally, this article will present what could be an alternative approach for buyers and sellers when faced with a dispute in their contractual arrangements.

2. LETTERS OF CREDIT

In order to understand why this issue is important, it is first necessary to understand the nature of the letter of credit. A letter of credit may assume many of the characteristics of a contract. However, it does not follow true contractual principles, instead it may be best described as a mercantile specialty.[10] In most international sales of goods contracts, parties will require that the contract price be paid either by a documentary letter of credit or a standby letter of credit. The reason for this being that most buyers and sellers are likely to be unknown to each other and given that they are located in different countries, a letter of credit will make the transaction more secure. Letters of credit are also useful when one party does not have sufficient financial history, assets, or credit to support good faith credit terms.

2.1. Types

There are two main types of letters of credit: Documentary letters of credit and Standby letters of credit. Documentary letters of credit are the most common, and are used on an individual transaction, order, or invoice basis. They generally have specific conditions applied to them, such as being irrevocable by the buyer and confirmed by the issuing bank. Standby letters of credit are used as a backup should the buyer fail to pay the contract price as agreed upon. Thus, a standby letter of credit allows the buyer to ensure the security of the transaction with the seller by showing that it can uphold its promise to pay the price.

[10] Gao Xiang and Ross Buckley (2003). The Unique Jurisprudence of Letters of Credit: Its Origin and Sources. 4 *San Diego International Law Journal* p. 91

2.2. How doLetters of Credit Work?

A typical documentary letter of credit works in the following way: once the buyer has concluded the contract with the seller, the buyer will request its bank (issuing bank) to open a letter of credit in favour of the seller (beneficiary). The issuing bank, in order to fulfil this request, sends the letter of credit details to the seller's bank (advising bank). The advising bank endorses the letter of credit and sends the beneficiary (seller) the details. The seller examines the details of the letter of credit to make sure that they are correct. If needed, the seller will contact the buyer and ask for the necessary amendments to be made. Once the seller is satisfied with the conditions of the letter of credit, the goods are shipped and the seller presents the documents to the advising bank. The advising bank examines the documents against the details on the letter of credit and the International Chamber of Commerce (UCP 500) rules. If they are in order, the bank will send them to the issuing bank for payment. If the details are not correct, the advising bank tells the seller and waits for corrected documents. The issuing bank examines the documents from the advising bank and if they are in order, pays the money as promised. If the details are not correct, the issuing bank contacts the buyer for authorisation to pay or accept the documents. If acceptable, the issuing bank releases the documents to the buyer, and pays the money as agreed. The buyer receives the documents from the issuing bank and collects the goods. The seller receives the payment through the advising bank. The advising bank notifies the seller that payment has been made.

To put this in perspective, it is more straightforward to view the letter of credit process as three separate obligations. The first obligation is found in the contract for the sale of goods, which sets out the responsibilities of the buyer and seller. The second obligation is between the buyer (applicant) and his chosen bank (issuing bank), whereby the bank agrees to ensure the creditworthiness of the buyer. The final obligation is found in the letter of credit itself, in which the issuing bank promises to pay the seller the contractual sum upon tendering of documents, which *strictly comply* with the terms of the letter of credit. As each of these obligations are *independent* of each other, no party to any of these three separate obligations can be held responsible for the performance of another obligation.[11]

2.3. Principle of Independence

One of the doctrines upon which letters of credit are built consists of the principle of independence. This means that the responsibility on the part of the issuing bank to pay the seller under the terms and conditions of the letter of credit is a separate obligation and is entirely severed from the contractual relationship between the buyer and seller. Therefore, the issuing bank *must* honour the payment under the letter of credit irrespective of any problems or disputes that arise under the contractual transaction for the sale of goods, unless fraud can be proven.[12] This principle is embodied in Articles 3 and 4 of the UCP 500, which stress that the banks are in no way concerned or bound by the underlying sales contract.[13]

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[11] John F. Dolan (1992). The Correspondent Bank in the Letter-of-Credit Transaction. 109 *Banking Law Journal* p. 396 (September-October) *See Also:* http://www.drfurfero.com/articles/art03/art03.html

[12] David C. Howard (1984). The Application of Compulsory Joinder, Intervention, Impleader and Attachment to Letter of Credit Litigation 52 *Fordham Law Review* p. 957 *See Also:* Supra 9

[13] Article 3: Credits v. Contracts: A. Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the Credit. Consequently, the undertaking of a bank to pay, accept and pay

2.4. Principle of Strict Compliance

The other principle that the letter of credit system is based on; an arguably the most important is the principle of strict compliance. The rules governing this principle state that if the seller wishes to be paid under the letter of credit transaction, then documents which comply with the letter of credit must be tendered. In a similar regard to the principle of independence as presented above, once the documents which on their face conform to the terms and conditions of the letter of credit are met then the issuing bank must honour their obligation to pay. This rule is strict in the sense that presentation of documents which almost conform will not be sufficient to render payment. If the issuing bank chooses to pay under these circumstances, it does so at its own risk and may not be reimbursed by the buyer.

While the rules of strict compliance are not explicitly mentioned in the UCP 500, it has for many years been embodied in judicial decisions both in the English courts and well as the United States. We can see for example in cases such as *Equitable Trust v Dawson Partners,*[14] where it was stated by Lord Sumner, "there is no room for documents which are almost the same or which will do just as well." This was supported by the decision in *Fidelity National Bank v Dade County*[15] which states "Compliance with the terms of a letter of credit is not like pitching horseshoes. No points are awarded for being close." The UCP 500 states in Article 13(a) and 14, that upon receiving the documents the issuing bank must decide the basis of the documents alone whether or not they appear on their face to be in compliance with the terms and conditions of the letter of credit. Furthermore, the bank is not required to clarify any ambiguities or discrepancies. In the case *Seaconsar Far East v Bank Markazi Jomhouri Islami Iran*[16] it was stated that the bank was correct in rejecting the non-conforming documents even though the discrepancy in question was trivial.

However, it has been argued that this does not mean the document will be deemed non-conforming if it "fails to dot every 'i' or cross every 't' or contains obvious typographical errors." This can be seen in the case *Hing Yip Fat Co. v The Diawa Bank Ltd.*[17] where it was held that the use of the word "industrial" rather than "industries" on a letter of credit application was an obvious typographical error.[18] Also, in the case of *New Braunfels National Bank v. Odiorne*[19] it was held that strict compliance can mean something other than absolute or perfect compliance. Therefore, the courts will have to decide whether the typographical error in question has the potential to have severe repercussions for the transaction.

One can observe from examining the process presented above that the letter of credit process is very technical and there are many things with the potential to go wrong. Indeed, in commercial

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Draft(s) or negotiate and/or to fulfil any other obligation under the Credit, is not subject to claims or defences by the Applicant resulting from his relationships with the Issuing Bank or the Beneficiary. B. A Beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the Applicant and the Issuing Bank. Article 4: Documents v. Goods/Services/Performances. In Credit operations all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate.

14 27 Lloyd's List L.R. 49, 52 (H.L.) (1927)

15 371 So 2d 545 p. 546

16 1 Lloyd's Rep 236 (1993)

17 2 H.K.L.R. 35 (1991)

18 Roy Goode (1994-1995). Abstract Payment Undertakings and the Rules of the International Chambers of Commerce 39 *St. Louis University Law Journal* p. 725

19 780 S.W. 2d 313 (Tex. Ct. App. 1989)

reality the letter of credit process can be revised many times before it is deemed to be in conformity with the documents identifying the contractual terms. In a study undertaken in the United Kingdom by the Midland Bank and SITPRO[20] in the mid 1980's, the amount of letter of credit transactions that failed upon first presentation of documents was staggering.[21] Out of 1,143 presentations, 51.4 % failed to meet the strict compliance standard, however most were accepted upon re-tender.[22] Furthermore, 23.7% of those that failed were due to discrepancies in transport documentation. In other studies carried out in countries such as Hong Kong and Australia, the failure rate was as high as 90% in some cases.[23] These numbers have not decreased. In a more recent study undertaken it was found that documents did not conform to the letter of credit 73% of the time.[24] The question remains as to under what circumstances can such non-conformities be deemed a fundamental breach under the CISG. Some experts have asserted that courts should apply a legal test rather than a commercial one when examining non-conforming documents; specifically they should inquire whether there is a substantial and more to the point a *real* discrepancy.[25]

3. FUNDAMENTAL BREACH

At the juncture, it is important to examine the requirement of a fundamental breach in order to justify avoidance of the contract under the CISG; albeit briefly. The Convention defines fundamental breach under the provisions of Article 25 CISG:

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

There are many ambiguous terms in this provision for which the Convention offers no clarification. These include terms such as: 'substantially to deprive,' 'entitled to expect,' 'did not foresee,' and 'reasonable person of the same kind in the circumstances.' These vague terminologies pose a potential threat to the correct interpretation that is to be given to the Convention, even more so when one considers the implications of the buyer or seller being able to avoid the contract rests on establishing fundamental breach.[26]

In order to decipher the meaning of this provision, the Convention provides interpretative guidance in the form of Article 7 CISG:

(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.

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20 The Simplification of International Trade Procedures Board.
21 Clive M. Schmitthoff (1988). Selected Essays on International Trade, Chia-Jui Cheng Ed. p. 432
22 Ibid.
23 Ibid.
24 Ronald J. Mann (2000). The Role of letters of Credit in Payment Transactions, 98 *Michigan Law Review* p. 2494
25 Ibid, p. 437
26 Article 49(1)(a) and Article 64 (1)(a) CISG

(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

From the above, it can be ascertained that in order to promote uniformity in the Convention one can look to the general principles upon which the Convention is based to answer any ambiguities which may arise.

The solution to filling any gaps which may be evident in the Convention was provided for in Article 7(2) CISG, which creates a hierarchical system for judges and arbitrators to adhere to. In order to resolve gaps in the Convention, one had to first look to its internal principles and only when this method was exhausted could external principles be brought in as a last resort.[27]

The Convention itself, neither in its provisions nor in the Secretariat Commentary,[28] states what these general principles are, but the academic literature assists in this matter.

Scholars put forth what is considered to be the four basic policies underlying the CISG: Freedom of Contract, promotion of co-operation and reasonableness to preserve the contract, facilitation of exchange even in the event that something goes wrong, and to provide compensation for the aggrieved party.[29]

Thus, in order to understand the ambiguous terms embodied in Article 25 CISG, we will look to the legislative history of the provision in addition to academic literature to shed some light on the subject.

The origins of fundamental breach can be found in ULIS Article 10,[30] which was drafted with an aim to prevent avoidance from inconsequential contractual breaches.[31] Although the provisions under this article contained both elements of subjectivity and objectivity, it was criticised as being too hypothetical in that the party in breach would have to possess what is referred to as, 'ex-post-facto' knowledge of the events.[32] As a result of these criticisms, when the committee to re-examine and create a new uniform law was established by UNCITRAL, it was mandated that a more 'material' test was needed.[33] This gave rise to the current provision under Article 25 CISG, however, as we can see there are many problems that still exist. The author will proceed by examining each of the ambiguous phraseology in an attempt to get at the root of what criteria are needed to establish fundamental breach under the Convention.

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27 C.M. Bianca and M.J. Bonell (1987). Commentary on the International Sales Law: The 1980 Vienna Sales Convention Giuffre: Milan, p. 75

28 The closest thing the Convention has to a reliable official commentary.

29 Robert Hillman, 'Cross-References and Editorial Analysis Article 7' Available at http://cisgw3.law.pace.edu/cisg/text/hillman.html

30 For the purposes of the present Law, a breach of contract shall be regarded as fundamental wherever the party in breach knew, or ought to have known, at the time of the conclusion of the contract, that a reasonable person in the same situation as the other party would not have entered into the contract if he had foreseen the breach and its effects.

31 C.M. Bianca and M.J. Bonell (1987). Commentary on the International Sales Law: The 1980 Vienna Sales Convention. Giuffre: Milan, p. 206

32 See id p. 207

33 See id

3.1. Substantial Deprivation

In order for a breach to be 'fundamental,' the breach must cause a 'detriment' that substantially deprives the non-breaching party of its reasonable expectations. The CISG, however, does not define the term 'detriment.'[34] It is argued that, "Detriment fills the function of filtering out certain cases as for example where breach of a fundamental obligation has occurred but not caused injury."[35] For example, taking the case of an antedated bill of lading, although the seller would be committing a fundamental breach of his obligations, if the breach does not cause the buyer any injury, it can be argued that detriment does not occur. It is important to recall that one of the significant principles of the CISG is the preservation of the contract and ensuring both parties receive the fruits of the contract. The Draft Commentary stated that, "The determination whether the injury is substantial must be made in light of the circumstances of each case for example, the monetary value of the contract, the monetary harm caused by the breach, or the extent to which the breach interferes with other activities of the injured party."[36] Furthermore, when the party whose interests were infringed decides that continuing to be bound to the contract impedes his business activities to such an extent that he can no longer be expected to be bound, avoidance will be the remedy he seeks for no other remedy in the Convention will satisfy the breach caused.[37]

3.2. Expectation

The two concepts of substantial detriment and contractual expectation are fused together, since detriment can be characterised as a fundamental breach if the injured party has no further interest in accepting performance of the contract.[38] Some delegations present at the drafting of the Convention thought the reference to expectations under the contract represented a great improvement, while others claimed it was less flexible and introduced an element of subjectivity. I disagree with this suggestion. In examining the legislative history of this article, there is nothing to suggest that it is merely the expectation of the injured party alone that is taken into consideration. Thus, in order to differentiate between a substantial and insubstantial detriment it is not only the decision maker's opinion of the non-breaching party expectations that matter, instead it is connected to the terms of the contract.[39]

3.3. Foreseeability

The test of foreseeability as set out in Article 25 CISG is meant to preclude a fundamental breach where the substantial detriment occurs unforeseeably; it is a mechanism which allows the party in breach to evade avoidance of the contract. Since it is improbable that the party in breach will

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34 Andrew Babiak (1992). 'Defining "Fundamental Breach" under the United Nations Convention on Contracts for the International Sale of Goods' 6 *Temple International and Comparative Law Journal* p.119

35 Alexander Lorenz (1998). 'Fundamental Breach under the CISG' available at http://cisgw3.law.pace.edu/cisg/biblio/lorenz.html See Also: C.M. Bianca and M.J. Bonell (1987). Commentary on the International Sales Law: The 1980 Vienna Sales Convention. Giuffre: Milan

36 See id. See also Yearbook VII 1976 at 101

37 See id

38 Alexander Lorenz (1998). 'Fundamental Breach under the CISG' available at http://cisgw3.law.pace.edu/cisg/biblio/lorenz.html

39 See id p. 215

acknowledge they foresaw the detriment in question the 'reasonable person standard' was established.[40] Where substantial detriment is deemed to exist, the party in breach has to show that he did not foresee the negative result, nor would a reasonable person have foreseen it, in order to escape avoidance. Thus, it will be necessary to evaluate this in light of whether business people in the same product market would have foreseen the detriment; the reason for this is that standards of reasonableness will vary amongst the different areas.[41] A reasonable person is considered to be a reasonable merchant of the same socio-economic background, so all of the standards of the trade would have to be met. In addition to the circumstances of the particular case, market conditions both regionally and globally must be considered, as well as legislation, political climate, and prior dealings[42] as stated in Article 8(3).[43]

The question arises as to the point in time when the detrimental result has to be foreseen; Article 25 does not state whether foreseeability should be decided at the time the contract was formed, or when the breach took place.[44] Some scholars contend that since the contractual terms establishes the rights and responsibilities of the buyer and seller, then the decisive time for when foreseeability is determined should be when the contract is formed. If not, one party could provide the other with further information, thereby changing what was deemed to be a substantial interest and could now give rise to a fundamental breach.[45] Others, however, disagree with this, arguing that if we take the notion of good faith into account, then credence must be given to any information received by the party in breach after the contract was formed.[46]

4. CAN DEFECTS IN LETTERS OF CREDIT OR DOCUMENTS RELATING TO LETTERS OF CREDIT CONSTITUTE A FUNDAMENTAL BREACH?

It is widely accepted as established above that letters of credit are a common method of payment under international sales contracts. In addition, the rules of the ICC in regards to such sales contracts are considered by courts and academics to be usages within the meaning of Article 9(2)[47]

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40 Alexander Lorenz (1998). 'Fundamental Breach under the CISG' available at http://cisgw3.law.pace.edu/cisg/biblio/lorenz.html

41 Leonardo Graffi (2003). 'Case Law on the Concept of "Fundamental Breach" in the Vienna Sales Convention' *Revue de Droit des Affaires Internationals/ International Business Law Journal* No 3. 338-349 Available at: http://cisgw3.law.pace.edu/cisg/biblio/graffi.html

42 Andrew Babiak (1992). 'Defining "Fundamental Breach" under the United Nations Convention on Contracts for the International Sale of Goods' 6 *Temple International and Comparative Law Journal* p.122 *See Also* C.M. Bianca and M.J. Bonell (1987) Commentary on the International Sales Law: The 1980 Vienna Sales Convention. Giuffre: Milan p. 219

43 "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."

44 Harry M. Flechtner (1998). 'The Several Texts of the CISG in a Decentralized System: Observations on Translations, Reservations and other Challenges to the Uniformity Principle in Article 7(1)'17 *Journal of Law and Commerce* pp. 187-217 Available at http://cisgw3.law.pace.edu/cisg/biblio/flecht1.html

45 Alexander Lorenz (1998). 'Fundamental Breach under the CISG' available at http://cisgw3.law.pace.edu/cisg/biblio/lorenz.html

46 Leonardo Graffi (2003). 'Case Law on the Concept of "Fundamental Breach" in the Vienna Sales Convention' *Revue de Droit des Affaires Internationals/ International Business Law Journal* No 3. 338-349 Available at: http://cisgw3.law.pace.edu/cisg/biblio/graffi.html

47 (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.

CISG.[48] Thus, it is accepted that the UCP 500 will be applicable either by express contractual reference by the parties or alternatively as a recognised international usage under the Convention.

Under the Convention, it is the principal responsibility of the buyer to pay the contractual price for the goods as set out in Articles 53 and 54 CISG.[49] In the same respect, it is the responsibility of the seller to hand over any documents relating to the goods as set out in Articles 30 and 34 CISG.[50] It is acknowledged both by international sales practice and UCP 500 Article 3 that letters of credit are considered to be separate transactions from the sales contract on which it may be based and the bank is in no way concerned with or bound by the sales contract. While this may be true, it can be argued that from examining the process by which a letter of credit is approved and paid, documents required by the sales contract, *need* to be in conformity with the letter of credit before payment can be made. Otherwise, this is what is known as tendering 'unclean' documents. Furthermore, the need for 'clean' or conforming documents is embodied in Article 13(a) of the UCP 500 in addition to Articles 20-38 which address the requirements of specific documents such as bills of lading, sea waybills, and commercial invoices. This notion is supported by Professor Ingeborg Schwenzer, rapporteur for the recent Opinion issued by the CISG Advisory Council. She states, "If the contract provides for payment by documentary credit, this implies that the documents have to be "clean" in every respect. Otherwise, the buyer has the right to avoid the contract.[51] Other scholars, however, oppose this view and instead argue that the doctrine of independence under the letter of credit rules means that even when the documents are non-conforming, there is still an underlying obligation for the buyer to pay for the goods if they comply with the contract.

This article has thus far stressed the importance of fundamental breach and the need for strict compliance between the documents and the letter of credit. It has been shown that, under the provisions of the Convention both the buyer and seller have core obligations to perform. It is now necessary to examine one such decision made by CIETAC, to determine if the principles on which the Convention is based are being upheld and applied by this governing body.

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48 CISG-AC Opinion no 5, The buyer's right to avoid the contract in case of non-conforming goods or documents 7 May 2005, Badenweiler (Germany). Rapporteur: Professor Dr. Ingeborg Schwenzer, LL.M., Professor of Private Law, University of Basel.

49 Article 53: The buyer must pay the price for the goods and take delivery of them as required by the contract and this Convention. 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.

50 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. 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.

51 Ingeborg Schwenzer (2005). "The Danger Of Domestic Preconceived Views with Respect to the Uniform Interpretation of the CISG: The Question Of Avoidance In The Case Of Nonconforming And Documents." 36 *Victoria University of Wellington Law Review* p. 795

5. EXAMINATION OF CIETAC DECISION OF 4 JUNE 1999 (*INDUSTRIAL RAW MATERIALS CASE*)

5.1. Facts of the Case

In a case involving a U.S. buyer and a Chinese seller for the sale of industrial raw materials, the contract stipulated that payment was to be made by letter of credit.[52] After the signing of the contract, the buyer opened the letter of credit in accordance with the terms of the contract. However, when the letter of credit was presented to the paying bank for negotiation, it was dishonoured because the bill of lading was dated 1999 instead of 1998. The seller then requested that the buyer accept this disparity and redeem the bill of lading; the buyer did not redeem the bill of lading but instead asked for a price reduction for the disparity. The Seller denied this request and when the buyer refused to make payment the seller resold the goods for a lesser sum.

5.2. Buyer's Arguments

The buyer argued that it was the seller who breached the contract by not delivering a complete set of documents as required by Article 34 CISG. In fact, the seller in its correspondence with the buyer, admitted that the misdated bill of lading was the seller's own fault and when the bank asked for the documents to be cured the seller failed to do so in a timely manner.

The buyer is in the business of trading and thus was not the end buyer for the goods; he had already arranged for the goods to be resold to his downstream buyers. It is commonly accepted that in documentary sales a wrongly dated bill of lading can have severe repercussions for the buyer trying to resell the goods. Therefore, even in the event that the sellers breach of article 34 CISG is not deemed fundamental, nevertheless the buyer should be entitled to some remedy for the trouble he will encounter with his other buyers in trying to resell the goods.

5.3. Arbitration Tribunal's Decision

In this case the Arbitration Tribunal held that even though, "Under the usual circumstances, the documents must strictly comply with the letter of credit," in this case the non-compliance *does not* constitute a breach since, "it is easy for [Seller], [Buyer] or any person with international trade knowledge to know that this was obviously a typing error." The Tribunal found that the mistake on the bill of lading would not have affected the buyer taking delivery of the goods and would not have constituted a barrier to the buyer reselling the goods. The Tribunal further goes on to state that, the buyer failed to act in accordance with good faith and in this situation the buyer should have used its *own* credit rather than that of the bank to pay for the goods. Therefore, this was not considered a fundamental breach and the buyer was expected to pay for the price of the goods including interest.

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[52] China 4 June 1999 CIETAC Arbitration proceeding (*Industrial raw material case*)

5.4. Analysis of Decision

First, this writer believes that it is important to note that whilst most arbitral tribunals consist of a panel of three arbitrators, this particular case involved a sole arbitrator as the amounts being claimed were less than RMB 500,000 and therefore summary procedure applied.

I find this decision most troublesome since it goes against the provisions of the Convention. It is understood that the letter of credit is a separate transaction from the sale of goods contract. However, it cannot be disputed that in order for the price to be paid under a letter of credit, the contract and its accompanying documents need to be in conformity. The seller in this case *did* breach his obligations to hand over conforming documents under Article 34 CISG, this is not in dispute. The dispute arises as to whether the discrepancy in the document was substantial enough to either avoid the contract or allow for some other remedy under the Convention.

While it has been argued that some typing errors for example, a word spelled wrong, 'mashine' instead of 'machine' might be permissible under the UCP 500 rules, an error such as the year on a bill of lading will not be tolerated as seen in Article 23 UCP. In order to understand why this decision does not fully appreciate the buyer's position in this set of circumstances, it is necessary to examine the nature of the bill of lading as an instrument in international sales. In the family of transport documents, the bill of lading is key, as it represents a negotiable document of title. Thus, the non-conformity in question must be weighed in accordance with the value of the document. For example, a bill of lading is one of a trio of documents that make up a basic CIF documentary sales contract; therefore, one can argue that without this document there is no evidence of the goods being shipped. Many academics and practitioners in the international sales forum support this notion, indeed, they stress the importance of the *merchantability* of documents, in this case the buyer relies on the merchantability of the bill of lading in order to resell the goods in an efficient and profitable manner.[53] The repercussions of such an error go much further than the bank failing to honour the letter of credit. If the buyer in a string sale tried to resell the documents, his sub buyer could refuse to take possession of the non-conforming documents. In its decision the Arbitrator states, "the typing mistake of the date in the bill of lading would not affect the buyer taking delivery of the goods." However, in this case the buyer is a trader. He is not interested in taking *possession* of the goods as he is not the end buyer. It is the documents which he requires to resell the goods to his other buyers and such documents need to be conforming in all respects, especially the documentary instrument of title, the bill of lading.

In addition to this, the contract itself called for payment to be made by letter of credit. Therefore it can be argued that the buyer had performed his obligation to pay the price by opening the letter of credit, but it is the seller who failed to perform his duties in supplying non-conforming documents. In the case of *Shansher Jute Mills Ltd. v. Sethia,*[54] it was held that when the documents tendered were non-conforming, the sellers who did not or could not present correct documents, were not entitled to recover the price of the goods from the buyers.[55] Furthermore, it can be argued that even though the principle of independence between the letter of credit and the underlying contract still remain, once the *method of payment* stipulated in the contract is that of a

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53 Boris Kozolchyk (1990). Strict Compliance and the Reasonable Document Checker, 56 *Brook Law Review* p. 65

54 The Financial Times, July 2, 1986

55 Note: this decision was entered as exceptional as neither buyer nor seller received any benefit.

letter of credit then such a stipulation becomes a *term* of the contract. Therefore, it is the seller who breaches his obligations under the sales contract and the buyer should either be entitled to avoid the contract in such a case or be entitled to one of the remedies set out under the Convention. I find the suggestion of the Tribunal that the buyer find other means by which to pay the price - a substantial sum - somewhat questionable as the very reason for which parties use a letter of credit is because they often lack the ability to finance their own credit.

One other point worthy of mention is the fact that when the discrepancy was discovered by the issuing bank, a request was made for there to be a revision. Such an action is permissible under Article 48 CISG, the right of the seller to cure any defects. In this case, however, the seller failed to make the revisions in a timely manner. Whether the issue was one of time or simply a matter of the defects being incurable, the facts of the case do not say. However, this writer feels the assertion by the Tribunal that the buyer acted in bad faith by asking for a price reduction as unfounded, as the buyer could have just as easily avoided the contract altogether. Instead, the buyer tried to renegotiate with the seller to keep the contract alive, a measure that was refused by the seller.

The circumstances of this case *should* constitute a fundamental breach under the meaning of Article 25 CISG, as the buyer was substantially deprived of what he was entitled to expect under the contract, and the seller could have foreseen what the repercussions of a wrongly dated bill of lading would mean for the letter of credit as well as the buyer's other customers. A reasonable person involved in this trade would know that this non-conformity was not a simple typing error, as it would have serious consequences for the buyer. In the event that these circumstances did not constitute a fundamental breach, the buyer should have been entitled to a price reduction,[56] as this was not an unreasonable request given the fact that he would have suffered a loss trying to resell these documents to his other buyers.

6. ALTERNATIVE SOLUTIONS

Upon reading the outcome of this decision as well as other CIETAC Arbitral decisions, one cannot help but notice that there is a lack of analysis or rationale given in the parts of the judgement that pertain to the CISG. The interpretation and examination put forth by this writer concerning CIETAC decision of 4 June 1999 (*Industrial Raw Materials case*), is only one perspective and understandably, others will disagree.[57] However, it is necessary at this juncture to examine what could be a possible alternative approach to this case.

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[56] Article 50 CISG

[57] Indeed there are other opinions presented on this issue that are divergent to my own. Some experts contend that the Tribunal was correct in its interpretation of the facts, for example it has been argued that this was a case of a buyer acting in bad faith, trying to get a reduction in price because of a typographical error. Furthermore, it is argued that the buyer, under the underlying contract, is not entitled to the same strict compliance standard (with all the terms of the contract) as the bank is under the letter of credit agreement. Others put forth the opinion that there are not enough facts presented to render a correct decision. I have attempted to present a clear, concise argument taking into consideration these comments, the result being the conclusion that I have reached. There is merit to these other arguments however, one has to separate the issues and examine not only the facts presented, albeit limited, but also the spirit of the Convention and a clear rationale of its provisions.

First, in order to determine whether a non-conformity has occurred, examination of the contract is required. This is known as the contract principle, whereby the business decisions are left to the parties of the contract, emphasising the strong theme of party autonomy under the Convention.[58] The Convention stipulates that the seller must hand over documents at the time and place in the form required by the contract and in return the buyer must pay the price as required under the contract. It is proposed that by abiding by the contract principle, uniformity of the Convention is upheld, thereby preserving its international character. In the case at hand, once again we must return to the contract itself where it is stipulated that payment is to be made by letter of credit, an obligation which has duties for both the buyer and seller to perform.

Moving away from the contract principle, we encounter another problem when examining non-conformities that may arise. Specifically, here we are looking at how to assess statements or acts which could have legal consequences for the performance of the contract. Some of these statements or acts can be interpreted according to Article 8 CISG.[59] In order to avoid divergent interpretations by the courts as to what constitutes a reasonable person, Hyland puts forth what is known as the 'discussion principle' whereby a party should not be allowed to rely on an ambiguous statement or act without first attempting to clarify it.[60] This principle places a responsibility of each of the parties to discuss the terms of the contract and to resolve any discrepancies or ambiguities that exist, this measure helps to promote good faith and potentially avoid termination of the contract later on down the road. By encouraging this discussion, the parties can resolve any disputes amongst themselves and courts would have to respect the agreements reached. We can apply this principle to the case at hand, as there are many times when this dispute could have been clarified by further negotiations from both parties. For example, when the discrepancy in the bill of lading was discovered and the seller knew such a breach would be difficult to cure, the prudent thing to do would have been to renegotiate with the buyer for the price of the goods. Did the buyer make his position as a trader during the contractual negotiations known? The facts of the case do not permit an answer. However, one can reason that if the seller had to resell the goods for a loss to another company why not renegotiate the price with the buyer and avoid litigation altogether?

7. CONCLUSION

This article has attempted to present an insight into one of the decisions made by CIETAC in relation to the issue of compliance of documents with letters of credit. The aim is not to cast dispersions on the integrity of the decision makers, instead it is to present to the parties to whom the CISG applies the potential problems that can arise within their contractual disputes. One is

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58 Richard Hyland (1987). Conformity of Goods to the Contract Under the United Nations Sales Convention and the Uniform Commercial Code, Peter Schlechtriem ed. Einheitliches Kaufrecht und nationals Obligationenrecht, Baden-Baden: Nomos p. 305-341

59 Ibid, See Also: 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.

60 Supra 56 p. 332

concerned that when fundamental breach is invoked the Tribunal does not provide much rational for why the breach may or may not be fundamental under the provisions of Article 25 CISG.

Many proponents of the Convention endeavour to ensure its success by demonstrating that its provisions can cope with the intricacies and technicalities of international sales transactions. It is only with the analysis of decisions by governing bodies can one determine if the CISG is being correctly applied. This writer would advocate a more hands on approach to applying the Convention, whereby decisions could be cited on their merit and analysis. When courts and tribunals fail to engage in the sprit and meaning of the provisions set out in the Convention, then its success as an instrument of international law is in doubt. The People's Republic of China with its vast amounts of trade being conducted everyday, in addition to the wealth of CISG decisions being handed down has the potential to significantly influence the success of the Convention as an instrument of international sales law.