THE CHALLENGE OF A UNIFORM APPLICATION OF THE CISG – COMMON PROBLEMS AND THEIR SOLUTIONS

BRUNO ZELLER*

I INTRODUCTION

Last year the CISG celebrated its 25th birthday. As of 15 January 2006, the United Nations reports that 67 States have adopted the CISG[1] making it one of the most successful international conventions. The Pace Website[2] reports over 1,700 cases and an immense volume of academic writing is also available on this site and is readily available.[3]

However despite a history of 25 years, judicial and arbitral decisions are still surfacing on a regular basis, which show a lack of understanding of the fundamental purpose of the CISG.

The two most common single miss-applications of the CISG are first, an ethnocentric approach and secondly, single articles are applied in isolation without due consideration to general principles contained within the convention.

Both of these problems have their origin in the fact that some courts and tribunals have not yet understood that the CISG must be read as a whole within its four corners. In other words the fact that the CISG contains general principles is ignored. These 'misadventures' stem from the fact that article 7 – the interpretative article – which is the corner stone of the CISG has not been fully understood.

---

* Senior Lecturer, School of Law, Victoria University, Melbourne, Adjunct Professor, School of Law, Murdoch University, Perth, Dip Business Admin (Switzerland), BCom, BEd (Uni of Melboune) MInt Trade Law (Deakin) and PhD in Law (Uni of Melbourne) FAICA.

1 Convention on Contracts for the International Sale of Goods See <http://www.cisg.law.pace.edu/>

2 Ibid.

3 It should be pointed out that academic writing has progressed well beyond general texts such as M R Islam, *International Trade Law* (1999) which is an excellent primer. Works such as Schlechtriem/Schwenzer, *Commentary on the UN Convention on the International Sale of Goods (CISG)* (2005) give a much more comprehensive coverage. For detailed analysis the Pace Website needs to be consulted.

This paper is not concerned with exhaustively explaining article7[4] as sufficient material has already been written on the correct application and interpretation of this article[5] but where needed, reference to article 7 will be made. This paper is only concerned with one aspect of the interpretative process which many academics have pointed out namely that article 7 demands that 'one should not read the Convention through the lenses of domestic law but rather in an autonomous manner'.[6] Such views are based on the mandate of article 7 which states that 'regard is to be had to its international character and to the need to promote uniformity in its application'.[7]

By using two practical examples this paper attempts to assist courts and tribunals to be aware of, and avoid the most common pitfalls in the application of the CISG. It should be noted that this article focuses on demonstrating the two problems in general and not in any specific country context.[8]

The starting point in the understanding of the CISG is that the convention was never intended to be a code and hence gaps exist. Pursuant to article 7(2) these gaps need to be filled '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'.[9]

The practical effect of this article is that the conflict of laws rules must determine the applicable domestic law. Once that has been ascertained, the conflict between international laws and domestic laws 'is played out each time a judge or arbitrator has to decide whether an issue falls within the scope of the Convention'.[10] The problem arises if the distinction between applying domestic law or staying within

---

4 Article 7 CISG states: (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. (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.

5 See for example: John Felemegas, 'The United Nations Convention on Contracts for the International Sale of Goods: Article 7 and Uniform Interpretation' <http://www.cisg.law.pace.edu/cisg/biblio/felemegas.html > Bruno Zeller, 'Four-Corners – The Methodology for Interpretation and Application of the UN Convention on Contracts for the International Sale of Goods http://www.cisg.law.pace.edu/cisg/biblio/4corners.html.

6 Franco Ferrari, 'Do Courts Interpret the CISG Uniformly?' in F Ferrari (ed), *Quo Vadis CISG* (2005) 4.

7 Article 7(1) CISG.

8 Examples of ethnocentric approaches can be found in most countries. Australia is no exception. See for example Bruno Zeller, '*Downs Investments Pty Ltd (in Liq) v Perwaja Steel* SDN BHD [2002] 2 QD R 462' in *The Vindobono Journal of International Commercial Law and Arbitration* (2005) 9 VJ (1) 43. However it can be said that some case law in Australia also reflects a clear understanding of the CISG by the judiciary such as *in Perry Eng. P/L v Bernold AG* No SCGRG-99-1063 [2001] SASC 15 (1 February 2001). For Australian case law see http://www.business.vu.edu.au/cisg.

9 Article 7(2) CISG.

10. H Hartnell, 'Rousing the Sleeping Dog: The Validity Exception to the Convention on Contracts for the International Sale of Goods' <http//cisg.law.pace/cisg/biblio/hartnell.html>.

the four corners of the CISG is not recognized. It is correct to apply only domestic law and jurisprudence if there is a gap within the CISG. If however the CISG governs a particular issue domestic principles including domestic jurisprudence must be excluded from any deliberations. It is hoped that this paper will enhance the Australian international trade lawyer's awareness of the scope and purpose of the CISG.

II THE ETHNOCENTRIC VIEW

It is not surprising that many judges and arbitrators approach a unified document such as the CISG in an ethnocentric manner as the convention is part of our domestic body of law. They see the words and because they look familiar or track domestic legislation the assumption is made that domestic principle and hence jurisprudence can be used to determine the matter. In essence an ethnocentric approach displays the tendency amongst adjudicators to apply the national law at the expense of the CISG.

The approach to and drafting of words in any international convention is unlike the drafting of a domestic legislation. Words need to be capable of being interpreted uniformly in order to fulfil the important desire of any legal instrument to be consistent and predictable. Therefore words cannot be viewed in a national context. It must be remembered that the interpreter of domestic legislation can look back and be assisted by a rich legal history. An international document cannot be approached in the same fashion but pursuant to article 7 must be interpreted free of any domestic connotations and only so will it overcome the problem Honnold describes as literary 'deconstruction'.[11]

Such considerations make the choice of words harder and require a special solution. The drafters of the CISG solved this particular problem and consciously 'rooted out words with domestic legal connotations in favour of non-legal earthy words to refer to physical acts'.[12]

Furthermore the method of construction is stipulated in the CISG. This is contained in articles 7 and 8. These articles do not allow the use of domestic rules in the interpretation of the contract if the matter is governed by the CISG. The latest example which illustrates this point is *Raw Materials Inc v Manfred Forberich GmbH*[13]. This case was nominated as the worst CISG decision in 25 years.[14]

---

11 John Honnold, 'Uniform Laws for International Trade: Early "Care and Feeding" for Uniform Growth' (1995) *1 International Trade and Business Law Journal* 1, n 6.

12 Ibid 2.

13 2004 WL1535839 (US Disrict Court for the Northern District of Illinois, July 7, 2004).

14 See Lookofsky and Flechtner,' Nominating Manfred Forberich: The Worst CISG Decision in 25 Years?' (2005) 9 VJ (1) *The Vindobono Journal of International Commercial Law and Arbitration* 199.

The facts in brief. Rails had to be delivered to the United States which were to be loaded in St Petersburg. The plaintiff contended that the freezing of the port was a foreseeable event as the port always froze over. It was pointed out to the court that 'it hardly could come as a surprise to any experienced shipping merchant (or any grammar school geography student) that the port of St Petersburg might become icy and frozen in the Russian winter months'.[15]

The court disagreed with this contention after examining the facts. It is undisputed that the port does freeze over but this normally happens in January and it also does not prevent shipping as icebreakers are working in the port. However this particular winter of 2002 was the worst in 60 years and even the ice breakers were stuck. The court had to consider whether the defendant had a viable defense under article 79.

Article 79 in brief releases a party from obligations and hence liability:

> 'if he proves that the failure was due to an impediment beyond his control' and 'he could not be reasonably be expected to have taken the impediment into account' and furthermore could not 'have avoided it or its consequences'.[16]

It is rather disturbing that, despite ample academic writing a court in 2004 still can maintain that

> … in applying Article 79 of the CISG, the court will use as a guide case law interpreting a similar provision of article 2-615 of the UCC.[17]

This was in response to the plaintiff's assertion (with the agreement of the respondent) that '[w]hile no American court has specifically interpreted or applied Article 79 of the CISG, case law interpreting the UCC[18] [provides] guidance for interpreting the CISG article 79'.[19] The correct approach would have been to consult international case law, which in this case, consisted of twenty-seven reported cases.[20] Even worse the court ignored the text of article 79 entirely and as Flechtner commented:

> Not one word of the [courts] discussion would have to be changed if UCC Article 2 had actually been the applicable law.[21]

---

15 Ibid.

16 Article 79(1).

17 *Raw Materials Inc v Manfred Forberich GmbH & Co KG* US District Court of Illinois <http:cisg3.law.pace.edu/cases/040706u1.html>.

18 Uniform Commercial Code.

19 Ibid.

20 See Bruno Zeller, *Damages under the Convention on Contracts for the International Sale of Goods* (2005) 177.

21 Harry Flechtner, 'The CISG in American courts: The Evolution (and Devolution) of the Methodology of Interpretation' in F Ferrari (ed), *Quo Vadis CISG* (2005) 107.

Furthermore despite similarities there is a difference between the UCC article 2-615 and article 79 CISG which can be significant in certain cases. Under the UCC the seller's failure to deliver due to *impractibility* is not a breach whereas under article 79 of the CISG the *impediment* exempts the non-performing party from liability that is paying damages.

This is so because the starting point under article 45(1) of the CISG is that if 'a seller fails to perform any of his obligations under the contract' a remedial right is awarded to the buyer. In other words liability for damages is strict. Article 79 is merely providing a limited exception to the principle of strict liability. The court therefore needs to examine whether the impediment as described in article 79 applies. The starting point for any court is that a seller is liable for non-performance of the contract pursuant to article 45 unless the four conditions listed in article 79 apply. First the court must be convinced that an 'impediment' existed. Secondly that the impediment was 'beyond his control' and thirdly that the impediment 'could not reasonably be expected [to be taken] into account'. Fourthly the seller must also show that he took all reasonable steps to 'avoid or overcome' the impediment.

If that is the case then article 79 will allow a softening of the strict liability rule but as contained in article 79(5) nothing prevents a party 'from exercising any right other than to claim damages under this Convention.' The conclusion in relation to the courts decision is that

> [this] case is soon buried and forgotten except perhaps as an example of an interpretational methodology to be avoided at all costs. Perhaps our nomination for the CISG Silver Anniversary 'Razzie' will help further that goal.[22]

Arguably an ethnocentric approach of any court in Australia could be challenged as the High Court has recognized the 'goal' of international uniformity. It is encouraging to note that the High Court understands that uniformity of law is an important feature which contributes towards certainty and predictability in international trade. Especially in the area of transplantation – in this case the Warsaw Convention - the courts have recognized that:

> decision must be reached by this court with close attention to any relevant developments of international law, including decisions of the municipal courts of other states parties.[23]

The Australian High Court went even further and clearly stated that 'no differentiation could be drawn on the basis that it was not obligatory for Australia to apply the language of the Warsaw Convention to domestic carriage by air within Australia'.[24]

---

22 Lookofsky & Fletchner above n 14, 208.
23 *Air Link Pty Limited v Paterson* [2005] HCA 39 (10 August 2005) 40.
24 *Air Link Pty Limited v Paterson* [2005] HCA 39 (10 August 2005) 49.

The mere fact that the Warsaw convention was transplanted into Australian domestic law was sufficient for the High Court to abandon ethnocentric interpretation in favor of an international one. Considering that the CISG is not a transplantation but a ratification of a treaty, hence forms part of our domestic law; no excuses or reasons not to adopt an international interpretation can be advanced.

III APPLICATION OF GENERAL PRINCIPLES

As pointed out above the CISG is not a code. Words and in a wider context articles on their own do not explain the legal principles contained within the CISG. The drafters purposefully included general principles into the CISG which in effect are the 'glue' giving cohesiveness to the CISG. These principles can be discovered within the CISG and are expressed in various articles.

The first part of any interpretative process is to look at and give meaning to words within the four corners of the CISG. To illustrate this, a question could be asked, namely how does the CISG define goods? Article 2 does not describe positively the meaning of goods. It states and lists exclusions. At first glance the solution to the definition of goods is; everything not excluded in article 2. This is not very satisfactory but further reading of the CISG can elicit a more narrowly defined description. Article 35 mentions goods as required by the contract and 'which are contained or packaged' in the manner required by the contract.[25] Article 46(3) requires that, if goods do not conform to the contract, the seller can remedy the lack of conformity by 'repair'.[26] Articles 85 to 88 regulate the preservation of goods and article 87 specifically mentions 'warehousing' of goods. What conclusions can be drawn from this? If there is uncertainty as to whether a particular item can be classified as goods, a court can ask additional questions such as whether the item in question is a movable, tangible property that can be packaged, if necessary repaired and warehoused if required.

In addition to this process decisions should reflect principles which the convention itself formulates and which do not necessarily have to be expressly mentioned in individual rules. Article 7(2) alludes to these principles as being 'general principles'. In this instance the process is no different to domestic law where courts also rely on general principles such a public policy or *pacta sunt servanda*. In essence problems in the application of the CISG can be traced back to the fact that courts and tribunals do not take the required holistic approach in interpreting specific provisions. In sum the holistic approach is warranted because of the international character of the convention as well as the need for uniformity, two principles which underpin the convention.

Only one general principle namely party autonomy is considered in this paper. The principle of party autonomy can be elicited through article 6, 7 and 8. The

---

25 CISG, above n 1, Article 35.

26 CISG, above n 1, Article 46(3).

application of article 6 is of special interest to this paper because in a recent arbitration decision an argument was advanced[27] that by virtue of article 6 the parties, in agreeing on a penalty clause, implicitly opted out of articles 74. Article 6 provides:

> 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.

The facts and arguments as presented by the arbitrators were that Chinese law is the proper law of the contract. The tribunal correctly observed that, as both parties are signatories to the CISG, the contract was therefore governed by the CISG. They also noted that article 114 of the Chinese Contract Law is applicable. The arbitrators argued that the inclusion of a penalty clause in the contract would bring article 6 into play. Because of article 114 of the Chinese Contract Law article 74 of the CISG is implicitly excluded in favor of the domestic clause.[28]

The argument to bring article 6 into play exhibits a common mistake where interpreters focus on one article without giving due consideration to the CISG as a whole. The question of an implied exclusion, though not impossible, must be approached very carefully and most importantly within the four corners of the CISG.

It is of value to understand the purpose of article 6. This article contains two rules; first, it allows the parties to exclude the application of the convention. This is only controversial if a statement or the intention to that effect is not clear.[29]

Secondly, article 6 also allows parties to 'derogate from or vary the effect of any of its provisions.' Hence both functions of article 6 are to deal with the principle of party autonomy.

Article 6 indicates that the parties' intentions take priority over the provisions of the CISG. The intention of articles 6 is to give parties the ability to import terms into the contract, in this case a liquidated damages clause, to restrict the liability of the seller. It is therefore possible to substitute the uniform laws contained in the CISG expressly or through usage or any other conduct, which may influence the rights and obligations of the parties.

A *Penalty Clauses and the CISG*

The arbitrators noted that Eiselen has pointed out that: 'the CISG consciously does not deal with so called liquidated damages and penalty clauses'.[30] This is correct but

---

27 Mealey's International Arbitration Report, 20(5) (2005).

28 Ibid.

29 For an example see *Perry Eng P/L v Bernold AG* No SCGRG-99-1063 [2001] SASC 15 (1 February 2001).

unfortunately the arbitral tribunal did not investigate the reason or purpose of the statement. Eiselen as well as the framers of the CISG did not have article 6 in mind when the question of liquidated damages was discussed but rather article 4.[31]

The general principle of party autonomy does allow the parties to exercise the express choice of partial contracting out. Many examples are found in standard form agreements such as penalty clauses. Lookofsky explained the approach in such a situation.

> … the parties' rights and obligations will be governed by a combination of (a) the express contractual provisions, (b) the applicable domestic rules of validity (which may serve to limit the effect of the express provisions) and (c) the supplementary Convention rules.[32]

To understand the Conventions rules in this case, the logical starting points are articles 74 to 76 which deal with damages. A close reading of these articles reveals that within the text there is no explicit exclusion, nor inclusion of penalty clauses.[33]

This poses an interpretative problem which the CISG has solved by including article 7 into its regime.[34]

The foremost mandate is to give 'regard to its international character and the need to promote uniformity'.[35] This has been interpreted as being an invitation to consult international jurisprudence and academic writing in order to arrive at uniform results.

Of importance for the purpose of this paper is subsection (2) which notes that questions which are not expressly settled must be 'settled in conformity with the general principles on which it is based.' If such principles were to be found that would be the end of the matter otherwise domestic law would need to fill the gap.

---

30 Sieg Eiselen, 'Remarks on the Manner in which the UNIDROIT Principles of International Commercial Contrast May be Used to Interpret or Supplement Article 74 of the CISG' http://www.cisg.law.pace.edu/cisg/principles/uni74.html#editorial.

31 In defence of the arbitrators it ought to be mentioned that CIETAC in a previous decision applied a similar flawed approach and came to the same conclusion as in the present case. See China 6 February 1997 CIETAC Arbitration Proceeding (Silicon-carbide case) http://www.cisg.law.pace.edu/cisg/wais/db/cases2/970206c1.html.

32 Joseph Lookofsky, in J Herbots and R Blanpain general editors, *International Encyclopaedia of Laws, Contracts*, Suppl 29 (December 2000) 1-192, 46.

33 Whether articles 75 to 76 are applicable is not clear, as Marcus Jacobs QC and Yanming Huang did not explain whether the buyer avoided the contract. Articles 75 and 76 are only applicable if the buyer validly avoided the contract. In all other cases article 74 is applicable. For the purpose of this discussion this fact is not of real significance.

34 For text see fn 2.

35 Article 7(1) CISG.

Pursuant to article 7(2) therefore the first step is to see whether there are general principles which govern the issue of damages. The general principle in cases of a breach of contract is full compensation as laid down in articles 74 to 76.

However it must be remembered that article 6 allow parties the autonomy to include terms into a contract. In this instance the parties deviated explicitly from the mandate of the CISG by substituting a penalty clause for the principle of full compensation. Penalty clauses in essence will determine the damages for a breach of contract irrespective of the true nature of such an events. The question of course would be whether the CISG allows such a 'determination' of damages. If that were the case an 'opting out' would be unnecessary as the penalty clause could arguably be accommodated within the mandate of article 74.

This is the case as in the second part article 74 states that damages are not to exceed the loss which the party foresaw or ought to have foreseen.

To solve the problem of foreseeability article 8 needs to be consulted.[36] In the first instance a contract would be interpreted within its four corners pursuant to article 8(1). In other words article 8 allows subjective as well as objective intent of the parties to be taken into consideration. In this case it is clear that the parties had a particular level of damages in mind and expressed their intent clearly in phrasing and adopting a penalty clause. So far there is no impediment to adopt the penalty clause within the ambit of the CISG and therefore there is no need to invoke article 6.

B *Article 4*

However there is another point to be considered namely article 4[37] which states in brief that the convention only governs the formation of the contract and that question of validity of the contract or any of its provisions are left to domestic laws.

If there is a question of validity, then the matter - that is the gap within the CISG - must be filled by domestic law. Only if there is a question in relation to the validity

---

36 Article 8 states: (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.

37 This article states in full: This Convention governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract. In particular, except as otherwise expressly provided in this Convention, it is not concerned with: (a) the validity of the contract or of any of its provisions or of any usage; (b) the effect which the contract may have on the property in the goods sold

of the penalty clause can domestic law be consulted. If there is no gap the CISG will supply the applicable rule to the exclusion of domestic law.

In fulfillment of the mandate of article 7(1), namely the international character of the CISG, case law needs to be consulted. The arbitrators did consult case law however, as with all jurisprudence, it is not the keywords namely penalty clauses which will determine the issue but rather the principles which stand behind the facts. The authors quoted specifically a passage of the judgment of an ICC arbitration case No 9978 (May 1999). The court stated:

> As to the merits, the Arbitral Tribunal dismisses the buyer's claim concerning damages. Stating the inclusion of a penalty clause for non-delivery prevented the buyer from invoking the provisions on damages laid down in Art. 74 CISG. In order to ascertain the validity of the penalty clause, since it is a matter excluded from the CISG in accordance with its art 4, the Arbitral Tribunal referring to the Domestic law otherwise applicable to the contract (ie, German Law).[38]

A reading of the above passage ought to make it clear that the tribunal did not invoke article 6 but article 4 which was only applicable because the validity of a contractual term was at issue. This may not be so in all cases and therefore article 74 is applicable. This position is supported by *Diepeveen-Dirkson BV v Niewenhoven Veehandel GmbH*.[39] The contract contained a penalty clause in the event of late payment. The court not only awarded damages pursuant to the penalty clause but also invoked article 78, the right to interest on overdue amounts. The buyer appealed on the basis that the penalty was disproportionate to the harm suffered by the seller. The court correctly dismissed that claim, as pursuant to article 6, parties are entitled to include clauses into the contract that will be enforced by courts.

The Russian Tribunal of International Commercial Arbitration in a decision of 23 November 1994[40] also did not see the need to rely on article 6. They simply noted that:

> As regards the claim for damages the Tribunal came to the conclusion that the clause in the contract which stipulated the payment of a penalty in case of a delay in delivery was of an exclusive nature and did not provide for payment of damages in excess of the sum due in accordance with this clause.[41]

The only article which is available in this case is article 74 which sets the amount of damages. As the penalty clause was not invalid in the Russian Federation, recourse to article 4, and certainly article 6, was not necessary.

---

38 See CISG.

39 22 August 1995, Hof Arnhem, Netherlands, <http:// cisgw3.law.pace.edu/cases/ 950822n1.html>

40 See http://cisgw3.law.pace.edu/cases/941123r1.html.

41 Ibid.

The authors also relied on and quoted a Finnish case. The conclusion is that article 4 was applicable and again no mention of article 6 has been made. The court noted in essence:

> As to the amount of damages claimed by the buyer, the court held that the amount could not exceed the sum fixed in the warranty term which it considers reasonable in accordance with Finnish law applicable since CISG did not regulate the matter (Art 4 CISG).[42]

The judgment of the Belgium court in Hasselt[43] illustrates the points further which are made in this paper. The court came to the following conclusion:

> The seller was therefore granted payment, damages and interests. The Court held that the validity of the penalty clause contained in the seller's standard terms was to be determined by Belgian law, under which it was invalid.[44]

An analysis of this case highlights the issues. As stated, the court would have consulted article 4 as to the validity of the provisions, that is the penalty clause. By applying Belgium law the clause was found to be invalid. Therefore the legal standing of the term containing liquidated damages has been resolved. Now the question of the quantum of damages needs to be addressed. This issue is governed by the CISG namely under article 74 and therefore recourse to this article will yield the appropriate amount of damages.

There is no room in the CISG to invoke article 6 for just the determination of penalty clauses and then turn around and rely on article 74 to determine the quantum of damages. Once opted out means opted out. Article 4 on the other hand will allow an application of the CISG in full once the problem of penalty clauses has been resolved by domestic laws.

It would be absurd to deny a party to rely on the provisions of the CISG just because a penalty clause has been determined to be invalid. The CISG is quite clear on the issue that domestic law is 'trumped' in all circumstances where the CISG would apply. This is the case here. As the authors state themselves 'under Chinese Law, there is no prohibition against penalty clauses which are not regarded as invalid'.[45] As such the CISG namely article 74 would apply.

In sum article 6 has no bearing at all on this issue only article 4 has. The above cases highlight the reason why article 6 is not applicable.

A simple hypothetical example will illustrate the above points further. A buyer includes into the contract a penalty clause if the goods are not in conformity with

---

42 See http://cisgw3.law.pace.edu/cases/020412f5.html.
43 See http://cisgw3.law.pace.edu/cases/970121b1.html.
44 Ibid.
45 Mealey's above n 27.

the contract. Furthermore one of the clauses stipulates that payment is due upon delivery of the goods. The goods are not fit for the purpose and the buyer now claims the damages pursuant to the clause. The seller did not reimburse the purchase price and the buyer had to borrow money to cover the shortfall at 14%.

A court would now apply article 4, as the validity of the penalty clause needs to be determined. Supposedly the clause is valid the buyer is limited to the amount prescribed by the penalty clause pursuant to article 74 which states that damages are limited to those the parties foresaw at 'the time of the conclusion of the contract'. The penalty clause is exactly such an event. However the CISG – irrespective of any other claims – allows a party to claim interest pursuant to article 78 on 'sums in arrears'. This article also states that such a claim is 'without prejudice to any claim for damages recoverable under article 74'. As the CISG does not nominate the rate of interest a gap exists which needs to be filled by domestic law. The courts have come to the conclusion that the applicable domestic rate of interest is applicable. Assuming it is 10%. However as indicated the buyer had to pay 14%. As a result he can now rely on article 74 to make up the shortfall of 4%. The two claims one for lack of fitness for purpose and the other one for the difference in interest rates must be dealt with separately as they emanate from different causes. In effect the buyers' claim in relation to fitness for purpose is capped at the penalty rate and he can claim an additional 4% damages under article 74 for interest on a sum in arrears.

If – as the authors of the original article claim – the parties have opted out of article 74 pursuant to article 6 the matter would be rather different. The penalty clause would apply but the excess interest paid by the buyer could not be recovered as the parties have opted out of article 74.

To argue that there was an implied opting out of article 74 would put a court into an impossible situation. On the one hand article 74 is excluded but on the other hand because of the validity of the penalty clause there is no gap hence article 74 should be applied. A court, if confronted with such a situation of implied opt-outs, arguably would apply the maxim *in dubio pro conventione.*

In sum the approach to penalty clauses starts with a question: is the clause valid or not? The solution to this question will rest with the applicable domestic law. In any case the CISG will then be applicable. If the penalty clause has been declared valid the damages are capped at the amount stipulated by the clause. If on the other hand the clause is declared invalid article 74 would determine the amount of damages. Pursuant to article 7 domestic law is displaced by the CISG in every case where the matter is governed by the convention. Penalty clauses are merely fixing the amount of damages. Damages are governed by the article 74 hence a opting out of the convention unless done explicitly is not possible. Any other approach would amount to the practice of 'cherry picking' which is not allowed in any system of law, domestic or international.

This approach has been clarified and is supported by international jurisprudence and is not in dispute.

IV CONCLUSION

This paper has explained that the CISG is an international document and as Lord Diplock stated in *Fothergill v Monarch Airlines*:[46]

> It should be interpreted, as Lord Wilberforce put it in *James Buchanan & Co Ltd v Babco Forwarding & Shipping (UK) Ltd* [1978] AC 141, 152, unconstrained by technical rules of English law, or by English legal precedent, but on broad principles of general acceptation.[47]

He went on to say that:

> the language ... has not been chosen by an English draftsman. It is neither couched in the Conventional English legislative idiom nor designed to be construed exclusively by English judges.[48]

The Australian High Court went one step further and even suggested that transplanted legislation must be interpreted with international jurisprudence in mind.

Considering that a precedent has been created in the correct application of international instruments it is somewhat disappointing that decisions, which do not take account of the international character of the CISG, are still surfacing. Equally problematic is the fact that the CISG – despite the mandate of the article 7 – is still not implemented in a holistic fashion. It is hoped that his paper will somewhat contribute to a better understanding of the CISG.

---

46 [1980] 2 All ER 696.
47 [1980] 2 All ER 696.
48 [1980] 2 All ER 696.