# The exclusion of the CISG in technology contracts: Fear of the unknown?

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Despite the large volume of foreign technology procurement by Australian government and business and the growing pool of Australian technology companies pursuing export opportunities in offshore markets, the relevance and application of the United Nations Convention on Contracts for the International Sale of Goods (***CISG***) (otherwise known as the Vienna Convention (***the Convention***)) to cross-border sales contracts is often dismissed or totally overlooked. US-centric technology companies often set the tone by generally including a standard exclusionary provision for the CISG in their sales contracts.

Is this exclusion based on actual bias towards a buyer within the CISG rules, is it merely perception only, or is it simply fear of a set of unknown rules? Is there any merit in contractually including the operation of the CISG for Australian technology suppliers or purchasers?

## CISG overview

The CISG was adopted in 1980 at a United Nations diplomatic conference in Vienna and came into effect on 1 January 1988 with Australia becoming a signatory in the same year.[1]

The purpose of the CISG is to provide a uniform set of rules to govern international sale of goods contracts including establishing various rules for interpretation contract formation and setting out certain rights and remedies available to the contracting parties.

The CISG is broadly structured into four parts:

- Part I deals with the scope and application of the Convention;
- Part II contains rules for governing the formation of a contract;
- Part III contains the obligations and remedies of both the seller and the buyer; and
- Part IV contains final clauses dealing with declarations of contracting states not to be bound by Parts II or III.

Article 2 of the CISG narrows its scope to exclude sales of goods '*bought for personal, family or household use*' and specifically excludes sales of shares, financial securities, ships, vessels, aircraft, electricity and sale by auction.

The Convention is not concerned with the issue of contract validity.[2] Contentious issues such as negligent misrepresentation or enforceability of disclaimers revert to be resolved under domestic law.[3] The liability of a seller for death or personal injury caused by goods sold is also outside the ambit of the Convention, so the typical contractual limitation of liability provisions in a technology supplier's standard sales contract will not be affected.[4]

## Application of the CISG

Article 1 of the CISG governs the application of the CISG to international sale of goods contracts where either:

- the seller and purchaser's places of business are in contracting states;[5] or
- the rules of private international law lead to the application of the law of a contracting state (***Article 1(1)(b)***).[6]

Due to this two limb approach of Article 1, it is conceivable, for example, that a technology supply deal between an Australian seller and a Japanese buyer would not attract the CISG as Japan is a non-contracting state. However, if the governing law of the contract was agreed to be Australian law (or the law of a neutral jurisdiction that is also a contracting state to the CISG), then the CISG would apply. China, Singapore, the Czech Republic and the United States have declared that they will not be bound by Article 1(1)(b) in their respective implementation of the CISG. Australia, however, is bound by Article 1(1)(b). In short, the nationality of the contracting parties is not the sole determining factor for the application of the Convention.

The CISG is not concerned with contracts for the sole supply of labour or services. In the technology industry, it is not uncommon for supply contracts to include bundling of hardware and services, particularly in the case of system integration and systems supply projects. Bundled goods and services supply contracts are not excluded by the CISG provided that the predominant parts of the supplier's obligations are not the provision of services.[7]

The CISG is often described as an opt-out instrument and Article 6 provides the flexibility for contracting parties to either totally exclude the operation of the CISG or to exclude selective sections of the CISG.

## Recognition of the CISG under Australian law

Every Australian state and territory has imported the CISG into local law through their respective implementations of the *Sale of Goods (Vienna Convention) Act* which in effect prevails over the operation the *Sale of Goods Act* legislation in each state and territory.

The CISG is also recognised under the *Trade Practices Act* 1974 (***TPA***) and to the extent of any inconsistency, prevails over Part V Division 2 of the TPA dealing with implied conditions and warranties.[8]

To date, the application of the Convention has only been considered by an Australian court in *Ginza Pte Ltd v Vista Corporation Pty Ltd*[9] where the Western Australian Supreme Court held that Vista (an Australian importer) could rely on Articles 50, 51 and 74 of the CISG to claim damages against Ginza (a Singapore-based manufacturer of contact lenses) for supplying bacteria-contaminated contact lenses which had to subsequently be recalled.

Currently, the majority of jurisprudence considering the CISG originates in European civil courts. This fact has led several commentators to suggest the reluctance to adopt the CISG is more prevalent in non-civil code jurisdictions such as Australia, due to local legal advisors' apprehension with importing civil law decisions and unfamiliarity with the operation of the CISG generally.[10]

## Does the sale of 'Goods' include software?

The Convention does not prescribe any definition of 'goods'. The same definition problem has been faced under the domestic sales law of various jurisdictions.[11] The analysis is to determine whether software is a 'good' versus a 'service' involving the licensing of intellectual property rights (as opposed to a clear transfer of title in the supply of goods).

In terms of actual judicial consideration of the issue of software constituting the sale of 'goods' under the CISG, the cases have mainly been restricted to Germany where the Munich district court held that commercial off-the-shelf software was a good for the purposes of the CISG.[12]

The lack of guidance raises the often debated issue that the practical interpretation of the CISG is reliant not on interpretative guidance from decisions involving the CISG in other contracting states but is heavily determined in favour of the existing jurisprudence and interpretation rules under domestic law.[13]

In the absence of any significant jurisprudence on this issue, there still appears to be sufficient general consensus that commercial off-the-shelf software supplied on disk or other standard storage media will be considered by courts to be goods for the purpose of the CISG. However, software which requires customisation or application development services needs to be assessed in light of the CISG exclusion of 'preponderent' or predominant services supply under Article 3(2). Given the conservative judicial observations on linking software to its supply on physical storage media to satisfy a 'goods' classification, the application of the CISG to the supply of software by electronic delivery or download is unclear.[14]

## Contract form and formation

Although there is a perceived civil law influence in the CISG, the rules relating to contract form and formation are consistent with common law:

- There is no requirement that contracts must be in writing.[15]
- The CISG permits the withdrawal of an offer prior to acceptance,[16] and a reply to an offer which does not contain any material alteration of the terms of the original offer constitutes acceptance. A material alteration includes additional or different terms relating to price, payment, quality and quantity of goods, liability and place and time of delivery.[17]
- Any material alteration in a reply to an offer is deemed to be a counteroffer.[18]

## Buyer and seller provisions

Some key obligations and rights of the buyer and seller include:

- The buyer must pay the price for the goods and take delivery as required by the contract and the Convention.[19]
- The seller must deliver the goods and transfer title in the goods to the buyer.[20]
- If the contract requires the buyer to make the specifications for the goods, and the buyer fails to make the specifications on the due date or within a reasonable time after the seller's request, the seller may make the specification based on the known requirements of the buyer. The buyer must be notified and may make a different specification. In the absence of any different specification, the seller's specification is binding.[21]
- If the goods are non-conforming and constitute a fundamental breach, the buyer can request substitute goods. If the non-conformity is not a fundamental breach, the buyer can request repair of the goods.[22]
- The buyer may accept unpaid non-conforming goods and reduce the purchase price for those goods on a pro rata basis.[23]
- The seller may remedy any non-performance of its obligations (even after the date for delivery) provided there will be no unreasonable delay and unreasonable inconvenience to the buyer.[24]

## Application to Australian law and contract practice

The CISG presents a few notable differences from Australian common law and general contracting practice in the technology industries.

### Admissibility of subjective intent

Article 8 of the CISG introduces the investigation of a party's subjective intent when determining any statements made or conduct by that party and includes the consideration of 'all relevant circumstances including the negotiations'.[25]

This is viewed in many quarters as being inconsistent with the parol evidence rule in common law jurisdictions which makes extrinsic evidence of a party's intent inadmissible in overriding the written terms of a contract.[26] The obvious implication for technology contracts is the risk of whether the pervasive boilerplate entire agreement clause will be overridden by Article 8. Although the issue has yet to be tested in Australia, the appellate court in the US decision of *MCC-Marble Ceramic Center Inc v Ceramica Nuova D'Agostino*[27] affirmed the view that Article 8 should override the parol evidence rule and is considered a landmark decision in the adoption of

the CISG within US law.[28] In *MCC-Marble*, the court held that although the parties signed a standard form order contract in Italian, the US buyer's affidavits obtained from the Italian seller's employees evidencing an oral agreement that the standard terms would not apply were admissible.

**Irrevocable offers**

The CISG does not allow offers to be revocable where a fixed time for acceptance is stated or where it is reasonable for the offeree to rely on the offer being irrevocable.[29] Under Australian law an offer may be withdrawn prior to acceptance except if given with an enforceable promise (by deed or with consideration) to remain open for a period of time. Suppliers submitting quotations with fixed validity dates will be more restricted under the CISG.

**Notification of non-conformity**

Under the CISG, buyers are required to be particularly vigilant in respect of their obligation to examine the goods and notify the supplier of the nature of any non-conformity of the goods within a 'reasonable time' of becoming aware of the non-conformity.[30] The decisions of European courts on 'reasonable time' suggest that courts in general have interpreted this narrowly and buyers have either failed to sufficiently prove that notice had been given to the supplier or notice given more than three weeks later has generally failed the test of 'reasonable time'.[31] Failure to notify the supplier results in the buyer forfeiting its non-conformity remedy. In the absence of scheduled acceptance testing in the contract, the onus is on the buyer of technology goods to be proactive in the inspection and notification of non-compliant goods.

**Buyer price reduction**

Where goods supplied are non-compliant and the price has yet to be paid, Article 50 adopts a traditional civil law remedy of permitting a buyer to accept the goods and unilaterally reduce the price payable by the proportion of the value which the goods actually delivered had at the time of delivery to the value that conforming goods would have had at that time. Commentators have suggested that the price reduction remedy may in certain instances (such as a price declining market) provide a better remedy than damages[32] and the lack of consensus on which country's market to use in determining the value of goods.[33] In *Ginza*, the WA Supreme Court found in favour of the buyer and applied Article 50 to reduce the purchase price to zero.

**Fundamental breach**

The Convention adopts an anti-avoidance stance by making it more difficult to quickly terminate a supply-of-goods contract. Under Article 49, a buyer can only avoid the contract if the seller's non-performance is a fundamental breach. Fundamental breach is defined in Article 25 as a breach which 'results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract' and must be foreseeable (or would not have been foreseen by a reasonable person in the same circumstances as the breaching party). The CISG offers no guidance or clear definition as to how to distinguish a fundamental breach from a non-fundamental one. The current body of existing case law suggests that proof of economic loss, proof of merchantability of goods and proof of the seriousness of the offer to cure defects are more determinative factors for fundamental breach.[34] It has not been universally held that late delivery will constitute a fundamental breach, much of this analysis will largely be fact driven.[35] As a consequence, if time is of the essence to the buyer, an appropriate provision will need to be reflected in the contract that delay will be considered a fundamental breach.

**Damages**

Article 74 of the CISG is consistent with common law and expressly recognises the recovery of loss of profit damages. The parties are free to contractually agree liability limits and recoverable heads of loss. Technology suppliers' standard contracts are typically populated with limitation clauses and their interpretation will still be guided by the principles of *Hadley v Baxendale*[36] and *Pegler Ltd v Wang (UK) Ltd.*[37] The WA Supreme Court in *Ginza* affirmed the application of Article 74 to award damages to the buyer for the lost profit margin on recalled goods.

**Force Majeure**

Article 79 of the CISG excuses a party from liability due to a failure to perform its obligations if it can be proven that the failure was due to an 'impediment beyond his control' and the impediment could not have been reasonably foreseen or avoided. Article 79 is generally consistent with the doctrine of frustration under Australian law but is more mechanical. Liability exemption is provided where non-performance is due to third party non-performance[38] and the non-performing party is required in all instances of non-performance to give notice to the other party otherwise the non-performing party is liable for damages.[39] In the absence of an express contractual *force majeure* clause, Article 79 will apply. Technology suppliers will no doubt be aware of the benefits of the inclusion of a broad overriding boilerplate *force majeure* clause in their supply contracts.

## Conclusion

It should always be remembered that the CISG is embedded into Australian law and will, in most cases, apply to any cross-border commercial supply transaction (not only technology supply deals) unless:

- the place of business of one of the parties is in a non-contracting state;
- the governing law selected is the law of a non-contracting state; or
- the parties have contractually agreed for the CISG not to apply.

As canvassed above, the CISG does import certain provisions which are potentially more favourable to the buyer than the remedies available to it under general Australian law. However, the Convention also places certain obligations on the buyer which are clearly beneficial to the seller. There may be circumstances where a technology supplier may find that the CISG provides more certainty rather than an unwanted assumption of greater contract risk (for example, a sale into a developing country where choice of law is at issue). On the other

hand, technology buyers may find favour with the price reduction right but will need to weigh it against the obligation of notification of non-compliance. Rather than casually dismissing the CISG, it is wise for exporters and buyers of technology to consider the application and benefits of the CISG (or parts of it) on a case by case basis.

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1 At the time of writing, 65 nations are contracting states to the CISG. Notable non-contracting nations are Japan, the UK (the UK chose to adopt the Hague Sale of Goods Convention) and several of the ASEAN nations. See http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html.

2 Article 4(a) of the CISG.

3 For further discussion on the pre-emption of the CISG over domestic law see Lookofsky, J *"In Dubio Pro Conventione? Some thoughts about opt-outs, computer programs and preemption under the 1980 Vienna Sales Convention (CISG)"*, 13 Duke J. of Comp. & Int'l L. 263, p 279.

4 Article 5 of the CISG.

5 Article 1(1)(a) of the CISG. If a contracting party has more than one place of business, the relevant place of business is the one with the closest link to the contract and its performance (Article 10(a)).

6 Article 1(1)(b) of the CISG.

7 Article 3(2) of the CISG. This naturally assumes that the supply of goods and related service obligations are necessarily dealt with together under one contract.

8 Section 66A of the TPA.

9 [2003] WASC 11.

10 Lutz H, *"The CISG and common law courts: Is there really a problem?"*, [2004] VUWLRev 28.

11 In Australia, courts have yet to definitively determine the issue of whether the definition of 'goods' under the TPA covers software or that software should be treated as a service: *ASX Operations Pty Ltd v Pont Data Australia Pty Ltd (No.1) 1990 27 FCR 460* although Rogers J in *Toby Constructions Products Pty Ltd v Computa Bar (Sales) Pty Ltd (1983) 2 NSWLR 48* held that the supply of a combined hardware and software system constituted 'goods' within the *Sale of Goods Act 1923* (NSW) but left open the issue of whether the licensing of software itself fell within the same definition. In the UK, Sir Iain Glidewell took the view in the English Court of Appeal case of *St Albans City and District Council v International Computer Ltd* [1996] 4 All ER 481 that the supply of software other than by delivery on a disk was not a supply of 'goods' for the purposes of the UK *Sale of Goods Act* 1979. In the US, courts have taken an expansive interpretation of the definition of 'goods' in Article 2 of the Uniform Commercial Code in *Advent Systems Ltd v Unisys Corporation* 925 F.2d 670, 675-76 (3d Cir. 1991), see also Diedrich F *"The CISG and Computer Software Revisited"*, (2002) 6 VJ Supplement 55-75, p 62.

12 District Court of Munich, 8 February 1995 [8 HKO 24667/93], see http://cisgw3.law.pace.edu/cisg/wais/db/cases2/950208g4.html.

13 Lutz H, above n 10.

14 Cox T 'Chaos versus uniformity: the divergent views of software in the international community", (2000) Vindobona Journal for International Law and Arbitration 3-29 and http://www.cisg.law.pace.edu/cisg/biblio/cox.html. Cox reviews the position of electronic software delivery as a service in various jurisdictions and points to the EU E-Commerce Directive's (Directive 2000/31/EC) treatment of electronic deliveries as services or an 'Information Society Service'.

15 Article 11 of the CISG. It should be borne in mind that some contracting states have made declarations not to be bound by Article 11, notably China and Russia.

16 Article 16(1) of the CISG.

17 Article 19(3) of the CISG.

18 Article 19(1) of the CISG.

19 Article 53 of the CISG.

20 Article 30 of the CISG.

21 Article 65 of the CISG.

22 Article 46 of the CISG.

23 Article 50 of the CISG.

24 Article 48(1) of the CISG.

25 Article 8(3) of the CISG.

26 The Australian High Court has affirmed the parole evidence rule, see Mason J's comments in *Codelfa Construction Pty Ltd v State Rail Authority of NSW* (1981-1982) 149 CLR 337 at p 352.

27 144 F.3d 1384, 1387-92 (11th Cir, 1998).

28 Kilian, M *"CISG and the problem with common law jurisdictions"*, 2001 Journal of Transnational Law & Policy, Vol 10:2, 217, p 231.

29 Article 16(a) of the CISG.

30 Articles 38 and 39 of the CISG.

31 Andersen, C *'Reasonable Time in Article 39(1) of the CISG – Is Article 39(1) truly a uniform provision?'* Pace ed., Review of the Convention on Contracts for the International Sale of Goods (CISG) 1998, Kluwer Law International (1999) 63-176 (http://www.cisg.law.pace.edu/cisg/biblio/andersen.html).

32 McMahon J *'Applying the CISG Guides for Business Managers and Counsel"* (http://www.cisg.law.pace.edu/cisg/guides.html).

33 Sondahl, E *'Understanding the Remedy of Price Reduction – A Means to Fostering a More Uniform Application of the United Nations Convention on Contracts for the International Sale of Goods'*, 7 Vindobona Journal of International Commercial Law and Arbitration (2003) 255-276 (http://www.cisg.law.pace.edu/cisg/biblio/sondahl.html).

34 Graffi, L *'Case Law on the Concept of Fundamental Breach in the Vienna Sales Convention'*, International Business Law Journal (2003) No.3, 338-349 (http://www.cisg.law.pace.edu/cisg/biblio/graffi.html).

35 *Ibid*, p 340.

36 9 Exch. 341, 156 Eng. Rep. 145 (1854).

37 [2000] EWHC Technology 137.

38 Article 79(2) of the CISG.

39 Article 79(4) of the CISG.