# IS AVOIDANCE UNDER CISG ART 64 A POWERFUL REMEDY?

# COMPARISON OF THE CISG REMEDY WITH THIRD-PARTY RIGHTS

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## Comparison Of The CISG Remedy With Third-Party Rights

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## I. Overview and Scope of the CISG

Today, international sales transactions in most parts of the industrialized world are governed by the 1980 United Nations Convention on Contracts for the International Sale of Goods (hereafter CISG or Convention)[1] which became effective on January 1, 1988, and has become "the uniform sales law in countries that account for more than two-thirds of all world trade."[2] In the US the CISG applies to any sales contract between a buyer and a seller, with places of business in different countries that are party to the Convention, unless the buyer and seller provide otherwise.[3]

The CISG is a self-executing treaty with the preemptive force of federal law.[4] Therefore, when applicable, the CISG will preempt Article 2 of the Uniform Commercial Code (hereafter UCC).[5] However, the CISG's international character and the need to promote uniformity in its application[6] also demanded that the scope of the law had to be restricted. It thus only governs the formation of the contract of sale and the rights and

[1] U.N. Doc. A/CONF.97/18 (1980); S. TREATY Doc. NO.9, 98th Cong., 1st Sess. 22-43 (1983); 52 Fed. Reg. 6262 (1987).
[2] This is the claim on the welcome page of Pace Law School CISG database website, accessed on May 27, 2004 at http://cisgw3.law.pace.edu/.
[3] CISG artt. 1(1), 6 and US Declaration under art. 95 CISG excluding applicability of the Convention based on art. 1(1)(b): S.TREATY Doc. NO. 9, 98th Cong., 1st Sess. (1983).
[4] Richard E. Speidel, The Revision Of UCC Article 2, Sales In Light Of The United Nations Convention on Contracts for the International Sale of Goods, 16 N.W. J. Int'l. L.& Bus. 165, 166 (1995); Franco Ferrari, The Sphere of Application of the Vienna Sales Convention, p. 4 En 59 (1995).
[5] Id. at 167.
[6] See CISG art. 7.

obligations of the seller and the buyer arising from such a contract.[7] Specifically excluded from this scope are the validity of the contract, any of its provisions or usages, and the effect which the contract may have on the property in the goods sold.[8] The question thus arises, how powerful are the remedies provided to the parties under the CISG in light of the possibility for domestic law to preempt the CISG in large areas of the law. Does the CISG really promote uniformity in international sales law and alleviate the concerns of sellers and buyers as to their respective rights when engaging in international sales transactions?

# II. Remedies under CISG

Let us first look at the available remedies for the parties to an international sales contract and then focus our analysis on the specific remedy of avoidance of contract.[9] This remedy has been described by one commentator as "the most powerful remedy"[10] but we will see that this characterization may not be so accurate when it comes to conflicting rights of third parties.

## *a. Buyer's Remedies*

The buyer's remedies available under the CISG are set forth in articles 45 to 52. If the seller fails to perform any of his obligations, the buyer may claim damages (art. 45 CISG). Alternatively, he may demand specific performance (art. 46(1) CISG), delivery of substitute goods (art. 46(2) CISG), repair (art. 46(3) CISG), or fix additional time for the

[7] CISG art. 4.
[8] CISG art. 4(a) and (b).
[9] CISG artt. 49 and 64.
[10] Henry Gabriel, Practitioner's Guide to The Convention on Contracts for the International Sale of Goods (CISG) and The Uniform Commercial Code (UCC), p.188 (1994).

seller to perform - the German concept of "*Nachfrist*" notice[11] (art. 47 CISG). He may also declare the entire contract avoided (art. 49 CISG), reduce the price for non-conforming goods (art. 50 CISG) or only partially conforming goods (art. 51(1) CISG), or refuse to accept early delivery of goods (art. 52 CISG).

### *b. Seller's Remedies*

The seller's remedies available under the CISG are set forth in articles 61to 65. If the buyer fails to perform any of his obligations, the seller may claim damages (art. 61 CISG), demand specific performance (art. 62 CISG), fix additional time for the buyer to perform (art. 63 CISG), declare the contract avoided (art. 64 CISG), or make necessary specifications as to form, measurement, or other features of the goods which the buyer failed to make (art. 65 CISG).

#### i. Avoidance under Article 64 CISG

Under article 64 CISG the seller may declare the contract avoided[12] if (a) the failure by the buyer to perform any of his obligations amounts to a fundamental breach,[13] or (b) the buyer does not perform his obligation to pay the price or take delivery of the goods within the additional time fixed by the seller, or declares that he will not do so.[14] As a result of avoidance of contract, article 81 CISG releases both parties from their obligations under the contract, subject to any damages which may be due, the continuing obligation to arbitrate, and subject to a claim of restitution of whatever has been delivered

[11] John O. Honnold, Uniform Law for International Sales under the 1980 United Nations Convention, §290 (3d ed. 1999).
[12] The buyer has an equal right to declare the contract avoided under art. 49 CISG if the seller fails to perform his obligations under the contract.
[13] CISG art. 64(1)(a).
[14] CISG art. 64(1)(b).

under the contract.[15] Therefore, once the seller has declared the contract avoided, the buyer loses his contractual right to possess the goods delivered.

The remedy of contract avoidance under the CISG must be understood as a remedy of last resort[16] and courts are advised to keep this conceptual approach to the CISG remedy in mind when determining whether to allow it or not.[17] As one tribunal put it, "according to both the general framework of the Convention and its interpretation in case law, the notion of fundamental breach is usually construed narrowly in order to prevent an excessive use of the avoidance of contract."[18]

### ii. Comparison to UCC and German Sales Law

To better understand this remedy in the international arena, it is helpful to compare it to US domestic and foreign sales law. As an example of foreign sales law I have looked to Germany as a civil law legal system and because we will later find that a seller's restitution right stemming from a declaration of contract avoidance is stronger under German law than under US law.[19]

#### (1) Comparison to the UCC

Compared to US sales law, the right to declare the contract avoided under article 64 CISG is similar in some respects to the seller's right to cancel the contract under

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[15] CISG art. 81(1) and (2).
[16] See Andreas Kappus, Vertragsaufhebung nach dem UN-Kaufrecht in der Praxis, Neue Juristische Wochenschrift [NJW] 984 (1994); Robert A. Hillmann, Applying the United Nations Convention on Contracts for the International Sale of Goods: The Elusive Goal of Uniformity, in Review of the Convention on Contracts for the International Sale of Goods (CISG), 21, 30 (Cornell Int'l L.J. ed., 1995).
[17] See Clemens W. Pauly, comment, The Concept of Fundamental Breach as an International Principle to Create Uniformity of Commercial Law, 19 J.L. & Com. 221, 225 (2000).
[18] ICC Ct. of Arb., award No. 9887, ICC Int'l Ct. of Arb. Bulletin, 2000, 118, cited in Franco Ferrari, Harry Flechtner, Ronald A. Brand (eds.), The Draft UNCITRAL Digest and Beyond, art. 64 ¶ 3 (2004).
[19] See chapter IV. infra.

section 2-703 of the UCC. Section 2-703 UCC allows the seller to cancel the contract if the buyer wrongfully rejects or revokes acceptance of the goods or fails to make a payment due on or before delivery.[20] However, unlike section 2-703 UCC, article 64 CISG does not distinguish between the rights of the seller before and after acceptance of the goods by the buyer and allows the seller this remedy in both situations. This is one of the reasons why the remedy of avoidance was labeled "the most powerful;"[21] the other reason lies in its effect to not only release both parties from their obligations under the contract,[22] but also to allow a claim of restitution of whatever was supplied.[23]

These effects of avoidance under article 81 CISG, i.e. the release from obligations under the contract and entitlement to damages, most closely resemble section 2-106 (4) UCC which provides that the effect of "cancellation" is the same as that of "termination", i.e. all obligations which are still executory on both sides are discharged but any right based on prior breach or performance survives except that the canceling party also retains any remedy for breach of the whole contract or any unperformed balance.[24] However, after the buyer is in possession of the goods, the effect of the UCC concept of cancellation does not go as far as the CISG. Only in a transaction involving a credit sale and when the buyer was insolvent at the time of acceptance of the goods,[25] or when the buyer signed an agreement that the seller retains a property interest or security interest in the goods does the seller have a claim of restitution of the goods.[26] Because of the far-reaching consequences of contract avoidance under the CISG, it is generally much easier

[20] UCC § 2-703.
[21] Gabriel, id.
[22] CISG art. 81(1).
[23] CISG art. 81(2).
[24] UCC § 2-106 (4).
[25] See UCC §2-702(2) providing for a 10 day period during which the seller may reclaim the goods.
[26] See UCC §9-203(1)(a); Honnold, id. at §444.

for a seller to cancel a contract under the UCC than it is for him to avoid a contract under the CISG.[27]

## (2) Comparison to German Sales Law

Outside the US, similar rights to recover the goods upon nonpayment by the buyer are known in some other legal systems.[28] In the German legal system, the concept of contract avoidance now[29] finds its sister provision in section 323 of the Bürgerliche Gesetzbuch (BGB), Germany's civil code. During its latest revision section 323 BGB was initially modeled after article 64 CISG with the intention of unifying international and domestic sales law.[30] Section 323 of the BGB allows the aggrieved party to rescind the contract if a fundamental breach of obligation occurs.[31] Like article 64 CISG, if a seller rescinds the contract under section 323 of the BGB for nonpayment of the purchase price he has a restitution claim for the delivered goods against the buyer.[32]

In contrast to the CISG, however, this German remedy is not working as a remedy of last resort which was criticized after the release of the 1992 revision draft.[33] Nevertheless, such criticism had to give way to other concerns relating to the practical

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[27] Albert H. Kritzer, Guide to Practical Applications of the United Nations Convention on Contracts for the International Sale of Goods, Art. 64 p. 431 (1988).
[28] See Honnold, id. at §444 Fn 8 citing to French, Norwegian, Canadian, and German law.
[29] The German law of obligations in the BGB was substantially reformed in 2002, its first major revision in more than 100 years. While from 1984-1992 a commission had reviewed German laws of obligations and issued a final revision draft in 1992, it took three EU regulations (1999/44/EU concerning consumer contracts; 2000/35/EU concerning default of payment; and 2000/31/EU concerning E-commerce) to finally harmonize and update the BGB. See Jürgen Schmidt-Räntsch, Das Neue Schuldrecht, ¶¶ 1-6 (2002); see also Pauly, id. at 238 concerning the 1992 revision draft.
[30] Walter Rolland, Schuldrechtsreform - Allgemeiner Teil, Neue Juristische Wochenschrift (NJW) 2377, 2380 (1992).
[31] Helmut Heinrichs in Otto Palandt (ed.), Bürgerliches Gesetzbuch, Kommentar §323 cmt. 33 (62d ed. 2003).
[32] Id. at §346 cmt. 5.
[33] Wolfgang Ernst, Kernfragen der Schuldrechtsreform, Juristen Zeitung (JZ) 801, 806 et seq. (1994).

application of the revised law.[34] The initial goal of internationalizing the principle of fundamental breach behind this remedy thus failed to take hold and German lawyers now have to apply different standards when faced with a purely domestic dispute, where section 323 of the BGB would be applicable, and an international sales contract, where article 64 CISG might be applicable.[35] Whether judges will be consistent in applying these different standards remains to be seen.[36]

### (3) Summary

This comparison of article 64 CISG to US and German sales law seems to indicate that article 64 CISG is indeed a much more powerful remedy than it is available under US domestic laws as it is more far-reaching than the UCC. At the same time it is more restricted than the comparable remedy under German law due to its design as the remedy of last resort, which also underlines its importance. However, the impression is deceiving because once we take commercial realities into account the impact of article 64 CISG is quickly diluted due to its limited sphere of application.

## III. The Sphere of Impact of Article 64 CISG

We have seen that a seller who declares the contract avoided for non-payment of the purchase price according to article 64 CISG is entitled to require the goods to be returned to him.[37] This claim for restitution of the goods is an important one if the buyer

[34] See Schmidt-Räntsch, id. at ¶¶ 493 et seq.
[35] See Pauly, id. at 239.
[36] In 1994, a German Intermediate Court of Appeals confronted with a breach of contract case under CISG had applied German standards of interpretation to interpret the Convention instead of looking beyond the national boundaries for guidance on the correct application of the law. See Oberlandesgericht (OLG) Düsseldorf, NJW-Rechtsprechungs Report 506 (1994)(F.R.G.); see also criticism in Pauly, id. at 231 et seq.
[37] CISG art. 81(2).

is in financial difficulties because a claim for damages may be worthless and recovery of the goods the seller's only option to cut his losses.

While important, however, the claim for restitution is also a weak one within the framework of the CISG because of the limited sphere of application of the Convention. Unless excluded by the parties[38] the CISG is the default law in all internationals sales of goods transactions, governing the rights and obligations of the parties to the contract.[39] However, specifically excluded from this international sales law are the effects which the contract may have on the property in the goods sold.[40] This area of the law was excluded, because the rift between those legal systems where property in the goods passes at the moment the contract is concluded[41] and those systems, where the property passes upon delivery of the goods,[42] could not be reconciled during the conference negotiations.[43] This is indeed unfortunate,[44] because it forces the seller prior to conclusion of the international sales contract to get a legal opinion as to his property rights in the goods delivered in case he has to later avoid the contract.

The CISG rules on avoidance have, therefore, been criticized as ill-suited to the situation in which the seller declares the contract avoided in order to recover goods which have already been delivered.[45] There is additional criticism of the CISG avoidance rules

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[38] CISG art. 6.
[39] CISG art. 4.
[40] CISG art. 4 (b).
[41] For instance in the Italian, French, and English legal systems: see Ferrari, supra FN 4 at 18 EN 225.
[42] For instance the German, Austrian, and Swiss legal systems; see Ferrari id. at 19 EN 227.
[43] See United Nations Conference on Contracts for the International Sale of Goods, Official Records, Secretariat Commentary on Article 4(b) of the 1978 Draft, p. 17, para. 4; Royston M. Goode, Reflections on the Harmonisation of Commercial Law, 1 Uniform L.R. (1991) 61-62, explaining that in addition to the chasm between the legal systems, the inclusion of these important topics would have made the project too large.
[44] See Ferrari, id. and in Abstraktionsprinzip, Traditionsprinzip e consensualismo nel transferimento de beni mobile. Una superabile devaricazione?, Rivista Di Diritto Civile 729, 756-757 (1993).
[45] Hans G Leser, Rainer Hornung in Peter Schlechtriem (ed.), Kommentar zum einheitlichen UN-Kaufrecht: das Übereinkommen der Vereinten Nationen über Verträge über den internationalen Warenkauf (CISG), art 81

due to the omission of explicit rules governing the buyer's liability for the delivered goods.[46] Even if the seller can later recover the goods from the buyer, it remains unclear whether the buyer will be liable for any damages to the goods until they are returned to the seller.[47] Since a claim for restitution of goods is unknown in the Anglo-American legal system[48] US domestic law is also not suited as a gap-filler[49] to provide an answer to the question of liability.

Since the effect on property rights is not governed by the Convention we must next examine the effect of contract avoidance on conflicting rights of third parties.

### *a. Effect of CISG Avoidance on Third Parties*

The CISG is restricted in scope when it comes to the conflicting rights of third parties. Article 4 CISG provides that "the 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."[50] Some commentators derive from this sentence as well as from the explicit exclusion of the effects on property rights in article 4 (b) CISG that the Convention does not govern the rights of third persons who are not parties to the contract.[51] Most importantly it is undisputed that the CISG rules yield to the rights of

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cmt. 20 (3d ed. 2000) (citing Hans G. Leser, Vertragsaufhebung und Rückabwicklung unter UN-Kaufrecht in Einheitliches Kaufrecht und nationales Obligationenrecht: Referate und Diskussionen der Fachtagung Einheitliches Kaufrecht am 16./17.2.1987, pp. 225, 253 et seq. (Schlechtriem ed. 1987); and art. 82 cmts. 8, 13-15.

[46] Leser/Hornung, id. at art. 82 cmt.15.

[47] Leser/Hornung, id., arguing for this liability by drawing an analogy to art. 84.

[48] Leser/Hornung, id. at art. 81 cmt. 11; art. 82 cmt. 8; Honnold, id.

[49] See CISG art. 7 (2).

[50] CISG art. 4.

[51] Speidel, id. at 173; Caroline Delisle Klepper, The Convention for the International Sale of Goods: A Practical Guide for the State of Maryland and its Trade Community, 15 Md. J. Int'l L. & Trade 235, 239 (1991); see also Honnold, id. at § 444.

creditors.[52] Therefore, while the CISG will preempt contrary state sales law such as article 2 of the UCC when we are concerned with the rights and obligations of seller and buyer,[53]a seller can never prevail with his claim for restitution of goods against the buyer, when compliance with the restitution claim would violate superior rights to the goods of a creditor.

This does not mean that article 81 CISG is always without influence on the rights to the goods sold: property in the goods sold may either revert back to the seller upon declaration of contract avoidance under domestic law following the principle that title passes upon conclusion of the contract[54] or the seller may be able to claim back title to the goods in jurisdictions following the "*Abstraktionsprinzip*".[55] However, the position of the seller after declaration of contract avoidance may be weaker than the right of a third party to the property. The question, therefore, is what a seller can do to strengthen his avoidance of contract rights.

### *b. Retention of Title Clause Effect on Third Parties Determined by Domestic Law*

One popular and widely-used possibility for the seller in an installment or credit sale to protect his rights is to retain title to the goods until payment.[56] Because of the restricted scope of the Convention, the effectiveness of this protection, however, must be measured against the laws of the jurisdiction to which the goods have been delivered

[52] Honnold, id. at § 444.1.
[53] See Speidel, id. at 166.
[54] Leser/Hornung, id. art. 81 cmt. 9c, the so-called *Konsensualprinzip*.
[55] Id. and see chapter IV b ii infra.
[56] See only Jan Ramberg, International Commercial Transactions, §4.6 p. 46 (2000).

since the *lex rei sitae* will likely point to the law of the location of the goods as the applicable law under private international law rules.[57]

The validity of title retention, or *Romalpa* clauses as they are called in the English and Australian legal system,[58] is not governed by the Convention.[59] Thus, domestic law will determine the validity of such a clause.[60] This has been the position in literature and commentaries,[61] and in reported case law from civil law jurisdictions.[62] Now, common law jurisdictions take the same position:

In Roder Zelt- und Hallenkonstruktionen GmbH v. Rosedown Park Party Ltd., [63] the Federal Court for the Southern Australian District in Adelaide was confronted with an installment contract between a German seller of tents and other prefabricated structures for public functions and an Australian buyer of such equipment for its rental business for large sports events.[64] After the buyer had fallen behind on his payments and the company was placed under administration, the German seller claimed the unpaid equipment back under the title retention clause in the contract.[65] The court found that the CISG governed the construction and meaning of the *Romalpa* clause, but that domestic law would govern its validity.[66] Since both Australian and German law recognized the validity and effects of title retention clauses as not allowing title in the delivered goods to pass until the

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[57] Franco Ferrari, in Schlechtriem (ed.) id. art. 4 cmt. 29; see also infra chapter IV.
[58] Jacob S. Ziegel, Comment on Roder Zelt- und Hallenkonstruktionen GmbH v. Rosedown Park Pty Ltd, in Review of the Convention on Contracts for the International Sale of Goods (CISG) 1998, Kluwer Law International (Pace ed. 1999) 53, 54.
[59] See Ferrari, The Draft UNCITRAL Digest and Beyond, supra FN 18 at p. 525 ¶12.
[60] Ferrari in Schlechtriem (ed.), art. 4 cmt 30.
[61] Id. FN 118.
[62] See Oberlandesgericht (OLG) Koblenz, Recht der Internationalen Wirtschaft (RIW) 1019, 1020 (1992); OLG Hamm, Neue Juristische Wochenschrift-Rechtsprechungs Report (NJW-RR) 489, 490 (1990).
[63] Roder Zelt- und Hallenkonstruktionen GmbH v. Rosedown Park Party Ltd., (1995) 57 Fed. Ct. Rep. (Austl.) 216-240, CLOUT No. 308 (Fed. Ct., S. Austl. District, Adelaide Apr. 28, 1995).
[64] Facts adopted from Ziegel, id. at 53.
[65] Id.
[66] Roder, id.

purchase price has been paid, the seller had retained his title and was able to reclaim his goods from the buyer against the conflicting claims of other creditors.[67]

While *Judge Van Doussa* maintained the distinction that construction and meaning of title retention clauses were governed by the CISG and only its validity was excluded from the Convention's scope,[68] this distinction has been criticized as "terribly unreal"[69] since the *Romalpa* clause only serves a security function.[70] Regardless of whether only the question of validity or all aspects of the title retention clause fall outside the scope of the Convention, domestic law will determine the effects of the clause.[71]

According to one study, title retention clauses are more readily accepted in jurisdictions which use the passing of property as the decisive criterion to determine ownership as opposed to jurisdictions using the conclusion of the contract.[72] This means that while an international seller may conclude contract negotiations in a credit sale believing that his rights to the goods are not only contractually preserved *inter partes* but also preserved as to any third party creditor of the buyer, this is far from true as we will find out.

## IV. Location of the Goods as Outcome Determinant

Since domestic law will determine the validity of title retention clauses, we must now examine differences in domestic law. Again I will look to US and German domestic law and also briefly show the results under French law, as this was the seller's jurisdiction in the only reported US case on this subject and the question was examined

[67] Id.
[68] Id.
[69] Ziegel, id. at 57.
[70] Id.
[71] Roder, id.
[72] Ramberg, id.; see also Ferrari, supra FN 4.

there, too.[73] I will also show that it depends on the location of the goods as well as the proper agreement on title retention whether a seller will be able to recover his goods or not.

### *a. US Tribunals Invalidate Title Retention Provisions in CISG Contracts*

Under US sales law, a title retention clause in a contract does not effectively retain title in the seller, because title to the goods passes upon delivery.[74] Title retention clauses rather create only a security interest.[75] Therefore, a bank which files a financing statement including in the inventory the goods delivered under the retention of title contract has a competing security interest under section 9-203 of the UCC and as a perfected security interest it will defeat the unperfected security interest of the seller[76] as the following case exemplifies.

#### i. Usinor Industeel v. Leeco Steel Products, Inc.

In Usinor Industeel v. Leeco Steel Products, Inc.[77] the United States District Court for the Northern District of Illinois denied the plaintiff's motion for replevin and his motion for avoidance of the sales contract.[78] The plaintiff, a French seller of steel, had delivered to the defendant, an Illinois buyer, eighteen tons of steel valued over $1 million dollars and the defendant had bought this steel partially drawing on a secured credit from a local bank while the seller allowed the buyer a certain period of time to pay the

[73] Usinor Industeel v. Leeco Steel Prods., Inc., 209 F.Supp.2d 880, 886 (N.D. Ill. 2002).
[74] UCC § 2-401 (2).
[75] UCC § 2-401 (a).
[76] See 9 William D. Hawkland, Uniform Commercial Code Series § 9-312:1 (Oct. 2002).
[77] 209 F.Supp.2d 880 (N.D. Ill. 2002).
[78] Synopsis adapted from Natascha Turner, Recent Decisions, Usinor Industeel v. Leeco Steel Prods., Inc., 17 N.Y. Int'l L. Rev. 103 (2004).

purchase price since the buyer had hoped to fulfill a contract for flat beds for trucks using the steel.[79] The buyer only paid a minor amount of the purchase price and then defaulted and the seller brought suit fearing that the buyer would begin selling off the steel in order to repay the bank.[80] While the seller had relied on his title retention clause in the contract the court decided that the CISG only governed the rights and obligations between an international seller and buyer and did not govern the rights of a third-party creditor.[81] Following the Australian case of Roder Zelt- und Hallenkonstruktionen GmbH v. Rosedown Park Party Ltd.[82] the court determined that the validity of the retention of title provision had to be decided according to domestic law.[83]

Under US law section 2-401(a) of the UCC provides that retention of title clauses create a security interest in the goods for the seller. However, as long as this interest is unperfected it is subordinate to perfected security interests of secured creditors, such as the bank here.[84] In contrast, the seller had an absolute right to contract for title until payment under French law.[85]

The outcome thus depended on the question, which law was applicable; that of France, as the seller's place of business, or that of Illinois as the buyer's and the bank's place of business.

[79] Id. at 104.
[80] Id.
[81] Usinor, 209 F. Supp. 2d at 885.
[82] Supra FN 63.
[83] Usinor, 209 F. Supp. 2d at 886, citing Roder.
[84] Usinor, 209 F. Supp. 2d at 889.
[85] Id. at 886.

### ii. Conflict of Laws Analysis

In determining the applicable domestic law, the court looked at five relevant factors under the "most significant contacts rule" of section 188 of the Restatement (Second) on Conflicts.[86] The five factors were 1) the place of contracting, 2) the place of negotiating, 3) the place of performance, 4) the location of the subject matter of the contract, and 5) the place of domicile, residence, place of incorporation and business of the parties.[87] It found that the location of steel was controlling and confirmed this result by applying the "appropriate relation" test of section 1-105 of the UCC.[88] Therefore, the domestic law of Illinois, and thus the Uniform Commercial Code of Illinois was applicable effectively invalidating the retention of title clause and giving the seller only a security interest in the steel[89] which the seller never perfected. Thus the bank's perfected security interest in the steel prevailed over the seller's restitution claim to the goods.[90]

### iii. Result

While the seller could not prevail with his restitution claim against the superior rights of the bank, the court pointed out that the seller had the opportunity to perfect his rights by filing a financing statement, by filing the lawsuit earlier, or by seeking reclamation of the goods under section 2-207 of the UCC, which allows the seller ten days from the buyer's receipt of the goods to reclaim the goods if the seller discovers the buyer is insolvent.[91]

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[86] Id.
[87] Id. citing Cent. States, S.E, and S.W. Areas Pens. Fund v. Tank Transp., Inc., 1991 WL 191342 at *2 (N.D. Ill. 1991).
[88] Id. at 887 citing Gordon v. Clifford Metal Sales Co., 602 A.2d 535 (R.I. 1992).
[89] According to UCC §2-401(a).
[90] Usinor, 209 F. Supp. 2d at 889.
[91] Usinor, 209. F. Supp. 2d 880, 887 at FN 1.

The result in Usinor sends an important signal to international sellers, who will have to do more due diligence than just rely on the remedies available under the CISG as well as the validity of the title retention clause under the laws chosen by the contracting parties. When contracting with a US buyer they must retain local US counsel to advise the seller as to the rights and obligations under US state law. Although the judge in Usinor did not think so,[92] for most sellers this may be cost-prohibitive and a deterrence from engaging in credit sales with US buyers. However, is the result the same for a US seller selling to Europe?

### *b. German and French Laws do Not Invalidate Title Retention Clauses*

Since it is established that property rights of third parties may prevail over restitution claims by the seller when the good are located in the US, the question arises if the same is true if the goods are delivered to a non-US location. In Usinor the goods came from Europe, more particularly from France. Therefore, I will examine the seller's position if he were to deliver the goods to Europe. While I cannot examine the result under the sales laws of each of the countries in Europe, I have chosen two of Europe's largest economies, that of Germany and France.

#### i. Result Before a French Tribunal

I am first turning to the seller's rights under French law. The expert witness in Usinor had informed the judge that under French law the seller of goods has an absolute right to contract for title until payment, and, therefore, the retention of title clause in the

[92] Id.

agreement would prevail over a security interest of a third party.[93] But would a French tribunal have applied US or French domestic law to determine the property rights to the goods?

French conflict of laws rules follow the *lex rei sitae* to determine property rights.[94] Thus the law of the location of the property is applicable. Therefore, had a French buyer of US goods defaulted on the purchase price after delivery, the seller's restitution claim would not have been defeated by conflicting third-party claims, since a French judge would have applied French domestic law to determine the property right to the goods and upheld the seller's absolute right to title until payment.

### ii. Result Before a German Tribunal

Looking to another large European market we find that under German law, a seller who retains the title to the goods until payment of the contract price has a restitution claim against the defaulting buyer.[95] A financing bank of the buyer may have a claim against the goods resulting from the security contract and assignment of the rights to the goods.[96] The security interest of the bank and the contractual restitution claim of the seller in case of the buyer's default are equally strong until the buyer actually delivers the goods either to the seller or to the bank, in which case the opposing claim is extinguished.[97] Therefore, the US seller's position would not appear to be superior to a third-party creditor.

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[93] Usinor, 209 F.Supp.2d at 886.
[94] Boitelle-Coussau, Götz-Sebastian Hök, Länderbericht Frankreich ¶ X (Verein für rechtsvergleichendes Grundbuch und Hypothekenrecht e.V.) available at http://www.european-hypotheque.de/d-Hypotheken-Frankreich.htm (last visited July 9, 2004).
[95] §§ 346 I and 985, 986 BGB (F.R.G.).
[96] Peter Bassenge in Palandt, id. at §930 cmt. 29.
[97] See § 275 (1) BGB (F.R.G.).

However, the German legal system is based on a special theory called the "*Abstraktionsprinzip*" according to which you have to distinguish between the validity of the contractual relationship aimed at conveying property rights and the transaction *in rem,* which is the actual conveyance of the property rights and regarded as a separate legal act.[98] In title retention contracts the seller has not transferred full title to the goods to the buyer, but rather a conditional right which only vests upon payment of the purchase price.[99] Therefore, if the buyer delivers the goods to the bank, thus extinguishing the contractual restitution claim of the seller, the seller still has a restitution claim *in rem*[100] which remains unaffected by the delivery to the bank, because the buyer only had an inchoate right to the goods, and this right never fully vested in the buyer for failure to pay the sales price.[101]

Under German law, therefore, the unpaid seller can successfully demand the return of the goods based on his restitution claim *in rem*, which cannot be defeated by the buyer assigning all rights in the goods to the bank and the bank's security lien in the goods will be subordinate to the seller's property rights.

German domestic law would also be applicable according to German conflict of laws rules[102] which provide that the *lex rei sitae* determines the applicable law.[103] Therefore, if the goods are located in Germany, German law applies.[104]

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[98] See only Bassenge in Palandt, id. Einl v. §854 cmt. 16.
[99] Hans Putzo in Palandt, id. at § 449 cmt. 23 et seq.
[100] §§ 985, 986 BGB (F.R.G.).
[101] Putzo in Palandt, id. at § 449 cmt. 9; Helmut Heinrichs in Palandt, id. at § 158 cmt. 1.
[102] Art. 43 EGBGB (F.R.G.).
[103] Andreas Heldrich in Palandt, id. at art. 43 EGBGB cmt. 1.
[104] Id.

### iii. Title Retention Clauses Must Be Valid

However, even if the result under German and French law can be determined so long as a title retention clause has been agreed upon, the question remains, whether the title retention clause was validly agreed upon. In Roder[105] the court had applied article 8 CISG to determine the parties' intentions with regard to the meaning and construction of the title retention clause in the contract. The application of the CISG to determine the meaning and construction of the title retention clause cannot be followed as *Professor Ziegel* pointed out in his criticism of Roder.[106] The better view would be to leave the entire question of meaning, construction, validity and effects of title retention clauses to domestic law.[107]

This does not necessarily mean that the same domestic law will be applied to resolve this issue as has been applied to determine the effect of the clause. In France and Germany, private international law would first seek to determine if the parties had a choice of law clause in the contract, or if it can be concluded from the circumstances that the parties had agreed on the applicable law.[108] In the absence of such a choice of law by the parties, the closest connection test[109] would look to the domicile or place of business of the party charged with the characteristic performance under the contract.[110]

This distinction in determination of the applicable domestic law is not academic in nature but can be rather important to the outcome of the case. In a German case[111] a Dutch seller of steel yachts had delivered a yacht to a German dealer, who never paid and

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[105] Supra FN 63.
[106] Ziegel, id. at 59.
[107] Id.
[108] Art. 27 EGBGB (F.R.G.); Art. 3 Rome Convention.
[109] See art. 28 EGBGB (F.R.G.); Art. 4 Rome Convention.
[110] Art. 28 (2) EGBGB (F.R.G.); Art. 4 (2) Rome Convention.
[111] Oberlandesgericht (OLG) Koblenz, Recht der Internationalen Wirtschaft (RIW) 1019, 1021 (1992).

later declared bankruptcy. The seller sued for recovery of the boat relying on the title retention clause in its general terms and conditions. The court found that German law applied to determine the validity of the title retention clause, because the German dealer was the party charged with the characteristic performance of the contract. [112] In addition to his obligation to pay the price, the German buyer was obligated to protect and promote the brand name of the seller and to promote the sale and service of the seller's products in Germany.[113] Under German law though, the title retention clause was not valid in this case, because while the contract was in German, the general terms and conditions were in a separate document and only in Dutch and there was no evidence that the buyer spoke Dutch or had been aware of these conditions to the sale.[114] Therefore, the court held that the conditions had not become part of the contract and the seller could not prevail with her restitution claim.

# V. Conclusion

We have seen that while the CISG is the applicable law is most of the international trade world thus encouraging business to embrace the Convention as governing most international sales, it leaves important aspects of transactions to be governed by domestic law. We have also seen that while generally the CISG preempts contrary domestic law, the scope of application of the Convention is limited.

[112] Id. at 1020.
[113] Id.
[114] Id. at 1021.

Since the remedies available under the Convention only bind the contracting parties, "the most powerful"[115] remedy of contract avoidance is not so powerful after all as it can easily be defeated by conflicting third-party rights to the goods if those goods are located in the US.

While it may be uncommon in European countries to demand prepayment of goods or to use international letters of credit in a sales transaction, it is advisable for sellers doing business with US buyers only to ship against letters of credit to secure payment or review existing UCC filings and to file financing statements with the support of a local US attorney to ensure that the seller can enforce his contractual rights. The same advisory is not necessary for US sellers to German and French buyers so long as a retention of title clause is agreed upon which is enforceable under both German and French laws. When agreeing on title retention clauses, however, US sellers must bear in mind that they also must validly agree on such a clause and comply with the laws on contract formation chosen as the applicable domestic law in case the Convention does not apply.

[115] Gabriel supra FN 10.