INADEQUACIES OF ARTICLE 42 CISG: DOES THE ANSWER LIE IN ARTICLE 79?

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Abstract

The United Nations Convention on Contracts for the International Sale of Goods (CISG) provides uniform laws that govern transnational sales contracts between businesses operating in Contracting States, or when the law of a Contracting State is applicable according to conflict of laws rules.[1] *Currently 97 Contracting States worldwide have adopted the CISG, including New Zealand.*[2] *Article 42 CISG requires a seller to deliver to the buyer goods that are free from any third-party intellectual property rights (IPRs). The territoriality of IPRs means that a seller may not be the party best suited to know the existence of any third-party IPRs in certain jurisdictions compared to the buyer. Article 42 creates uncertainties for parties involved in international commerce with regards to intellectual property (IP) disputes and can lead to unsatisfactory results. In this paper, I explore whether an aggrieved party to a contractual dispute about a third-party IPR claim can pursue a cause of action under art 79. I apply a two-stage enquiry to selected cases, under art 42 (stage one) and then art 79 (stage two) of the CISG, and demonstrate that a losing party in a third-party IPR dispute is also unlikely to succeed under art 79, even in rare circumstances.*

I. Introduction

Sale of goods legislation helps reduce transaction costs for businesses as it saves parties to a contract of sale from having to negotiate express contractual terms.[3] Contracts for the sale of goods between New Zealand businesses are governed by default rules contained in pt 3 of the Contract and Commercial Law Act 2017 (CCLA), except where the parties or other legislation provides otherwise. Typically, the

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1 United Nations Convention on Contracts for the International Sale of Goods 1489 UNTS 3 (opened for signature 1 January 1988, entered into force 1 January 1988) [CISG], art 1.

2 "CISG-online" <https://cisg-online.org/home>.

3 Nicholas Wood *A to Z of New Zealand Law* (online ed, Thomson Reuters) at [14.G.1.1.1].

seller has an obligation to give good and clear title to the buyer,[4] unless the parties implicitly or expressly agree otherwise.[5] That is, firstly, there is an implied condition that the seller has the right to sell the goods.[6] Secondly, there is an implied warranty that the buyer is entitled to enjoy quiet possession of the goods.[7] This warranty extends beyond the time of sale and is breached if the seller disturbs, or a third party lawfully disturbs, the buyer's quiet possession,[8] while the seller can hardly warrant against unlawful interference from third persons.[9] Thirdly, there is an implied warranty that the goods are free from any charge or encumbrance that is not declared or known to the buyer.[10]

In the context of IPRs and claims, the leading applicable case in New Zealand national sales law is *Niblett Ltd v Confectioners' Material Co Ltd*.[11] In *Niblett Ltd v Confectioners'*, the Court ruled that, since the seller contravened the equivalents of both subss 135(1)(a) and (b) of the CCLA because the goods infringed a third party's trademark, as a result, the seller could be legally prevented from selling them and the buyer was unable to enjoy quiet possession.[12] However, in *Microbeads AG v Vinhurst*, where no third-party patent rights subsisted at the conclusion of the sales contract (unpublished patent), but the patentee claimed infringement of its patent after it was published, the Court held that the seller was in breach of a cognate provision to subs 135(1)(b) but not subs 135(1)(a).[13] Therefore, goods marred by third-party IPRs or claims can be characterised as having a legal defect in title.

If a sales contract falls within the scope of the CISG, its provisions take effect and will prevail over any other New Zealand law if there are any inconsistencies.[14] New Zealand adopts and incorporates the CISG into its national law by virtue of ss 202–206 of the CCLA. In international commercial sales contracts governed by the CISG, the buyer is protected from third-party claims on the goods by arts 41 (non-IP) and 42 (IP). Consequently, the matter of how art 42 is interpreted by courts and arbitral tribunals around the world, and whether there are any alternative causes of action where IPRs are concerned under the CISG is a salient topic for New Zealand businesses engaged in international commerce. According to art 42(1):

4 Contract and Commercial Law Act 2017 [CCLA], s 135.
5 CCLA, s 135 (2).
6 At s 135(1)(a).
7 At s 135(1)(b).
8 Matthew Barber *Laws of New Zealand – Sale of Goods* (online ed, New York, LexisNexis) at [137].
9 Above n 3, at [14.G.5.4]
10 CCLA, s 135(1)(c).
11 *Niblett Ltd v Confectioners' Materials Co Ltd* [1921] 3 KB 387 (CA).
12 At [398]–[403].
13 *Microbeads AG v Vinhurst Road Markings Ltd* [1975] 1 WLR 218 (CA) at [221]–[227].
14 CCLA, s 205.

> The seller must deliver goods which are free from any right or claim of a third party based on industrial property or other intellectual property, of which at the time of the conclusion of the contract the seller knew or could not have been unaware.

Sales contract laws of many jurisdictions place an obligation on the seller to deliver to a buyer goods that are free of any third-party rights or claims. In a domestic transaction, a seller is responsible for any IPR infringements in the jurisdiction where he or she conducts business, and is better suited to know of any existing IPRs than the buyer. However, in an international sales transaction the goods may end up being re-sold or used in a number of states where it can be quite challenging to obtain information about the potential existence of IPRs and about the legal regime applicable to them.[15] Furthermore, the seller has no control over where the buyer will resell or use the goods.[16]

The drafters of the CISG recognised this flaw, which they attempted to mitigate by limiting the seller's liabilities to third-party IPR claims arising from "the State where the goods will be resold or otherwise used",[17] and "the State where the buyer has his place of business".[18] The onus is on the buyer to prove that it was contemplated by the parties when the contract was concluded that the goods would be resold or otherwise used in a particular State (art 42(1)(a)), if not then art 42(1)(b) is applicable.[19] A parallel reverse onus on the buyer was included, relieving a seller of its obligation in two situations: (i) if the buyer knew or "could not have been unaware" of the claim,[20] or (ii) if the claim arises out of the seller complying with the buyer's instructions and specifications.[21] This creates further problems in the interpretation of art 42.

I argue that art 42 of the CISG can be ambiguous. Some of the problems that art 42 presents are well documented, but very little exists in the literature in the form of practical solutions. In the domestic setting, a seller is responsible for and should know any potential claims against the goods (both IP and non-IP). The policy rationale behind non-IP claims is largely uncontroverted in both domestic and international sales transactions. Similar to domestic transactions, the seller is the party best suited to know any non-IP claims in international sales contracts. The situation is much different for IPRs and claims. In international sales, I think that, with a few

15 Peter Huber and Alastair Mullis *The CISG: A New Textbook for Students and Practitioners* (Sellier, Munich, 2007) at 175, n 664.
16 Allen M Shinn Jr "Liabilities under Article 42 of the UN Convention on the International Sale of Goods" (1993) 2 Minn J Global Trade 115 at 119, n 25.
17 Article 42(1)(a).
18 Article 42(1)(b).
19 Huber and Mullis, above n 15 at 175, n 665.
20 Article 42(2)(a).
21 Article 42(2)(b).

exceptions, the buyer is better positioned, rather than the seller, to know of the existence of any third-party IPR claims in the relevant jurisdictions. For example, in *Niblett Ltd v Confectioners'* and *Microbeads AG v Vinhurst* discussed above,[22] because IPRs are territorial, if the sellers were located in foreign jurisdictions, it appears that it would likely be excessively burdensome to expect them to know and warrant against any IPR claims in the buyers' jurisdictions.

The legislative history of art 42 refers to the Charter of the World Intellectual Property Organization (WIPO).[23] The WIPO Convention does not attempt to define IP, but provides a broad list that includes inter alia: "literary, artistic and scientific works", performances by artists, broadcasts, inventions, scientific discoveries, industrial designs, trademarks, protection against unfair competition, "and all other rights resulting from intellectual activity in the industrial, scientific, literary or artistic fields".[24] Essentially, IP would encompass any human endeavour that involves creativity, innovation or invention. The main types of industrial property are generally regarded as patents, trade marks, copyright and industrial designs (also protected by copyright in New Zealand). For the purposes of this study, the term intellectual property shall be taken to refer to both industrial and intellectual property. Since the author is familiar with the New Zealand IP regime, where a discussion of IP law is necessary in this paper, reference is made to New Zealand IP laws. The United States Uniform Commercial Code (UCC) is the national legislation used for comparative purposes to the CISG where required as it is cited frequently in CISG commentaries and scholarly materials.[25]

Article 79 of the CISG is premised on the concept of supervening circumstances – an event that happened or became known to the party in breach after the conclusion of the contract. Unlike many national legal systems and other uniform contract law projects,[26] as well as model contract clauses such as those provided by the International Chamber of Commerce (ICC),[27] the CISG does not specifically mention *force majeure* or hardship.[28] Article 79(1) exempts either party from liability to pay damages if it fails to "perform any of [its] obligations" in accordance with the contract, subject to certain strict conditions being met. Exemption from liability

22 *Niblett Ltd v Confectioners'*, above n 11; and *Microbeads AG v Vinhurst*, above n 13.
23 Shinn Jr, above n 16, at 116.
24 Convention Establishing the World Intellectual Property Organization 828 UNTS 3 (opened for signature 14 July 1967, entered into force 26 April 1970) [WIPO Convention], art 2(viii). In New Zealand, "trademarks" is spelt with a space under the Trade Marks Act 2002 (hereinafter "trade marks" is used).
25 For example, see Donald J Smythe "Clearing The Clouds On The CISG'S Warranty Of Title" (2016) 36 Nw J Intl L & Bus 509.
26 See UNIDROIT Principles of International Commercial Contracts 2016 [UPICC], arts 7.1.7 (*force majeure*), 6.2.2 (hardship).
27 International Chamber of Commerce (ICC) *Force Majeure and Hardship Clauses*, March 2020.
28 CISG, art 79.

under art 79 arising from the existence of a third-party IPR claim on the goods is in principle possible if such a claim is asserted after the conclusion of the contract.

This paper aims to answer the following questions:

(1) Which party is responsible for the "knowledge component" of the existence of a third-party IPR or claim in an international commercial sales contract dispute? When is it the buyer, and when is it the seller?

(2) Is art 42 of the CISG adequate to resolve IPR disputes involving a third party in international commercial sales transactions?

(3) In what situations can the difficulties arising from a third-party IPR or claim be categorised as a supervening event sufficient to excuse the affected party from liability under art 79 of the CISG in an international commercial sales contract dispute?

II. Article 42 Problems

A. Interpretation: "Could Not Have Been Unaware"

The phrase "could not have been unaware" has caused controversy in the interpretation of art 42. The *Secretariat Commentary* appears to place an affirmative obligation on the seller to research the IP registries of the country where the goods will be resold or used.[29] If the seller is well-positioned to research IP registries in a foreign jurisdiction, then it would seem that the buyer is in an even better position to know of IPRs registered in their place of business or wherever they intend to sell the goods. Where the buyer makes the initial step to enquire about the goods, they should have a responsibility to check for any potential infringements that might occur in relation to the goods. If a third-party claim arises from unpublished IPRs, the *Secretariat Commentary* says that the seller is not liable for any infringements.[30] I agree with this assertion primarily because it would be difficult for the seller to know of any foreign IPRs that are not publicly accessible. This is even more problematic for unregistered IPRs as they are never published.

A notable illustration of the precarious nature of unregistered IPRs is a New Zealand High Court decision in *Flujo v Merisant*.[31] Flujo launched, *inter alia*, a passing off lawsuit claiming that the appearance of the defendant's packaging for a sweetener

29 UN Secretariat *Commentary on the Draft Convention on Contracts for the International Sale of Goods* UN Doc A/CONF 97/5 (14 March 1979) [*Secretariat Commentary*] art 40, at [6].

30 At [6].

31 *Flujo Sanguineo Holdings Pty Ltd v Merisant Co* [2021] NZHC 1505.

was "confusingly similar" to its own. The claim was dismissed on the grounds that the relevant product description on both sets of packaging ("the 100 per cent natural sweetener") had not "acquired a secondary meaning" or distinctive character in the minds of consumers to warrant exclusive use by the plaintiff,[32] but it was ruled not "unjustified".[33] In a similar precedent United Kingdom case (the *Jif Lemon case*), a different result was reached.[34] In my view, the buyer, as the party dealing with competitors in its jurisdiction, is in the best position to assess if the goods will potentially breach rivals' IPRs. The widely accepted interpretation of "could not have been unaware" places responsibility on both parties not to be negligent about information that is reasonably at hand at the time of contract formation,[35] especially if the other side is not likely to have the same information.[36] It denotes something much more than mere negligence and requires proof of something closer to gross negligence or wilful blindness on either party.[37]

B. Interpretation: "Free from Any Right or Claim"

Before any infringement occurs only an IPR exists. In an international sales transaction, since IPRs are territorial, the goods can only infringe any third-party rights in the country they are in effect upon importation. A claim only arises if the owner decides to enforce the right, and it is usually costly. How then "[c]an a seller 'know' of a claim which has not yet arisen" because the goods are yet to be imported into the State in which IPR claims may be brought?[38] Shinn postulated that the seller's liability should extend to claims which he or she knew would arise upon import at the time the contract was made.[39] Shinn borrowed this reasoning from the UCC *Official Comment*, which provides that it is the seller's duty to ensure that no infringement claims of a patent or trademark by a third party will mar the buyer's title.[40] However, property rights are not self-enforcing.[41] IP owners are often quite selective about enforcing rights and sometimes leave some of their exclusionary rights on the table for others to use for a number of reasons, including enforcement

32 At [19]; and Trade Marks Act 2002, s 89.
33 At [71]; and Trade Marks Act, s 105.
34 *Reckitt & Colman Products Ltd v Borden Inc* [1990] 1 WLR 491 (HL) [*Jif Lemon case*]. *Reckitt & Colman* is a passing off precedent case in New Zealand.
35 Smythe, above n 25, at 520.
36 Shinn Jr, above n 16, at 126–127.
37 Huber and Mullis, above n 15, at 176–177, n 670, 672.
38 Shinn Jr, above n 16, at 127.
39 At 127.
40 UCC § 2-312 *Official Comment* (1992) at [3].
41 Robert P Merges "What Kind of Rights Are Intellectual Property Rights?" in Rochelle Dreyfuss and Justine Pila (eds) *Oxford Handbook of IP Law* (online ed, Oxford Handbooks, 2018) at 9 <https://doi.org/10.1093/oxfordhb/9780198758457.013.8>.

costs and strategic advantage.[42] For example, in platform markets such as computer hardware which provide a common starting point for further technological development, IP rights are often purposely waived for allies but used to exclude direct competitors.[43] While a seller will almost certainly have intimate knowledge of these types of arrangements in their own jurisdiction, and might even be party to some of them, the buyer is bound to be equally knowledgeable about the same in their place of business.

Another question that is raised by art 42 is whether the seller should be held liable for invalid claims. Under the UCC, the "cloud on title standard", which holds the seller liable for valid non-IP claims and invalid ones that are not clearly lacking merit but still raise "colorable claims" against the buyer's title, has been adopted by United States courts and was extended to an IP case.[44] If *Flujo* (discussed in section IIIA) is persuasive, it would appear the cloud on title standard is consistent with New Zealand trade mark law as applied by Woolford J in his interpretation of s 105 of the Trade Marks Act 2002.[45] According to the Court in *Pac Sunwear*, the mere existence of a "cloud on title" is enough for a buyer to establish a breach of the warranty of title, and neither good faith nor a lack of knowledge of the defect on the part of the seller are adequate defence.[46] A difficulty of applying the cloud on title standard to international sales is that the CISG, in contrast, provides the seller with a defence to claims of which he or she has no knowledge at the time of contracting.[47] Applying Mullis' assertion that the seller should be exempt from liability except in circumstances raising the possibility that they wilfully shut their eyes to the obvious or were grossly negligent,[48] it seems a good faith defence might be sustained.

C. Case Law

1. Brief introduction

Article 42 has been applied in only a few cases and I summarise the most relevant ones. Interestingly, and I think correctly, the courts have always found reasons not to hold sellers liable for third-party IPR claims against the buyer.[49] It has been held that the onus is on the buyer to prove that the seller knew or could not have been unaware of the existence of a third party's IPR claim at the time of the conclusion

42 At 9.
43 At 9.
44 Smythe, above n 25, at 513.
45 *Flujo*, above n 31, at [68].
46 *Pac Sunwear of Cal, Inc v Olaes Enterprises, Inc* 167 Cal App 4th 466 (2008).
47 Article 42(1).
48 Huber and Mullis, above n 15, at 176–177, n 670, 672.
49 Smythe, above n 25.

of the contract, except in circumstances when reasons of equity would demand otherwise.[50] The buyer, as the party relying on the breach, also bears the burden of proving that a breach of a third party's IPRs based on the law of either of the States designated in art 42(1)(a) or (b) actually occurred.[51] The seller is not only liable in instances where a third-party IPR actually existed, but also if an IPR is being "unrightfully claimed" because "[i]t is part of the seller's sphere of risk to deal with the third party in such cases".[52] Though it is unclear to what extent "unrightfully claimed" IPRs should be indemnified by the seller, it would be folly to hold a seller liable for clearly spurious claims.[53] According to Schwenzer, a seller will only very rarely be held liable for unfounded claims because it will often lack the requisite knowledge at the conclusion of the contract.[54]

2. Application of article 42 in cases

In a case involving a transaction governed by the Hague Sales Convention (ULIS),[55] the Court made an analogy to art 42 of the CISG when deciding the case.[56] An Israeli seller supplied a Belgian buyer with jeans boots that violated a well-known trade mark of Levi's Jeans for export to its customer in the United States. The Supreme Court of Israel correctly ruled that both the seller and the buyer "must have known" about the infringement of a famous mark, and then held that the seller was not liable to the buyer because the buyer could not have been unaware of the infringement. In a similar case, a Spanish company sold footwear with ribbons that infringed a third party's trade mark to a French buyer.[57] The Rouen Court of Appeal held that the buyer was an "informed professional" who, at the time of conclusion of the contract, could not have been unaware of the existence of third-party IPRs on the goods.[58] The Court added that the buyer has to be "informed on the existence of the protected rights on the French market", and that the seller merely complied with the buyer's specification.[59] The decision was confirmed by the French Supreme Court.

50 *Maglificio Esse v Wehkamp BV* 21 May 1996 Gerechtshof Arnhem (Court of Appeal Arnhem) Netherlands 95/246 AL. The same reasoning was repeated in *Blank CDs case* 12 September 2006 Oberster Gerichtshof (Austrian Supreme Court) CISG-online Case No 1364 at [41].
51 *Blank CDs case*, above n 50, at [41].
52 At [44].
53 See discussion on cloud on title standard under the UCC in Section IIIB above.
54 Ingeborg Schwenzer (ed) "Article 42" in *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods* (3rd ed, Oxford University Press, Oxford, 2016) at [6].
55 Convention relating to a Uniform Law on the International Sale of Goods (opened for signature 1 July 1964, entered into force 18 August 1972) [ULIS].
56 *Eximin SA v Itel Style Ferarri Textiles and Shoes Ltd* 22 August 1993 Supreme Court of Israel CISG-online Case No 1082.
57 *SA Tachon diffusion v Marshoes SL* 19 March 2002 Court of Cassation (Supreme Court of France) CISG-online Case No 479.
58 *SA Tachon v Marshoes*, above n 57.
59 *SA Tachon v Marshoes*, above n 57.

In another case, it was held that two French professional buyers of "counterfeit furniture" from a Spanish seller who were advised by professional interior decorators could not have been unaware of the existence of a third party's IPRs.[60] Similarly, a French company which bought shirts in its "professional capacity" from a German company, was held to not have been unaware of the existence of a French third party's IPRs in the patterns printed on the shirts.[61] In yet another case, a South Korean company sold LED illuminators for automobiles to a United States buyer.[62] A third party claimed that the holder of the illuminator infringed on its patent in the United States. The Seoul High Court held that "regardless of whether the IP party is rightfully claimed, this falls within the seller's sphere of risk".[63] The Court, however, exonerated the seller, arguing that for a seller to be liable "it had to have known or not have been unaware about the claim of the company owner of the patent". This means "to have intentionally disregarded the claim or to have been materially negligent in having been unaware of the claim". This interpretation appears to be consistent with Mullis' suggestion that the phrase "could not have been unaware" places a duty on the seller not to be grossly negligent about information that is reasonably at hand or wilfully close his eyes to obvious facts at the time of the conclusion of the contract.[64] The third party's patent was only registered after each of the three sales contracts were concluded, but it is not clear if the patent application was published. Had it been published then, according to the *Secretariat Commentary*, the seller would be liable.[65]

In light of the above, it can be said that:

(1) Despite art 42 requiring a seller to warrant against any third-party IPR claims on the goods, the buyer will almost invariably be found to have known or at least not have been unaware of the existence of such rights in its jurisdiction or the State where the goods are resold or used, thus freeing the seller of liability. However, in exceptional circumstances where the buyer can prove that it could not have known of such claims, but rather the seller did, significantly, the buyer still has to prove that the seller was grossly negligent about, or wilfully blind, to facts that were reasonably available.

60 *Fondation Le Corbusier v Grand Optical France* 23 November 2004 Tribunal de Grande Instance de Versailles (Versailles Court of First Instance) CISG-online Case No 953.
61 *IP infringing shirts case* 13 November 2002 Cour d'Appel de Colmar (Court of Appeal Colmar) CISG-online Case No 792.
62 *LED Illuminator Case* (24 December 2015) Seoul High Court CISG-online Case No 4238.
63 *LED Illuminator Case*, above n 62.
64 Huber and Mullis, above n 15, at 176.
65 *Secretariat Commentary*, above n 29, art 40, at [6].

(2) Article 42 CISG can be ambiguous, and it creates uncertainties for the parties in international sales contracts.

III. Does a Third Party Claim Qualify as a Supervening Circumstance?

A. Is Article 79 CISG Applicable to Third-Party IP Rights or Claims?

Article 79 is a very narrow exemption from the principle of strict liability underlying the CISG which, though necessary, only very rarely succeeds.[66] Schwenzer argues that art 79 applies to any type of breach by one of the parties.[67] Huber reasons that this is the correct position since the provision uses the words "failure to perform any of his obligations".[68] This all-inclusive interpretation of exemption corresponds to the broad concept of breaches of duties which result in liability under arts 45 or 61.

Despite assertions to the contrary by some leading commentators,[69] the predominant view is that exemption under art 79 is in principle possible if the seller fails to supply goods which conform to the contract, as long as the non-conformity was brought about by circumstances which meet the strict criteria of art 79.[70] This view is also supported by the *Secretariat Commentary*.[71] The argument here is that the seller has delivered to the buyer goods which are non-conforming because of a legal title defect caused by a third-party IPR claim.[72] Schwenzer suggests that an exemption under art 79 is possible in exceptional circumstances if the seller is unaware of an existing IPR and has to be assessed on a case-by-case basis.[73]

B. Force Majeure or Hardship?

The wording of art 79 CISG closely resembles *force majeure* clauses of other uniform law projects and the International Chamber of Commerce (ICC). In fact, the wording used by art 79(1) is basically identical to art 7.1.7(1) of the UNIDROIT

66 Schwenzer "Article 79", above n 54, at [1].
67 At [6].
68 Huber and Mullis, above n 15, at 258.
69 Schwenzer "Article 79", above n 54, at [7], n 21.
70 At [7], [29].
71 *Secretariat Commentary*, above n 29, art 65, at [6].
72 Thomas M Beline "Legal defect protected by Article 42 of the CISG: A Wolf in sheep's clothing" (2006). 7 Pitt J Tech L & Poly 1 at 3; See also Schwenzer "Article 79", above n 54, at [6] on defective performance.
73 Schwenzer "Article 79", above n 54, at [6].

Principles of International Commercial Contracts (UPICC).[74] That has caused controversy over whether art 79 also includes hardship situations. The drafting history of this provision was highly controversial and is unclear on this matter.[75] However, the widely accepted view, as reflected in court and arbitral decisions, as well as in scholarly writings, is that hardship falls into the scope of art 79.[76] Or alternatively, the requirements of art 79 are fulfilled through gap filling with general principles of private international law pursuant to art 7(2) of the CISG.[77] A resort to gap filling using domestic law is undesirable because (i) it now appears settled that there is no internal gap within the CISG on hardship;[78] and (ii) this is contrary to the principles of uniformity and unification promoted by the CISG, and disregards its international character.[79]

C. Criteria For Exemption Under Art 79

Article 79(1) of the CISG provides that:

> A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

Since the CISG does not distinguish between *force majeure* and hardship, it seems to be accepted that both scenarios have to be interpreted with the guidance of art

74 See UNIDROIT Principles 2016, art 7.1.7(1).

75 John O Honnold *Uniform law for international sales under the 1980 United Nations Convention* (4th ed, Kluwer Law International BV, Alphen aan den Rijn, 2009) at 472–495; Denis Tallon "Article 79 Commentary" in Cesare Massimo Bianca and Michael Joachim Bonell (eds) *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Giuffrè, Milan, 1987) at 572–575; and Christoph Brunner *Force Majeure and Hardship Under General Contract Principles: Exemption for Non-Performance in International Arbitration* (vol 18, Kluwer Law International BV, Alphen aan den Rijn, 2009) at 410.

76 Honnold, above n 75; CISG Advisory Council (AC) Opinion No 7 *Exemption of Liability for Damages Under Article 79 of the CISG* (Rapporteur: Professor Alejandro Garro) 12 October 2007, at [26], n 28; and Ingeborg Schwenzer and Edgardo Muñoz "Duty to renegotiate and contract adaptation in case of hardship" (2019) 24 Unif L Rev 149 at 152–153.

77 *Scafom Intl v Lorraine Tubes SAS* 19 June 2009 Court of Cassation (Supreme Court of Belgium) CISG-online Case No 1963; *Dupiré Invicta industrie v Gabo Sp z oo* 17 February 2015 Court of Cassation (Supreme Court of France) CISG-online Case No 2598 [*D21 v Gabo*]; and Laura Maria Franciosi "The effects of COVID-19 on international contracts: A comparative overview" (2020) 51 VUWLR 413 at 428.

78 Honnold, above n 75 at [425], [32.2]; and Schwenzer "Article 79", above n 54, at [31].

79 CISG, art 7(1).

79.[80] Two leading cases, one decided by the Belgian Supreme Court in 2009 (*Scafom v Lorraine Tubes*),[81] and the other by the French Supreme Court in 2015 (*D21 v Gabo*),[82] applied art 79 of the CISG to hardship situations with supplementation from s 6.2 of the UPICC.[83] It has been suggested, validly I think, that there is some inconsistency in concluding that economic hardship falls within art 79 but that there is still a gap in the CISG to be filled with the UPICC.[84] The key difference between *force majeure* (under art 79 CISG or art 7.1.7 UPICC) and hardship (s 6.2 UPICC) is the remedial consequences of their invocation.[85] The primary remedy for a party claiming *force majeure* is an exemption from a potential liability to pay damages, whereas hardship aims to keep the contract alive.[86] The choice to invoke either hardship or *force majeure* resides with the affected party, depending on whether it wants to keep the contract alive (hardship) or be released from the contract temporarily or permanently (*force majeure*).[87]

Force majeure refers to an impediment (supervening event) that renders performance of the contract by a party (the obligor) impossible or impedes a party from performing one or more of its contractual obligations temporarily or permanently.[88] Under hardship, performance remains possible but the occurrence "fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished".[89] However, the principle of *pacta sunt servanda* aims to preserve the bindingness of the contract and takes precedence.[90] Accordingly, "[w]here the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations".[91] Only in exceptional circumstances where an obligor proves that performance of its contractual obligations "has become excessively onerous" will an exemption for *force majeure* or hardship be appropriate.[92]

80 Tuğçe Oral "Exemption from liability according to the art 79 of the Convention on International Sale of Goods (CISG)" (2019) 9 *Tribuna Juridică* 644 at 649.
81 *Scafom*, above n 77.
82 *D21 v Gabo*, above n 77.
83 As provided by CISG, art 7(2).
84 Stefan Vogenauer (ed) *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC)* (2nd ed, Oxford University Press, Oxford, 2015) at 810, [5].
85 At 810, [7].
86 CISG, art 79(5); UNIDROIT Principles 2016, arts 6.2.3, 7.1.7.
87 Vogenauer, above n 84 at 810, [7].
88 See CISG, art 79(1); UNIDROIT Principles 2016, art 7.1.7; and ICC *Force Majeure* Clause, March 2020.
89 See UNIDROIT Principles 2016, art 6.2.2; and ICC Hardship Clause, March 2020.
90 Sanctity of contract (agreements must be kept).
91 UNIDROIT Principles 2016, art 6.2.1; and see Brunner, above n 75, at 117.
92 At 117; and ICC Hardship Clause, cl 2.

1. Impediment beyond obligor's control

In order to trigger the *force majeure* and hardship exemptions, the starting point is to undertake an analysis of the allocation of risks by interpreting the contract.[93] This is to determine whether the risk of the occurrence of the event was something within the buyer's or seller's sphere of control.[94]

In this analysis of risk attribution, an examination of the parties' intention is necessary according to art 8 CISG,[95] and the *contra proferentem* rule may be applied. This is ultimately derived from the basic principle of party autonomy because the specific terms of the contract take priority over any CISG provisions or case law unless a provision is mandatory.[96] The obligor is expected to take all precautions to perform all the obligations foreseen in the contract for all the circumstances in its sphere of control.[97] The CISG rules on allocation of risk apply if there is no express or implied agreement.[98] The court or arbitral tribunal should pay attention to any usages or practices which the parties have established between themselves, together with any international trade usages common in the particular trade concerned.[99] The ICC clause provides a list of events that are presumed to amount to *force majeure*, absent evidence to the contrary.[100] They include natural disasters, war, sanctions, explosions, general strikes, embargoes, acts of authority, pandemics and these will suffice under art 79 CISG.[101] The obligor is typically responsible for its financial capacity, personal circumstances, procurement risk, utility risk and employees' behaviour except certain general strikes.[102]

2. Unforeseeability of the impediment

An aggrieved party who made no reservations about an impediment which a reasonable person of the same kind, under similar circumstances, should have foreseen when the contract was concluded is taken to have assumed the

93 At [2]; Brunner, above n 75, at 118; Huber and Mullis, above n 15, at 259; and Ingeborg Schwenzer "Force majeure and hardship in international sales contracts" (2008) 39 VUWLR 709 at 715, n 34.
94 United Nations Commission on International Trade Law "Article 79" in *UNCITRAL Digest of Case Law on the United Nations Convention on the International Sale of Goods* (United Nations Publications, Vienna, 2016) at [6]; and Huber and Mullis, above n 15, at 259.
95 Brunner, above n 75, at 118.
96 CISG, art 6; and Brunner, above n 75, at 118.
97 Oral, above n 80, at 646–647, n 16.
98 Huber and Mullis, above n 15, at 259.
99 CISG, art 9; CISG Advisory Council (AC) Opinion No 20 *Hardship under the CISG* (Rapporteur: Professor Edgardo Muñoz) 2–5 February 2020 at [4.4]; and Huber and Mullis, above n 15, at 259, n 929.
100 ICC *Force Majeure* Clause.
101 ICC *Force Majeure* Clause, long form, cl 3, short form, cl 2.
102 Schwenzer "Article 79", above n 54, at [12]; and Brunner, above n 75, at 169.

risk.[103] This includes events outside the obligor's sphere of control.[104] It is almost unanimously accepted that a *force majeure* exemption may be available under art 79 for an impediment that existed at the time of the conclusion of the contract if this impediment was unknown to the obligor,[105] provided it was unrecognisable to a reasonable person in the same circumstances.[106] Despite some dissenting voices, and the wording of art 6.2.1 UPICC suggesting otherwise,[107] the prevailing view seems to be that hardship also encompasses initial circumstances rendering performance excessively onerous.[108]

3. Unavoidability of the impediment

An affected party who could not foresee an impediment at the conclusion of the contract is still expected to do all in its power to avoid or overcome the impediment or its consequences if it is reasonable to do so.[109] The question of how much effort the obligor must make to overcome the impediment requires a consideration of both the contractual and statutory allocation of risks.[110] In this regard, the disadvantaged party must make maximum effort to perform the contract as agreed,[111] including incurring greatly increased costs and even a loss as long as it is short of a significant loss.[112] This means possibly offering a commercially reasonable substitute or acquiring goods at a higher price.[113] A seller proposing to deliver substitute goods must give notice as required by art 79(4).[114] The obligee can only avoid the contract if the subsequent performance results in a fundamental breach.[115] An obligor is only exempted from liability where extraordinary expense and effort would be required in order to overcome the impediment, that is, when the ultimate limit of sacrifice has been exceeded.[116]

103 At [14], n 40.
104 At [14].
105 At [13]; Muñoz CISG-AC Opinion No 20, above n 99, at [6.1]; Honnold, above n 75 at [432.3]; Brunner, above n 75, at 112, 228; and *Secretariat Commentary*, above n 29, art 65, at [4].
106 Huber and Mullis, above n 15, at 262.
107 Muñoz CISG-AC Opinion No 20, above n 99, at [6.2].
108 At [6.4], n 76; and see also UNIDROIT Principles 2016, art 6.2.2(a).
109 *Secretariat Commentary*, above n 29, art 65, at [7]; Schwenzer "Article 79", above n 54, at [15]; and Schwenzer "Force majeure and hardship in international sales contracts", above n 93, at 719.
110 Huber and Mullis, above n 15, at 262.
111 *Pact sunt servanda*.
112 Schwenzer "Article 79", above n 54, at [15].
113 At [15].
114 Tallon, above n 75, at [2.8].
115 CISG, arts 25, 49, 64.
116 Schwenzer "Article 79", above n 54, at [15]; and Huber and Mullis, above n 15, at 262.

4. Causal link

The unforeseeable and insurmountable event must be the sole cause of the failure to perform.[117] If a party fails to perform for another reason, exclusively or in combination with the invoked event, it remains liable.[118] For example, an unforeseeable and unavoidable natural disaster damages goods with defective packaging.[119]

IV. Applying Article 79 to Third-Party IPR Claims: Two-Stage Enquiry

A party who plans to seek an exemption from liability under art 79 arising from the existence of a third-party IPR claim on the goods faces an uphill struggle,[120] but it is at least theoretically possible to succeed if such a claim is asserted after the contract has been concluded.[121] To narrow down the issue of central interest to this paper, in this section I explore (i) whether a party which has received or is likely to receive an unfavourable result from art 42 on its own is able to resort to art 79 in the circumstances of the case; and (ii) if there is a realistic possibility of a different or more favourable outcome for such an aggrieved party under art 79. The primary difficulty originates from the fact that art 42 takes priority in such cases.

Under art 42, the losing party in a dispute is held liable because it "knew or could not have been unaware" of the existence of a third-party IPR claim at the time of contracting.[122] Or alternatively, because the IPR claim was within its sphere of risk.[123] It appears there is very little or no room for the application of art 79. However, there are issues with the wording of art 42 which, coupled with the complexities surrounding IPRs (discussed in detail in Section III above), leave the door open for an aggrieved party to seek recourse under art 79. For example, the effect of the parallel obligations on both the seller (art 42(1)) and the buyer (art 42(2)(a)) to be aware of third-party IPR claims means that a losing party might be able to successfully place the claim in the other party's sphere of control.

117 Schwenzer "Article 79", above n 54, at [16].
118 Tallon, above n 75, at [2.6.6]; and Schwenzer "Article 79", above n 54, at [16].
119 Schwenzer "Article 79", above n 54, at [16].
120 At [1].
121 Schwenzer "Article 42", above n 54, at [6].
122 Articles 42(1), 42(2)(a).
123 *Blank CDs case*, above n 50, at [44]; *LED Illuminator Case*, above n 62; and CISG, art 42(2)(b).

A. Two-stage enquiry

The case law has established that a buyer will face a difficult task to demonstrate that it was unaware of a third-party claim based on an IPR registered or created in the jurisdiction in which it is located or the jurisdiction in which it intends to resell the goods.[124] Despite the case law adopting the position that third-party IPR claims are within the sphere of risk of the seller,[125] it remains unclear from the judicial decisions in what situations the seller should have known about them. Since art 42 takes precedence in a dispute about a third-party IPR claim, one has to first determine which party should have been aware of the claim at the time the contract was finalised before invoking art 79. Therefore, I conduct a two-stage process to resolving third-party IPR disputes under art 79 CISG (see Figure 1 below).

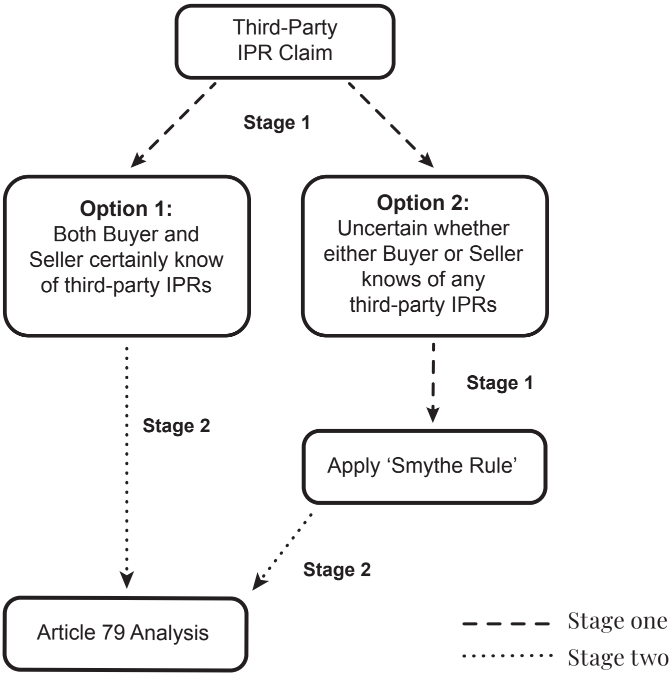

Figure 1. The two stages of analysis carried out in this study to determine liability in cases involving third-party IPR claims.

124 See Section III above.
125 *Blank CDs case*, above n 50, at [44]; and *LED Illuminator Case*, above n 62.

The first stage separates cases where the parties clearly knew that a third-party IPR claim was attached to the goods from precarious ones. The clear-cut cases immediately go to stage two. The uncertain cases are resolved according to a rule suggested by Professor David Smythe for determining which party should be held responsible for the "knowledge component" of art 42, and then proceed to the stage two.[126] Smythe argues that there is an analogy between the question of whether goods are defective because they fail to conform to the laws or regulations in the buyer's jurisdiction and whether there is legal defect in title resulting from a third-party IPR claim under the laws of the buyer's State (or the State in which the buyer plans to resell the goods).[127]

In the *New Zealand mussels case*, the German Supreme Court held that it is not important under arts 35 (2)(a) and (b) that the seller supply goods which conform to all statutory or public law requirements of the buyer's State, except in three limited circumstances.[128] Smythe adjusted the general rule stated by the German Supreme Court to formulate an analogous rule (the Smythe Rule) that applies to third-party IPR claims in similar limited circumstances.[129] He suggested that the seller should only be held liable to have known of third-party IPR claims where: (1) the buyer resells the goods in the seller's country; (2) the buyer informs the seller of their existence before the contract is made; and (3) the seller knows or should know due to "special circumstances".[130] Many special circumstances could suffice, for example: (i) the seller has a branch in the country under which the third party's IPRs are registered;[131] (ii) the seller regularly exports in the buyer's country; (iii) the seller advertises its own goods in the buyer's country; and (iii) the parties have done business for a long time.[132]

B. Applying Article 79 to Cases

In this subsection, I introduce a hypothetical fact scenario in which a seller (S), based in country X supplies goods to a buyer (B), whose place of business is country Y. The goods are to be resold either in country Y, or a third country, Z. The scenario is split into four categories depending on which party receives a third-party IPR claim in respect of the goods after the contract is concluded (see Table 1 below). In

126 Smythe, above n 25.

127 Smythe, above n 25, at 535, 538. Also see Bruno Zeller "Intellectual Property Rights & the CISG Article 42" (2011) 15.2 Vindobona J Intl Com L & Arb 289 at 295–296.

128 *New Zealand mussels case* 8 March 1995 No 159 Bundesgerichtshof (German Supreme Court) CISG-online Case No 144.

129 Smythe, above n 25, at 538–539.

130 At 538–539; and also see *New Zealand mussels case*, above n 128.

131 Smythe, above n 25, at 538–539, n 153.

132 See *New Zealand mussels case*, above n 128.

category 0 neither party receives a claim, category 1 (buyer only), category 2 (seller only), and category 3 (both parties). Most cases fit into either category 0 or 1.

Seller Buyer	No IPR Claim	IPR Claim
No IPR Claim	Category 0	Category 1
IPR Claim	Category 2	Category 3

Table 1: Hypothetical scenarios where parties to a contract receive an IPR claim from a third party.

I then analyse selected cases from case law fitting into categories 1 and 2. Categories 0 and 3 will be discussed simultaneously in general terms. The aim of this enquiry is to determine whether the third-party IPR claim in each case can realistically be categorised as a supervening event sufficient to excuse the affected party from liability under art 79 of the CISG.

1. Case 1: *Eximin v Itel*

The facts of this case are described in section IIIC2 above (category 1 case).[133] In a widely criticised decision, the Israeli Supreme Court apportioned the liabilities between the buyer and seller. One of the criticisms of this decision is that the seller should not have been held liable since the buyer also knew of the third-party trade mark. For that reason, I examine whether the seller might be eligible to seek an exemption from liability to compensate the buyer for losses incurred under art 79.

(a) Stage one

The Court correctly observed that both parties must have known about Levi's famous "V" trade mark,[134] so this case falls under option 1 of the first stage (see Figure 1).

(b) Stage two

The first question is whether the seller breached any of its contractual obligations under the ULIS (I will address the CISG requirements here). The Court was of the opinion that there was a breach by the seller under the CISG based on its splitting of liabilities, and I respectfully disagree. In reaching that decision, the Court held that both parties breached Israel's general contract law good faith obligation. It was not necessary for the Court to apply domestic law on a third-party IPR dispute, as it is

133 *Eximin v Itel*, above n 56.
134 *Eximin v Itel*, above n 56.

expressly covered by art 42 CISG (there is no internal gap).[135] One might argue that the goods had a legal title defect and did not conform to the contract.[136] The difficulty for the buyer in making such a claim is that it selected the infringing "V" sign and requested changes in the designs because of customs problems.[137] Despite questions about whether a seller that has delivered non-conforming goods is eligible to claim an exemption under art 79,[138] at least one decision has granted an exemption because there was no evidence of bad faith by the seller.[139]

The second question is whether the seller faced an impediment to the performance of the contract. It is unclear from case law whether the impediment requirement must be explicitly met before the elements characterising it are assessed.[140] While some decisions have discussed the presence or absence of an impediment within the meaning of art 79(1),[141] others have disposed of cases without clarifying whether the impediment requirement had been satisfied or not.[142] Given that there is a plethora of circumstances that have been held,[143] or assumed (from a successful exemption),[144] to constitute an impediment, it is possible that difficulties arising from a third-party IPR claim could satisfy the impediment requirement of art 79.

However, one decision used language suggesting that a party seeking an exemption under art 79 because of financial difficulties is likely to struggle to prove an impediment.[145] According to this decision, an impediment must be "an unmanageable risk or a totally exceptional event, such as force majeure, economic impossibility or excessive onerousness".[146] There are other similar decisions suggesting that factors such as market fluctuations and a change of economic conditions were not impediments within the meaning of art 79(1).[147] However, market fluctuations were first characterised as an economic impediment capable of

135 CISG, art 7(2).
136 See Beline, above n 72, at 22 for a carefully reasoned argument; and CISG, art 35.
137 *Eximin v Itel*, above n 56.
138 *UNCITRAL Digest* "Article 79", above n 94, at [8].
139 *Christian Flippe v Sarl Douet Sport Collections* 19 January 1998 Tribunal de Commerce de Besançon (Commercial Court of Besançon) Unilex.
140 *UNCITRAL Digest* "Article 79", above n 94, at [10]–[13].
141 At [10], [12].
142 At [11], [13].
143 At [10].
144 At [11].
145 *Chinese goods case* 21 March 1996 Schiedsgericht der Handelskammer Hamburg (Court of Arbitration of the Hamburg Chamber of Commerce) CISG-online Case No 187.
146 At [12].
147 *UNCITRAL Digest* "Article 79", above n 94, at [11].

triggering hardship under art 79 by the Belgian Supreme Court in *Scafom* (2009),[148] and the French Supreme Court followed suit in *D21*(2015).[149]

If an impediment is found to exist, the next issue is determining whether it was within the sphere of control of the seller. It is logical to determine the sphere of risk from the provisions of art 42. Third-party IPR claims typically fall into the sphere of risk of the seller,[150] but in this case the buyer's own knowledge would nullify the seller's knowledge as the Court correctly ruled.[151] The buyer probably also implicitly assumed the risk of violating Levi's trade mark: the buyer selected the sign,[152] consulted its customer in the United States and made some changes to the designs.[153] Therefore, one might argue that the impediment lies within the buyer's sphere of risk. On the other hand, it would be difficult for the seller to argue that it could not foresee that a claim would result from a company that, according to the Court, "any sensible person ought to have assumed … would register a trade mark for its products".[154] The Court correctly observed that both parties "foresaw the damage but did not trouble to clarify the risk of its happening to the other party".[155] Even if the seller claimed that it assumed that the buyer or the buyer's customer had sought permission from Levi's to import the boots as allowed under United States law,[156] the seller could have avoided this impediment by enquiring with the buyer. The seller is unlikely to succeed under art 79.

2. Case 2: *LED Illuminator Case*

The facts of this case are described in section IIIC2 above (category 1 case).[157] The Court dismissed the buyer's claim for damages. My question is whether the buyer can qualify for an exemption from liability under art 79.

(a) Stage one

It can be assumed that, prima facie, neither party could have been aware of the third party's patent when the contract was formed. The subject patent was only registered after each of the three sales contracts had been concluded.[158] Therefore,

148 *Scafom*, above n 77; Also see Dai Tian "A Case Analysis of *Scafom International BV v Lorraine Tubes SAS*: the Application of Article 79 of the United Nations Convention on International Sale of Goods" (2016) 1 Perth ILJ 131.
149 *D21 v Gabo*, above n 77.
150 CISG, art 42(1); Also see *Blank CDs case*, above n 50, at [44]; and *LED Illuminator Case*, above n 62.
151 CISG, art 42(2)(a).
152 CISG, art 42(2)(b).
153 CISG, art 8: A party's statements and conduct are relevant in determining its subjective intent or that of a reasonable person of the same kind.
154 *Eximin v Itel*, above n 56.
155 *Eximin v Itel*, above n 56.
156 *Eximin v Itel*, above n 56.
157 *LED Illuminator Case*, above n 62.
158 *LED Illuminator Case*, above n 62.

the case goes through option 2 in stage one (see Figure 1). Applying the "Smythe Rule",[159] absent any special circumstances, the buyer is held liable to have been aware of the third-party patent registered in the United States. The goods were to be resold in the United States,[160] the buyer's place of business was in the United States,[161] and the claim was made under American law.[162] There is nothing in the case facts to suggest that the buyer cautioned the seller of a pending third-party patent application.[163] Nor are there any other special circumstances which, under the "Smythe Rule", would indicate that the seller but not the buyer knew or should have known about the third-party's patent.[164] As in all the other cases discussed in section IIIC2 above, the findings of the Court are consistent with the "Smythe Rule".

(b) Stage two

Although it is unclear if the buyer failed to perform any of its obligations, it is possible the buyer may have, for example, refused to pay the purchase price or take delivery of the goods prior to commencing legal proceedings.[165] It would be difficult to convince a court that a third-party IPR claim is an impediment within the meaning of art 79,[166] but this is an exceptional case because the third-party patent was not registered at the time of contracting.[167] The Court's ruling, in its interpretation of art 42(1), that a third-party IPR claim "falls within the seller's sphere of risk" is consistent with other case law.[168] Nonetheless, if there has been no publication of the IPRs, the seller is not liable to the buyer.[169]

It can be argued that the buyer ought to have reasonably expected that the LED illuminators, or any part thereof, could be subject to another party's patent rights. Developers of electrical equipment, especially those incorporating emerging technologies, usually patent their inventions,[170] or obtain some form of proprietary rights such as integrated circuits layout design rights,[171] copyright protection,[172] or design registrations.[173] Layout designs and copyright are unregistered rights in New Zealand, so protection is automatic. The buyer, however, neither provided

159 Smythe, above n 25, at 538–539.
160 CISG, art 42(1)(a).
161 Article 42(1)(b).
162 Smythe, above n 25, at 538–539.
163 At 538–539.
164 At 538–539.
165 CISG, art 53.
166 See case 1 discussion in Section VB1 above.
167 See Schwenzer "Article 42", above n 54, at [6].
168 *Blank CDs case*, above n 50, at [41].
169 *Secretariat Commentary*, above n 29, art 40, at [6].
170 In New Zealand, patentable inventions are granted under the Patents Act 2013.
171 In New Zealand, original semiconductor integrated circuits layout designs are protected under the Layout Designs Act 1994.
172 In New Zealand, original works are protected under the Copyright Act 1994.
173 In New Zealand, qualifying novel works are registered under the Designs Act 1953.

any specifications to the seller,[174] nor can it be inferred from the facts if the patent application was in process when the contract was formed. If so, a search of the United States IP register would have revealed such information. In New Zealand, a patent specification is published on the Intellectual Property Office of New Zealand (IPONZ) website 18 months after the earliest claimed priority date of a patent application.[175] One might argue that the buyer was incorrectly assumed to have taken the risk of a third IPR claim because the wording of art 42 is faulty, and the risk falls back to the seller. The *Secretariat Commentary* holds the seller liable for a third-party claim based on a published patent application or grant.[176] It is also plausible, though unlikely, that the patent application was not published at the time of contracting and the buyer could not have been aware of it. The buyer will, of course, struggle to demonstrate that the third party's patent was unforeseeable, considering that such goods are frequently patented or subject to some type of proprietary right.

Exemption cannot be granted if it is still possible and reasonable to avoid the impediment or overcome its consequences,[177] that is, if the ultimate limit of sacrifice cannot be exceeded.[178] Exemption is only granted if performance requires extraordinary expense and effort.[179] The threshold is extraordinarily high, but there is no fixed value. The first edition of the UPICC (1994), in comments to art 6.2.2, suggested that a fluctuation of 50 per cent or greater would likely constitute a fundamental alteration,[180] but the 2004, 2010 and 2016 editions are silent on the issue.[181] Brunner suggested that a threshold of 100 per cent or greater should suffice,[182] but courts have refused to grant exemptions even in cases of price fluctuations exceeding 100 per cent.[183] In sectors such as commodities trading with highly speculative traits, even a 300 per cent increase in market price may not qualify for exemption.[184]

It seems reasonable for the buyer to contest the validity of the patent, negotiate a license or market allocation with the third party, or even resell the goods in a different jurisdiction where the goods are not subject to patent rights. The willingness of the third-party patent owner to negotiate, or lack thereof, will help the buyer decide

174 CISG, art 42(2)(a).
175 Intellectual Property Office of NZ "Examination process" <https://www.iponz.govt.nz>.
176 *Secretariat Commentary*, above n 29, art 65, at [6].
177 CISG, art 79(1).
178 Muñoz CISG-AC Opinion No 20, above n 99, at [4.8]; and Schwenzer "Article 79", above n 54, at [15].
179 Huber and Mullis, above n 15, at 262.
180 UNIDROIT Principles 2016, art 6.2.2, comment 2.
181 Muñoz CISG-AC Opinion No 20, above n 99, at [7.1]; and Schwenzer "Force majeure and hardship in international sales contracts", above n 93, at 716.
182 Brunner, above n 75, at 428–441.
183 Schwenzer "Article 79", above n 54, at [31], n 106.
184 *Iron molybdenum case* 28 February 1997 Oberlandesgericht Hamburg (Court of Appeal Hamburg) CISG-online Case No 261.

whether to opt for *force majeure* or hardship. For example, if the third party insists that the buyer cease and desist, *force majeure* could be the preferred option. But if the third party is willing to issue a license, and the ultimate limit of sacrifice is surpassed, the buyer is best advised to seek protection under hardship with a view to renegotiating new contract terms with the seller.[185] In my view, the probability that the buyer will succeed under hardship is very low and it is unlikely to succeed under force majeure.

3. Case 3: hypothetical case

The last case I analyse is a hypothetical example of a third-party infringement claim served on a seller (category 2) based on IPRs registered in a third State (T) where the goods are neither resold nor used.[186]

In a dispute not governed by the CISG, an Indian seller entered into a contract to supply generic pharmaceuticals to a Brazilian buyer.[187] While in transit, the goods were seized in the Netherlands in December 2008 for breaching a Dutch patent. Upon establishing that the goods were not meant for the European market, the goods were sent back to India after 36 days. The medicines did not infringe on any patent in Brazil or India. The dispute was resolved amicably before reaching the World Trade Organization (WTO) Dispute Settlement Body. From the buyer's perspective, the seller breached the contract due to non-delivery,[188] or delayed delivery of the goods.[189] It is not clear if the goods were eventually belatedly delivered to the buyer. The relevant question is whether the seller can invoke an art 79 defence and seek an exemption from liability to pay damages.

(a) Stage one

This is a complicated case that exposes the deficiencies of art 42. The third-party patent rights derive from a State (the Netherlands) that does not appear to be contemplated by either art 42(1)(a) ("where the goods will be resold or otherwise used": Brazil) or art 42(1)(b) ("where the buyer has his place of business": Brazil). A key issue is whether the seller "knew or could not have been unaware of the existence" of the third-party patent in the Netherlands.[190] In stage-one of my analysis, it is uncertain if either the buyer or the seller knew of the third party's patent. So, this is an option 2 case, and the "Smythe Rule" applies. Applying the "Smythe Rule" exonerates the seller, unless there were special circumstances not mentioned in the

185 See Vogenauer, above n 87, at 810, [7].
186 *European Union and a Member State: Seizure of Generic Drugs in Transit* WT/DS408/1, 19 May 2010 (Request for Consultations by India).
187 *Seizure of Generic Drugs in Transit*, above n 186.
188 Zeller, above n 127, at 290; and CISG, art 30.
189 CISG, art 30.
190 Zeller, above n 127, at 293.

case facts.[191] This is consistent with a strict reading of art 42, which only requires the seller to deliver goods that are free from third-party IPR claims in Brazil. In the *Blank CDs case*, the Austrian Supreme Court held that "[t]he seller merely has to guarantee a corresponding conformity in certain countries, but not on a worldwide level".[192] The seller fulfilled that criterion as there was no patent infringement in Brazil.

(b) Stage two

An important question for art 79 is: in which party's sphere of risk was the Netherlands patent? One might argue that this is an unfounded claim as the goods were not intended for use or resale in the Netherlands or the European Union. Regardless, it has been held that unfounded third-party IPR claims fall within the seller's sphere of risk,[193] and it is the duty of the seller to defeat such claims.[194] Conversely, it appears that the drafters intended that if the seller was unaware of any third-party IPRs then the buyer must bear the loss.[195] The issue of risk is finely balanced, and it could tip either way depending on how a court or arbitral tribunal will interpret the contract terms as a whole, giving due regard to arts 7, 8 and 9.

Determining whether it was foreseeable and avoidable that the goods would be confiscated by the Netherlands authorities will depend on which party made the decision to transit the goods through the Netherlands and why. If the seller envisaged transit through the Netherlands, was aware of their standard of protection and procedure of seizures, then it can be inferred that the risk of seizures had to be known to the seller.[196] On the other hand, it is arguable that the seizures were unwarranted since the generic medicines were legitimately made in India and did not breach any patent in the intended destination country. Significantly, the European Union (EU) revised its Customs Regulations in 2013, indicating that the seizures would be halted except in cases where there is adequate evidence to suggest a substantial likelihood of diversion of such medicines to the EU market.[197] The European Court of Justice (ECJ) held that such seizures contradict EU law unless the goods were intended for the European market,[198] and consequently the State of transit qualifies as the State of use within the meaning of art 42(1)(a). But Belgian

191 Smythe, above n 25, at 538–539.
192 *Blank CDs case*, above n 50, at [41].
193 At [44]; and *LED Illuminator Case*, above n 62.
194 Schwenzer "Article 42", above n 54, at [11].
195 Zeller, above n 127, at 291.
196 Schwenzer "Article 42", above n 54, at [14].
197 *Seizure of Generic Drugs in Transit*, above n 187.
198 Schwenzer "Article 42", above n 54, at [14]; Marrakesh Agreement Establishing the World Trade Organization 1867 UNTS 3 (opened for signature 15 April 1994, entered into force 1 January 1995), annex 1C (Agreement on Trade-Related Aspects of Intellectual Property Rights) [TRIPS Agreement], art 51.

and Dutch courts have ruled that such seizures are allowed, even in cases where they are only standards of protection in the State of transit.[199] I think that this case encompasses the exceptional circumstances only available in the rarest of cases contemplated by Schwenzer, where the seller is unaware of an unfounded claim that is based on an existing IPR.[200] Although this appears to be the strongest case for exemption under art 79 of the ones discussed in this paper, I think the probability of success is low because it would be difficult for the seller to prove that the risk of confiscation was unforeseeable.

4. Categories 0 and 3

For completeness, I will briefly address categories 0 and 3 simultaneously. The subject matter falling under the definition of industrial or intellectual property is broad.[201] The threat of IPR infringement claims being asserted on both buyers and sellers by third parties is always looming. Consequently, there is often a fine line in moving from category 0 (no claim on either party) through categories 1 and 2 to category 3 (both parties receive infringement claims). Commercial interests always prevail and businesses frequently only assert their rights on rivals. The territorial nature of IPRs mean infringement claims mostly arise from the jurisdiction they are registered or were created in. Businesses show little or no interest in asserting their IPRs in foreign jurisdictions for strategic commercial reasons. The fact that no claim has been made does not mean there are no existing third-party IPRs. A claim may arise at any time during performance of the contract. Claims on both parties (category 3) are likely to arise from a third party which has existing IPRs in both the seller's jurisdiction and the buyer's jurisdiction (or the place where the goods are resold or used). The same principles discussed above will apply in stages one and two of my analysis.

It is likely that both parties will face difficulties in this situation, so it might be in their best interests to agree to terminate the contract or to renegotiate terms if licenses or some other arrangements are available from the IPR owners. In any case, the seller will not be allowed to manufacture or export the goods without the permission of the IPR owner, thereby breaching its obligation to deliver the goods.[202] Likewise, the buyer is precluded from importing the goods without permission.[203] Another category 3 situation arises when third-party IPR claims from the seller's jurisdiction are recognised in the buyer's jurisdiction (or the place where the goods

199 Schwenzer "Article 42", above n 54, at [14], n 48.
200 At [6].
201 WIPO Convention, art 2(viii).
202 CISG, art 30.
203 See *Eximin v Itel*, above n 56.

will be resold or used) based on conflict of laws rules, or on treaties providing for the international recognition of IPRs such as the European Patent Convention (art 64(1)).[204] Such a claim is known and foreseeable by the seller, but the buyer can possibly deny such knowledge. This scenario would qualify as a special circumstance under the "Smythe Rule", where the seller ought to know of the third-party claim.[205]

Taking everything into account, I summarise that, while a losing party in a third-party IPR dispute can theoretically pursue a cause of action under art 79 in the rarest of cases, such as when the seller is unaware of an unfounded claim that is based on an existing IPR, or if goods are confiscated under the IP laws of a transit country, its likelihood of success is low. Subsequently, I argue that the seller should only warrant against third-party IPR claims in its jurisdiction, whilst the buyer should be responsible for IPR claims in its own jurisdiction and the State where the goods are resold, except when the goods are resold in the seller's jurisdiction.

V. Conclusions

The interpretative questions posed by art 42 CISG create unique problems for the courts and uncertainty for parties to an international commercial sales contract about who should bear the liabilities for a third-party IPR claim not found in domestic sales contract law. The case law and the legislative history of the CISG, aided by scholarly commentary, have provided some guidelines but loopholes still exist. A rule suggested by Smythe seems to produce results that are consistent with case law, but it is still inadequate because the exact scope of "special circumstances" is unclear, thus it does not produce any certainty for the parties. In principle, an aggrieved party is able to rely on art 79 for an exemption from liability in a dispute about a third-party IPR claim where art 42 produces an unsatisfactory result. It would benefit the parties if art 79 could achieve an equitable and fair resolution to a dispute by exempting the aggrieved party from liability. It is important to note that this is a very narrow exemption from the principle of strict liability underlying the CISG which, though necessary, only very rarely succeeds, more so in third-party IPR disputes. Only under extraordinarily exceptional circumstances will a third-party IPR claim possibly qualify as a supervening event sufficient to excuse an affected party from liability under art 79. For example, when: (i) a patent application is published and subsequently granted after a contract is concluded; or (ii) when goods are confiscated under the IP laws of a transit country. However, the party claiming exemption must also prove that the event was outside its sphere of control,

204 Honnold, above n 72 at 392; and Schwenzer "Article 42", above n 54, at [13].
205 Smythe, above n 25, at 538–539.

unforeseeable, unavoidable and causal to the breach. This is a very high threshold which is unlikely to be realistically met even in the rarest of cases, meaning art 79 is not the answer to art 42's woes. Therefore, I suggest that, under the CISG, each party should be held liable for third-party IPR claims in its own jurisdiction, and the buyer should also be liable for claims in the State where the goods are resold, unless the goods are resold in the seller's jurisdiction. In any other case, liability should fall on the party which assumes the risk of loss or damage during transportation.