Case Note
Fryer Holdings v Liaoning MEC Group [2012] NSWSC 18

Bruno Zeller[1]

Two issues occupy arbitration, namely the procedural aspects which includes court interference with the arbitral process and the substantive issues. However the real question in the end is whether the outcome that is the substantive part has been applied correctly in order to instil confidence in the arbitral process.

A substantive issue which has not been dealt with well in Australia by courts is the application of the United Nations Convention on Contracts for the International Sale of Goods (CISG). The problem is the application of conventions and model laws which incorporate their own interpretative articles. A discussion of the application of substantive rules where there is a lack of understanding is of value as it shows where the courts 'got it wrong' in order for arbitral tribunals 'to get it right'.

This discussion is timely as in the recent matter between *TCL Air Conditioner (Zhongshan) Co Ltd v The Judges of the Federal Court of Australia* (*TCL*)[2] the High Court ruled that an error of law appearing on the face of an award does not give rise to an appeal. Despite the fact that Article 35 and Article 28 of the Model Law do not require an arbitral award to be correct in law,[3] it is nevertheless important that parties to arbitration have confidence in the tribunals ability to apply the law correctly.

Fryer Holdings v Liaoning MEC Group[2] (Fryer) on the face of it is not remarkable at all. However, what makes it worthwhile to take note of is the fact that, despite its simple legal issues, the problem of a wrong interpretation of international conventions has been perpetuated. The issues were whether the goods conformed to the contract and how much damages can be awarded. The court correctly noted that the CISG applies. The discussion then turned to article 35(2) CISG and the court noted appropriately that the goods must be fit for the purpose and also fit for a particular purpose expressly or impliedly made known to the seller.[5]

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2 [2013] HCA 5 (13 March 2013)

3 Ibid para 5

4 [2012] NSWSC 18

5 Fryer Holdings paara 16.

The court however went on to state:

> *Were the goods fit for purpose? The test which has been applied in this country is that fitness for purpose equates to being of merchantable quality. See, for example,* Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd *[2010] FCA 1028 at [123]. It seems to me that I should follow that test, particularly since it has been applied in other common law jurisdictions.*[6]

The point to make is that Article 35 CISG indeed notes that goods must be fit for a particular purpose, but there is nothing in the article suggesting that fitness of purpose equates to merchantable quality. This term is purely of domestic origin and does not reflect the approach the CISG takes. It is therefore wrong to suggest that:

> *The test of merchantable quality requires that the goods should be in such an actual state that a buyer fully acquainted with both latent and patent defects within them, and not limited to their apparent condition, would buy them without abatement of the price that would be paid if they were in fact in reasonably sound order and condition. See Dixon J in* Australian Knitting Mills Ltd v Grant *[1933] HCA 35; (1933) 50 CLR 387 at 418.*[7]

It is not permissible to rely on domestic case law as it is in breach of Article 7 the interpretative article. In a recent New Zealand case dealing with breaches of Article 35 the suggestion that fitness for purpose equates to merchantable quality has not been made. Indeed, except in Australia this statement cannot be found in case law in other jurisdictions.

Furthermore it is equally wrong to suggest as a second point that this test 'has been applied in other common law jurisdictions." [8] As an example the New Zealand court of Appeal noted':

> *Counsel for [Buyers] properly acknowledged that resort to authorities dealing with domestic law is not permissible. This follows from the requirement in art 7, dealing with the interpretation of the Convention, to have regard to 'its international character and to the need to promote uniformity in its application and the observance of good faith in international trade'. Thus the Convention is to be given an autonomous interpretation requiring the Convention to be interpreted exclusively on its own terms and applying Convention-related decisions in overseas jurisdictions.*[9]

The court correctly applied jurisprudence from various countries such as Germany, France and the United States, as suggested by the CISG.

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6 Ibid para 19
7 Fryer at 20
8 Fryer para 19
9 New Zealand 22 July 2011 Court of Appeal of New Zealand (*RJ & AM Smallmon v. Transport Sales Limited and Grant Alan Miller*) [http://cisgw3.law.pace.edu/cases/110722n6.html]

If the court would have consulted the CISG websites the editorial remarks in *Castel Electronics*[10] should have indicated that this case, and others for that matter, should not be relied on.[11] As a matter of fact the editorial comments do not vary much since 2003.[12] The reason is that courts in Australia, instead of following the mandate of Article 7 and consult in international jurisprudence and academic writing, tend to refer to Australian case law, which has been flawed and hence perpetuates the misapplication of the CISG.

It is also of interest that in none of the Australian cases a question as to the compliance with articles 38 and 39 has ever been asked. These are crucial articles as they mandate that a buyer must examine the goods as quickly as possible and notify the seller within a reasonable time (that is, at least within a month) specifying the nature of the lack of conformity. If that is not done the buyer pursuant to Article 39 'loses the right to rely on the lack of conformity of the goods'. One would expect that counsel for the buyer would at least note that his client fulfilled the requirements of Articles 38 and 39 or alternatively the seller would claim that the buyer has not done so.

The court addressed the point of damages and unfortunately did not direct its attention to Article 74 CISG. It should be noted that the heads of damages correspond to the ones listed in Article 74 – namely a sum equal to the loss and loss of profit.

In sum the court again displayed an inability to apply the correct method of statutory interpretation pursuant to Article 7 CISG. Furthermore words with a domestic connotation such as implied warranty[13] are still used despite the fact that the warranties are not a remedy contained within the CISG. A breach of a term either gives rise to a breach that is the contract is still afoot and damages can be claimed. If a party loses the main benefits and wishes to terminate the contract a fundamental breach pursuant to Article 25 CISG needs to be claimed.

It is of interest to compare the High Court's decision in *TCL*, where the court displayed an ability to move away from domestic statutory interpretation where required and adopt the interpretative tools mandated by conventions and model laws. The court noted:

> *… considerations of international origin and international application make imperative that the Model Law be construed without any assumptions that it embodies common law concepts or that it will apply only to arbitral awards or arbitration agreements that are governed by common law principles.*[14]

The court furthermore referred to the UNCITRAL analytical commentary as well as the UNCITRAL Explanatory Note as an aid to the interpretation of Article 28 of the Model Law.[15]

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10 [2010] FCA 1028

11 See editorial remarks by B. Zeller, Australia 28 September 2010 Federal Court of Australia (*Castel Electronics Pty. Ltd. v. Toshiba Singapore Pte. Ltd.*) [http://cisgw3.law.pace.edu/cases/100928a2.html]

12 Australia 24 April 2003 Supreme Court of Victoria (*Playcorp Pty Ltd v Taiyo Kogyo Limited*) (Toys case) [http://cisgw3.law.pace.edu/cases/030424a2.html]

13 See Fryer oara 22.

14 TCL para 8

15 TCL para 13 and 14.

The CISG also has an international origin and contains its own interpretative article, namely Article 7. Simply put, Article 7, as noted by the Multi-Member Court of First Instance of Athens, mandates that:

> *The interpretation of the CISG by national courts, by order of the provision of Article 7(1) of the CISG, must be made 'autonomously', through its uniqueness and originality thereof as a text, i.e., through the system of its provisions and general principles and free of any ethnocentric approaches, 'unique' terms of domestic law, and [free] of methods that usually follow for the interpretation of domestic provisions, since otherwise that may result in the application of institutions and provisions of domestic laws and furthermore, in undesired lack of uniformity in its application.*[16]

The issue, as seen above, is that the High Court appreciated the international origin of the Model Law and refrained from using common law concepts. In contrast, the application of the CISG by courts so far has failed to take the interpretative article, namely Article 7 into consideration. This unfortunately is perpetuated by courts referring to past CISG cases, as seen in Fryer. It is hoped that courts and tribunals will take note of the High Court and start applying the correct statutory interpretation, namely autonomously and free of ethnocentric approaches. Obviously the High Court in *TCL* has ruled that articles 35 and 28 are valid but it is in the interest of arbitration that the outcomes procedurally as well as substantively are correct. As noted above it will instil confidence in the process and foster hopefully an increased desire to arbitrate in Australia.

16 Greece 2009 Decision 4505/2009 of the Multi-Member Court of First Instance of Athens [http://cisgw3.law.pace.edu/cases/094505gr.html]