PSL Advocates & Solicitors

Unpleasant Surprise of Exclusion of Liability for Damages in International Sales Contracts

Introduction

The use of Standard Terms in international sales contracts is quite common and such terms are typically prepared in advance for general and repeated use by one party and often used without negotiation with the counter party. Such terms are often incorporated into the contract by reference to supplement the specifically negotiated terms and differ across various industries and sectors. It has been observed that majority of standard form contracts used globally contain clauses having the effect of restricting, limiting or excluding liability of a defaulting party to pay damages in some form or the other as a measure to allocate contractual risks. While such clauses are usually enforceable across civil and common law jurisdictions with varying degrees and exceptions, interpretation and enforceability of atypical clauses raises certain contentious issues, which is the subject of brief analysis in this note. Due to prevalent application of the *UN Convention on Contracts for the International Sale of Goods, 1980*[1] (CISG) worldwide in international sales, we seek to examine validity of 'surprise terms' which stipulate exclusion or restriction of liability of a defaulting party for damages on the anvil of principles envisaged under CISG.

For signatory nations, the CISG governs contracts for the sale of commercial goods between parties whose places of business are in different countries. The CISG can also be specified by contracting parties as the choice of law to govern substantive rights and obligations in lieu of municipal law. Thus, CISG rules can govern international contracts even if one or both parties are from non-signatory states. When a dispute arises out of a contract for sale of goods between parties from contracting states, the CISG will apply to the dispute unless the parties contractually exclude its application. Several eminent ICC, SIAC and CIETAC arbitral tribunals as well as national courts across various legal systems have relied on CISG jurisprudence to substantively decide international sales disputes with great authority.

What are 'surprising terms'?

In some cases, an exemption or limitation of liability is a necessary condition to the performance of risky ventures. It is often required to make the risk insurable. It may also benefit the other party in the form of a price reduction and facilitate international trade. Such clauses perform a useful function of anticipating future contingencies that may hinder or prevent performance, establish procedures for the making claims and provide for allocation of risks between contractual parties. Where a party has unambiguously communicated to the counter party that it wishes the agreement to be subject to its standard terms, then the standard terms should be applicable, unless such incorporation is clearly disagreed after having a reasonable opportunity to take notice of the contents of the standard terms. Where the Standard Terms of a party have been successfully incorporated into a contract, the counter party is bound by those terms whether it has read them or not or is aware of their contents or not. An important exception to this rule, however, states that, notwithstanding the acceptance of Standard Terms, a party would not be bound by them as their content,

language or presentation is of such character that it could not be reasonably expected by it.[2] Therefore, where the terms are of such a nature that the other party could not reasonably have expected them, such 'surprising terms' should not bind the parties. An example of this maybe a term which completely exonerates a defaulting party from any monetary liability or otherwise.

Approach to Interpretation

As with other terms and conditions of a business contract, limitation and exclusion clauses are generally governed by the fundamental principles of modern contract law, namely: a) the freedom of contract (party autonomy); b) good faith and fair dealing (reasonableness); and c) public policy (which include mandatory national rules). However, where the terms are of such a nature that the other party could not reasonably have expected them, such surprising terms should not form part of the consensus between the parties. This is not a validity issue but a contract formation issue and therefore falls within the scope of the CISG. It is simply not a risk that can be ascribed to the party in such circumstances as the same will be onerous and inequitable. If the party using the standard terms wishes to include such terms, it needs to specifically inform the other party of their existence and inclusion.

Courts and arbitral tribunals generally rely on the interpretation of provisions dealing with the formation and interpretation of contracts under the CISG namely Article 8(2), which embodies the principle of reasonableness to test the validity of such terms. A term contained in Standard Terms may come as a surprise to a party by reason of its content when it is such that a reasonable businessperson would be shocked by inclusion of it. Interpretation of a contract depends upon common intention of parties and preliminary negotiations between parties are the relevant circumstances to be applied to determine such common intention. According to Article 7(1), international character of the CISG, uniformity of application and good faith should be the basis for interpretation of terms under the CISG. This provision encompasses the principle of good faith and fair dealing in international commerce.[3]

Limits to Enforcement

Despite the principle of full compensation embodied in the CISG under Article 74, the extent of damages is regulated by most legal systems and most often self-regulated by contracting parties through allocation of risk and monetary liability. Given the width of the parties' freedom to allocate their risks and liabilities in a manner which modifies the remedies regime established in Article 6 of the CISG, the interpretation of the protection mechanisms set forth in the otherwise applicable law or rules of law must follow the priority of freedom of contract. It is pertinent to note that limitation or exclusion of liability clauses are subject to specific regulation in several legal systems and precedents suggest that courts and tribunals in various jurisdictions have attempted to protect a contracting party by means of judicial or legislative principles designed to make it difficult to exclude liability under certain specific circumstances. Generally, a clause seeking to limit or exclude a defaulting party's liability for breach must not leave the innocent party without any remedies to enforce its contractual rights. A non-exhaustive list of principles evolved across various legal systems and jurisdictions to invalidate exclusion of liability clauses is laid down below:[4]

- When non-performance is the result of fraudulent or willful breach or gross negligence
- When it concerns the very substance of the obligation or a fundamental obligation
- Where it relates to the breach of obligations deriving from mandatory norms
- When it is unreasonable
- When it concerns the liability for death or personal injuries
- When it runs foul to the general principles of domestic legislation concerning “unfair terms” or if such clauses cause “grossly unfair” results
- When it is unconscionable

Thus, it may be seen that invalidation of such restrictive clauses by the competent state court or arbitral tribunal is the most common protection mechanism against abusive limitation of liability clauses and the principles highlighted above generally guide such decisions. However, it must be noted that CISG provides the background against which the validity of an exemption or limitation of liability clause must be assessed for international sales contracts. Thus, the unfairness tainting the validity of a limitation clause must be determined qua fairness in international trade and not with reference to domestic rules of contractual interpretation. The same reasoning applies to a limitation of liability clause concerning the breach of a fundamental or substantial contractual obligation i.e. a fundamental breach must be determined in view of the principles established by the CISG.

To conclude, the interpretation of the validity of protection mechanisms set forth in the otherwise applicable law or rules of law must observe the principles of reasonableness and freedom of contract underlying the CISG while deciding the validity and enforceability of exclusion of liability clauses in international sales contracts. Yet, one may sometimes observe a dichotomy in the approach of national courts and arbitration tribunals across common and civil law jurisdictions, influenced by their distinct legal traditions and judicial principles. However, the dynamism of these approaches nevertheless tacitly underscores the cardinal theme of CISG and its interpretational adventurism to promote uniformity in interpretation and enforcement of international sales contracts.

[1] CISG formulates uniform rules with respect to international commercial transactions and was intended to be a uniform and fair set of rules for contracts for the international sale of goods to prevent parties to an international transaction from having to analyze the various national or international laws to determine the law applicable to the contract. As on date, 89 nation states are signatories to the CISG, notably excluding the United Kingdom, India, Hong Kong and Taiwan as non-signatories

[2] UNIDROIT Principles of International Commercial Contracts 2010 ("UNIDROIT Principles") Article 2.1.20.

[3] CISG-AC Opinion No. 13, R.7

[4] CISG- AC Opinion No. 17, R. 4(a)