

## THE BUYER'S "SAFETY VALVE" UNDER ARTICLE 40: WHAT IS THE SELLER SUPPOSED TO KNOW AND WHEN?

*Alejandro M. Garro*

### INTRODUCTION

If the seller fails to disclose to the buyer facts related to the non-conformity of the goods, Article 40 of the CISG relieves the buyer from the consequences of failing to meet its obligations under Articles 38 (governing the buyer's obligation *to examine* the delivered goods) and 39 (governing the buyer's obligation *to notify* the seller that the goods do not conform to the contract). The seller's loss of remedies under Article 40, however, is contingent upon the buyer being able to establish that the seller knew or could not have been unaware of the facts to which the lack of conformity relates. Thus, Article 40 of the CISG provides buyers with a sort of "safety valve": there is no need to examine the delivered goods or to notify the seller that those goods do not conform to the contract as long as the lack of conformity is known to the seller, or as long as the seller "could not have been unaware" of such lack of conformity.<sup>1</sup>

To the extent that Article 40 has been held to express a fundamental principle of good faith and fair dealing, and that such a principle has been identified as one of those "underlying" the CISG, the rule embodied in Article 40 has been identified as one of the "general principles" of the Vienna Sales Convention referred to in Article 7(2).

Article 40 appears to favor buyers to the extent that they are exempted from giving appropriate or timely notice of the lack of conformity. However, for this exemption to apply, the buyer bears the burden of establishing that the seller was aware or could not have been unaware of the facts relating to the non-conformity. The following comments focus on what level of knowledge the seller is required to have and at which point in time he must be imputed with such knowledge.

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1. Article 43(2) of the CISG provides for a similar rule in regard to the seller's failure to alert the buyer as to defects in the merchantability of title to the goods and the existence of third party rights or claims. But in this case the seller's actual notice of the existence of the claim and its nature suffices for precluding the seller from relying on the buyer's failure to give notice.

## BURDEN OF PROOF UNDER ARTICLE 40

The requirements of Article 40 are met if the seller readily admits that it was aware of the defect. But admissions of this type are rare, and it is the buyer who must prove that the seller was aware of the specific flaws claimed to result in non-conformity or, alternatively, that the seller could not have been unaware of those flaws.

Even if the buyer fails to prove the seller's awareness of non-conformity, the buyer may still be able to prove facts which, though falling short of establishing actual awareness of non-conformity, nevertheless suggest that the seller was aware of facts that relate to the non-conformity. If the buyer succeeds in producing this type of evidence, the burden shifts to the seller, who must then prove that whatever knowledge he or she might have had about the status of the goods, such knowledge did not reach the requisite level of awareness as to preclude the seller from relying on the buyer's duty to examine the goods.

While considering the burden of producing proof of facts relating to the non-conformity, it is appropriate to bear in mind basic standards of common sense. Thus, German judicial doctrine tends to allocate the burden of proof, taking into account which of the parties was in the best position to know what happened (i.e., "proof proximity" considerations). Accordingly, if the buyer is able to establish that the facts suggesting non-conformity were within the domain of knowledge and expertise of the seller, the burden of production shifts to the seller, who is then responsible for providing an explanation and demonstrating a lack of awareness of the non-conformity.<sup>2</sup>

## SELLER'S DUTY TO WARN OR TO DISCLOSE NON-CONFORMITY IN A CLEAR AND STRAIGHTFORWARD MANNER

The relief provided to a buyer under Article 40 does not apply if the seller had disclosed the lack of conformity to the buyer. Yet, does the seller actually bear a duty to disclose and, if so, how far does this duty extend?

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2. See Bundesgerichtshof, Germany, 30 June 2004, available at <http://cisgw3.law.pace.edu/cases/040360gl.html> (CISG-online Case 847), involving the sale of "sweet paprika" by a Spanish exporter, which the German importer found subject to radiation exposure. Finding that it was unreasonable for the buyer but not for the seller to find out the material non-conformity, the Supreme Court of Germany held that the burden of explanation must be placed on the seller and remanded the case for further evidentiary proceedings.

If by the time the contract is concluded the seller had already disclosed the defects to the buyer, then the seller is not liable for non-conformity under Article 35 of the CISG. If, on the other hand, the seller discloses the defects of the goods sold only after the conclusion of the contract, there is lack of conformity and the buyer must either reject the goods or accept them with their defects. In this case, however, where the buyer learns about the lack of conformity from the seller, there is no need for the buyer to give notice of the defects. But if the seller's disclosure is not altogether clear as to what those defects are and how relevant they are, the buyer must give notice of non-conformity upon discovering that the defects are material.

It is not enough for the seller to disclose that something may not be altogether right. The seller's disclosure of the non-conformity, in the sense of Article 40, must be express and straightforward; it is not enough to let the buyer deduce that there is a risk that the goods may not conform to the contract. The seller's compliance with this duty to alert the buyer of relevant or material flaws in the goods to be sold is also subject to its own evidentiary considerations.

Once the buyer is able to prove that the seller was aware or should have been aware of the non-conformity, it pertains to the seller to show that he disclosed such non-conformity to the buyer. And if the seller seeks to rely on his disclosure of non-conformity to the buyer, the seller bears the burden of proving that he did make such disclosure.<sup>3</sup>

#### THE EXCEPTIONAL NATURE OF ARTICLE 40

Because the buyer's duty to examine the goods is so basic and fundamental, there is agreement in court decisions and scholarly doctrine that only in very limited, exceptional, and even "unusual" circumstances should sellers be precluded from relying on the buyer's failure to meet its examination/notice obligations. How "exceptional" should those circumstances be is, of course, a matter of degree.

One of the driving concerns for limiting the application of Article 40 to exceptional cases is to protect sellers by requiring buyers to bring claims of non-conformity within a relatively short period of time.<sup>4</sup> Thus, in several

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3. Landgericht Landshut, Germany, 5 Apr. 1995, available at <http://cisgw3.law.pace.edu/cases/950405g1.html> (CISG-online Case 193).

4. CLOUT Case No. 237 [Arbitration Institute of the Stockholm Chamber of Commerce, 5 June 1998], holding that Article 40 "results in a dramatic weakening of the position of the seller, who loses his absolute defenses based on often relatively short-term time limits for the buyer's examination and notice

cases, courts and arbitral tribunals held that those “exceptional” circumstances were not present and that the requirements to apply Article 40 have not been established.<sup>5</sup> In other cases, those exceptional circumstances were found to exist and sellers were precluded from relying on Article 38 and/or Article 39.<sup>6</sup> In a third category of cases, courts decided that further factual findings were needed in order to ascertain whether the seller was aware or could not have been unaware of the lack of conformity.<sup>7</sup>

#### WHEN SHOULD THE SELLER KNOW ABOUT THE LACK OF CONFORMITY OF THE GOODS?

Article 40 fails to specify the time at which the seller knew or could not have been unaware of the non-conformity. Should the seller be aware of the defect at the time of delivery, or at any time before or after delivery? Because the purpose of giving notice of defects is to allow the buyer to make an informed decision as to whether or not to go ahead with a purchase, the point in time at which the seller must have known or could not have been unaware of the defects ought to be before the goods are handed over to the buyer, and in any event before the period for the buyer to give notice of the defects has expired (though it is possible the seller may learn about the facts leading to relevant or material non-conformity by means other than receiving notice of non-conformity from the buyer).

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of non-conformity, and instead is faced with the risk of claims only precluded by . . . general prescription rules” (a dissenting opinion in this arbitration was in favor of limiting the application of Article 40 even further to truly “exceptional circumstances”).

5. CLOUT Case No. 285 [Oberlandesgericht Koblenz, Germany, 11 Sept. 1998]; CLOUT Case No. 341 [Ontario Superior Court of Justice, Canada, 31 Aug. 1999]; CLOUT Case No. 232 [Oberlandesgericht München, Germany, 11 Mar. 1998]; CLOUT Case No. 378 [Tribunale di Vigevano, Italy, 12 July 2000]; CLOUT Case No. 230 [Oberlandesgericht Karlsruhe, Germany, 25 June 1997]; CLOUT Case No. 270 [Bundesgerichtshof, Germany, 25 Nov. 1998]. *See also* Landgericht Landshut, Germany, 5 Apr. 1995, *supra* note 3 (holding that seller was aware of some non-conformities, hence Article 40 applied, but that the buyer failed to establish the seller’s awareness regarding other alleged non-conformities).

6. *See, e.g.*, CLOUT Case No. 45 [Court of Arbitration of the International Chamber of Commerce, Case No. 5713, 1989]; CLOUT Case No. 237, *supra* note 4; CLOUT Case No. 170 [Langericht Trier, Germany, 12 Oct. 1995].

7. CLOUT Case No. 98 [Arrondissementsrechtbank Roermond, Netherlands, 19 Dec. 1991]; CLOUT Case No. 341, *supra* note 5. *See also* Bundesgerichtshof, Germany, 30 June 2004, *supra* note 2.

HOW MUCH SHOULD THE SELLER KNOW ABOUT THE NON-CONFORMITY OF  
THE GOODS?

Does Article 40 call for the seller's awareness of non-conformity in general, or would it suffice for the seller to be aware of specific facts that would render the goods non-conforming? What is the level of awareness of the non-conformity that is required under Article 40? Is there any relevant difference between, on the one hand, a seller's general awareness that the goods "are not of the best quality" or "leave something to be desired" and, on the other hand, plain fraud or bad faith in failing to disclose the non-conformity? Should Article 40 be limited to cases in which the non-conformity is apparent and can be easily detected, so that the seller's failure to disclose those defects amount to fraud or gross negligence, as opposed to those cases in which the defects were not so obvious?

If the seller disregarded or failed to pay due attention to facts which are relevant to the non-conformity, Article 40 may excuse the buyer's failure to examine the goods or to notify its defects, because in such a case the seller's "could not have been unaware" requirement may be satisfied. Everything seems to indicate, however, that the defects leading to the lack of conformity must have been rather obvious for Article 40 to apply.

Establishing that the seller was aware of one defect or missing product does not mean that the seller was aware or should have been aware of other defects. More than once the courts had the opportunity to hold that whether the buyer is entitled to invoke Article 40 depends on each specific complaint about non-conformity. Whereas a seller may be precluded from relying on Articles 38 and 39 with respect to one type of non-conformity (e.g., color or weight of the merchandise), the same seller may be allowed to raise the defenses that the buyer failed to examine and notify the seller about other types of non-conformity (e.g., that the model of the merchandise was different from the one called for by the contract).<sup>8</sup> In another case, admission by the seller that he was aware before delivering the clothes that they had a shrinkage problem was held fatal to the seller's claim that the buyer failed to complain timely about that problem. Yet, the same seller was able to rely on the buyer's

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8. Thus, in a case in which the seller was aware that some jackets were of a different model than that specified in the contract, Article 40 was held to preclude the seller from relying on the buyer's late notice with regard to this specific type of non-conformity. However, since the buyer was unable to establish that the same seller was aware that the jackets were of a different color and weight than called for by the contract, the buyer's late notice of non-conformity with respect to those two problems was held to be fatal. CLOUT Case No. 251 [Handelsgericht Zürich, Switzerland, 30 Nov. 1998].

late notice to complain that some of the clothes were missing from the boxes in which they were delivered.<sup>9</sup>

These decisions confirm the widely held perception that the general rule is that the buyer must timely complain of the lack of conformity, the exceptional cases being those in which the buyer can establish that the seller was aware or could not have been unaware of a specific problem of non-conformity.

FACTUAL CRITERIA POINTING TO THE SELLER'S (ACTUAL OR  
CONSTRUCTIVE) "AWARENESS"

It is not easy at times to establish whether the seller was actually aware of the non-conformity of the goods. Much of the jurisprudence under Article 40 focuses on the circumstances from which it may be inferred that the seller knew of the vices of the goods sold or, alternatively, the circumstances under which it should be presumed that the seller was aware of the non-conformity. The decision-maker's inquiry is so fact-intensive that in several cases the tribunal found it necessary to remand the case for further proceedings to determine whether the facts were such as to warrant a finding of the seller's awareness or lack thereof.

How courts balance, manipulate, and weigh the facts is very important to assess the reach of Article 40, yet not all of the decisions reported in CLOUT disclose the facts in support of their conclusions. An account of several factual scenarios may help national courts to assess the narrow, rigid, or broad criteria with which one ought to apply Article 40. Cases have gone both ways, depending on the facts, and it seems somewhat unrealistic to presume that every seller has a duty to examine the goods or to adopt, as many legal systems do, a presumption that every seller acts in bad faith.

In many instances, it is the nature of the goods or the non-conformity and the seller's position in the relevant trade sector that determine whether the seller knew or should have known of the defects. In some cases it is not possible to rely on direct evidence of what the seller knew, but a court or arbitrator should be able to rely on facts sufficient to infer or conclude that the defects complained of were obvious. Thus, in cases of serious misdelivery, it may be assumed that the seller could not have been unaware of the non-conformity, although this may depend on whether the seller was the manufacturer of the goods or merely a distributor who relied upon the

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9. Landgericht Landshut, Germany, 5 Apr. 1995, *supra* note 3.

manufacturer's information with respect to goods that were sold in their original packaging, or whether the products had been on the market for a while or had just been released. Under Article 40 of the CISG, it is up to the trier of facts to offer the buyer the opportunity and the means to meet its burden of establishing that the seller knew or should have known better.

CAN A BUYER WAIVE THE RIGHT TO INVOKE THE PROTECTION AFFORDED  
BY ARTICLE 40?

Article 6 of the CISG allows the parties to derogate from or vary the effect of any provision of the Convention and Article 40 is not expressly excepted from this principle of party autonomy. Thus, a buyer may be held to its waiver not to invoke Article 40 against the seller if it is established that the buyer negotiated a reduction in the price of the goods with the seller based on certain defects in the goods. Yet, courts are likely to scrutinize such waivers very closely.

It is highly questionable, under general principles underlying most legal systems and even under the CISG, whether a court or an arbitral tribunal will readily enforce a warranty clause expressly derogating from Article 40 if it is established that the seller was fully aware of defects he intentionally omitted to disclose to the buyer.

Issues of validity being expressly excluded from the CISG under Article 4(a), the proper answer to this question must be sought under the applicable national law, rather than under the CISG. Under a general principle of good faith and fair dealing that may be said to underlay the CISG, the seller may be estopped from invoking the buyer's failure to examine/notify the non-conformity whenever the seller was aware of the defects and failed to disclose them (*venire contra factum proprio*). Accordingly, a waiver of Article 40 is unlikely to be implied from a warranty clause expressly derogating from Articles 35, 38, and 39, even though such protection to the buyer is closely associated and works in tandem with the protection afforded under Article 40.

SELLER'S FAILURE TO DISCLOSE NON-CONFORMITY MEETS BUYER'S  
SILENCE ON NON-CONFORMITY

Whereas Article 40 relieves the buyer from the consequences of its failure to examine and notify the seller of the non-conformity on account of the seller's knowledge (actual or imputed) of the non-conformity, Article 35(3) relieves the seller of its liability for any lack of conformity on account of the buyer's knowledge (actual or imputed) of the lack of conformity. What if

both knew or should have known of the lack of conformity and both remained silent?

Any court or arbitral tribunal is likely to be reluctant to allocate rights and obligations in a situation where both seller and buyer were equally negligent in not failing to disclose that the goods did not conform to the contract. However, Article 40 has been read as suggesting that a negligent buyer deserves more protection than a negligent seller, whose failure to disclose seems closer to fraudulent misrepresentations than a buyer's failure to file a timely complaint on account of material non-conformity of the goods.