SELLER'S OBLIGATION TO DELIVER GOODS WHICH ARE FREE FROM ENCUMBRANCES

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ABSTRACT

In a CISG governed contract the seller must deliver the goods which are free from third party right or claim (Article 41). In case of third party right or claim based on industrial or intellectual property against the buyer, the seller is liable only if he "knew or could not have been unaware of such claim" at the time of conclusion of contract, provided the third party right or claim arises under the law of the State where the goods will be resold or used as per contract; or if no State was contemplated in the contract, under the law of the State where buyer has his place of business (Article 42). In order to rely on Articles 41 or 42 and for other remedies under Article 45, the buyer is required to give notice to the seller describing the nature of the right or claim within a reasonable time (Article 43).

The paper concludes that the seller is not liable in case if the buyer at the time of conclusion of the contract knew or could not have been unaware of existence of third party right or claim (Article 42 (2)(a)); or if the right or claim is resulted from the seller's compliance of buyer's instructions (Article 42 (2)(b)); frivolous claims; seller has no positive knowledge of third party right or claim, if the resale or use of goods is in a State other than agreed by the parties in the contract. It is recommended that for the purpose of fixing liability, the parties to the agreement may include customized warranty of title term in the contract by deviating from CISG under Article 6, otherwise, as a default CISG provisions apply.

Keywords: UN CISG, Third Party Right or Claim, Infringement, Industrial or Intellectual Property, Damages

INTRODUCTION

The United Nations Convention on Contracts for the International Sale of Goods (UN CISG, 1980) (hereinafter referred as CISG), applies to the contracts of sale of goods between parties whose places of business are in different States (Article 1). The Convention obligates the seller to deliver goods as required by the contract and this Convention (Article 30). Further, the goods delivered must be conforming to the contract (Article 35) and free from any right or claim of third parties (Article 41), including the right or claim based on industrial or intellectual property against the buyer (Article 42).

The paper identifies the scope of liability of a seller for any third party right or claims in general, right or claim based on industrial or intellectual property in particular and what are the conditions buyer is required to fulfill. The research is based on doctrinal study in which reference is made to CISG provisions and related case law to know under what circumstances seller's liability arises for third party right or claim against the buyer.

DISCUSSION

Any defect in title poses a threat of legal action against the buyer as the buyer is not purchasing a lawsuit from the seller (Honnold, 1999). In order to ensure peaceful ownership of

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property Article 41 obligates the seller to deliver goods which are free from any third party right or claim, and Article 42 requires that goods must be free from third party right or claim based on industrial or intellectual property rights.

Under the CISG Convention the defects in goods are regulated by Article 35, whereas the defects in title are governed by Articles 41 & 42. The non-conformity of goods relate to physical features whereas freedom from encumbrance is related to the goods history (Brunner & Gottlieb, 2019). The CISG requires the buyer to examine the conformity of the goods (Article 38), whereas with regard to third party right or claim there is no such obligation on buyer under Article 41.

Seller's Obligations Concerning Third Party Right or Claim (Article 41)

In international sales when there is a third party right or claim on goods the buyer may require to defend the suit in a jurisdiction other than his place of business and it would be a expensive affair for the buyer (Honnold, 2009). Hence, Articles 41-44 of CISG necessitate the seller to transfer the ownership of property which is free from any encumbrances, including the goods delivered must be free from any cloud of claim on title (Pacific Sunwear of California Inc. V. Olaes Enterprises Inc., 2008).

Article 41 specifically prescribes a comprehensive liability of the seller for any impairment of the buyer by rights and claims of third parties (Brunner & Gottlieb, 2019). Third parties could be creditors of the seller, freight carrier, warehouse owner or public authorities who seized the goods. The seller is fully liable for all claims, whether they are well founded or frivolous and such claims constitute encumbrance on the goods under Article 41. The exception to this rule is that if the buyer consented to accept the goods subject to third party right or claim, the seller is not liable for any claims (Article 41). The consent of the buyer to receive the goods subject to right to third party claim may be express or implied. For the purpose of ascertaining the consent of the buyer, the conduct of the buyer before and at the time of conclusion of the contract is relevant (Article 8).

In international sales there are issues of complying export and import regulations, such issues are required to be complied by the party affected (Schelechtriem & Schwenzer, 2016). Any encumbrance under public law does not amount to defect in title; however, it depends upon the reason for public measure in question. The public law restrictions relate to consumer protection, environment, health do not constitute defect in title, these defects be considered as non-conformities of the goods in the quality and are governed by Article 35 of CISG.

If the goods are being seized in connection with a third party's right it could be considered as defect in title. For example, if the creditor of the seller seized the goods, this will be a case of violation of article 41. If a third party claiming to be owner claims against the goods received by the buyer, there will be a breach of Article 41 and the buyer is entitled to receive damages incurred for defending the title of the goods (Huber & Mullis, 2007).

The third party right or claim must be an existing legal position regarding the delivered goods (Brunner & Gottlieb, 2019). The circumstances giving rise to the third parry right or claim must relate to the claim arose before delivery of goods, than only falls under Article 41(Huber & Mullis, 2007). The right or claim may be related to right "in rem" (available against the whole world) or right "in personam" (rights against a person). The issues relating to right in rem are

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governed by domestic law and right in personam are governed by law applicable to the contract (Brunner & Gottlieb, 2019).

If the third party right or claim is frivolous, the seller can provide clarification to the buyer and the buyer would be entitled to indemnification for costs associated with such claim by the party who brought it (Belinel, 2007). Where the claim involves substantial litigation, the buyer may demand the seller to take over the defense of the legal action (Honnold, 2009). If the buyer incurred expenses to defend the suit, he is entitled to claim such expenses as damages from the seller under Articles 74 to 77 (Article 45 (1)). In *Colton v. Decker* (1995), the vehicle was seized for having different serial numbers, which indicates as a stolen vehicle or containing stolen parts. The vehicle owner sued the seller for damages, and the court held that seller committed a breach of warranty and is liable to pay damages to the buyer.

The seller is not liable under Article 41 in following two situations; First, where the buyer has consented to receive the goods subject to the right or claim of third party. However, the seller remains liable to the buyer for third party claims other than the one to which buyer consented (Honnold, 2009). Second, if the parties to the contract have derogated from the provisions of Article 41 (Article 6).

Right or Claim Based On Industrial or Intellectual Property (Article 42)

The risk of industrial or intellectual property violation claims raises threat to international trade (Smythe, 2016). The World Trade Organization (WTO) agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) recognized the important relation between Intellectual Property (IP) and trade. The World Intellectual Property Organization (WIPO) promotes the protection of intellectual property throughout the world through the cooperation among the States.

In international trade legal actions based on patents, copyrights and trademarks can generate problems of considerable complexity (Honnold, 1999). The existence of third party rights based on industrial or intellectual property may impact on the buyer's usability of the goods (Schlechtriem & Butler, 2009). Therefore, the CISG law that governs international sale of goods contemplates the seller to furnish goods which are free from any third party right or claim based on industrial or intellectual property (Article 42).

The CISG Convention has not provided the definitions for industrial or intellectual property, therefore, what are the properties that fall under the category of industrial or intellectual properties are regulated by related international conventions and national legislation. The phrase "industrial or Intellectual property" refers to all rights rustling from intellectual activity in the industrial, scientific, literary or artistic fields, such as copy right, trademarks, trade secrets and patents (WIPO).

Article 42 obligates the seller to deliver goods which are free from any third-party right or claim based on industrial or intellectual property against the buyer. Article 42 operates under following circumstances:

- The right or claim of third party must be based on industrial or intellectual property;
- The buyer required to prove that at the time of conclusion of contract the seller knew or could not have been unaware of the right or claim of a third party (Article 42 (1));
- The third-party right or claim must arise under the law of the State where the parties have agreed or contemplated at the time of entering of the contract to resale or use the goods (Article 42 (1) (a)); if no State was contemplated in the agreement, under the law of the State where the buyer has his place of business (Article 42 (1) (b));

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Jurisdiction Contemplated By the Parties

The right or claim must arise in a jurisdiction (State/Country) in which the goods will be resold or used by the buyer and that it was viewed by the parties at the time of conclusion of the contract (Article 42 (1)(a)). The word "contemplated," means where and how the goods are to be used according to the contract (Belinel, 2007). The Austrian Supreme Court in a Blank CDs case (2006), held that seller is under obligation to deliver the goods free from any third-party right under the law of the State in which the goods were to be resold, if this was regarded by the parties at the time of conclusion of contract.

In the absence of any agreement between the parties with regard to State in which the goods are to be resold or used, the seller is liable for any right or claim that arises in a State where the buyer has his place of business (Article 42 (1) (b)), provided the seller knew or could not have been unaware of third party right or claim in buyer's jurisdiction (Article 42 (1)).

The possibilities of resell or use could be in seller's State, buyer's State or third State; this has to be determined by referring to agreement between the parties. If there is no mention in the contract, the buyer has a right to resell or use the goods where he has his place of business. The place of business of buyer is the place which has closest connection with the contract and its performance (Article 10 (a)). If a buyer does not have a place of business, reference can be made to his habitual residence (Article 10 (b)). What the parties have agreed in regard to where and how the goods were to be used helps to ascertain the seller's liability (Schlechtriem &Butler, 2009).

If a particular State where the buyer is reselling or using is not included in the contract, the seller is not obligated under Article 42 (1)(a). The seller should not be expected to have knowledge of all intellectual property rights that may give to a third party right against the buyer, as he may not have his business in that particular jurisdictions (Smythe, 2016). The seller's obligation extends only to indemnify the resale or use in a State that has agreed in the contract, alternatively, in the State of the buyer (Allen, 1993). The relevant territories for resale or use are to be determined by the parties at the time of conclusion of contract (Brunner & Gottlieb, 2019).

Whether third party owns particular claiming rights of industrial or intellectual property or not has to be resolved according to the domestic law of the State where such rights are being registered.

Knowledge of Seller

The seller is liable under Article 42 only if he 'knew or could not have been unaware' of third party right or claim, which means there is no legal obligation on seller to get aware of the potential third party right or claim. However, he must be aware of well-known or publicized rights or claims. The phrase 'Ought to have known' means that the buyer or seller cannot ignore concrete indications of a third party's right or claim (Schelechtriem & Schwenzer, 2016). Article 42 uses the words 'could not have been unaware' which means closer to actual knowledge of seller (Honnold, 1999). The buyer bears the responsibility to establish the knowledge of the seller of the facts stated in Article 42 (1) (a)&(b), and seller bears the responsibility to prove the facts stated in Article 42 (2)(a)&(b).

Article 42 (1) refers to seller's knowledge of existence of third party right and 42 (1) (a) deals with existence of such right in the State that was contemplated by the parties at the time of entering of the contract. Article 42 (2) (a) relieves the seller from liability if he can prove that the buyer 'knew or could not have been unaware' of third party right or claim. Article 42 (2) (b) provides that the seller is not liable if the right or claim resulted from seller's compliance of buyer's instructions.

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In CLOUT Case No. 479 (2002), the court held that if a buyer had a complete knowledge of existence of third party's trade mark rights, the buyer is not entitled to receive the damages from the seller which the buyer paid to the trade mark's owner. If the seller also knew or could not have been unaware of such third party right, both parties should bear part of the liability (Eximin SA v. Itel Style Ferarri Textiles & Shoes Ltd., 1993). In *Textile designs case* (1996), a Dutch buyer purchased the textile from Italian seller, third-party claimed infringement of copy right used on textile designs and the buyer was needed to pay damages, therefore, the buyer sued the seller.

The seller is obligated for a third party's intellectual property claim only if the seller "knew or could not have been unaware" of such claim, and even then only if the claim arose under the laws of the State designated by Article 42 (1)(a) or (b) (Harry, 2008). The relevant time to assess the knowledge of seller is the time when the buyer's notice under Article 43 (1) would have been reached the seller (Schelechtriem & Schwenzer, 2016). Article 42 precludes the liability of seller when the patent application is pending and that had not been published (Zuege, 2018).

If the seller notified the buyer for compliance of third party's trade mark rights and the buyer failed to meet such requirement, the seller is not liable under Article 42 (Footwear case, 2000). In a *Counterfeit furniture sale case* (2004), the buyers were subjected to intellectual property infringement. The court held that counterfeit furniture violates third party rights and one of the buyers was aware of well known, publicized third party intellectual property rights, therefore, the seller is not liable.

The German Supreme Court dealing with a case of defect in goods laid down the circumstance under which seller's liability arises for not meeting the statutory requirements in buyer's State (New Zealand Mussels case, 1995). If the same test is followed for defect in title, the seller's liability arises under following circumstances: unless the parties' agreement clearly indicates otherwise, the seller is liable for third-party industrial or intellectual property right or claim against the buyer if: (a) the buyer resells the goods in the seller's State and the right or claim arises in seller's State; (b) the buyer notified the seller about third party right or claim prior to contract; or (c) the seller knew or should have known about the third party right or claim due to special circumstances, such as the seller has a business or branch in that particular country. The courts may follow the tests laid down in New Zealand Mussels case (1995) to resolve the disputes relating to third party right or claim based on industrial or intellectual property, and this will promote the uniformity in the application of UN CISG (Smythe, 2016).

Relevant Point for Seller's Knowledge

The encumbrance must exist at the time of delivery and the seller must know or cannot be unaware of encumbrance at the time of conclusion of contract (Brunner & Gottlieb, 2019). Accordingly, the seller is liable only when he "knew or could not have been unaware of such right or claim" at the time of conclusion of the contract (Article 42 (1)). If the seller is acquired knowledge after conclusion of the contract that does not lead to liability under Article 42 (1), however, he has a duty to inform the buyer (Schelechtriem & Schwenzer, 2016).

In order to impose liability the right or claim was foreseeable in light of the seller's knowledge of the jurisdiction where the goods were intended to be used or resold (West & Ohnesorge, 1999). A seller cannot plead for lack of knowledge when the trade mark or patent is widely publicized or well known.

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Seller is Liable in Following Cases

- At the time of entering of agreement the seller knew or could not have been unaware of existence of third party right or claim and the buyer has provided notice to the seller within a reasonable time after he become aware of the right or claim, the seller is liable (Article 43 (1));
- At the time of conclusion of contract the seller knew or could not have been unaware, even though the buyer failed to notify the seller within a reasonable time after he has become familiar or ought to have become aware of the right or claim, the seller is liable (Article 43 (2)).

Seller is Not Liable in Following Cases

- At the time of conclusion of contract if the buyer knew or could not have been unaware of the third party right or claim (Article 42 (2)(a));
- Where third party right or claim arises due to the goods being manufactured by the seller according to the technical drawings, designs, formulae or other such specification provided by the buyer, the seller is not liable (Article 42 (2)(b));
- The seller is not liable if the buyer after conclusion of contract without consent of seller resells or uses the goods in a State other than that agreed in the contract (Article 42 (1) (a));
- If the buyer failed to give a notice to the seller of third party right or claim within a reasonable time, after he has become aware or ought to have become aware of the right or claim (Article 43(1)).

Notice to the Seller (Article 43)

The buyer is required to give a notice to the seller, with details of claim, within a reasonable time after he has become aware or ought to have become aware of the third party right or claim, otherwise the buyer is not permitted to rely on Articles 41 or 42 (Article 43 (1)). What constitutes reasonable time will depend upon the circumstance of each case (Schelechtriem & Schwenzer, 2016). Presumably, the period of time to give notice to the seller starts when the buyer become aware or ought to have become aware of third party right or claim.

The seller is not permitted to rely on notice from the buyer (Article 43(1)) if he already knew the right or claims of third party (Article 43 (2)). The decisive time in this case is the time at which buyer's notice would have had to reach the seller (Schelechtriem & Schwenzer, 2016). If the buyer failed to give notice to the seller but he is relying on Article 43 (2) for seller's knowledge, the buyer must prove that the seller knew or could not have been unaware of third party right or claim.

In Mobile faceplates case (2006), the goods have been confiscated from the buyer due to infringement of trade mark, buyer sued the seller for damages, and the court held that buyer failed to give notice to the seller within a reasonable time, therefore, not entitled for damages. Similarly, in CLOUT case No. 822 goods have been confiscated and the court held that buyer lost his rights under Article 41 as he failed to give notice of third party rights within the time stipulated in Article 43.

Remedies Available to the Buyer

If the seller contravenes his obligations under Articles 41 or 42 and the buyer is complied with notice to the seller under article 43, the buyer's remedies are governed by Article 45. Article 45 provides that buyer is entitled to seek remedies recognized under Articles 46 to 52 such as; right to specific performance; or avoid the contract; or reduce the purchase price; and claim damages under Articles 74 to 77.

If the seller delivers the counterfeit goods the buyer may take action against the seller under Article 35 for delivering defective goods, and not as defect in title. If the third party's

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claim is substantial there is a fundamental breach of contract by the seller for which buyer may avoid the contract. If the seller quickly resolves the dispute, the seller's breach may not be a fundamental (Honnold, 2009).

Reduce the Price (Article 44)

Where a buyer unable to give notice of third party's right or claim to the seller within a reasonable time due to some valid excuse, Article 44 allows the buyer to reduce the price or claim damages (except for loss of profits). However, the right to reduce purchase price is not available in case of defects of title (Schlechtriem & Butler, 2009).

Burden of Proof

The burden of proof to establish the breach of Articles 41 and 42 is on the buyer to prove the existence of any third party right or claim over the goods delivered by the seller. The buyer is also required to prove knowledge of the seller about existence of the right or claim at the time of conclusion of the contract. If the seller is relying on Article 42(2) to exclude his liability basing on buyer's knowledge, he must bear the burden of proof.

CONCLUSION

Articles 41 and 42 provide default warranty of title for the goods delivered to the buyer and for the breach of which seller is liable under CISG. If the buyer accepts the goods subject to third party right or claim, there is no liability on seller. For the right or claim based on industrial or intellectual property, the seller's liability arises only for the breach of right or claim under the law of the State where the goods will be resold or used as contemplated in the contract, or if no State was agreed, under the law of the State where buyer has his place of business.

In order to avoid any future claims, the seller and buyer at the time of conclusions of the international sales contract should take into consideration issues related to third-party intellectual property rights in the State in which the buyer intended to resale or use the goods delivered. The seller and buyer may opt out from the CISG under Article 6, and insert a customized title warranty clause to the contract which can provide sufficient protection to the buyer against any third party right or claim. The buyer before conclusion of the contract may conduct search of the records for the presence of any third-party intellectual property rights in the jurisdiction in which he is intended to resale or use the goods. However, there is no legal obligation on the buyer to investigate the existence of any third party right or claim.

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