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Principles and the Necessity of Recognizing the Seller's Obligation to Guarantee against Hidden Defects in the Contract.

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Abstract:

The seller's obligation to guarantee against hidden defects in a contract provides the buyer with confidence, allowing them to proceed with the purchase with peace of mind. This obligation implies that the seller will bear the losses if a defective product is delivered. It is grounded in principles such as the duty of cooperation between the parties in the execution of the contract, the principle of good faith, the principle of compensation for damages, the duty to preserve and sustain the contract, all of which can be termed as the principles underlying the seller's obligation. These principles are referenced in international sales agreements, reflecting the significance of the sales contract as one of the most common and important agreements in daily life. On one hand, the seller's guarantee provides the buyer with assurance that they will not suffer harm; on the other, it offers the seller an opportunity for redress, thereby reflecting the importance of preserving the contract.

Keywords: Principles of recognition, seller's obligation, guarantee against hidden defects, contract.

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Introduction:

Many domestic laws governing contracts contain provisions related to compensating for non-conformity. Even in legal systems that lack specific rules addressing non-conformity, proposals to address non-conformity are considered when assessing damages. Similarly, in international agreements, to avoid the waste of capital resulting from the termination of a contract, appropriate provisions have been established for the party at fault, allowing the defaulting debtor to remedy the non-conformity by offering a substitute or repairing the goods, documents, or other relevant materials. In this context, Article 34 grants the seller, who has delivered documents concerning the goods before the specified delivery date, the possibility to remedy the non-conformity until the contract's deadline. Additionally, Article 37 of the convention provides the seller with a similar right in cases of non-conforming goods delivery. According to Article 48 of the convention, and under certain circumstances, the possibility of remedying non-conformity remains available even after the delivery deadline has passed.

There is significant divergence concerning the foundation and objective of legal rules, to the extent that it can be said no other social issue has been debated as intensely. The examination of the foundation on which legal rules are based and the objectives these rules serve has a venerable history, having occupied the thoughts of countless writers, thinkers, and scholars since the time of the Greek philosophers[1]. In Iranian legal thought, according to the jurisprudential approach to examining and analyzing a subject, exploring issues such as the nature and foundation of rules is of great importance and holds a high status. Conversely, such an approach is not commonly observed in many foreign legal systems or in the literature pertaining to international conventions. In today's world, fraught with challenges, legal systems are increasingly adopting a problem-solving approach, devoting most of their efforts to addressing needs rather than preserving foundational principles or adhering to them.

Despite the importance of studying the foundations and the necessity of recognizing the seller's obligation, among the vast amount of articles and written works on this topic, the specific foundations of this right are seldom addressed independently, and comments on the matter are often brief and scattered. In this article, we will examine the foundations of the seller's obligation. Generally, certain aspects stand out more than others as the basis for the seller's obligation in international sales, namely: the parties' interest in the international sales contract, the preservation of contract stability, the cooperation of parties in fulfilling contractual obligations, and the principle of mitigating damages.

1. The Foundations and Necessity of Recognizing the Seller's Obligation in International Sales

The convention must be interpreted with deliberation, favoring solutions that embody common sense, coherence, and formal unity. By relying on the preparatory works and the historical study of the convention's provisions, the origins and some seemingly unusual rules can be understood[2].

The International Sale of Goods Convention does not explicitly reference the reasons for defining the seller's obligations. Scholars have attempted to deduce the philosophy of the convention through the works of commentators and interpreters, though they have not achieved clear success. Nevertheless, by analyzing and interpreting the articles of the convention, and considering that these articles are based on various principles recognized to some extent in Iranian law, we will explore some of these foundations and their underlying philosophy.

1.1. The Parties' Interest in the International Sales Contract

In the realm of international trade, the termination of an international contract, particularly after the goods have been delivered and payment made, has numerous adverse consequences for the defaulting party, such as bearing insurance and storage costs, capital loss, and similar issues. On the other hand, the advancement and development of trade require the contract's execution to the greatest extent possible. Thus, failure to deliver goods is tantamount to non-performance of the contract, leading to its termination. Naturally, if the goods are never delivered, termination is the only way to compensate for the breach, as the fundamental obligation of the contract—delivery of goods—has not been fulfilled. Consequently, if the seller has received payment, they must return it to the buyer, and the buyer must terminate the contract.

Termination in international trade, which may take months from the time the contract is established until it is executed, can result in irreparable material and moral harm. Therefore, the convention grants the seller the opportunity to remedy or correct the goods and associated documents, while simultaneously enabling the buyer to achieve their goal of acquiring the desired goods and documents.

Based on the perspective that the parties' interest in the contract lies in maintaining the stability of the international contract, the convention, in cases where the seller can remedy any non-conformity, grants the seller the right to rectify any defects or discrepancies in the goods or documents, thereby preventing the buyer from exercising the right of termination.

1.2. The Principle of Maintaining Contract Continuity

The convention strives to ensure the continuation of the international sales contract as much as possible, limiting instances of termination. This approach is justified by the notion that a contract is formed for a beneficial social purpose and should not be terminated except in significant circumstances. In other words, the convention is based on the principle that the right to terminate a contract arises only when the breach is so fundamental and substantial that the contract's performance would no longer benefit the aggrieved party.

[3]These restrictions on contract termination are also observed in other legal systems[4]. In the Iranian legal system, it is likewise recognized that the default position for contracts is their binding nature. In the International Sale of Goods Convention, contract termination is considered an exceptional remedy, and there is a general preference for maintaining and executing the contract[5]. As such, the convention does not treat every breach as a justification for termination. In fact, although contract termination is listed as a legal remedy for breach in Articles 45 and 61 for both the seller and buyer, the conditions for its use are more stringent than those for other enforcement methods and guarantees. Generally, the contract can only be terminated if the other party has committed a fundamental breach. Therefore, it can be said that one of the significant, and perhaps the most important, reasons for terminating a contract under the International Sale of Goods Convention is a fundamental breach of contract[6]. In other words, the primary purpose of recognizing the guarantee of termination is to release one party from further obligations when a fundamental breach occurs, whether due to the other party's failure to perform their contractual duties, failure to deliver the goods, or failure to pay the price[7].

The International Sale of Goods Convention adopts the common law approach concerning breach of contract remedies, prioritizing "specific performance" over other remedies[8], including contract termination. In other words, the fundamental principle in compensating for damages is to ensure that the contract is performed as intended[9]. This means that the foundation for determining remedies in most legal systems is to place the aggrieved party in the position they would have been in had the contract been fully performed. To achieve this goal, several legal systems rely on the principle of "specific performance" as the primary means of compensating damages, while other remedies are provided when performance is not possible[10]. The convention has adopted the stance of the former group, and this adoption is reflected in various articles, such as Article 28 and Articles 46 and 62.

Some scholars believe that the guarantee of termination, as a unilateral right of either party[11], will only be enforced through the declaration of termination. Therefore, termination of the contract is viewed as a powerful and decisive weapon that either party to an international sales contract can use to end the agreement in the event of a breach by the other party. None of the other remedies available in the convention, such as specific performance, price reduction, or claims for damages, carry the same weight as termination[12]. Thus, contract termination is seen as the ultimate remedy available to a dissatisfied buyer. The convention only permits the exercise of termination in limited circumstances. The declaration of termination must be made in a timely manner, and if the buyer fails to declare termination within a reasonable period, they will lose the right to do so[13].

Consequently, the outcome of this research suggests that the convention aims to achieve certain objectives, such as the principle of pacta sunt servanda (the necessity of fulfilling commitments) and mitigating the negative economic effects of contract termination, such as capital loss due to the return of rescinded goods, among others. Thus, the convention seeks to allow for the termination of a contract only in the context of a fundamental breach. In other words, if the breach is not fundamental, the aggrieved party does not have the right to terminate the contract and must resort to other remedies provided in the contract[14], such as claims for damages or specific performance. The reason for this is that the convention strives to preserve the continuity of the contract, which is of great importance in international trade. Even if the seller commits a fundamental breach, the convention recognizes the buyer's right to terminate the contract if they wish to do so, but there is no obligation to terminate, and the buyer may also insist on specific performance according to Article 46[15].

1-3- The Principle of Cooperation between the Parties in the Execution of the Contract (The Duty to Cooperate)

The parties to a contract are obligated to cooperate in its execution, and there exists a general and implicit duty to ensure the effective fulfillment of the contract, even if it is not expressly stated within the terms of the agreement. For instance, the seller must take the necessary steps to enable the buyer to receive the goods, as the seller's duty to deliver the goods and the buyer's duty to receive them are closely intertwined. Thus, if the buyer sends an agent on their behalf to transport the goods, but the seller fails to cooperate, this would be considered a breach of the duty to cooperate.

Although the provisions of the International Sale of Goods Convention do not explicitly address the principle of cooperation, both judicial interpretation and legal scholarship acknowledge its existence within the framework of the convention. Several provisions allude to this principle, but Article 60 of the convention serves as a particularly clear and prominent example. According to paragraph (a) of this article, the buyer must take all necessary steps typically expected of the seller to facilitate the delivery of goods. Failure to fulfill the duty of cooperation allows the non-breaching party to seek any of the legal remedies available, such as demanding specific performance, terminating the contract, or claiming damages[16].

Thus, the third general principle underpinning certain provisions of the convention is the principle of cooperation and the collaborative efforts of the parties in the execution of the contract. The seller's obligations align with this principle. In other words, if the necessary conditions for performance are present, the seller can rectify any non-conformity, and the buyer must cooperate to the fullest extent in the execution of the contract.

1-4- The Principle of Good Faith

Many interpreters of the convention have asserted that good faith is a recognized principle within the convention. However, the International Sale of Goods Convention has struggled to define the precise requirements for good faith. Many scholars believe that good faith should be defined according to the laws of each individual country. However, if this approach is adopted, the uniformity sought by the convention would be lost[17]. The duty of good faith has a longstanding presence. In ancient times, good faith was a recognized duty in commercial transactions. The fundamental principles of good faith from ancient Roman law are remarkably similar to those acknowledged today under the Uniform Commercial Code (UCC).

Before drafting the convention, it was anticipated that a rule requiring respect for the principle of good faith would be established, given that such a rule exists in the laws of many European countries. However, some representatives unfamiliar with this concept were initially resistant to its inclusion. Nonetheless, it is surprising that this rule was ultimately incorporated into the section on the interpretation of the convention. Therefore, the duty to act in good faith governs the relationships between the parties, and it is essential that the convention, and the rules related to sales, be interpreted in a manner that ensures adherence to its terms[18]. Good faith is the commitment to a mutually agreed general objective, which, in our case, is the preservation of the contract's continuity and cooperation with the legitimate expectations of the other party. In other words, due to the necessity of fostering behavior aligned with good faith, the inclination should be towards maintaining contracts wherever possible, and the buyer should not terminate the contract if the seller can rectify a minor discrepancy in the goods. In other words, interpretations of the laws and regulations within the agreement should aim to enhance the value of a behavioral standard in international trade as a recognized necessity. Furthermore, good faith reduces the rigidity of legal principles and contributes to the enhancement of commercial justice. Good faith is one of the fundamental rules and principles upon which the agreement is generally based, and thus, even if the first paragraph of Article 7 is merely an interpretative rule from which the parties' obligation to act in good faith cannot be directly derived, it can be inferred as one of the unwritten foundations of the agreement, from which this obligation arises. Similarly, the first paragraph of Article 201-1 of the Principles of European Contract Law indicates that each party must act in good faith and deal fairly. This demonstrates that the principle of good faith and fair dealing is a pervasive rule present in various parts of these principles.

In Article 7-1 of the Principles of International Commercial Contracts, the necessity of acting in good faith is explicitly recognized as an acknowledged obligation[19]. This article states that each party in international trade is obligated to act in accordance with good faith and fair dealing. The concept of good faith is also reflected in several provisions of the Uniform Commercial Code of the United States. For instance, Article 230-1 stipulates a general and absolute obligation to adhere to the principle of good faith. In other words, according to this article, any obligation or duty arising from this law requires consideration of good faith during the execution phase and in applying the resulting guarantees. Additionally, Paragraph 19 of Article 102-1 provides a general definition of good faith, stating that good faith is practical and objective honesty in the conduct or transaction in question. Of course, some sub-articles of this law contain other definitions of good faith; for example, Article 2 states that good faith not only means practical and objective honesty but also adherence to reasonable standards of fair dealing in trade[20]. Therefore, it can be said that adherence to the fair and necessary standards of good faith in contracts leads to the possibility that, in cases where the seller who has delivered non-conforming goods and documents to the buyer can correct the non-conformity, international laws and agreements also allow the seller to make the correction. This right is also recognized for the seller in the Convention on the International Sale of Goods and in other international documents, and it seems that one of the reasons for recognizing this right is the obligation to uphold the principle of good faith and standards of fair dealing.

5- The Principle of Mitigating or Addressing Damages

This principle is primarily recognized in common law jurisdictions[21], where the injured party is expected to take steps to mitigate the damages. Generally, a rational person seeks to avoid actions and behaviors that put their life and property at risk, and when a harmful act occurs, they strive to prevent the damage from escalating or accumulating. This is particularly relevant in commercial activities, where the nature of business involves the potential for profit and loss, and any improper conduct may lead to irreparable harm.

In the realm of commercial activities, a breach of contractual obligations by one party may cause damage to the other party. In such a situation, the question arises whether the injured party can simply observe the damage unfold without taking any action, hoping to later claim compensation for the damages from the breaching party, or whether they are obligated to take reasonable steps to mitigate or even prevent the damages[22].

In response to this question, it should be clarified that it is now recognized that even if the injured party is not responsible for the breach of contract and its consequences, they cannot claim compensation for damages that they could have avoided by taking reasonable measures. This rule is generally accepted in many legal systems, although the exact wording and the emphasis on the rule vary across jurisdictions.

In the context of the International Sale of Goods Convention, it can be argued that the party relying on a breach of obligation is required to take the necessary measures to mitigate damages under the available circumstances. Several reasons justify this obligation, such as promoting economic efficiency, preventing waste of resources, upholding good faith and fair dealing, as well as the injured party's own interest in minimizing their losses. This rule appears not to be limited to specific guarantees but applies to any situation where the injured party is expected to provide cooperation and assistance in reducing damages. It seems that one of the foundations of the seller’s obligations in the International Sale of Goods Convention is the attention paid by the drafters of this international document to principles like this rule.

Conclusion

Based on the discussion presented, it can be concluded that the principles and foundations that form the basis for ensuring the seller’s obligation regarding latent defects in a sales contract reflect the significance and value of this contract due to its essential role in the economic life of individuals. These principles confer a special value on the contract for both parties, preventing harm to them in various ways. Among these fundamental principles are the principle of cooperation between the parties in executing the contract, the principle of good faith, the principle of addressing damages, and the principle of maintaining the contract’s continuity, all of which are directly or indirectly referenced in the International Sale of Goods Convention.

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