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# Ethical Values and International Sales

By Prof. Dr. Ingeborg Schwenzer, LL.M.<sup>1)</sup>

Frå redaksjonen: Etikk er i dag eit viktig tema i internasjonalt forretningsliv. Føretak som på ein eller annan måte blir knytte til barnearbeid, alvorleg forureining, korrupsjon, stønad til diktaturregime, omstridd våpenhandel osv., kan miste kundar og investorar. Temaet for denne artikkelen er dei kjøpsrettslege konsekvensane av uetisk framferd. Forfattaren meiner at det kan vera eit mangel ved ei vare at ho til dømes er produsert ved hjelp av barnearbeid, og at kjøpsrettslege mangelsverknader kan vera aktuelle. Drøftingane er knytte til konvensjonen om lausøyrkjøp (CISG). Artikkelen byggjer på ei førelesing ved Institutt for privatrett, Universitetet i Oslo i april 2008 (Carl Jacob Arnholms minneføreling). I eit tilfelle som dette vil redaksjonen gjerne trykkje ein artikkel på eit ikkje-skandinavisisk språk.

DR. INGEBORG SCHWENZER er professor ved Det juridiske fakultet, Universitetet i Basel (Sveits). Forfattarsskapen hennar er omfattande, mellom anna innafør familiereppen, obligasjonsretten og samanliknande rett. Saman med Peter Schlechtriem var ho medforfattar og redaktør av standardverket *Kommentar zum einheitlichen UN-Kaufrecht (CISG)*, 4. Auflage, München 2004 (*Commentary on the UN Convention on the International Sales of Goods (CISG)*, 2nd (English) edition, Oxford 2005), og etter Schlechtriems død i 2007 er ho eineredaktør av neste utgåve (2008).

## I INTRODUCTION

### 1 Business and Ethics?

Before turning to the subject-matter of this talk, it is appropriate to explain what business or contract law has to do with ethics and human rights and how this issue becomes relevant in modern international sales contracts.

1) An earlier version of this paper has been published as *Ethical Values and International Sales Contracts*, in: Cranston/Ramberg/Ziegel (ed.), *Commercial Law Challenges in the 21st Century*, Jan Hellner in Memoriam, Stockholm 2007, pp. 249–275 = in: Leisinger/Probst (eds.), *Human Security and Business*, Zurich 2007, pp. 124–148 (jointly with Benjamin Leisinger). I am deeply indebted to my research assistant, lic. iur. Alain F. Hosang, for updating this article.

Years ago, business and ethics were as far apart as to be viewed as some kind of contradiction. According to leading economists «the business of business is business».<sup>2)</sup> Companies' only social responsibility was thought to be to use their resources to make profits for their shareholders.<sup>3)</sup> The corporation, as such, was simply used as a means to an end.<sup>4)</sup> Human rights were seen as belonging to the realm of government concerns, not of companies, and human rights violations as internal political issues, with which companies should not, on principle, interfere.<sup>5)</sup>

It is, therefore, no wonder that the early age of industrialization is known as one of the darkest chapters in history regarding human rights and the protection of the environment. Only slowly did governments start to realize that such corporate behavior was unsustainable and react with the enactment of legislation.<sup>6)</sup> Thus, first and foremost it was – and still is today – the duty of *states* and the *community of states* to legislate and then enforce such regulations in order to prevent unethical behavior by any actor of society, inclusive business enterprises. But is that tool still efficient today? In an age of globalization and, most importantly, of so-called «failing states» – states in which the government is unwilling or unable to guarantee the rule of law by deciding and implementing state-of-the-art legislation – reliance on the state has, in fact, lost its power to guarantee minimum ethical standards.<sup>7)</sup> But, failing action by the states, who is then responsible and powerful?

During recent years, publicly listed firms, especially those acting on a global level, have started to realize that ethical behavior can, in fact, have a positive impact and, con-

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- 2) See MILTON FRIEDMAN, *The Social Responsibility of Business is to Increase its Profits*, The New York Times Magazine, 13 September 1970, available online at <<http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html>> (02 June 2008).
  - 3) See MILTON FRIEDMAN, *Capitalism and Freedom*, Chicago/London 1982, p. 133. See also PETER MUCHLINSKI, *The Development of Human Rights Responsibilities for Multinational Enterprises*, in: Rory Sullivan (ed.), *Business and Human Rights*, Sheffield 2003, p. 33–51, p. 35, listing the arguments against the extension of human rights responsibilities to transnational corporations.
  - 4) See MILTON FRIEDMAN, *Capitalism and Freedom*, op. cit. (fn 3), p. 135.
  - 5) See GEOFFREY CHANDLER, *The Evolution of the Business and Human Rights Debate*, in: Rory Sullivan (ed.), op. cit. (fn 3), p. 22–32, p. 24.
  - 6) See KARIN LUCKE, *States' and Private Actors' Obligations under International Human Rights Law and the Draft UN Norms*, in: Thomas Cottier/Joost Pauwelyn/Elisabeth Bürgi (eds.), *Human Rights and International Trade*, New York 2006, pp. 148–163, p. 149.
  - 7) Cf., e.g., *Human Rights Watch (HRW)*, an NGO that is dedicated to human rights and their enforcement, available online at <<http://www.hrw.org>> (10 June 2008). For the role NGOs have in protecting human rights in international trade, see CHRISTINE BREINING-KAUFMANN, *The Legal Matrix of Human Rights and Trade Law*, in: Thomas Cottier/Joost Pauwelyn/Elisabeth Bürgi (eds.), *Human Rights and International Trade*, op. cit. (fn 6), pp. 95–136, p. 135.

versely, unethical behavior a negative impact on their business.<sup>8)</sup> It has been statistically shown that corporate reputation does indeed translate into financial value.<sup>9)</sup>

In addition to this, there is also a more subtle benefit from ethical behavior: the rule of law is promoted. This can have positive effects on the development of legal systems in which contracts are enforced fairly, bribery and corruption are less prevalent, and all business entities have equal access to legal process and equal protection under the law.<sup>10)</sup> In such circumstances, a smoother and more profitable operation of business is thereby simultaneously promoted.<sup>11)</sup>

Another reason why ethical behavior pays – especially from a shareholder's perspective – is that a considerable amount of money is invested based on social responsibility.<sup>12)</sup> In 2007, 437 so-called SRI – socially responsible investment – funds existed in Europe.<sup>13)</sup> According to a study by the European Social Investment Forum (Eurosif), in 2006 socially responsible invested institutional and retail funds in Europe amounted to 1.033 trillion Euro.<sup>14)</sup>

## 2 States – The Primary Duty Holders

As already mentioned,<sup>15)</sup> it is, first and foremost, the task of public lawmaking bodies, established by states or the community of states, to deal with the attainment of ethical

- 8) See PETER BUOMBERGER, *Walking the Talk: How to Create Business Value while Delivering Stakeholder Value*, in: Benjamin K. Leisinger/Marc Probst (eds.), *Human Security and Business*, Zurich 2007, pp. 80–87, p. 81.
- 9) See RENÉ KIM/ERIK VAN DAM, *The Added Value of Corporate Social Responsibility*, 2003, available online at <<http://www.triple-value.com/upload/docs/addedvalueofcsr.pdf>> (02 June 2008).
- 10) See KLAUS LEISINGER/KARIN SCHMITT, *Corporate Ethics in a Time of Globalization*, 2nd ed., Basel/Colombo 2003, p. 79.
- 11) See DAVID KINLEY/JUNKO TADAKI, *From Talk to Walk: The Emergence of Human Rights Responsibilities for Corporations at International Law*, in: Va. J. Intl. L. 2004, Vol. 44, pp. 931–1022, p. 953.
- 12) See KLAUS LEISINGER, *Unternehmensethik in Zeiten der Globalisierung: Idealistische Verirrung, Wettbewerbsnachteil oder Marktchance?*, in: Schwäbische Gesellschaft (ed.), *Schriftenreihe* 44–47, Stuttgart 2003, pp. 49–89, p. 77; CLAUDE FUSSLER, *Responsible Excellence Pays!*, in: JCC 16 (2004), pp. 33–44, p. 35, available online at <[http://www.unglobalcompact.org/docs/news\\_events/9.5/jcc16fussler.pdf](http://www.unglobalcompact.org/docs/news_events/9.5/jcc16fussler.pdf)> (02 June 2008).
- 13) See the report of SIRI COMPANY (ed.), *Green, Social and Ethical Funds in Europe 2005*, October 2005, available online at <[http://www.siricompany.com/pdf/SRI\\_Funds\\_Europe\\_2005.pdf](http://www.siricompany.com/pdf/SRI_Funds_Europe_2005.pdf)> (02 June 2008).
- 14) The study is available online at <[http://www.eurosif.org/media/files/eurosif\\_sristudy\\_2006\\_complete](http://www.eurosif.org/media/files/eurosif_sristudy_2006_complete)> (02 June 2008). For further details about SRI, see PHILIPPE SPICHER, *Human Rights – Best Practice in Mainstream Investment Decisions?*, in: Benjamin K. Leisinger/Marc Probst (eds.), op. cit. (fn 8), pp. 151–165, pp. 159 et seq.
- 15) Supra I 1: Business and Ethics?

standards.<sup>16)</sup> They have to define which standards are to be applied to the respective labor market and concerning the environment. Thus, it is primarily up to the governments in the country where the incriminating behavior takes place to take appropriate action. However, these governments all too often fail in implementing and enforcing human rights, labor or environmental standards.<sup>17)</sup>

In the second place, it is arguably also the task of the community of states to react to unethical behavior and to force the failing states to comply, for example, by means of embargos and other trade sanctions.<sup>18)</sup> However, in many cases, the necessary majority cannot be obtained or applied sanctions are not sufficiently efficient. As all these traditional means have proven inadequate to achieve the intended goals, recent years have seen several initiatives implemented to shift the task from governments to private enterprises.<sup>19)</sup>

### 3 «Non-voluntary» Initiatives

On an international level, so-called «non-voluntary» initiatives are taking shape with regard to corporations. One important example is the «Draft Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights» which have been approved by the United Nations Sub-Commission on the Promotion and Protection of Human Rights in 2003.<sup>20)</sup>

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- 16) For a detailed discussion about this matter, see FLORIAN WETTSTEIN, *Multinational Corporation and Global Justice: The Human Rights Obligations of a Quasi-Governmental Institution*, St. Gall 2007, pp. 176 et seq.
- 17) An example for a state failing to implement human rights is China. In the case *Bao Ge v Li Peng*, 201 F. Supp. 2d 14, D.D.C. (2000), four Chinese citizens and former inmates of a «Shanghai Reeducation Through Coerced Labour» prison camp claimed that they were victims of various human rights violations. Amongst others, the inmates were forced to produce soccer balls for Adidas AG. However, the case was dismissed because the District Court found that it lacked jurisdiction. For further details, see CHRISTINE BREINING-KAUFMANN, *The Legal Matrix of Human Rights and Trade Law*, in: Thomas Cottier/Joost Pauwelyn/Elisabeth Bürgi (eds.), *Human Rights and International Trade*, op. cit. (fn. 6), p. 127.
- 18) See HENRY J. STEINER/PHILIP ALSTON, *International Human Rights in Context: Law, Politics, Morals*, 2nd ed., New York 2000, p. 621.
- 19) See THOMAS COTTIER/JOOST PAUWELYN/ELISABETH BÜRGI, *Linking Trade Regulation and Human Rights in International Law: An Overview*, in: Thomas Cottier/Joost Pauwelyn/Elisabeth Bürgi (eds.), *Human Rights and International Trade*, op. cit. (fn. 6), pp. 1–26, p. 4.
- 20) See U.N. Doc. E/CN.4/Sub.2/2003/L.11., available online at <<http://daccessdds.un.org/doc/UNDOC/LTD/G03/158/48/PDF/G0315848.pdf?OpenElement>> (02 June 2008). The Norms submitted by the Working Group, E/CN.4/Sub.2/2003/12/Rev.2, can be found online at <[http://www.unhchr.ch/huridocda/huridoca.nsf/\(Symbol\)/E.CN.4.Sub.2.2003.12.Rev.2.En](http://www.unhchr.ch/huridocda/huridoca.nsf/(Symbol)/E.CN.4.Sub.2.2003.12.Rev.2.En)> (02 June 2008).

The Commission on Human Rights in 2004 expressed the view that the draft norm document contained «useful elements and ideas» but had no legal standing.<sup>21)</sup> To clarify the complex issues to be considered in the Business and Human Rights debate, a «Special Representative» was appointed who recently submitted a first interim report.<sup>22)</sup>

#### 4 The OECD Guidelines for Multinational Enterprises

An initiative that is also worth mentioning here is the OECD Guidelines for Multinational Enterprises, which form part of the OECD Declaration on International Investment and Multinational Enterprises.<sup>23)</sup> These rules set out recommendations made by governments to multinational enterprises. The governments are committed to promoting the Guidelines. The recommendations cover, among other things, human rights, labor standards, environmental standards, anti-corruption and bribery, and consumer protection.

#### 5 Private Initiatives

There are innumerable private initiatives that seek to ensure basic ethical standards in global trade.

##### *a Know Your Business Partners*

Many businesses spend a considerable amount of money on so-called *ethics audits* before they actually begin cooperation with another company, such as a supplier. Some companies even publish a list of all their suppliers to guarantee transparency.<sup>24)</sup> The Global Reporting Initiative<sup>25)</sup> is one such measure undertaken in regard of guaranteeing transparency.

21) See COMMISSION ON HUMAN RIGHTS (ed.), *Report on the Sixtieth Session* (15 March–24 April 2004), E/CN.4/2004/127 (Part I), p. 28, available online at <<http://domino.un.org/UNISPAL.NSF/eed216406b50bf6485256ce10072f637/49aeb986f721b9b785256f33005102f9!OpenDocument>> (02 June 2008).

22) See COMMISSION ON HUMAN RIGHTS (ed.), *Promotion and Protection of Human Rights – Interim Report of the Special Representative of the Secretary-General on the Issue of Human Rights and Transnational Corporations and other Business Enterprises*, E/CN.4/2006/97, 22 February 2006, available online at <<http://daccessdds.un.org/doc/UNDOC/GEN/Go6/110/27/PDF/Go611027.pdf?OpenElement>> (03 June 2008).

23) The Guidelines that were revised in 2000 are available online at <<http://www.oecd.org/dataoecd/56/36/1922428.pdf>> (03 June 2008).

24) One of these companies is e. g. Puma AG, a German sporting goods manufacturer. This list can be consulted online at <<http://www.fairlabor.org/participants/companies>> (03 June 2008).

25) The Global Reporting Initiative is a multi-stakeholder process aimed at the development and dissemination of globally applicable Sustainability Reporting Guidelines. For more information see <<http://www.globalreporting.org/Home>> (03 June 2008).

Additionally, standard norms have been created, such as the ISO 9000 and 14000 family from the International Standardization Organization, which deal with – predominantly environmental – ethics in business and have been implemented by more than a million organizations in 161 countries.<sup>26)</sup> Another example is SA8000 from Social Accountability International (SAI), which operates as a business tool for defining and verifying compliance with key human rights norms.<sup>27)</sup> There are several organizations that are accredited to do SA8000 certification, which ensures the application of an independent and objective standard.<sup>28)</sup> A further example, familiar to most consumers, is the labels on food products stating that the food was produced in an ecologically friendly manner and traded fairly.<sup>29)</sup>

### *b United Nations Global Compact*

On an international level, the UN Global Compact has to be specially highlighted as one of the most successful private initiatives. This initiative goes back to 1999<sup>30)</sup> and consists today of ten principles – covering human rights, labor, environment and anti-corruption. It has a total of more than 5200 participants, including 4000 businesses in 120 countries.<sup>31)</sup>

The UN Global Compact begins with a general part, which states that businesses should, within their sphere of influence, support and respect the protection of internationally-proclaimed human rights and make sure they are not complicit in human rights abuses. «Sphere of influence» can be understood not only as the companies' responsibility for their own *employees*, but also for their *next tier suppliers* and *direct business partners*. Complicity usually refers to corporate involvement in governmental action.<sup>32)</sup>

26) For a brief introduction to these standards, see <[http://www.iso.org/iso/iso\\_catalogue/management\\_standards/iso\\_9000\\_iso\\_14000.htm](http://www.iso.org/iso/iso_catalogue/management_standards/iso_9000_iso_14000.htm)> (03 June 2008).

27) For an article giving an overview and showing concrete case-studies, see DEBORAH LEIPZIGER/EILEEN KAUFMAN, *SA 8000: Human Rights in the Workplace*, in: Rory Sullivan (ed.), op. cit. (fn 3), p. 197–206.

28) For more information see <<http://www.sa-intl.org>> (03 June 2008).

29) See, e.g., the seals by Max Havelaar for fair trade, available online at <<http://www.max-havelaar.be/international>> (06 June 2008) and the EU-Seal for organically produced food according to the EU Regulation on organic production of food ((EEC) No 2092/91).

30) For further details about the establishment of the UN Global Compact, see KARIN LUCKE, *States' and Private Actors' Obligations under International Human Rights Law and the Draft UN Norms*, in: Thomas Cottier/Joost Pauwelyn/Elisabeth Bürgi (eds.), *Human Rights and International Trade*, op. cit. (fn 6), pp. 148–163, p. 149.

31) See a list of the participants to UN Global Compact, available online at <<http://www.unglobalcompact.org/ParticipantsAndStakeholders/index.html>> (05 June 2008).

32) Cf. STEVEN R. RATNER, *Corporations and Human Rights: A Theory of Legal Responsibility*, in: Yale L.J. 2001, Vol. 111, pp. 443–545, p. 510.



The second group of principles deals with labor standards. Issues addressed here are the freedom of association and the effective recognition of the right to collective bargaining, forced and compulsory labor, child labor,<sup>33)</sup> and discrimination in respect of employment and occupation.

The third part of the Global Compact addresses environmental issues.

The last principle of the Global Compact, which was added in 2004, deals with corruption.

The UN Global Compact initiative is voluntary and imposes no sanctions if its members fail to comply with the standards. However, as there are reporting obligations associated with membership to the initiative, the behavior of the members becomes transparent.<sup>34)</sup>

### c Initiatives in Special Trade Branches

Apart from such initiatives on a global level, there are private initiatives in specific trade sectors. The Electronic Industry Code of Conduct,<sup>35)</sup> for example, incorporates norms, such as setting a maximum number of working hours at 60 per week, and prescribing human treatment or non-discrimination in supplier contracts, as the partici-

33) According to ILO Convention No. C138 from 1973, which has been ratified by 142 countries, child labor is the full-time employment of children that are – in general – under the age of 15 years, Article 2(3) ILO Convention. Labor which, by its nature or the circumstances in which it is carried out, is likely to jeopardize the health, safety or morals of young persons shall not be conducted by workers under the age of 18, Article 3(1) ILO Convention. The Convention is available online at <<http://www.ilocarib.org.tt/childlabour/c138.htm>> (03 June 2008); Another convention concerning child labor is the Sialkot Initiative 2007 on the prevention of child labor in the soccer ball producing industry, available online at <[http://home.scci.com.pk/Sialkot\\_Initiative\\_2007.pdf](http://home.scci.com.pk/Sialkot_Initiative_2007.pdf)> (11 June 2008).

34) For a summary on the achievements of the Global Compact, see GEORG KELL, *The 2007 Global Compact Leaders Summit: Major Outcomes and Preliminary Conclusions*, in: Benjamin K. Leisinger/Marc Probst (eds.), op. cit. (fn. 8), pp. 221–228. For the impact the Global Compact has on companies, see MCKINSEY & COMPANY (ed.), *Assessing the Global Compact's impact*, 11 May 2004, available online at <[http://www.unglobalcompact.org/docs/news\\_events/9.1\\_news\\_archives/2004\\_06\\_09/imp\\_ass.pdf](http://www.unglobalcompact.org/docs/news_events/9.1_news_archives/2004_06_09/imp_ass.pdf)> (11 June 2008). For more details on the Global Compact, its purpose and its future, see JOHN G. RUGGIE, *The Theory and Practice of Learning Networks: Corporate Social Responsibility and the Global Compact*, in: J. Corp. Citizenship 2002, Vol. 27, pp. 27–36.

35) Companies like Celestica, Cisco, Dell, Flextronics, HP, IBM, Jabil, Lucent, Microsoft, Sanmina SCI, Seagate, Sollectron and Sony have adopted and/or implemented these norms. This code is available online at <[http://www.hp.com/hpinfo/globalcitizenship/environment/pdf/supcode.pdf?jumpid=reg\\_R1002\\_USEN](http://www.hp.com/hpinfo/globalcitizenship/environment/pdf/supcode.pdf?jumpid=reg_R1002_USEN)> (11 June 2008).

pants are under an obligation to, at least, require their *next tier suppliers* to acknowledge and implement the code.<sup>36)</sup>

## 6 Problematic Cases

All these aforementioned initiatives, however, are not able to prevent that alarming events still occur in the world – especially in developing countries. Although for example, the global number of child laborers is indeed constantly decreasing, in 2004 there were still about 126 million children working in hazardous work, many of whom even being forced or «bonded laborers».<sup>37)</sup> What can a buyer do if it realizes that the products it has purchased were produced under such conditions?

But not only buyers might be affected by comparable problems. Take for example a simple sale of pesticides. By adding a few chemical components, dangerous chemical weapons can be – and are – produced.<sup>38)</sup> Similar problems arise in connection with all so-called «dual-use goods».<sup>39)</sup> What are the seller's possibilities if it learns about serious human rights violations by one of its buyers, where one of its products is involved?

Some questions can be answered by referring to the applicable public law. With regard to private law matters, these need to be resolved by applying the law governing the contract. In an international context, this is likely to be the Convention on Contracts for the International Sale of Goods – CISG. This convention has now been ratified by 70 countries<sup>40)</sup> and, according to its Article 1, is applicable to contracts of sale of goods between parties whose places of business are in different states when the States are Contracting States or when the rules of private international law lead to the application of the law of a Contracting State. If the CISG is indeed applicable, it is crucial to determine whether ethical standards have become part of the contract in the first place and, if so, what remedies the aggrieved party may resort to.

36) Similar codes of conduct have been created and implemented by companies such as LEGO, (online at <[http://www.lego.com/info/pdf/CODEOFCONDUCT\\_English.pdf](http://www.lego.com/info/pdf/CODEOFCONDUCT_English.pdf)> (03 June 2008)), Novartis (online at <[http://www.corporatecitizenship.novartis.com/downloads/business-conduct/Novartis\\_TP\\_Code.pdf](http://www.corporatecitizenship.novartis.com/downloads/business-conduct/Novartis_TP_Code.pdf)> (03 June 2008), and others.

37) For a facts sheet on child labour, see UNICEF, available online at <<http://www.unicef.org.nz/school-room/child-labour/child-labour-the-facts.html>> (11 June 2008).

38) For further information see fluoride action network, available online at <<http://www.fluoridealert.org/pesticides/effects.chem.weapon.prekurs.htm>> (03 June 2008).

39) For a list of goods that are qualified as «militarily critical» by the US Government, see *Militarily Critical Technologies List (MCTL)*, available online at <<http://www.dtic.mil/mctl>> (10 June 2008).

40) For a list of all states that have ratified the CISG, see <[http://www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html)> (03 June 2008).

## II CONSEQUENCES OF PUBLIC LAW REGULATIONS

### 1 Illegality

If, in a given case, there are indeed public law regulations that condemn certain behavior, it is up to state law to define the legal consequences of a violation of such a prohibition.<sup>41)</sup> Although it might be conceivable, albeit in rather rare cases, that a state declares a sales contract to be void if the goods in question have been manufactured by a means in violation of human rights – such as child labor – this would not fall under the CISG. According to Article 4(a) CISG, the validity<sup>42)</sup> of the contract is not governed by the Convention. Thus, the applicable law to the question of validity would have to be determined by private international law.

### 2 Prohibition of Import or Export

In cases in which the community of states or – as the case may be – even a single state announces an embargo, thus prohibiting either the import or export of goods from or to a state in which the enforcement of basic human rights is not ensured, questions of exemption from liability to perform contractual obligations may arise. State interventions preventing contractual performance, such as quotas, export or import embargoes or trade bans are – generally – outside the parties' sphere of control.<sup>43)</sup> This leads to the following consequences: imagine a case where the community of states or a specific state prohibits the import of goods from a country where basic standards of human rights are constantly violated.<sup>44)</sup> A buyer who has a contract with a seller in such a state might be excused from paying damages for its failure to take over the goods and to pay the purchase price, in accordance with Article 79(1) CISG.<sup>45)</sup> Conversely, where export into a certain country is prohibited, a seller with a contract with a buyer in that country might be excused from paying damages for non-delivery.

41) See PETER SCHLECHTRIEM, *Non-Material Damages – Recovery under the CISG?*, in: Pace Int'l L. Rev. 2007, Vol. 19, pp. 89–102, p. 100.

42) However, in order to ensure uniform application, the term «validity» has to be interpreted autonomously. See SCHLECHTRIEM in Schlechtriem/Schwenzer (eds.), *Commentary on the UN Convention on the International Sale of Goods (CISG)*, 2nd ed., Oxford 2005, Art. 4 para 7.

43) Cf. HANS STOLL/GEORG GRUBER in Schlechtriem/Schwenzer (eds.), op. cit. (fn 42), Art. 79 para 37; DIETRICH MASKOW in Enderlein/Maskow/Strohbach (eds.), *Internationales Kaufrecht*, Berlin 1991, Art. 79 para 3.6. In a decision of the Bulgarian Chamber of Commerce and Industry Tribunal, 24 April 1996, CISG-online 435 (online at <<http://www.cisg-online.ch/cisg/overview.php?test=%20435>> (03 June 2008)), a Bulgarian buyer purchased coal from a Ukrainian seller. The seller relied on an export ban and a strike of miners. The Tribunal decided that such circumstances could constitute an impediment. However, in this case, the export ban as well as the strike was foreseeable at the time of the conclusion of the contract and the exemption was not granted.

The consequences in these cases might be questionable if the import or export ban was foreseeable – for example, because of the bad human rights record of the other state – at the time of the conclusion of the contract. The wording of Article 79(1) CISG provides for exemption only in cases where the supervening event was *not* foreseeable. However, it is doubtful whether the drafters of the CISG took these situations – situations where trade bans are installed because of unethical behavior of other states – into account at all.<sup>46)</sup> The typical case in which the requirement of non-foreseeability seems to be appropriate – and actually could prevent the breaching party from relying on Article 79 CISG – is where the interests of the country, in which the party seeking to rely on the exemption has its place of business, are intended to be protected by the trade ban. In many cases, such interests are of economic nature and states want to protect the own market. In this case, it can well be argued that the party in question has to bear the risk<sup>47)</sup> of actions taken by its *own* government and, consequently, is not exempted from liability. The case that we are discussing here, however, is different. It does *not* fall within a party's sphere of risk if its *own* government implements a trade ban due to the behavior of a *foreign* state or party. The other party – directly or indirectly profiting from poor standards, for example, because of low wages – should bear the risk of trade bans due to its *own*, or its *own* governments's, conduct or mistakes. Thus, this latter party may not argue that the breaching party could reasonably be expected to have taken the impediment into account at the time of the conclusion of

44) An example for an economic sanction against a state that violates basic human rights is the US-embargo against China from 1989. The Chinese Police killed hundreds of demonstrators during the break up of the occupation of the Tiananmen Square in Beijing. Amongst other things, the US-Government threatened China to revoke its MFN (Most Favorable Nation) trading status, if the violation of human rights continued. For further details on this matter, see HOSSEIN G. ASKARI/JOHN FORRER/HILDY TEEGEN/JAIWEN YANG, *Case Studies of U.S. Economic Sanctions: The Chinese, Cuban and Iranian Experience*, Westport 2003, pp. 20 et seq. For a detailed list concerning embargoes and other economic sanctions imposed by the UN, see resolutions by the *UN Security Counsel*, available online at <[http://www.un.org/Docs/sc/unsc\\_resolutions.html](http://www.un.org/Docs/sc/unsc_resolutions.html)> (09 June 2008).

45) See INGEBORG SCHWENZER in Schlechtriem/Schwenger (eds.), *Kommentar zum Einheitlichen UN-Kaufrecht CISG*, 5th German Edition, Munich 2008, Art. 79 para 32.

46) The examples of impediments given by the Commentary on the Draft Convention on Contracts for the International Sale of Goods prepared by the Secretariat («Secretariat Commentary»), UN DOC. A/CONF. 97/5, are: wars, storms, fires, government embargoes and the closing of international waterways. See Secretariat Commentary, Art. 65 (now Art. 79) para 5, available online at <<http://www.cisg-online.ch/cisg/materials-commentary.html#Article%2065>> (03 June 2008).

47) The possibility of exemption under Article 79 CISG is primarily one of distribution of risk. Cf. PETER SCHLECHTRIEM in Schlechtriem/Schwenger (eds.), *op. cit.* (fn 42), Art. 8 para 8.

the contract. This result is in accordance with Article 7(1) CISG and the ideas underlying Article 80 CISG.

### III INCORPORATION OF ETHICAL STANDARDS IN SALES CONTRACTS

In most cases, however, there will be no relevant regulations of public law. The first question that then arises is whether and how basic ethical standards become a part of the contract.

#### 1 Express Terms

The first way to incorporate ethical standards into sales contracts is to stipulate that the seller, for example, has to abide by specific standards concerning human rights, labor conditions or the environment. By so doing, such norms become part of the contract and may be enforced, or their violation sanctioned, in the same way as with any other terms. It is highly advisable that the interested party insists on incorporating such express terms into the contract, in order to circumvent any later disputes in this respect and in order to «tailor»<sup>48)</sup> individual clauses to address specific human rights issues.

Novartis, one of the leading pharmaceutical companies, for example, includes the following clause in its contracts:

«Novartis gives preference to third parties who share Novartis' societal and environmental values, as set forth in the Novartis Policy on Corporate Citizenship ... Accordingly, Seller represents and warrants this agreement will be performed in material compliance with all applicable laws and regulations, including, without limitation, laws and regulation relating to health, safety and the environment, fair labour practices and unlawful discrimination.»<sup>49)</sup>

#### 2 Other Means of Incorporation

Problems may arise where such express terms regarding ethical values are absent. Very often, particularly small and medium-sized companies do not have the bargaining power to insist on incorporating such express terms concerning ethical values into their contracts.<sup>50)</sup> Here, however, contract interpretation and supplementation may well lead to similar results to those reached with express incorporation.

48) Cf. KLAUS LEISINGER, *Are «Human Rights» the «Business of Business»?*, Comment to the Contribution of David Weissbrodt, in: *zfwu* 2005, Vol. 3, pp. 298–303, p. 302.

49) Cf. NOVARTIS AG (ed.), *Novartis Third Party Code of Conduct*, available online at <[http://www.corporatecitizenship.novartis.com/downloads/business-conduct/Novartis\\_TP\\_Code.pdf](http://www.corporatecitizenship.novartis.com/downloads/business-conduct/Novartis_TP_Code.pdf)> (06 June 2008).

50) However, they sometimes confederate in order to have more market power.

According to Article 9(1) CISG, the parties are bound by any usage to which they have agreed and by any practice which they have established between themselves. Thus, two situations have to be distinguished: the first one is where the parties have repeatedly<sup>51)</sup> agreed on express terms setting up certain ethical standards; in such a case, a justified expectation might arise that the parties will continue to proceed accordingly in the future.<sup>52)</sup> Thus, although an express term is lacking, the contract may be supplemented in accordance with the previous conduct of the parties. The second situation is the one where the parties have individually agreed to a certain usage. This may be presumed where both parties participate in one of the above-mentioned private initiatives, such as the UN Global Compact. Under these conditions, it is irrelevant whether the agreed usage could also fall under Article 9(2) CISG as an international trade usage. If both parties have agreed to certain standards on a broader scale, they must, consequently, be deemed to have, at least implicitly, agreed to such a usage in their individual contracts.

If neither of the foregoing situations is at hand, ethical standards might still become part of the contract via Article 9(2) CISG. This presupposes that they can be regarded as an international trade usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned. In this regard, first and primary consideration should be given to usages and practices that have been established in certain trade branches, such as the «Electronic Industry Code of Conduct» already mentioned.<sup>53)</sup> If there are no usages or practices prevalent in the specific sector, special regard can be given to general private initiatives, such as the UN Global Compact. Although its provisions are rather broad and unspecified, there can be no doubt, that – at the very least – minimum ethical standards are to be safeguarded. These include prohibition of child labor and forced and compulsory labor, as well as a minimum of humane labor conditions.<sup>54)</sup> Thus, via Article 9(2)

51) According to the prevailing view, at least some practice – i.e. a sequence of previous contracts – is necessary. Cf. MARTIN SCHMIDT-KESSEL in Schlechtriem/Schwenzer (eds.), op. cit. (fn 42), Art. 9 para 8; WOLFGANG WITZ in Witz/Salger/Lorenz (eds.), *International Einheitliches Kaufrecht*, Heidelberg 2000, Art. 9 para 16.

52) See LG Frankenthal (Germany), 17 April 1997, CISG-online 479, available online at <<http://www.cisg-online.ch/cisg/urteile/479.htm>> (03 June 2008), stating: «Eine Gepflogenheit im Sinne des Artikel 9 CISG setzt nämlich eine gewisse Häufigkeit und Dauer eines Verhaltens voraus, so daß es berechtigt erscheint, wenn eine Partei auf ein solches Verhalten als üblich vertraut.»

53) For other examples of industry initiatives, see <<http://www1.umn.edu/humanrts/business/icgi.html>> (03 June 2008).

54) See UN Global Compact, available online at <<http://www.unglobalcompact.org>> (16 June 2008)

CISG, these minimum ethical standards may form, as implied terms, part of every international sales contract.

#### IV CONSEQUENCES OF THE FAILURE TO COMPLY WITH ETHICAL STANDARDS

As already mentioned, it is commonplace nowadays for many corporations to take precautions to ensure that their contractual partners adhere to the required ethical standards. Usually, ethics audits as well as ecological audits are conducted *before* the corporations actually enter into a contract with a new business partner. This, however, cannot prevent ethical values from being violated in individual cases of performance. In such cases, the remedies available to the obligee be it as a buyer or as a seller, are questionable.

##### 1 Buyer's Remedies

The first question in cases where goods are or have been produced in violation of the ethical values requirement of the contract is whether this fact constitutes a non-conformity of the goods according to Article 35 CISG.

###### *a Non-Conformity of the Goods, Art. 35 CISG*

The problem in this context is that, in most cases, the violation of ethical standards does not negatively influence the physical features of the goods. No third party would be able to ascertain the violation of ethical standards upon a mere examination of the goods. Still, the very way of producing the goods influences their value on the market.<sup>55)</sup> Many buyers are willing to pay a higher price for goods produced under circumstances that safeguard ethical standards. This is an established fact with regard to goods produced by observing specific biological and organic standards.<sup>56)</sup> However, the same holds true for other goods, for example clothes that are not produced under sweatshop conditions.

55) Cf. JAN HEILMANN, *Mängelgewährleistung in UN-Kaufrecht*, Berlin 1994, p. 179: «Beschaffensheiten für die der Verkäufer wegen Wertbeeinträchtigung haftet, sind nur die wertbildenden Faktoren wie Herkunft, Zusammensetzung [...]»

56) Cf. OLG München, 13 November 2002, CISG-online 786, available online at <<http://www.cisg-online.ch/cisg/urteile/786.pdf>> (03 June 2008). In this case, the buyer purchased organically produced barley from the seller. The seller did not provide the buyer with the necessary documents that showed that the goods had been produced in the appropriate way. The court held that it is almost impossible to establish, with reasonable expense, whether the barley had, in fact, been produced organically. It further held that organically produced barley is more than twice as expensive as normal barley, i.e. DM 625 instead of DM 290 per ton. The court emphasized that it was not a question of missing documents, but one of non-conforming goods, because the documents had no independent meaning («Das Begleitpapier hat hier keine eigenständige Bedeutung. Vielmehr macht sein Fehlen die Ware selbst vertragswidrig [...]»).

If an express or implied term can be derived from the contract itself, non-conformity of the goods already follows from Article 35(1) CISG. It must be remembered here that, in this day and age, the observance of, at least, basic ethical standards can be regarded as an international trade usage and, thus, as an implied term in every international sales contract. Goods processed under conditions violating the contractually fixed ethical standards are not of the *quality* asked for by the contract. Quality must be understood as not just the goods' physical condition, but also as all the factual and legal circumstances concerning the relationship of the goods to their surroundings. It is irrelevant whether those circumstances affect the usability of the goods due to their nature or durability. The agreed origin of the goods, which necessarily comprises issues of ethical standards, also forms part of the quality characteristics.<sup>57)</sup>

Insofar as the contract does not contain any, or only insufficient details in order to determine the requirements to be satisfied in producing the goods, recourse is to be had to the subsidiary determination of conformity set forth in Article 35(2) CISG.

First of all, the goods must be fit for any particular purpose according to Article 35(2)(b) CISG. In this context one may think of a buyer purchasing goods in order to sell them in specific markets, such as one specializing in organic food, biodynamic agriculture or fair trade. However, this particular purpose must be made known to the seller at the time of the conclusion of the contract, be it expressly or impliedly.<sup>58)</sup> This requirement may be fulfilled in cases where the buyer's firm, i.e. the company's name, contains information in this regard or where its reputation in context with ethical values is widely known in the trade sector concerned.

The further prerequisite laid down in Article 35(2)(b) CISG, namely that the buyer relied on the seller's skill and judgment and it was reasonable for it to do so, should not cause any problems in these cases.

If a particular purpose in the above-mentioned sense cannot be construed, it might be questionable whether fitness for the ordinary purpose, according to Article 35(2)(a) CISG, presupposes that the goods have been manufactured or processed in accordance with specific ethical standards. Ordinary purpose primarily means that the goods must be fit for commercial purposes. In the resale business, this means that

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57) Bundesgerichtshof (Germany), 3 April 1996, CISG-online 135, online at <<http://www.cisg-online.ch/cisg/urteile/135.htm>> (05 June 2008): «Selbst wenn man davon ausgehe, daß die Lieferung englischer Ware vereinbart worden sei und Kobaltsulfat in England tatsächlich hergestellt werde, stelle die in Südafrika produzierte Ware zwar ein aliud dar. Dieses sei nach UN-Kaufrecht jedoch wie eine Schlechtlieferung zu behandeln [...]».

58) See INGEBORG SCHWENZER in Schlechtriem/Schwenzer (eds.), op. cit. (fn 42), Art. 35 para 21; HANNS-CHRISTIAN SALGER in Witz/Salger/Lorenz (eds.), op. cit. (fn 51), Art. 35 para 10.



it must be possible to resell them.<sup>59)</sup> In general, this purpose of the goods will not be influenced by the mere way in which the goods are manufactured or processed.<sup>60)</sup> Thus, in cases not covered by Article 35(1) CISG or Article 35(2)(b) CISG, there will be little chance for the buyer to allege non-conformity of the goods and to hold the seller responsible if ethical standards have not been met.

If the goods are non-conforming, the buyer must notify the seller in accordance with Articles 38 and 39 CISG. However, where the non-conformity results solely from the way in which the goods are manufactured or processed, any eventual examination of the goods themselves will not reveal this fact. Thus, notification can only be required from the buyer after it has actually learned about the violation of ethical standards. Such knowledge may, in an individual case, be inferred from missing certificates relating to the origin of the goods.<sup>61)</sup> If the non-conformity is not discovered until more than two years have passed since the handing-over of the goods, however, Article 39(2) CISG prevents the buyer from relying on the non-conformity.

#### *b Possible Remedies*

In the case of non-conforming goods, the buyer may resort to the usual remedies, namely avoidance of the contract, damages and price reduction;<sup>62)</sup> all such remedies raise special questions in connection with the violation of ethical standards.

Even if one finds that violation of ethical standards does not result in non-conformity of the goods in accordance with Article 35 CISG, if compliance with certain standards is a duty resulting from the contract, any non-compliance amounts to a breach of contract, giving rise to all remedies that are not specifically limited to cases of non-conformity.

59) Cf. JOHN O. HONNOLD, *Uniform Law for International Sales*, 3rd ed., The Hague 1999, Art. 35 para 225; INGBORG SCHWENZER in Schlechtriem/Schwenger (eds.), op. cit. (fn 42), Art. 35 para 14; HANNIS-CHRISTIAN SALGER in Witz/Salger/Lorenz (eds.), op. cit. (fn 51), Art. 35 para 9. See also High Court of Auckland (New Zealand), 31 March 2003, CISG-online 833, para 58–60, available online at <<http://cisgw3.law.pace.edu/cases/030331n6.html>> (03 June 08).

60) But see FRITZ ENDERLEIN in Enderlein/Maskow/Strohbach (eds.), op. cit. (fn 43), Art. 35 para 8, who agrees that goods are not fit for the ordinary purpose under Article 35(2)(a) CISG if their commercial value is reduced considerably because of the lack of conformity.

61) OLG München, 13. November 2002, CISG-online 786, available online at <<http://www.cisg-online.ch/cisg/urteile/786.pdf>> (03 June 2008).

62) See INGBORG SCHWENZER in Schlechtriem/Schwenger (eds.), op. cit. (fn 42), Art. 35 para 43; ULRICH MAGNUS in *J. von Staudingers Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen, Wiener UN-Kaufrecht (CISG)*, 15th ed., Berlin 2005, Art. 45 para 1 et seq.

*aa Avoidance of the Contract, Art. 49(1)(a) and Art. 25 CISG*

Avoidance of the contract is possible only in cases where the non-conformity amounts to a fundamental breach of contract.<sup>63)</sup> This presupposes a substantial deprivation of what the buyer is entitled to expect under the contract.<sup>64)</sup> Such deprivation can be ascertained, in the first place, from the terms of the contract.<sup>65)</sup> If the parties stipulate that certain ethical standards have to be adhered to, the parties have, thereby, sufficiently made clear that compliance is of special interest to the buyer and, therefore, such deprivation can be assumed in the event of a breach. In cases where *basic* ethical standards have been violated, such a fundamental breach also exists, having regard to the fact that damages in these cases are often not sufficient to sanction this breach of contract.<sup>66)</sup> Furthermore, if the buyer is not allowed to avoid the contract, its reputation may still be endangered, because the buyer could be seen to be associated with the seller and its unethical behavior. In all other cases, where the alleged violation does not concern *basic* ethical values, whether or not the breach is fundamental has to be determined on a case-by-case basis.

*bb Damages, Art. 45(1)(b) and 74 CISG*

The easiest way for the buyer to obtain financial redress in case of violation of ethical standards is where the parties have agreed upon a liquidated damages clause or a contractual penalty, whereby the latter generally functions as both a compensatory remedy as well as a deterrent.<sup>67)</sup> Such a clause releases the buyer from its – maybe difficult – obligation of proving whether or not it suffered any loss at all and, if so, in what amount. However, parties may not think of such a clause in connection with compliance with ethical standards, or the buyer may not be in a position to force such a clause on the seller. Furthermore, in Anglo-American legal systems penalty clauses as such are invalid. Therefore, it is important to examine what can be considered to be a recoverable loss within the meaning of Article 74 CISG.

63) See INGEBORG SCHWENZER in Schlechtriem/Schwenzer (eds.), op. cit. (fn 42), Art. 49 para 4; JOHN O. HONNOLD, *Uniform Law for International Sales*, op. cit. (fn 59), Art. 49 para 304.

64) See PETER SCHLECHTRIEM in Schlechtriem/Schwenzer (eds.), op. cit. (fn 42), Art. 25 para 9; BENJAMIN K. LEISINGER, *Avoidance of the Contract Considering Non-Conformity of the Goods*, Munich 2007, pp. 38 et seq.

65) Cf. PETER SCHLECHTRIEM in Schlechtriem/Schwenzer (eds.), op. cit. (fn 42), Art. 25 para 9; CISG-AC OPINION No 5, *The Buyer's Right to Avoid the Contract in Case of Non-Conforming Goods or Documents*, 7 May 2005, Badenweiler (Germany). Rapporteur: Professor Dr. Ingeborg Schwenger, LL.M., Professor of Private Law, University of Basel, para 4.2, available online at <[http://www.cisg-online.ch/cisg/docs/CISG-AC\\_Op\\_no\\_5.pdf](http://www.cisg-online.ch/cisg/docs/CISG-AC_Op_no_5.pdf)> (03 June 2008).

66) Cf. CISG-AC OPINION No 5, op. cit. (fn 65), para 4.1.

67) See HANS STOLL/GEORG GRUBER in Schlechtriem/Schwenzer (eds.), op. cit. (fn 42), Art. 74 para 49.

In the first place, if the goods have not been sold before the violation of ethical standards is discovered, lost profits will be likely to occur. This may be because the goods are no longer resalable, or because the buyer decides not to resell them under the given circumstances. The latter behavior cannot be sanctioned as a violation of the buyer's general duty to mitigate damages according to Article 77 CISG, at least not where the buyer cannot be expected to sell the goods elsewhere, possibly at a lower price. This, i.e. whether the buyer can be expected to sell the goods, in turn, has to be decided by taking all the circumstances into account, such as the respective weight of the breach.<sup>68)</sup> In addition, further damages accruing from substitute transactions can be recoverable under Articles 75 and 76 CISG in these cases.

If the goods have already been resold prior to discovering the breach, damage in the form of loss of reputation may come into play.<sup>69)</sup> As Article 74 CISG recognizes the principle of full compensation, there is no question that loss of goodwill can be recovered under this article.<sup>70)</sup> Such a loss should always be foreseen or ought to be foreseen according to Article 74 CISG. It might, however, be difficult to financially quantify a loss of goodwill in an individual case. In assessing the amount, due regard is to be given to the level of public ethical commitment by the individual buyer, such as, for example, participation in one of the above-mentioned private initiatives.

Problems arise, however, where all goods have been resold and the violation of ethical standards by the buyer's supplier has never become public knowledge. Although, even in such a case, one might argue that there is a loss of goodwill that could perhaps materialize in some future sale of the business itself, for example during due diligence proceedings, the loss becomes more and more elusive. Therefore, in these cases, another method of calculating damages is called for if one does not want to allow the seller to get off scot-free.<sup>71)</sup> One possibility could be to assess the decrease in value of the goods on an

68) In this regard, several aspects have to be taken into account. One is the very nature of the ethical standard. Another aspect is whether the breach is merely an anomaly, or occurs regularly.

69) See *Interbrand* for a study concerning the value of global brands, available online at <[http://www.interbrand.com/best\\_brands\\_2007.asp](http://www.interbrand.com/best_brands_2007.asp)> (03 June 2008).

70) See HANS STOLL/GEORG GRUBER in Schlechtriem/Schwenzer (eds.), *op. cit.* (fn 42), Art. 74 para 21; HERBERT SCHÖNLE in Honsell (ed.), *Kommentar zum UN-Kaufrecht*, Berlin/Heidelberg/New York 1996, Art. 74 para 13; CHRISTOPH BRUNNER, *UN-Kaufrecht – CISG*, Bern 2004, Art. 74 para 8; WOLFGANG WITZ in Witz/Salger/Lorenz (eds.), *op. cit.* (fn 51), Art. 74 para 12; INGEBORG SCHWENZER/PASCAL HACHEM, *The Scope of the CISG Provisions on Damages*, in: Ralph Cunnington/Djakhongir Saidov (eds.), *Contract Damages: Domestic and International Perspectives*, Oxford 2008, pp. 91–105, p. 98.

71) See INGEBORG SCHWENZER/PASCAL HACHEM, *The Scope of the CISG Provisions on Damages*, *op. cit.* (fn 70), p. 95

abstract level. The purchase price always reflects the costs of producing of the goods and a profit for the seller. If the seller, by violating ethical standards, substantially reduces the costs in production and thus respectively maximizes its own profit, the equilibrium of the contract has become unbalanced. One may well argue that the real value of the goods is decreased by the amount of the – unethically – reduced production costs. The buyer may claim this margin as minimum damages. Although this might appear to be a windfall profit for the buyer, it is the only way to secure that – in the long term – ethical standards can be and actually are enforced by buyers having an incentive to do so.<sup>72)</sup> Moreover, in many legal systems today – at least in scholarly writings – the law of damages is regarded as a means for *prevention* and not only for compensation.<sup>73)</sup>

*cc Price Reduction, Art. 45(1)(a) and Art. 50 CISG*

Finally, the possibility of a price reduction according to Article 50 CISG exists. As has been set out, any reduction of the production costs resulting from a violation of ethical standards can be regarded as causing a decrease in the value of the goods. Thus, the buyer may reduce the purchase price in proportion to the lower value that the goods actually delivered had at the time of the delivery.

## 2 Seller's Remedies – Avoidance of the Contract and Damages, Art. 45(1) CISG

The factual situations for sellers who want to assure that their contract partners comply with certain ethical standards are different. As has been shown above, the main sphere of application for the seller is the sale of so-called dual-use goods that can be misused in violation of basic ethical values, such as to produce chemical, biological or nuclear weapons.<sup>74)</sup> If compliance with ethical standards has become part of the contract in the way described above,<sup>75)</sup> any non-compliance would amount to a breach of contract. If such a misuse becomes apparent, the question again arises as to what remedies the seller has.

72) See INGBORG SCHWENZER/PASCAL HACHEM, *The Scope of the CISG Provisions on Damages*, op. cit. (fn 70), p. 95.

73) For Germany, see REINHARD MÖLLER, *Das Präventionsprinzip des Schadensrechts*, Berlin 2006; THOMAS DREIER, *Kompensation und Prävention*, Tübingen 2002, p. 500 et seq. For developments on an European level, see ULRICH MAGNUS, *Comparative Report on the Law of Damages*, in: Magnus (ed.), *Unification of Tort Law: Damages*, The Hague/London/Boston 2001, p. 185 para 8 et seq. See also WALTER VAN GERVEN/JEREMY LEVER/PIERRE LAROCHE, *Cases, Materials and Text on National, Supranational and International Tort Law*, Oxford/Portland 2000, p. 25.

74) For a detailed list of EU-legislation concerning dual-use technology, see *Activities of the European Union*, available online at <<http://europa.eu/scadplus/leg/en/lvb/l11029.htm>> (09 June 2008).

75) *Supra* III: Incorporation of Ethical Standards in Sales Contract.

In relation to both avoidance of the contract and damages, the same considerations as those concerning the buyer apply.

Again, it has to be established that the breach by the buyer is fundamental in order to give rise to the remedy of avoidance.<sup>76)</sup> A claim for damages will predominantly depend on the question of whether lost profits and loss of goodwill are present. Here, however, any abstract calculation of damages based upon the equilibrium of the contractual obligations is likely to fail. The only way to construe damages mirroring the buyer's solution outlined above would be to speculate that goods for the intended unethical use would have a higher value on the international market. The loss of the seller would then be that, in relying upon the buyer's contractual promise to comply with ethical standards, the purchase price did not reflect the real value of the goods.

### 3 Hardship, Art. 79 CISG and Art. 6.2.1 et seq. Unidroit Principles 2004

Ethical questions may also arise where it is not one of the contracting parties that violates ethical standards and thereby breaches the contract, but where the political situation in the buyer's or the seller's country changes in a way that basic ethical standards are disregarded. Although it must be mentioned again that it is the primary task of the community of states to take the appropriate political measures, prompt action by private companies may be called for prior to such – often time-consuming and long-winded – endeavors. Otherwise, companies carrying on business with partners from states violating basic human rights may be later blamed for being complicit with human rights abuses, be it actively or passively.<sup>77)</sup> In this regard, the discussions with regard to doing business in South Africa under the Apartheid-Regime and the now pending class actions against many global companies come to mind.<sup>78)</sup>

76) *Supra* IV 1 b aa: Avoidance of the Contract, Art. 49(1)(a) and Art. 25 CISG.

77) See Principle Two of the UN Global Compact, available online at <<http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle2.html>> (03 June 2008): «Businesses should make sure they are not complicit in human rights abuses.»

78) See NARANDRAN JODY KOLLAPEN, *Human Rights and Business: The Apartheid Experience*, Speech given at the Novartis Symposium «Human Rights and the Private Sector», in: Novartis Foundation for Sustainable Development/The Prince of Wales International Business Leaders Forum (eds.), *Human Rights and the Private Sector*, International Symposium Report, Basel 2004, pp. 26–28, available online at <<http://www.novartisfoundation.org/platform/apps/Publication/getmfmlfile.asp?id=611&el=1432&se=717479138&doc=127&dse=2>> (03 June 2008). For further information, see webpage <<http://www.business-humanrights.org/Categories/Miscellaneous/Historical/Businessduringapartheid>> (03 June 2008). For further information about the class action regarding apartheid, see an article on [swissinfo.ch](http://www.swissinfo.ch) (14 May 2008), available online at <<http://www.swissinfo.ch/eng/search/Result.html?siteSect=882&ty=st&sid=9088889>> (16 June 2008).

Reasonable action that could be taken by sellers and buyers concerning their contractual relationship with their business partners would be, primarily, to suspend the performance of the contract. In order to escape liability for damages, suspending performance is only possible if the requirements for an exemption under Article 79 CISG are met. According to this Article, firstly, there must be an impediment beyond the party's control. Impediments are usually defined as external circumstances or exogenous causes that impair the promisor's ability to perform.<sup>79)</sup> Taken at face value, such an impediment could not be assumed in the cases discussed here. However, there can be no doubt that it would be commercially unreasonable to continue performance of the contract where this would risk causing detriment to one's business reputation. The management may even be under a duty of corporate law, e.g. towards their shareholders, to suspend the performance of such contracts. Whether *ethical hardship*, as present in the described cases, is an impediment within the meaning of Article 79(1) CISG has never been discussed, neither in case law nor in scholarly writing.

To answer this question, recourse is to be had to the legislative intention underlying Article 79 CISG. Although, admittedly, the provision's history, systematic placement and wording imply that an exemption comes into consideration only under very narrow conditions,<sup>80)</sup> it reflects the intention of reasonable parties who are willing to take responsibility for risks that are outside their sphere of control only to the extent that they are able to insure against these risks or can take them into account when drafting the contract.<sup>81)</sup> The fact that, after the conclusion of the contract, grave violations of basic ethical values – such as human rights – in the country of the obligee occur certainly falls outside the sphere of risk of the promisor. If, for ethical reasons, it cannot reasonably be expected of the obligor to perform the contract, this certainly amounts to an impediment.

The other prerequisites set out in Article 79(1) CISG, namely that the obligor could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences, do not pose any major problems in connection with the cases discussed here.

79) See HANS STOLL/GEORG GRUBER in Schlechtriem/Schwenzer (eds.), op. cit. (fn 42), Art. 79 para 11. Impossibility, however, is not required as even laws can be evaded. See JOHN O. HONNOLD, op. cit. (fn 59), Art. 79 para 432.1.

80) See HANS STOLL/GEORG GRUBER in Schlechtriem/Schwenzer (eds.), op. cit. (fn 42), Commentary Art. 79 para 1.

81) Cf. PETER SCHLECHTRIEB in Schlechtriem/Schwenzer (eds.), op. cit. (fn 42), Art. 8 para 8; HANNS-CHRISTIAN SALGER in Witz/Salger/Lorenz (eds.), op. cit. (fn 51), Art. 79 para 5 et seq.

## V CONCLUSION

As has been shown, ethical behavior is becoming increasingly important for businesses and for conducting business. Such importance must necessarily translate into appropriate action, for example, as prescribed in codes of conducts or in contracts.<sup>82)</sup>

A crucial question is how those ethical values can be realized and upheld in daily commercial business transactions. It has been shown that, in contracts governed by the CISG, ethical norms can be incorporated by several different means.<sup>83)</sup>

The violation of – express or implied – contractual ethical duties by the seller usually leads to non-conformity of the goods under Article 35 CISG. Consequently, the party in breach can face remedies, such as a claim for damages, price reduction or – in the event of a fundamental breach under Article 25 CISG – avoidance of the contract.

As for damages, the loss of a buyer at least equals the amount by which the seller reduced its production costs by producing the goods in an unethical way. The loss of a seller equals the eventual difference between the contractual value of the goods – i.e. the purchase price – and the real value of the goods, taking into account the unethical use that is intended and the possible consequences arising there from.

In cases where the external circumstances change in a way that third parties – such as governments or rebels – severely violate ethical standards, this amounts to an impediment under Article 79(1) CISG. Here, sanctions by the community of states are likely to occur, and – for ethical reasons – it cannot reasonably be expected of the obligor to perform the contract. The obligor, in such cases, is entitled to suspend the performance of the contract without having to fear liability for damages.

Thus international sales law, especially the CISG may play an important role in ensuring that basic human rights and ethical standards are observed in international business so that – in the long run hopefully – a violation of basic human rights will not pay anymore.<sup>84)</sup>

82) *Supra* I 5: Private Initiatives.

83) *Supra* IV: Consequences of the Failure to Comply with Ethical Standards.

84) For a critique on this approach, see PETER SCHLECHTRIEM, *Non-Material Damages – Recovery under the CISG?*, op. cit. (fn 41), p. 98: «[...] [T]here are doubts as to whether the CISG is the right instrument to promote our convictions. [...] [T]he condemnation of certain production methods only reflect social standards of affluent minorities wanting to do good, and whose members can easily do without the goods in question. [...] It is also uncertain to what extent all members of this group share the same convictions and are willing to act accordingly [...]».

