

EMOTIONAL NON-CONFORMITY IN THE INTERNATIONAL SALE OF GOODS, PARTICULARLY IN RELATION TO CSR-POLICIES AND CODES OF CONDUCT

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5.1 INTRODUCTION

History has shown that the law faces challenges when commercial practices undergo changes. In the 18th century when transactions in raw materials created speculation and price volatility, contract law needed to develop new concepts of 'fair price' and force majeure. In the 19th century, technical development posed problems for the law relating to implicit terms and merchantability. In the early 20th century, mass transactions created legal problems relating to standard forms. Later during the 20th century, the increased use of sub-suppliers and outsourcing made it necessary to address problems relating to direct action against parties other than contracting parties.

What is the problem for the 21st century? This article will briefly describe the rather new trend in commerce that companies see large profits in the sale of emotions, that is, in the value provided by brand names.¹ This entails challenges for law. I will analyse how the present rules in contract and sales law apply to the sale of emotions. My analysis will mainly result in unanswered questions. It is natural that an area of the law under development due to new business behaviour has more uncertainties than clear-cut answers.²

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1 The marketing guru Bruce Burton stated already in 1923 that the task for marketing was to help business find its soul, its own profile. See R. Marchand, 'The Corporation Nobody Knew: Bruce Barton, Alfred Sloan and the Founding of the General Motors Family', *Business History Review*, Vol. 65, No. 4 (Special Issue), 1991, p. 825.

2 M. Luz, 'The Lawyer's Role in Mitigating CSR Risk', *American Society of Int'l Law Proceedings*, Vol. 99, 2005, pp. 267-268: "This lack of clarity as to CSR standards has important consequences to those of us advising clients on how to avoid litigation risk. Indeed, unclear legal standards, or the faulty application of standards, can cause the wrong sorts of incentives. In the CSR context, if the relevant legal standards are unclear, or are applied in an inconsistent and unpredictable way, then the risks attendant to any particular foreign investment will become more difficult and expensive to manage."

Phil Knight, the co-founder, chairman and former CEO of Nike, was once asked why Nike sport shoes are so expensive and why anybody would be willing to pay twice as much for Nike shoes compared to no-brand shoes. He answered that Nike does not sell shoes, Nike sells feelings.³

Nike is by no means the only company to sell feelings. We see it everywhere, in the fashion industry, in the sale of cars, computers, food, knives, guns, pharmaceuticals, cigarettes, furniture, etc. The commercial rationale is that a standardized no-brand product will be exposed to competition and the profit margins will inevitably become very small. There are better possibilities for large profit margins when a product is loaded with positive connotations and when the buyer wants to become associated with the product's emotional values. It is not mainly a matter of selling a product with a function, but selling a possibility for the buyer to communicate his or her personality through the use of the product. It is much harder for a competitor to mimic the feeling of a product than a product's technical and visual features.

It is expensive to physically produce goods. It is also expensive to produce emotions through brand names. Many companies invest substantially in the production of the good feeling to be associated with its brand names. The law normally supports investments. Is contract law able to protect investments in emotions? Is it a task for contract law to protect investments aiming at the sale of emotions? Ought contract law develop in a direction towards increasing or decreasing investments in brand names?

One way for a producer to create emotional value and to allow premium pricing is to invest in brand name recognition. This is sometimes partly achieved by implementing a policy for corporate social responsibility (a CSR-policy) or a Code of Conduct.⁴ Thereby a company demonstrates that it is ethically responsible which in turn will contribute to the 'good feeling' associated with the company and its brand names.⁵ This paper will analyse how CSR-policies and Codes of Conduct may affect whether products are in conformity with the contract.

The sale of emotions is ultimately aimed at the end customer. It is often necessary that the whole production process is set up with the aim to create emotional value for which the end customer is willing to pay. All sub-suppliers contribute in the creation of the

emotional value. If one sub-supplier fails, the whole emotional value may be destroyed. This paper mainly concerns the relation between a supplier and its sub-suppliers and not the relation between the supplier and its end customer. This paper concerns international business-to-business contracts. The end customer is sometimes a business willing to pay for feelings and emotional value. Very often the end customer is a consumer. This paper does not cover consumer law aspects.

There is abundant criticism against companies selling emotions and feelings by implementing CSR-policies. The critics claim that the good-making efforts are made for the wrong reasons – only as window-dressing – and not really meant to improve social or environmental problems related to child labour, pollution, poverty, arms, drugs, etc. The companies' activities are called 'green-washing' and accused of being made in bad faith.⁶ In this paper, I will not address that discussion.

5.3 THE LEGAL PROBLEMS

Let me give some examples of the legal problems relating to the sale of emotions. All the examples are sketched with inspiration from real situations – although not all of them have ended up as legal disputes.

A furniture company had a Code of Conduct stating that it and its sub-contractors only use personnel aged 15 or older. It turned out that a carpet supplier consistently used employees under that age. This was widely reported in the media, and the furniture company's brand was substantially harmed. Is the furniture company entitled to early termination of the five-year contract with the carpet supplier? Is the furniture company entitled to damages from the carpet supplier? If so, how should the damage be calculated?

A goose down producer plucked feathers from living birds. This was very painful for the birds and amounted to animal cruelty. The production methods were revealed in a television programme and created widespread upset reactions. A pillow producer, who was unaware of the production methods, had a long-term contract with the down producer, and its brand name was severely damaged. Is the pillow producer entitled to damages from the down producer?

A fashion company had contracted with a very famous photo model to launch its new collection. All the photos and commercials were finished. Two weeks before the marketing campaign was to be released, the photo model was caught on a photo snorting cocaine and she was heavily criticized in media. The fashion company decided to cancel the marketing campaign and to re-make the entire campaign with a new photo model. Is the

3 G.E. Willigan, 'High-Performance Marketing: An Interview with Nike's Phil Knight', *Harvard Business Review*, July 1992, p. 92; D. Katz, *Just Do It: The Nike Spirit in the Corporate World*, Adams Media Publishing, Avon, Massachusetts, 1994, p. 24.

4 L. Sharp Paine, *Value Shift: Why Companies Must Merge Social and Financial Imperatives to Achieve Superior Performance*, McGraw-Hill Professional, New York, 2003, p. 125.

5 For a description about the development with references, see I. Schwenger & B. Leisinger, 'Ethical Values and International Sales Contracts', in R. Cranston, J. Ramberg & J.S. Ziegler (Eds.), *Commercial Law Challenges in the 21st Century: Jan Hellner in Memoriam*, Iustus Forlag, Sweden, 2007, p. 249.

6 See S. Pakrash, *Setting Global Standards: Guidelines for Creating Codes of Conduct in Multinational Corporations*, New Jersey, Wiley, 2003; T. Collingsworth, 'Corporate Social Responsibility Unmasked', *St. Thomas Law Review*, Vol. 16, No. 4, 2004, pp. 670-671.

fashion company entitled to repayment of the snorting photo model's pay? Is the snorting photo model liable to pay damages to the fashion company for the costs of the new marketing campaign? Is the snorting photo model liable to compensate the fashion company for the harm to its brand name (as it was known in the press that the fashion company was planning on using the famous photo model for its marketing campaign)? Are the fashion company's customers (clothes stores and boutiques) entitled to terminate their contracts with the fashion company, since the clothes will likely not be as popular as anticipated at the time the stores bought the clothes?

A large telecommunication company was accused of having bribed civil servants in a foreign state. Even though it is not clear whether the telecommunication company had violated any law, the telecommunication company's brand name is severely damaged. Is the telecommunication company's domestic distributor entitled to terminate the distribution contract with the telecommunication company and entitled to damages for loss of profit due to the early termination?

For many years, a very well known and respected athlete had a marketing contract with an insurance company. The marketing was very successful. Once the marketing contract had expired after ten years of cooperation, the athlete confessed that he had been doped during his whole life as an athlete. The athlete is in breach of the marketing contract. Is price reduction an available remedy? How should the price reduction be calculated? Should there be any price reduction if the market was unaware of the doping at the time the marketing campaigns were rolling? How is the insurance company's damage calculated? Is there any damage if the marketing campaigns were successful at the time they were rolling?

A producer of fast food had a meat supplier who breached contract. The supplier supplied horsemeat instead of the contracted beef. The food producer's brand name received enormous bad-will when the horsemeat content was reported in the media. It is clear that the food producer is entitled to early termination, to damages for price difference in acquiring beef from a substitute supplier and to a price reduction for the price paid for the meat delivered up until the termination. It is more problematic to determine whether the food producer is also entitled to damages for the harm to its brand name and damages for the decline in demand for all the food producer's products, including products not related to those containing horsemeat.

An owner of an investment fund, after whom the investment fund was named, was found to be a paedophile. This created a scandal in the press. Are the investors (of which some are charity funds for protecting children against abuse) entitled to early termination of their contracts with the investment fund and to withdraw their invested capital, since they are afraid of being associated with the investment fund to the detriment of their brand names and to the detriment of their potential to attract charity gifts?

A yacht producer had always produced its boats in Sweden. The producer started to produce the yachts in Poland. The change of production premises was not communicated in the marketing material. There was no false statement in the marketing material as to the country of origin. The market price for yachts produced in Sweden was higher than for yachts produced in Poland. For some (strange) reason, the market was willing to pay more for a Swedish feeling than a Polish feeling. Is the yacht producer liable to give the buyer a price reduction when, after the sale, the buyer becomes aware that the yacht was produced in Poland?

The emotions need not only be ethical in nature. Some companies sell feelings of security. A car manufacturer was able to increase the price by promoting a feeling of safety. This was partly achieved by certifications from third parties of all the components in the car. One component supplier decided to only go through the expensive certification process for one batch of components. For the following batches, the supplier used counterfeit certificates (fake copies from the real certificate for the first batch). When the car producer learned about the counterfeit certificates, all the cars with uncertified components were withdrawn from the market in order to replace the components. The components were processed in the same manner as certified components and physically in conformity with the contract. The recall and replacement procedure was extremely costly. Is the supplier liable to compensate the car producer for these costs? Or must the car producer mitigate the harm by accepting the lack of the agreed certification in circumstances where the components are physically perfect and the supplier can demonstrate that the components are produced in such a way which would have led to them being certified had the third-party certificate institute been asked to certify them?

My final example comes from the 1990's, and I include it even though it concerns consumer law: A consumer named Kasky bought Nike sport shoes. He was willing to pay the high price in order to get the 'Nike feeling'. This feeling partly consisted of Nike being an ethical company. Nike had published a CSR-policy on its website, which stated that Nike did not use child labour. It turned out that one of Nike's sub-suppliers used children in the production of Nike sport shoes. Kasky had no physical problems with the shoes. They looked great. They functioned perfectly. But the feeling was gone. Could Kasky claim that the shoes were defective? Was he allowed to terminate the sale? Was he entitled to any damages or price reduction?⁷

7 In the Swedish Supreme Court case *NJA 2001 s. 155* a consumer was held to be entitled to a price reduction. The Swedish Supreme Court stated that the buyer was entitled to information from the seller regarding matters which negatively influence market value, and that lack of such information entitled the buyer to a price reduction. It was undisputed that the yacht's physical standard was wholly equivalent to a yacht produced in Sweden. In my opinion this is an outrageous application, whereby the Swedish Supreme Court acknowledged the market's unsubstantiated prejudices against the Polish yacht industry.

8 *Kasky v Nike, Inc.* 27 Cal. 4th 939 (2002). The case concerned whether Nike had breached marketing rules. The case did not concern Kasky's right to termination, price reduction or damages. For an analysis of how

Much of the writing on CSR concerns how to ensure ethical behaviour abroad by multinational corporations through public national legislation (or conventions), by marketing law, company law and corporate governance rules.⁹ This paper only concerns the private law relationship between contracting parties, that is, to what extent a party having as a goal that its brand name be associated with high ethics can hold its suppliers responsible by means of contractual remedies when suppliers use unethical production methods.

5.4 IS THE SALE OF EMOTIONS A SALE?

A fundamental question is how to qualify the sale of products with a large emotional value. Is it possible to distinguish the emotional value from the physical value of a product? What is the emotional value of a Nike sport shoe? What would the price be without the logo type? And what is the emotional value of an Apple iPhone? It is probably not completely wrong to assess the emotional value in these products corresponds to some 75 % of the purchase price. If you buy such a product, you buy 25 % tangibles and 75 % emotions. Is that a sale at all?

The CISG is applicable to sales, which entails that the purpose of the contract is to transfer ownership from the seller to the buyer. Emotions cannot be 'owned', and consequently ownership of emotions cannot be transferred from the seller to the buyer in the sense that the emotion leaves the seller and is transferred to the buyer. The wonderful thing about emotions is that when they are conveyed to another person, they do not disappear.

⁹ Nike handled its reputation in relation to the Kasky case, see E. Collins, C. McDonald & L. Zoch, 'A Crisis In Reputation Management: The Implications of Kasky v. Nike', paper presented to the International Communication Association, 2004.

¹⁰ See J.W. Pitts III, 'Corporate Social Responsibility: Current Status and Future Evolution', *Rutgers Journal of Law and Public Policy*, Vol. 6, No. 2, 2009, pp. 334-433. I. Vytöpil, 'Contractual Control and Labour-Related CSR Norms in the Supply Chain: Dutch Best Practices', *Utrecht Law Review*, Vol. 8, No. 1, 2012, p. 164: "The answer to the question whether codes of conduct are legally binding upon the MNC that publicly adheres to them is not clear-cut. Generally speaking, there are two streams of thought in the international literature. The maximalist perspective argues that codes of conduct are legally binding and that the clauses of these codes should be enforceable in the courts. The minimalist view believes that the character of codes of conduct is not legally binding and that compliance with these codes should be voluntary. A third perspective is that of the 'zebra code', which contains both legally binding and non-binding clauses [...]. The general view, therefore, is that a COC is not in and of itself binding for the MNC that adheres to it. What, if anything, does that mean for the status of the COC in supply relationships? I believe that a mere reference to a code of conduct ('Please take note of the Code of Conduct of Company X, enclosed as Annex A') in a contractual document is insufficient for a contract to be concluded. After all, it is not clear to the supplier that the MNC expects him to uphold the COC and does not constitute an offer in the private law sense." B.V. Ikejaku, 'Consideration of Ethical and Legal Aspects of Corporate Social Responsibility: The issue of Multi-National Corporations and Sustainable Development', *Nordic Journal of Commercial Law*, No. 1, 2012, p. 1, analyses whether CSR for multinational corporations should be implemented voluntarily (self-regulatory) or mandatorily.

pear from the provider and need not necessarily ever have been felt by the provider. CISG Article 3(2) states that the CISG is not applicable when the predominant part of the obligation consists of 'labour or other services'. To provide an emotional feeling is closely related to services.

Furthermore, the CISG is applicable to goods. This is often referred to as tangibles, that is, things that can be touched.¹⁰ Emotions are not tangibles. We see a problem resembling mixed contracts. When products are sold and the price to a large extent is motivated by the high emotional value, it is a mixed contract – partly the sale of tangibles, partly a contract providing emotions. CISG Article 3(1) concerning mixed contracts refers to the buyer supplying a 'substantial part' of the material. By 'substantial part', what is meant is the economic value of the material.¹¹ When we sell a pair of sport shoes or an iPhone, we envisage one self-contained contract for the sale of a product. We do not perceive it as two separate contracts; one for the sale of a physical product and another for the service of transferring an emotion. If the value of the emotion exceeds more than half of the price – that is, if a physically equivalent product without the brand name could be bought at less than half the price – it could be argued that the CISG is not applicable to the transaction.

The discussion on the nature of modern transactions is of philosophical and theoretical interest. However, this discussion is not very fruitful from a practical point of view. In my opinion, it is probable that courts and arbitrators will apply the CISG to international sales of goods irrespective of whether a substantial proportion of the price relates to emotions rather than the product's physical properties. If courts decide not to apply the CISG, general contract law principles will normally apply instead. The outcome will in most cases not differ between the CISG and general contract law with respect to non-conforming emotions.

¹⁰ I. Schwenzer & P. Hachem, in I. Schwenzer (Ed.), *Schlechtriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG)*, 3rd edition, Oxford University Press, Oxford, 2010 ('Schlechtriem & Schwenzer 3rd English edition'). Art. 1, para. 16, refer to "moveable, tangible objects". In a French decision (Cour d'appel de Chambéry [Court of Appeals], France, 25 May 1993, 93-648, CISG-online No. 223) the court did not consider the CISG applicable on the basis that the goods had to be produced according to designs provided by the buyer. In the opinion of the French court, the designs amounted to a substantial part of the materials in the sense of Art. 3(1) CISG. It appears from the report of the case that the only "material" provided by the buyer were the designs.

¹¹ The CISG Advisory Council Opinion No. 4, *Contracts for the Sale of Goods to Be Manufactured or Produced and Mixed Contracts* (Art. 3 CISG), 24 October 2004, Rapporteur: Professor Pilar Perales Viscasillas, states that the notion "preponderant part" refers to the economic value. I do not get the impression that the Advisory Council has analysed to what extent CISG Art. 3 applies to emotional components in the sale of goods.

5.5.1 Express Reference

The parties may have express contractual provisions as to the emotional characteristics of the goods. It is quite common that the parties have referred to a Code of Conduct in their contract, included it in an annex and explicitly stated that the supplier shall adhere to the Code of Conduct. It is also rather common to find express contractual requirements for certification procedures.¹² If the supplier has breached such explicitly contracted terms, the goods are non-conforming and the purchaser is entitled to remedies (see below, Sec. 8).

If the Code of Conduct is included in the contract and gives a right to contractual remedies, it must be determined whether the suppliers' obligation is strict or only imposes an obligation for the supplier to use its best efforts to adhere to the policy. It is fairly frequent that a supplier has implemented costly and impressive procedures to ensure that its sub-suppliers adhere to the Code of Conduct, but it may still turn out that some sub-suppliers use child labour or forbidden chemical substances. Is the supplier liable for all unethical behaviour by its sub-suppliers? Or is the supplier only liable for implementing sufficient procedures to ensure that the Code of Conduct is followed? We often see bold language in Codes of Conduct indicating a strict liability, such as: 'We do not use child labour in the manufacturing of our products'. Such language is normally not addressed at individual purchasers, and the intention is often only to 'do our best to ensure that our products are not produced by children'. How shall the contract be interpreted: solely according to the wording or with an emphasis on trade usages and the nature and purpose of the contract?

5.5.2 No Explicit Reference in the Contract: Introduction

The parties may have communicated generally to the world that they apply a CSR-policy or other ethical standard, without having made an explicit reference in the contract. Sometimes companies use ethical guidelines, but only intended them to serve as an internal document for its employees. This paper concerns ethical standards communicated externally with the direct or indirect purpose of enhancing the surrounding society's impression of the company.

When there is no express special provision in the individually negotiated contract terms, the problem concerns the inclusion of standard terms. The CISG Advisory Council

has explained that standard terms are included in the contract where the parties have expressly or impliedly agreed to the inclusion of the terms and the other party has had a reasonable opportunity to take notice of the terms. Implied agreement may be inferred where the conduct of the other party has created a reasonable understanding that it has accepted the inclusion of the standard terms.¹³ The CISG Advisory Council has furthermore explained that a party is deemed to have had a reasonable opportunity to take notice of the standard terms where the terms are available to and downloadable by the other party at a website and are accessible to that party at the time of negotiating the contract or where the parties have had prior agreements subject to the same standard terms or where the other party is aware of the contents of the standard terms.

The willingness to include standard terms in the contract differs in different jurisdictions.¹⁴ There are examples of strict prerequisites to include standard terms. A German Supreme Court case from 2001 required that it be apparent to the offeree that the offeror wants to include his terms and conditions into the contract. Furthermore, the German Supreme Court stated that the CISG requires the user of general terms and conditions to transmit the text or make it available in another form where the other party did not know of them or was not in a situation in which it could not be unaware of them (CISG Art. 8(2)).¹⁵ In a Dutch case from 2007, a simple reference to the seller's standard terms was insufficient to make the standard terms binding on the buyer, even though the buyer received the general terms and conditions and the use of them was typical in the field of business in which the parties operated.¹⁶ In an Italian case from 2007, the court required the seller to have knowledge of the buyer's standard terms.¹⁷ There are examples of a more generous attitude as to including standard terms. In a case from 1999, the Austrian Supreme Court stated that inclusion can be done implicitly or can be inferred from the negotiations between the parties or a practice which has developed between them.¹⁸

¹³ CISG Advisory Council Opinion No. 13, *Inclusion of Standard Terms Under the CISG*, 20 January 2013, Rapporteur: Professor Sieg Eiselein.

¹⁴ See *id.* referring to various case laws. It is noteworthy that the Principles of European Contract Law (PECL) Art. 2:104(2) states that terms which are not individually negotiated are not brought appropriately to a party's attention by a mere reference to them in the contract document, even if that party signs the document. The same rule does not apply in the UNIDROIT Principles Art. 2.1.19.

¹⁵ Bundesgerichtshof [Federal Supreme Court] (BGH), Germany, 31 October 2001, VIII ZR 60/01, CISG-online No. 617, available at <<http://cisgw3.law.pace.edu/cases/011031gl.html>>. The CISG Advisory Council states that the case is controversial, CISG-AC Opinion No. 13, *supra* note 13.

¹⁶ Rechtbank [District Court] (Rb) Arnhem, Netherlands, 17 January 2007, 146453/HA ZA 06-1789, CISG-online No. 1455, available at <www.unilex.info/case.cfm?id=11919>.

¹⁷ Tribunale [District Court] di Rovereto, Italy, 21 November 2007, 914/06, available at <www.unilex.info/case.cfm?id=12199>.

¹⁸ Oberster Gerichtshof [Supreme Court] (OGH), Austria, 6 February 1996, 10 Ob 518/95, CISG-online No. 224, available at <<http://cisgw3.law.pace.edu/cases/960206a3.html>>. There are examples in national law of generous incorporation of standard terms by a mere reference (without attachment) even when the reference was made after the conclusion of the contract, see the Swedish Supreme Court Case *N/A*, 1980, p. 46. In

¹² Vytöpil, *supra* note 9, p. 155, makes an empirical investigation on how CSR-policies and Codes of Conduct are incorporated in contracts between multinational companies.

Three situations of non-explicit references will be analysed below:

1. Both parties have communicated generally to the world that they apply the same CSR-policy (e.g. by referring to the UN Global Compact).¹⁹
2. Only the purchaser has made such a general communication.
3. Only the supplier has made such a general communication.

5.5.3 Both Parties Make General Communications Regarding the Same CSR-Policy

When both parties have generally communicated externally that they apply a particular CSR-policy or Code of Conduct without expressly referring to the policy or code in their contract, the question is whether this has created a reasonable understanding that they have accepted the inclusion of the ethical standards in their contract.

Schwenzer and Leisinger argue that if both parties participate in a private initiative for ethical standards (such as the UN Global Compact), they are deemed to have implicitly agreed to such a usage in their individual contracts, even though there is no mention of the CSR-policy in the parties' contract.²⁰ I am hesitant to make the same conclusion. It is one thing to generally participate and sponsor a UN initiative. It is another thing to contractually agree that a contractual party is entitled to contractual remedies if an ethical standard is not met.²¹

5.5.4 The Purchaser Makes a General Communication

Very often the question of inclusion of standard terms concerns the *supplier's* reference to terms whereby he limits his liability for damages and other remedies.²² It is, however, in the interest of the *purchaser* to include rules on ethical production methods in order to achieve emotional value, and the question is therefore to what extent the purchaser's general statements regarding its ethical behaviour make the supplier liable for using production

methods non-conforming to the purchaser's ethical aspirations.²³ I do not think that the purchaser's general CSR-policy could form a basis for a claim of non-conformity against a supplier even when the supplier is aware of the policy. It is also necessary that the supplier understands that the purchaser intends that this particular sale fits into his CSR-policy. In other words, it is necessary that the supplier understands that the purchaser has a particular purpose to resell the goods to customers who are willing to pay more for a particular feeling based partly on the production methods. The supplier must also understand that his production methods entail problems for the purchaser in making profits.

In English law, the questions would read:²⁴ Does the CSR-policy form part of the contract because the purchaser's interest in its CSR-policy is too obvious to need stating? Is it necessary to include the CSR-policy in the parties' contract in order to give the contract business efficacy, taking into account that the purchaser's purpose is to sell feelings? The latter question would probably not lead to incorporation of the CSR-policy, since the court would be hesitant to imply such a term on the ground of business efficacy. It requires that the contract would not be commercially workable without it. But if the very essence of the contract is to acquire a feeling more than a physical product, the purchaser's CSR-policy may form part of the contract.

Very often the purchaser has implemented advanced auditing procedures including on-site visits at the supplier's premises by independent third parties. Such procedure is an indicator that the CSR-policy forms part of the contract between the purchaser and the supplier (behaviour subsequent to the conclusion of the contract; see CISG Art. 8(3) and UNIDROIT Principles Art. 4.3(c). In some situations, however, the supplier could successfully argue that he perceived the auditing procedures only as a means for the purchaser to determine whether he wishes to continue to purchase goods from the supplier – and that he did not perceive the auditing procedures to imply that he was liable for production methods contrary to the purchaser's CSR-policy.

5.5.5 The Supplier Makes a General Communication

Normally, in a dispute concerning sale of goods, it is purchasers who wish to rely on the CSR-policy and to hold the suppliers liable for non-conformity. Is the purchaser entitled

²³ The CISG Advisory Council states in Opinion No. 13, *supra* note 13: "There should be a reasonable attempt to make the other party aware of the incorporation. Although standard terms are very frequently used in international trade, there should be no obligation on a party to go hunting for a reference on their inclusion. The obligation should be on the party relying on them to ensure that they are set out in a manner and at a place where a reasonable contractual party would have noticed them."

²⁴ See E. McKendrick, *Goode on Commercial Law*, 4th edition, Penguin, London, 2010, p. 96.

English law a mere reference sometimes suffices to incorporate the standard terms. A.G. Guest, in H. Beale (Ed.), *Chitty on Contracts*, 31st edition, Sweet & Maxwell, London, 2012, s. 12-015, n. 68.

¹⁹ See <www.unglobalcompact.org>.

²⁰ I. Schwenzer & B. Leisinger, *supra* note 5, p. 265. See also I. Schwenzer, in Schlechtriem & Schwenzer 3rd English edition, *supra* note 10, Art. 35, para. 7.

²¹ Also Schlechtriem is hesitant. He states: "it should be considered whether and to what extent the public at large, in the setting of global trade, shares certain ethical values clearly and overwhelmingly, or whether the 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." P. Schlechtriem, "Non-Material Damages – Recovery Under the CISG?", *Pace International Law Review*, Vol. 19, No. 1, 2007, p. 98.

²² It is interesting to note that the CISG Advisory Council in Opinion No. 13, *supra* note 13, has a special 'rule' No. 8 only relevant for the inclusion of the *seller's* standard terms.

to rely on the supplier's general statement about the supplier's ethical behaviour as externally communicated in a CSR-policy or Code of Conduct?²⁵

The supplier's general statement and reference to certain ethical standards can be made in different ways. It can be at the core of the supplier's identity and very clear to everyone coming in contact with the supplier. Other suppliers may keep the reference to their ethical standards hidden.²⁶ Our problem concerns a situation where the purchaser has in fact read the information about the supplier's ethical standards and relied on it. Is this sufficient to hold the supplier liable in a sales contract? I would instinctively say that it is not sufficient that the purchaser has read and relied on the information. An additional prerequisite for holding the supplier liable is that the supplier somehow has communicated a willingness to undertake *contractual* responsibility towards the purchaser.²⁷ Such communication may be implicit if the supplier's ethical policy is at the core of the supplier's marketing and clearly demonstrates the supplier's 'identity'.

It is controversial to hold the supplier contractually liable for not adhering to the supplier's CSR-policy when the purchaser has not ascertained that the policy is included in the contract between the parties. Schlechtriem argues that the fact that the purchaser has an opportunity to explicitly regulate the supplier's liability for production methods in the contract is a strong reason not to include such standards as implicit terms.²⁸

5.6 IMPLICIT TERMS (MERCHANTABILITY, FIT FOR PURPOSE, NORMAL USE): CISG ARTICLE 35

Historically, the notion of lack of conformity has been associated with physical defects.²⁹ It is rather certain that none of the CISG drafters had the sale of feelings and emotions in mind. The wording in the CISG, however, does not exclude that defective emotions may

constitute non-conformity.³⁰ CISG Article 35(2)(a) states that the goods shall be 'fit for purpose'. The notions of merchantability and 'fit for purpose' concern not only the goods' practical and physical use but also include emotional characteristics.³¹

The CISG's rule on non-conformity is basically dependent on the buyer's reasonable expectations. Can the purchaser have reasonable expectations in relation to emotions and feelings? Are feelings of such individual nature that there can be no objective and reasonable expectation? Some companies are more sensitive and care more about feelings than others. Different companies may focus on feelings relating to different matters, such as use of child labour, anti-corruption, peace, the environment, etc. Many international initiatives cover all aspects in CSR-policies, and this tendency may gradually lead to some kind of normal reasonable expectations with respect to feelings and emotions. In my opinion we are not there yet, and for the time being it is hardly possible to identify reasonable, typical expectations. Consequently, it is presently difficult to base a claim for non-conforming emotions solely on the notion of 'fit for purpose'. Normally the purchaser will have little of holding the supplier responsible if ethical standards have not been met by referring to fitness for the ordinary purpose according to CISG Article 35(2)(a) or to the purchaser's particular purpose in CISG Article 35(2)(b).³²

It has been argued that some CSR-policies constitute trade usage in certain trade branches.³³ I doubt that CSR-policies constitute trade usages. They are not normally drafted

30 Schwenzer refers to the good's "characteristics" which clearly includes feelings and emotions, see Schwenzer, in: Schlechtriem & Schwenzer 3rd English edition, *supra* note 10, Art. 35, para. 6 *et seq.*, Schwenzer states that the agreed origin of the goods forms part of its quality characteristics (at 573 with reference to Bundesgerichtshof [Federal Supreme Court] (BGH), Germany, 3 April 1996, VIII ZR 51/95, CISG-online No. 135, available at <www.unilex.info/case.cfm?id=922>, 'Cobalt Sulphate Case'). She continues to state that the same applies to observing certain manufacturing standards, in particular Goods Manufacturing Practices (to be found in EU directives) or fundamental ethical principles (at 573). A case from the Oberlandesgericht München in 2002 concerned the sale of organically produced barley. The barley was non-conforming when the seller was unable to provide a certificate proving the organic origins of the product, irrespective of whether the barley was actually organically produced or not. The buyer, however, lost its right to remedies due to late notice. This case is further discussed below.

31 The term "quality" in CISG Art. 35(1) does not exclude emotional quality. Schwenzer & Leisinger, *supra* note 5, p. 267, state: "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..." The agreed origin of the goods, which necessarily comprises issues of ethical standards, also forms part of the quality characteristics." Schwenzer states that a discrepancy in quality includes "all factual and legal circumstances concerning the relationship of the goods to their surroundings", see Schwenzer, in: Schlechtriem & Schwenzer 3rd English edition, *supra* note 5, Art. 35, para. 9 *et seq.*, with a reference to A. Mullis, in P. Huber & A. Mullis, *The CISG - A New Textbook for Students and Practitioners*, Sellier European Law Publishers, Munich, 2007, p. 132, who advocates a "wide interpretation which is not restricted to the physical characteristics of the goods".

32 Schwenzer & Leisinger, *supra* note 5, p. 267 *et seq.*, argue that in the resale business the only ordinary purpose is that the goods can be resold and that this purpose is not influenced by the mere way in which the goods is manufactured or processed.

33 Schwenzer & Leisinger, *supra* note 5, p. 265, give the 'Electronic Industry Code of Conduct' as an example. Schwenzer, in: Schlechtriem & Schwenzer 3rd English edition, *supra* note 10, Art. 35, para. 16: "where there

25 Schwenzer states that advertisements of the seller may form part of a contract. Schwenzer, in: Schlechtriem & Schwenzer 3rd English edition, *supra* note 10, Art. 35, para. 6 *et seq.*; Directive 1999/44/EC on Certain Aspects of the Sale of Consumer Goods and Associated Guarantees, Art. 2(2)(d) stipulates that consumers could often reasonably expect that the goods conform the seller's public statements on their specific characteristics.

26 M.R. Siebecker critically points to companies trying to bury CSR policies in excessive amounts of information, impeding the individuals and sophisticated institutional investors from making sound judgements, M.R. Siebecker, 'Trust & Transparency: Promoting Efficient Corporate Disclosure Through Fiduciary-Based Disclosure', *Washington University Law Review*, Vol. 87, No. 130, 2009-2010, pp. 115-174. See also Werner v Werner, 267 F.3d 288, 297 (3d Cir. 2001) deeming a disclosure inadequate when information is presented in a way that conceals or obscures the information sought to be disclosed.

27 As stated by the CISG Advisory Council in Opinion No. 13, *supra* note 13: "where the conduct of the other party has created a reasonable understanding that it has accepted the inclusion of the standard terms".

28 Schlechtriem, *supra* note 21, p. 101.

29 According to the Hague Sales Convention (ULIS) Art. 33(2) immaterial discrepancies are irrelevant.

with an intention that they apply to individual contracts. Many companies make their own individual Codes of Conduct which diminish the importance of general CSR-policies. When the purchaser's business idea is to create a special feeling only associated with its products, it would be contradictory for the buyer to base a claim on internationally common usages. In some branches, ethical production methods may be sufficiently stabilized and harmonized to constitute trade usage, but this is hitherto not the general situation.

Schwenzer and Leisinger argue that the use of child labour and a minimum of humane labour conditions are ethical standards that apply to international sales contracts as implied terms due to trade usage according to CISG Article 9(2).³⁴ I disagree. I believe that most courts and arbitral tribunals would make a presumption that it is sufficient that the producer acts in accordance with its domestic law, even if it allows child labour or poor labour conditions. It should be noted that my opinion is not wholly in contrast to Schwenzer and Leisinger, as they make an exemption for cases where the buyer is only willing to pay a price that is so low that it is impossible to anticipate the use of ethical production methods. I agree with Schwenzer and Leisinger that the answer must depend on the situation in the individual case. When the purchaser has paid for emotional value, it is easier to hold the supplier liable for emotional non-conformity. When the purchaser has only paid the lowest price possible for the goods and only sought to receive certain physical properties, it is more difficult to base a claim on unethical production methods.

Another problem is whether the supplier is responsible towards the purchaser when the production methods violate domestic law.³⁵ In the case with the down from living geese – which amounts to illegal animal cruelty in the European Union – the supplier may perhaps be held liable for non-conformity even though the contract did not expressly state anything about the manufacturing processes. I am hesitant to express a general view on this matter.³⁶ Further, when both parties are from the European Union, the supplier's responsibility may depend on to what extent the purchaser was only asking for a low cost product or was prepared to pay extra for an emotional value. The down producer's animal cruelty attracts sanctions imposed by public law, and a sanction in private law is not appropriate when

the public law sanction creates a sufficient disincentive against the illegal behaviour; see UNIDROIT Principles Articles 3.3.1 and 3.3.2 on illegality.³⁷

In a German case (Supreme Court, 2 March 2005), the Belgian authorities decided that it was forbidden to sell pork produced in a certain manner.³⁸ The court stated that in international wholesale and intermediate trade, the resaleability (tradability) of the goods is one aspect of being fit for the purpose of ordinary use in terms of Article 35(2)(a) CISG and that in the case of foodstuffs intended for human consumption, the resaleability includes that the goods are at least not harmful to health.

It is problematic to distinguish between 'fit for purpose' and 'fit for particular purpose' in relation to emotional non-conformity. As indicated earlier, it is often difficult to base a claim on the very general concept of 'fit for purpose'. When the purchaser has made known that he has a particular purpose, the goods must possess the qualities required for this intended purpose.³⁹ This implies a rather low threshold for making the particular purpose part of the contract and holding a supplier liable for non-conformity.

The concept of 'made known' is unclear. To whom must the purchaser's intended purpose be made known? Is it sufficient that it is publicly made known, or must it be made known specifically to the supplier? As I understand it, it must be specifically made known to the supplier. However, the intended purpose – the purchaser's intention to make a profit out of the goods' emotional characteristics – need not be contractually agreed upon. The concept of *made known* is less restrictive than *contractually agreed upon*. It is sufficient that the purchaser's particular purpose is communicated implicitly to the supplier.⁴⁰ According to the CISG Secretariat Commentary, the seller shall have actual awareness of the buyer's particular purpose, and it is sufficient 'if a reasonable seller could have recognized the particular purpose from the circumstances'.⁴¹

The example with the cocaine-snorting photo model is illustrative in this respect. To snort cocaine is perhaps normal in the photo model industry. She was perhaps unaware that such behaviour would damage the fashion company's brand name. Her unawareness is relevant in determining whether she breached the contract.⁴²

37 See also Principles of European Contract Law 15:102; Study Group on a European Civil Code and Research Group of EC Private Law, *Principles, Definitions and Model Rules of European Private Law: The Draft Common Frame of Reference (DCFR)*, Sellier European Law Publishers, Munich, 2009, II.-7:302; and The Law Commission of England and Wales Consultation, *Illegal Transactions: The Effect of Illegality on Contracts and Trusts: Paper No. 154*, 1998.

38 Bundesgerichtshof [Federal Supreme Court] (BGH), Germany, 2 March 2005, VIII ZR 67/04, CISG-online No. 999, available at <<http://cisgw3.law.pace.edu/cases/050302g1.html>>.

39 Schwenzer, in Schlechtriem & Schwenzer 3rd English edition, *supra* note 10, Art. 35, para. 13.

40 See Schwenzer, in Schlechtriem & Schwenzer 3rd English edition, *supra* note 10, Art. 35, para. 19 *et seq.*

41 CISG Secretariat's Commentary, Art. 33, No. 8; Schwenzer advises the buyer to draw special attention to its particular purpose, in Schlechtriem & Schwenzer 3rd English edition, *supra* note 10, Art. 35, para. 22.

42 This is of course not a sales contract and CISG does not apply. The correspondence to fitness for a particular purpose in the sale of services is to determine whether the photo model has breached an implicit term, see

is an international usage as to particular characteristics or manufacturing standards of the goods, those characteristics must be regarded as minimum quality requirements." In English law terms can be implied by usage if they are reasonable, generally known or known to the party against whom it is invoked, see McKendrick, *supra* note 24, p. 97.

34 Schwenzer & Leisinger, *supra* note 5, p. 265.

35 Schwenzer states the supplier must generally comply with EU standards of manufacturing when both parties are from the EU (Schwenzer, in Schlechtriem & Schwenzer 3rd English edition, *supra* note 10, Art. 35, para. 16).

36 Schwenzer puts the burden of proof on the supplier who needs to show that the parties have explicitly agreed to apply less stringent standards; see Schwenzer & Leisinger, *supra* note 5, p. 262.

It may be that there is an implicit particular purpose in some special markets with special emphasis on fair trade and ethical principles.⁴³ In determining the relevant market, both the purchaser and the supplier must be acting in the same 'ethical arena'. For instance, both parties must act in the market for high-brand sport shoes, as opposed to the general market for sport shoes.

For the seller to be liable for the buyer's particular purpose, the buyer must have relied on the seller's skill and judgement, CISG Article 35(2)(b). Very often when the supplier is a low-cost producer focussed on the physical (non-emotional) matters, the purchaser does not rely on the seller's skill and judgement with respect to emotional characteristics. The purchaser cannot rely on the supplier's skill and expertise when the purchaser is more knowledgeable and more experienced than the supplier regarding how to make profits from feelings and emotions. Therefore, in practice, the purchaser will normally not have a case if only based on the supplier's liability for conformity with particular purpose.

As a consequence of the general duty to act in accordance with good faith and fair dealing, it may be that the supplier must inform the purchaser if the supplier becomes aware that the products are not conforming with the purchaser's particular purpose. In such situations, the purchaser may have a claim, not for non-conforming goods, but for damages based on a breach against the general obligation to act in accordance with good faith and fair dealing. The purchaser can only win such a claim if the supplier acted in bad faith and was aware of the severe consequences for the purchaser and of the costs that would ensue.

5.7 THE NOTICE REQUIREMENTS (CISG ARTS. 38 AND 39)

The buyer has a duty to examine the goods according to CISG Article 38.⁴⁴ This duty is mainly a duty to examine the goods' physical condition. The duty of examination probably does not include an obligation to examine the production methods.⁴⁵ The reason is that it is practically difficult for the buyer to make an examination of the production methods.

The buyer may have a duty to extend the examination and investigate the production methods when he has reason to understand that the supplier has violated the ethical standards. It is common that purchasers use expensive and extensive auditing procedures to ascertain that suppliers and sub-suppliers adhere to the purchasers' Codes of Conduct. Such procedures may expand the purchaser's duty to examine the goods to include

in particular DCFR IV.C. - 2:105(5) and 2:106(1). See also UNIDROIT Principles Arts. 4.3(d), 5.1.2(a) and 5.1.4(2).

⁴³ Schwenzer, in Schlechtriem & Schwenzer 3rd English edition, *supra* note 10, Art. 35, para. 20.

⁴⁴ See generally CISG Advisory Council Opinion No. 2, *Examination of the Goods and Notice of Non-Conformity: Articles 38 and 39*, 7 June 2004, Rapporteur: Professor Eric E. Bergsten.

⁴⁵ Schwenzer & Leisinger, *supra* note 5, p. 268.

examination of production methods. This is, however, uncertain, and the CISG Advisory Council has implicitly indicated that the duty to examine the goods is not extended in such a situation.⁴⁶

When the contract requires documentation of the production methods or the goods' origin, the buyer has a duty to examine the goods and to provide notice rather quickly. The CISG case from the Oberlandesgericht of Munchen in 2002 discussed above,⁴⁷ concerned barley which was deemed non-conforming when the seller could not provide a certificate that the barley was organically produced. The court stated that the buyer was under a duty to examine the certificates immediately at delivery. The buyer lost its right to rely on the non-conformity because it did not send notice of the non-conformity in time, CISG Article 39(1). The deliveries took place between November and September, and the buyer gave notice of non-conformity in February the following year.

If the contract contains provisions regarding auditing procedures, the purchaser may lose his right to rely on a lack of non-conformity if it does not apply the contracted auditing and therefore does not discover production methods that violate the contract (CISG Art. 39).

5.8 REMEDIES

Having established a situation where the supplier is responsible for emotional non-conformity, we continue by analysing to what extent the purchaser is entitled to remedies. The remedies in the CISG are designed for physical defects. In the following, I will highlight some problems in applying the CISG remedies to emotional non-conformity.

5.8.1 Specific Performance

Specific performance is often not a suitable remedy for emotional defects (CISG Art. 46). Some emotional defects are of a nature where specific performance is to no avail, for example, in the above described examples with the cocaine-snorting photo model, the bribing telephone company and the doped athlete. These three examples all refer to services and not to sales. It is well known that specific performance is rarely a useful remedy in service contracts.

⁴⁶ The CISG Advisory Council states that the period for examining latent defects commences when signs of the lack of conformity become evident. At the same time, the Advisory Council states that the buyer shall examine the goods to the extent it is practical in the circumstances. See CISG-AC Opinion No. 2, *supra* note 44. Schwenzer and Leisinger claim that the buyer's duty to notify of non-conformity only arises after the buyer has *actually learned* about the violation of ethical standards: Schwenzer & Leisinger, *supra* note 5, p. 268.

⁴⁷ See *supra* note 30.

In sales contracts, the purchaser can rarely claim specific performance by requiring the supplier to change his production methods and deliver products with the 'correct emotion'. Often the harm is already done and cannot be undone by specific performance. Furthermore, it would often be unreasonable within the meaning of CISG Article 46 to require the supplier to change his production methods. It is often more efficient from a transaction cost point of view to make a substitute performance through another supplier with ethical production methods.

5.8.2 Termination (CISG Arts. 25, 49 and 72)

It is generally difficult to determine whether the supplier's breach is *fundamental*.⁴⁸ The determination is particularly difficult when the breach concerns non-conforming emotions. When has the purchaser been substantially deprived 'of what he is entitled to expect' with respect to emotional characteristics?

One important factor in determining the fundamental nature of non-conformity is the level of importance to the purchaser. The purchaser can communicate the level of importance by an explicit requirement in the contract that the supplier should use ethical production methods. The contracted terms are important in the assessment of fundamental non-conformity.⁴⁹ If the contract does not make clear what amounts to a fundamental non-conformity, regard is to be given in particular to the purpose for which the goods are bought. As pointed out by Schwenger and Leisinger, it is necessary to make an assessment on a case-by-case basis. They consider it relevant whether the breach concerns *basic* ethical standards.⁵⁰ It is, however, unclear what constitutes basic ethical standards, and there is hardly universal international consensus as to what such basic ethical standards might be.⁵¹ I question whether this notion is useful in relation to assessing fundamental emotional non-conformity.

A factor to take into account when determining if an emotional non-conformity is fundamental is whether the purchaser can be required to retain the goods because the purchaser can be adequately compensated by damages or a price reduction.⁵² When the

48 It is also problematic to what extent the purchaser may terminate due to *anticipated* breach of contract, i.e. when it is clear that the supplier's production methods constitute fundamental emotional non-conformity, CISG Art. 72. I will not analyse the problem with anticipated breach.

49 CISG Advisory Council Opinion No. 5, *The Buyer's Right to Avoid the Contract in Case of Non-Conforming Goods or Documents*, 7 May 2005, Rapporteur: Professor Dr. Ingeborg Schwenzer. When the parties have explicitly agreed on ethical production methods, it is common to allow the supplier a chance to correct the inaccurate production methods before the buyer is entitled to terminate the contract.

50 Schwenger & Leisinger, *supra* note 5, p. 269.

51 Schlechtriem writes: 'The global application of the CISG will very often bring together merchants with quite different ideological and ethical beliefs, resulting in sometimes extremely diverging social standards for productions methods': Schlechtriem, *supra* note 21, p. 101.

52 CISG-AC Opinion No. 5, *supra* note 49.

purchaser is in the business of selling emotions, it normally has no use for unethically produced products. The purchaser can be compensated by damages, but due to the problems in assessing and proving the loss (see sec. 5.8.4), the purchaser is often not adequately compensated. As to price reduction, the purchaser may sometimes be able to resell the products in a low-cost market. But when the purchaser is acting in the high-end markets by selling emotions, it is often inefficient that it resells the products in a market with which it is unacquainted. It would often be a heavy burden on a purchaser to require it to resell the defective goods if the purchaser is mainly selling emotions and not physical products. A business in the sale of emotion industry normally does not have adequate selling channels for the sale of no-brand products, and it is more efficient if the sale is terminated and the supplier takes responsibility for reselling the non-conforming goods.⁵³ Furthermore, a retailer cannot be expected to resell the goods at a discount price if, by doing so, it would be likely to damage its own reputation.⁵⁴ Normally non-conforming emotions cannot be compensated by price reduction or damages as a substitute for termination. It is normally not possible to remedy non-conforming emotions. In conclusion, the purchaser is often entitled to terminate a contract when there is an emotional non-conformity.

A case from the German Supreme Court in 1996 concerned goods produced in South Africa that according to the contract should have been produced in England. The goods were non-conforming, but the buyer was not entitled to terminate the contract since it was able to resell the goods in the course of its usual commercial relationships without incurring any unreasonable difficulties. The fact that the buyer might be forced to resell the goods at a lower price was not in itself an unreasonable difficulty.⁵⁵

In the case described above about carpets produced by child labour, the furniture company's brand name may have been very much associated with ethical production methods, and it would be inconsistent for it to sell any carpets produced by child labour. Furthermore, the furniture company would not be acquainted with the relevant markets and would therefore not be able to resell the carpets at a good price. In such a case, the

53 CISG-AC Opinion No. 5, *supra* note 49, states: "Where the buyer himself is in the resale business, the issue of a potential resaleability becomes relevant [...]. The question then is whether resale can reasonably be expected from the individual buyer in his normal course of business."

54 CISG-AC Opinion No. 5, *supra* note 49. See the German cases: Landgericht [District Court] (LG) Landshut, Germany, 5 April 1995, 54 O 644/94, CISG-online No. 193 (the 'Sports Clothing Case'); Hanseatisches Oberlandesgericht [Appellate Court] (OLG) Hamburg, Germany, 26 November 1999, 1 U 31/99, CISG-online No 515 ('Jeans' case); Oberlandesgericht [Appellate Court] (OLG) Köln, Germany, 14 October 2002, 16 U 77/01, CISG-online No 709 ('Designer Clothes' case); Oberlandesgericht [Appellate Court] (OLG) Oldenburg, Germany, 1 February 1995, 11 U 64/94, CISG-online No 253 ('Furniture' case) (limited circle of interested sub-buyers would only buy the goods at a discount of 50%); Oberlandesgericht [Appellate Court] (OLG) Köln, Germany, 14 October 2002, 16 U 77/01, CISG-online No. 709 ('Designer Clothes' case) (buyers of designer clothes have higher standards).

55 See Bundesgerichtshof [Federal Supreme Court] (BGH), Germany, 3 April 1996, VIII ZR 51/95, CISG-online No. 135, available at <www.unilex.info/case.cfm?id=182>.

emotional non-conformity is likely fundamental, and the furniture company would be entitled to terminate the contract.

It may be different when the purchaser has different production lines and brands; one for ethical products and one for cheap stuff. In the example with the pillow producer, it may be that it has two different brand names and consequently without much trouble can relocate the goose down pillows produced by animal cruelty to the low-cost pillow brand. In such a case, the non-conformity may not be fundamental.

A problem relating to termination is how quickly the purchaser must *notify* of the termination (i.e. when it ought to have become aware of the emotional non-conformity), CISG Article 49. When must the bribing telephone company's distributor notify of the termination: as soon as there is a rumour about the bribery or only after a court has decided that the action qualifies as bribery?

5.8.3 Price Reduction (CISG Art. 50)

According to CISG Article 50 the buyer is entitled to price reduction in a case of non-conformity. The difficulty in relation to emotional non-conformity is how to assess the price reduction. Normally, an ethically produced product has a higher market value than a non-ethically produced product. It is, however, only rarely that there are comparable market prices for ethical products and non-ethical products. In the case of the carpets produced by child labour, it would be difficult to establish the price difference between carpets produced by children and carpets produced by adults.

In a case from the German Supreme Court in 2005, the purchaser had no means by which to utilize meat that the authorities had forbidden from sale, and the buyer was entitled to reduce the purchase price to zero.⁵⁶ It is rare that products have no value at all. Many 'non-ethical' products can be sold in a market where the customers do not care about emotional value.

5.8.4 Damages

There are many problems concerning damages for emotional non-conformity, CISG Articles 74–77. Is there a causal link between the supplier's production methods and the harm caused to the purchaser's brand name? How is the value of a harmed brand name determined? Was the loss foreseeable to the supplier? What lies in the purchaser's obligation

to mitigate the harm? What mitigating measures should the purchaser take, and to what extent is the supplier liable to compensate the purchaser for such measures?

The purchaser is entitled to damages for loss of goodwill.⁵⁷ The CISG Advisory Council clearly states that an infringement of goodwill is a pecuniary loss to be compensated under CISG Article 74 if the prerequisites of this provision, in particular the foreseeability of such losses, are met.⁵⁸ It is highly uncertain to what extent losses caused by emotional non-conformity can be foreseen. Is it foreseeable to a supplier that a purchaser's bank increases the cost for lending money due to a breach against the CSR-policy? Is it foreseeable to the supplier of carpets that the furniture company's whole brand name would be ruined for years to come?⁵⁹

There are many practical problems in relation to damages for goodwill. The first problem is to assess and evaluate the loss.⁶⁰ The second problem is to determine how damages for loss of goodwill relate to damages for other losses. There is a risk that the purchaser receives double compensation when it receives damages for lost profits and at the same time receives compensation for loss of goodwill, which is often determined as the value of potential future sales.⁶¹ In a German case, the buyer claimed damages for loss of profit and for loss of goodwill. The court stated that the buyer cannot claim a loss of turnover – which could be reimbursed in the form of lost profits – and at the same time

57 CISG Advisory Council Opinion No. 6, *Calculation of Damages under CISG Article 74*, 2006, Rapporteur: Professor John Y. Gotanda.

58 *Id.*; see also W. Witz, 'Internationales Einheitskaufrecht, Schriftenreihe Recht der internationalen Wirtschaft', in H.C. Salger & M. Lorenz (Eds.), *Unified Sales Law Series: Law of the International Economy*, Verlag Recht und Wirtschaft, Heidelberg, 2000. For an analysis of damages for loss of goodwill, see Schlechtriem, *supra* note 21.

59 According to Schlechtriem and Leisinger, there is no question that a loss of goodwill as a result of unethical behaviour is foreseeable, Schlechtriem & Leisinger, *supra* note 5, p. 270.

60 The difficulties in establishing the prerequisites of pecuniary losses in the case of harm to goodwill of a buyer are illustrated by a case decided by the German Supreme Court: Bundesgerichtshof [Federal Supreme Court] (BGH), Germany, 24 October 1979, VIII ZR 210/78, available at <<http://cisgw3.law.pace.edu/cases/791024gl.html>>. The German Supreme Court pointed to the need for expert opinions to establish the causal connection between the breach and the loss of customers, i.e. the loss of goodwill and its pecuniary consequences. CISG-AC Opinion No. 6, *supra* note 57, states that the fact that goodwill may be difficult to measure should not result in a requirement of a higher level of proof to obtain such damages. It is sufficient that the aggrieved party can prove with reasonable certainty that its reputation has been damaged by the breach. See also Schlechtriem, *supra* note 21, p. 97.

61 CISG-AC Opinion No. 6, *supra* note 57, para. 7.4: "In certain cases, the loss of goodwill may be measured by loss of profits. However, these cases present a potential for double recovery because of the overlap between goodwill damages and lost profits damages. Specifically, compensation for the decrease in the value of the aggrieved party's commercial interest may equal the compensation it would receive for the lost future profits [citing *inter alia*, Waddams and Anderson, the latter stating that 'lost future profits that are not attributable to an erosion of the customer base do not constitute a loss of goodwill']. In this circumstance, the aggrieved party cannot claim damages for the loss of return customers resulting from a loss of goodwill and future lost profits."

56 Bundesgerichtshof [Federal Supreme Court] (BGH), Germany, 2 March 2005, VIII ZR 67/04, CISG-online No. 999, available at <<http://cisgw3.law.pace.edu/cases/050302gl.html>>.

get additional compensation for loss of reputation.⁶² In the example above regarding the horsemeat, we can see how the purchaser's brand name is harmed (a loss of goodwill) and that the purchaser's future sales decline (loss of profit). It is important to withdraw the specific compensation for loss of future sales from the compensation for loss of general goodwill in order to ensure that the purchaser does not receive double compensation.

The purchaser is entitled to damages for loss of profit if it can show that he is unable to load its products with emotional value due to his sub-supplier's breach. This should be proven with reasonable certainty.⁶³ In the example described above concerning distribution of telecommunication products, the distributor is entitled to compensation for loss of profit if he can show that his customers prefer another brand due to the principal's alleged illegal bribery.

Mitigation of harm (CISG Art. 77) comes into play to reduce the loss caused by emotional non-conformity.⁶⁴ How far reaching is the duty to mitigate? In the example above concerning a car component's counterfeit certificates, is the purchaser obliged to mitigate the harm by not making a withdrawal and replacement procedure to thereby avoid costs and end customer worries when it is clear that the products have been accurately produced (but lack the contracted certificates)? Or can the purchaser claim that it is necessary for its brand's overall credibility that formal certification is always in order? Can the pillow producer in the case referred to above regarding animal cruelty claim that an expensive marketing campaign is a 'reasonable measure' to mitigate the harm to the pillow producer's brand name?

5-9 THE FUTURE DEVELOPMENT

This paper has not provided any answers. Instead it has pointed to many uncertainties concerning how to apply old traditional sales and contract law rules in a new commercial setting. The law is sometimes challenged by changes. It is natural that an area of law exposed to new business behaviour has more uncertainties than clear-cut answers. It is a general phenomenon of law that its concepts sometimes do not satisfy the developing commercial needs. Then the law will eventually be adjusted.⁶⁵

⁶² The German case Landgericht Darmstadt [District Court] (LG) Darmstadt, Germany, 9 May 2000, 10 O 72/00, CISG-online No. 560, available at <www.unilex.info/case.cfm?id=501>.

⁶³ See CISG-AC Opinion No. 6, *supra* note 57, para. 2.6.

⁶⁴ CISG-AC Opinion No. 6, *supra* note 57: "4. The aggrieved party is entitled to additional costs reasonably incurred as a result of the breach and of measures taken to mitigate the loss."

⁶⁵ See, e.g., the English law reform *Frustrated Contracts Act 1943* (UK). C.M. Schmitthoff, 'Modern Trends in English Commercial Law', *Tidskrift, utgiven av Juridiska Föreningen i Finland (FJFT)*, 1957, p. 360, that such a "black and white jurisprudence calls for a different approach, a jurisprudence of adjustment".

Should contract law protect investments in emotions? Is it a task for contract law to protect investments aiming at the sale of superficial emotions? Are persons' shallow emotions more worthy of contract law protection when they contribute to a better world with respect to poverty, child labour, corruption, pollution, drugs, etc.?

Will contract law develop to support investments in all kinds of emotions? It may be uncontroversial to support investments leading to emotions of non-pollution. It is, however, controversial to support investments in nationalistic emotions, for instance, to promote feelings of 'Swedish and non-Polish'.⁶⁶

Ought contract law develop towards creating incentives or disincentives for businesses to invest in brand names? If incentives are appropriate in order to encourage more use of CSR-policies, is the best means to establish incentives in private contract law? Or are the incentives best implemented solely by introducing rules on marketing and other public law regulations? Schlechtriem had an opinion and stated: 'It is easy to agree with these concerns, and it is tempting to meet them by interpreting the CISG's damages provisions as allowing claims for non-pecuniary loss, thus providing a tool to "punish" sellers of such "ethically tainted" products by granting claims for damages without pecuniary loss. However, there are doubts as to whether the CISG is the right instrument to promote our convictions'.⁶⁷ He concluded that 'The correct way for those who want to make their moral convictions legally operative is, therefore, to campaign or lobby in their countries to have legislators ban certain production methods by rendering contracts to market such products illegal and void'.⁶⁸ Schlechtriem's argumentation appears convincing to me. But I am perhaps too old and conventional to accurately predict in which direction contract law will develop. Anyone is free to disagree with Schlechtriem's opinion. We do not know whether contract law will develop in accordance with his view.

Who of the parties has the burden to demonstrate that contract law ought to protect him? The purchaser – who wants to make a profit on the sale of emotions which simultaneously improve the world? Or the supplier – who desperately tries to produce goods at a low cost and honestly abides by the laws in its home country?

Will the sale of emotions be supported by an increased willingness to incorporate CSR-policies and Codes of Conduct with less strict requirements as compared to inclusion of 'ordinary' standard terms? And will less strict requirements for incorporation of CSR-policies and Codes of Conduct entail less strict requirements for 'ordinary' standard terms? Whittaker expresses a careful prediction when he analyses the Human Rights Convention's impact on contract law: 'At least as regards the protection of the Convention rights of the

⁶⁶ See the consumer law case from the Swedish Supreme Court, NJA 2001 s. 151 referred in note 7.

⁶⁷ Schlechtriem, *supra* note 21, p. 98.

⁶⁸ Schlechtriem, *supra* note 21, p. 100.

parties to the contract, use of an implied term to achieve compatibility may not be alien to the spirit of the common law technique'.⁶⁹

Will the sale of emotions be supported by a wide interpretation of the purchaser's rights to contractual remedies – or will there be a restrictive approach due to the difficulties in assessing the consequences of non-conforming emotional characteristics and/or due to the enormous cost of harm to brand names? Schwenger and Leisinger are in favour of a generous calculation of damages: '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'.⁷⁰

The purpose of this article has been to make clear that it is impossible to predict what the outcome will be in a court or in arbitration when a dispute concerns emotional non-conformity. The future development lies at the crossroads of traditional contract law, public law, politics and new business behaviour. I am looking forward to studying how it ultimately transpires. Learning from the history of legal development in contract law, it is likely that the development of law in relation to emotional non-conformity will be relatively stabilized by 2050. Until then, we must learn to handle unpredictability. In the meantime, businesses are well advised to explicitly regulate in their contracts to what extent CSR-policies, Codes of Conduct and other emotional aspects are relevant or irrelevant in their contractual relationships.

During the time the contract law develops, judges and arbitrators will be inclined to stretch the existing legal concepts to satisfy commercial needs. Consequently, legal counsellors should present facts about the commercial conditions in order to persuade the judge or arbitrator to apply – or twist – the abstract rules in their client's favour.

69 S.J. Whittaker, in *Chitty on Contracts*, *supra* note 18, sec. 1-081.

70 Schwenger & Leisinger, *supra* note 5, p. 271.