

THE CISG IN ISRAEL

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Israel adopted the CISG, on October 25, 1999.¹ However, as the deposition of Israel's instrument of accession to the CISG was delayed until January 22, 2002, Israel officially became a Contracting State only as late as February 1, 2003. The same statute also repealed² the two 1964 Hague CISGs on the International Sale of Goods. The late adoption of the CISG is one of the factors responsible for the relatively small body of Israeli case law relying directly on the CISG.³ Another, and arguably not less significant factor, concerns the lack of awareness on the part of many practicing lawyers of the existence or relevance of the CISG. The paucity of Israeli scholarly commentary on the CISG⁴ poses an additional obstacle to Israeli lawyers and law students understanding of the CISG. Finally, as in other jurisdictions, the low level of reliance on the CISG might be explained to a considerable extent by the general reluctance of professional international traders and their lawyers to rely on the legal system, preferring arbitration or alternative dispute resolution mechanisms.

Despite the scarcity of Israeli case law, two factors mitigate this problem. First, in a number of Israeli Supreme Court cases a rather comprehensive analysis is offered by the Court. Furthermore, some of these cases discuss not only the appropriate interpretation of

¹ It is noteworthy that Part IV (Articles 89-101) was completely omitted from the Israeli version of the CISG (with the exception of Article 96), which was included.

² *Id.* at § 5.

³ This survey includes cases in which the CISG was either relied upon directly, or as a source of comparison and inspiration, as well as cases decided on the basis of ULIS but which have been deemed to have a considerable guiding force with respect to issues arising under the CISG. The relevant cases include, *inter alia*: CC (BS) 3246/09 Iskur Pipes & Profilers Ltd. v. Eclipse Magnetics Ltd. (03.01.2010) Nevo Legal Database (Isr.); CA 465/80 S. Solondz Ltd. v. Hatehof Iron Industry Ltd. [1984] IsrSC 38(3) 630; CA 366/89 Pine Aluminum Ltd. v. D. Metal A.G Foreign Company [1991] IsrSC 45(5) 850; CA 339/86 Earl Orient Shipping Company v. O.T.C Oil Trading Company [1988] IsrSC 42(1) 506; CA 741/79 Kalanit HaSharon v. Horwitz [1981] IsrSC 35(3) 533; CC (Jer) 618/95 Banita Trade and Investment Ltd. v. Tiemme Raccorderie s.r.l (22.10.2008) Nevo Legal Database (Isr.)

⁴ See Arie Reich, *The Uniform Law of International Sales: A Need for Revision*, 14(1) BAR ILAN L. STUDIES 127 (1997), (Hebrew). An English abstract of the article is available at: <http://www.biu.ac.il/law/cisg/cisgArtEng.htm>; Eyal Zamir, *European Tradition, the CISGs on International Sales and Israeli Contract Law*, in EUROPEAN LEGAL TRADITIONS AND ISRAEL. (A.M. Rabello ed., The Harry and Michael Sacher Institute for Legislative Research and Comparative Law, the Hebrew University of Jerusalem: Jerusalem 1994); Gabriela Shalev, *International Sale of Goods Between Europe and Israel*, in ESSAYS ON EUROPEAN LAW AND ISRAEL 1113 (A. Rabello ed., The Harry and Michael Sacher Institute for Legislative Research and Comparative Law, The Hebrew University of Jerusalem: Jerusalem, 1996); For more recent writings relating to the CISG, see, e.g., Jonathan Yovel, *Contract Law in the Third Millennium: Neo-Classical and Relational Contract Theories in the New Israeli Civil Code*, 4 L. & Business J. 241 (2006); Nir Bar, *Contract Validity and the CISG - Closing the Loophole*, (2007), <http://www.israelbar.org.il/uploadFiles/Contract Validity and the CISG.pdf>.; Arie Reich, *Globalization and Law: The Future Impact of International Law on Israel's Commercial Law*, 17(1) BAR ILAN LAW STUDIES 17 (2001).

relevant provisions, but also the underlying policies and principles that the judiciary should apply in resolving international sales disputes. Second, some of the cases which involve transactions that were concluded prior to 2003 and thus are officially based on Uniform Law on the International Sale of Goods (ULIS), which was adopted at The Hague on July 1, 1964, offer insights into issues which today are raised by parallel provisions in the CISG. Cases explicitly referencing the CISG have been included in this chapter.

II. Scope of Application

One of the unique characteristics of the Israeli approach to the CISG concerns its scope of application under Israeli law. While most jurisdictions have incorporated the general provisions of the CISG (Articles 1-13) "as is", the Israeli legislature expressly deviated by extending its application as follows: "In addition to what is provided by Article 1 of the CISG, its provisions will apply in the case where a party to the contract operates its business in a non-contracting state." Hence, under Israeli law, assuming an Israeli Court has jurisdiction over the dispute, *it is sufficient that either the seller or the buyer operates a business in a Contracting State for the convention to apply*. Unlike the regime provided by Article 1 CISG, there is no need to show that the rules of private international law lead to the application of the law of a contracting state.⁵ This also means that the CISG would apply even if an Israeli seller or buyer operates his business in a non-Contracting State. Moreover, a literal interpretation of the Israeli provision cited above may enable a court to apply the CISG even if both parties operate their businesses in non-contracting states.

According to the explanatory notes to the Israeli statute, this deviation from the general norm of the CISG was deemed justified on three grounds. First, it was believed that such an arrangement would minimize uncertainties and controversies over the choice of law, especially when one party operates in a Contracting State while the other party does not. Secondly, it was argued that a wide application of the CISG would introduce more coherence and consistency into the legal system. Finally, such an expansion was deemed normatively desirable, for it would enhance reliance on the CISG, which was considered by the Ministry of Justice a more sophisticated, complete and up to date legal regime compared to most national sales law regimes.⁶

Notwithstanding these advantages, the expansive approach is subject to serious criticism.⁷ The very deviation from the rule of application provided in the CISG, though intended to enhance consistency and reliance on the CISG, as well as the prospect of Contracting States deviating from the general rule of the CISG, will increase uncertainty within the general business community. Thus, there is a case for reconsidering the Israeli position, and for removing the controversial provision from the Israeli statute.

III. Concurrent Grounds of Liability

One of the most intriguing questions relating to the CISG—and one of substantial practical importance—is the question of whether, in a dispute over the performance of a transaction to which the CISG applies, the aggrieved party should be allowed to rely on a non-contractual cause of action (tort or in unjust enrichment). The question has been

⁵ See, respectively, CISG §§ 1(1)(a), 1(1)(b).

⁶ Draft Bill of The Sales (International Sale of Goods) Law, 1997, HH, 432, 434.

⁷ See Reich, *supra* note 4, at 176-177.

debated in the legal literature.⁸ In 2009, the Israeli Supreme Court weighed in on this issue in *Pamesa v. Mendelson*.⁹

The case before the Court concerned a contract for the sale of tiles between Pamesa Ceramica, a Spanish manufacturer (hereinafter "seller") and Mendelson Engineering, an Israeli importing company (hereinafter "the buyer"). The tiles were purchased from the seller in 1996, and were sold on to an Israeli building company named Eisenberger (hereinafter "builder") who installed them in one of its buildings. The tiles proved to be defective and had to be removed and replaced. The builder brought an action against the buyer alleging nonconformity of the tiles and demanded compensation for the full cost of their replacement, as well as for loss of reputation. The buyer then sent a third party notice to the seller.

The Court of first instance accepted both the claim and the third party notice.¹⁰ The Court refused to accept the seller's defense that the buyer's claim against it was barred under Article 39(a) of the ULIS (CISG). The reason given by the court for rejecting the seller's defense was twofold. First, there was evidence that the seller had been aware of defects in its products, and thus was not allowed to rely on Article 39.¹¹ Second, even assuming that the contractual cause of action was barred, recovery could still be given under a theory of negligence.¹²

The seller appealed the decision to the Supreme Court, claiming that the contractual claim of the buyer against it was barred and further, the buyer should not be allowed to rely on an extra-contractual cause of action. The issue here is whether a buyer suffering from nonconformity in the goods supplied to her by the seller should be allowed to seek a tort remedy, even when her contractual remedies are barred under the prescription rules of the ULIS or the CISG? The Court agreed that the non-conformity claim was time barred.¹³ The Court emphasized that even though the case was formally resolved according to ULIS, the same decision would apply to the CISG.¹⁴ The Court extensively referenced CISG literature in rendering its decision.

In analyzing the concurrent liability issue, the Supreme Court adopted an interpretive approach that viewed the resolution of the issue as depending first and foremost on the

⁸ See e.g. the debate between Honnold and Schlechtriem on products liability: JOHN O. HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CISG 74-76 (3rd ed., Kluwer Law International: The Hague 1999) (arguing that allowing concurrent liability would decrease uniformity, ruin the balance of justice designed by the CISG, and might encourage judges to use domestic law); and compare Peter Schlechtriem, *The Borderland of Tort and Contract – Opening a New Frontier?* 21 CORNELL INTERNATIONAL L.J. 467, 473-476 (1988) (arguing tort actions should be barred only when they are brought to protect an "economic interest", as opposed to "property interests", existing independently of any contractual relationship).

⁹ CA 7833/06 Pamesa Ceramica v. Yisrael Mendelson Engineering Technical Supply Ltd., (17.03.2009) Nevo Legal Database (Isr.) (hereinafter the Pamesa Case), available at <http://cisgw3.law.pace.edu/cases/090317i5.html>.

¹⁰ CC (Hi) 137/01 Yaakov and Tovi Eisenberger Building and Public Works Co. Ltd. v. Yisrael Mendelson Engineering Technical Supply Ltd. (20.08.2006) Nevo Legal Database (by subscription) (Isr.).

¹¹ See ULIS, § 40.

¹² Eisenberger v. Mendelson, at para. 18.

¹³ See *infra*, VI.C.

¹⁴ Pamesa Case, *supra* note 9, paras. 17-18, 23.

internal interpretation of the CISG itself, rather than on domestic law.¹⁵ This decision reflected an important, if subtle, policy choice by the Court. It testifies to the Courts' preference to allow the CISG to determine its own applicability. It is not at all obvious, from a legalistic point of view, that the CISG should be given priority over domestic sources of law in the area of non-contractual liability.

The second step in the Courts' analysis was to analyze the relevant CISG provisions. The Court referenced CISG Article 4. It noted that Article 4 made it clear that the CISG would apply, under its own terms, only to rights and obligations *arising from the contract* of sale itself. Legal issues arising not from the agreement but from other facts and events – and only such issues – should be decided according to other domestic law sources.¹⁶ At first blush, this analysis argues that the CISG does not apply to any obligations arising from tortious conduct. The Court, however, reasoned that such a literal interpretation would mean that the CISG would be completely ignored in any tort action and such a sweeping approach would clearly circumvent and frustrate the goals of the CISG, at least in those cases where the tortious conduct are based on the very conduct which is regulated under the CISG.¹⁷ However, since there is no consensus in the cases or CISG commentary, the Court resorted to domestic law on the general issue of competing causes of action.¹⁸

Israeli case law also wasn't definitive on this issue. The only Supreme Court judgment which had addressed the issue expressed a very conservative approach.¹⁹ In *S Solondz Ltd. v. Hatehof Iron*, the buyer's contractual claim for compensation due to nonconformity of the merchandise had been barred following the latter's failure to give timely notice. The Court explicitly rejected the buyer's attempt to recover on an alternative tort theory, reasoning that by denying recovery in contract on the basis of nonconformity, the domestic sales law barred a tort action based on the same nonconformity.²⁰

On the other hand, the Supreme Court in *Pamesa* alluded to academic criticism of the *Solondz* case and demonstrated that in practice this position was not always implemented by the lower courts.²¹ According to the Court, in these circumstances, and in light of the

¹⁵ The Court cited with approval Schlechtriem's view that "The question whether the ground of liability in question falls within the scope of the CISG must be clarified by interpretation and, since the CISG defines its own scope, it is the CISG itself which must be interpreted." *id.* at para. 53, quoting, PETER SCHLECHTRIEM, COMMENTARY ON THE UN CISG ON THE INTERNATIONAL SALE OF GOODS (CISG) (1998).

¹⁶ *Pamesa* Case, *supra* note 9, at para. 53.

¹⁷ *Id.* at para. 54. The Court goes on to cite Honnold's position that "Domestic rules that turn on substantially the same facts as the rules of the CISG must be displaced by the CISG; any other result would destroy the CISG's basic function to establish uniform rules" (quoting JOHN O. HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CISG 122 (2nd ed., Kluwer Law & Taxation Publishers: Deventer 1991).

¹⁸ *Id.* at para. 58.

¹⁹ CA 465/80 *S. Solondz Ltd. v. Hatehof Iron Industry Ltd.* [1984] IsrSC 38(3) 630.

²⁰ *Id.* at 636-637.

²¹ The vast majority of these cases concerned disputes over nonconformity of apartments, which in Israel are regulated mainly by the Sale (Housing) Law, 5733-1973, 27 LSI 213 (1972-73) (Isr.) rather than the Sale Law, 5728-1968, 22 LSI 107 (1967-68) (Isr.) [hereinafter the Sales Statute]. Arguably, this enabled some of the courts to distinguish their case from the *Solondz* case.

importance of harmonizing the Israeli position with those of other jurisdictions, adherence to the restrictive view adopted in the *Solondz* case was not absolute.²²

In light of the indeterminacy of domestic law on the issue at stake, the Court then considered the issue on its merits. It offered a general *analytic distinction between contractual and non-contractual interests*. Under this “interests” approach, the court considered whether and to what extent the interests protected by the extra-contractual cause of action are identical to those protected by the contractual one. The Court reasoned that this could be done in two ways. First, on the abstract level, the interests created by the agreement itself must be distinguished from those which are typically protected under the law of tort.²³

Second, in the context of a negligence claim against a manufacturer, a distinction must be drawn between the latter's role as seller and as manufacturer. Negligence in the performance of any particular contractual obligation made by the manufacturer to a specific a buyer is within the domain of the CISG. In contrast, a manufacturer also owes a duty of care towards the public in general, which should be viewed as independent sources of obligation. Therefore, the breach of such obligations would not be subject to the specific limitations and conditions imposed by the CISG.²⁴

In implementing these distinctions, the Court reached the conclusion that the lower court had not erred in allowing the buyer to claim and litigate an alternative cause of action in negligence against the manufacturer. The buyer should be able to make a claim not based on any specific obligation under the contract, but against *Pamesa* attributable to its negligence:

In the case before us, the claim is that Pamesa was negligent in manufacturing the tiles and it shipped a product that a reasonable manufacturer would not have marketed. If Pamesa was indeed negligent in this way, this is not a negligent performance of an obligation under the contract, but a negligent performance of a general duty of care of manufacturers that does not derive from the agreement between the parties.²⁵

Therefore, a cause of action based upon such negligence should not be barred *a priori* because a parallel contractual cause of action was so barred under the CISG. However, on the merits, and unlike the trial Court, the Supreme Court was not convinced that there had

²² *Pamesa Case*, *supra* note 9, at para. 69. The Court's assertion that "...domestic law does not contain a clearer determination than the one that exists in international law" is unconvincing. Under the Israeli legal system, a ruling of the Supreme Court is a binding source of law, regardless of any deviations from it by some lower courts. It would have been better if the Court either distinguished the *Pamesa* case from the *Solondz* case or to expressly reject *Solondz*.

²³ For example, a buyer's interest in compensation for a tangible consequential loss (either a property loss or a personal injury) caused by a defective product would be considered a "tort interest". On the other hand, the interest of the same buyer in being compensated for the direct economic loss embodied in the defect itself should generally be regarded as a purely economic and thus a "contractual interest".

²⁴ *Id.* at paras. 71-72.

²⁵ *Id.* at para 71.

been sufficient evidence to maintain the negligence claim. Therefore, in the end, the buyer's claim against the seller was dismissed.²⁶

In two other Supreme Court cases, the analysis in the *Pamesa* case is pertinent—one directly, and the other by analogy. The first of the two cases is *Harel Insurance Co. Ltd. v. BTR Environmental Ltd.*²⁷ In this case, the Court implemented and reinforced the rule it laid down in *Pamesa*. In *Harel*, an Israeli Energy company claimed damages for the financial loss resulting from an explosion of an oil filter which was produced by an Irish manufacturer and supplied by the defendant, an Australian company. The buyer's claim was dismissed in the Court of first instance. The dismissal was based on an alleged distinction under the CISG between sellers who are also manufacturers – and who are thus responsible for defects in the goods they sell, and those who are merely suppliers – who are not. In the appeal, this distinction was flatly rejected by the Supreme Court as unsound and inconsistent with the CISG.

Moving on to examine the question of the seller's liability on its merits, the Court opined that the contractual claim was sound.²⁸ Furthermore, and more to our point, even if the contractual claim to be barred under the CISG, the trial Court erred in failing to explore the possibility of buyer's claim on an alternative cause of action in negligence. Given the tight relationship between the supplier and the manufacturer, the negligence in manufacturing the defective filter could be attributed to both. Under the *Pamesa* analysis, a tort claim founded in negligence in manufacturing was distinguishable from a claim founded on a negligent performance of a purely contractual duty, the barring of the latter kind of claim should not necessarily impede the seller's concurrent liability in tort.²⁹

The second concurrent liability case is *Adras Building Materials Ltd. v. Harlow and Jones*.³⁰ In that seminal case,³¹ an Israeli importer of steel had brought suit against a German seller for having resold part of the promised steel to a third party in Germany. The buyer's claim for damages was approved by the trial court. However, the decision was reversed by the Supreme Court on appeal by the German seller. The Supreme Court held that, notwithstanding the breach, under the ULIS the buyer had no right to damages. The buyer's attempt to recover alternatively on the basis of a claim in restitution was flatly rejected on the grounds that: "[T]he laws of unjust enrichment do not apply, except where there hasn't been a contract between the parties."³²

²⁶ See *id.* at paras. 78-80.

²⁷ CA 9422/06 *Harel Insurance Company Ltd. v. BTR Environmental Ltd.* (17.01.2010) Nevo Legal Database (by subscription) (Isr.) [hereinafter *Harel Case*].

²⁸ For the reasoning of the Court see *infra*, IV.B, text to notes 89-92.

²⁹ *Harel Case*, *supra* note 27, at para. 17-19.

³⁰ FH 20/82 *Adras Building Materials Ltd. v. Harlow and Jones G.M.B.H* [1988] IsrSC 42(1) 221.[hereinafter *Adras Case*].

³¹ Peter Schlechtriem, *Uniform Sales Law - The Experience with Uniform Sales Law in the Federal Republic of Germany*, JURIDISK TIDSKRIFT 12-13 (1991/92), Daniel Friedmann, *Restitution of Profits Gained by Party in Breach of Contract*, 104 L. QUARTERLY REV. 384-386 (1988), Itzhak England, *The Preying Eagle's Wings: On the Law of Unjust Enrichment*, in ESSAYS IN MEMORY OF PROFESSOR GUIDO TEDESCHI 37 (Aharon Barak et al. eds., The Harry and Michael Sacher Institute for Legislative Research and Comparative Law, Faculty of Law, the Hebrew University of Jerusalem: Jerusalem 1995); The judgment was translated to English and appears at 3 *Restitution L. Rev.* 235 (1995).

³² *Adras Case*, *supra* note 30, at para. 9.

The buyer then requested permission to bring its appeal before the Supreme Court once again, under a special procedure which allowed the Court to re-examine rulings of great legal significance. The permission was granted on the single question of whether or not a party to a contract should be allowed to bring suit based upon an independent cause of action in unjust enrichment and, if the answer was positive, what were the implications for the buyer's rights and remedies.

In a very detailed and controversial judgment, the majority of the Court (per Justices Barak, Levine and Bach) held that the existence of a contractual cause of action (or any other kind of action, for that matter) should not, as a general rule, be regarded as sufficient reason to prevent a plaintiff from relying alternatively (or even additionally) on a cause of action in unjust enrichment. The majority then examined the more concrete question of whether, under the circumstances, the buyer should recover disgorgement damages – i.e., damages based on the seller's gain from breaching the contract (rather than compensatory damages based on the buyer's loss). Answering the question in the affirmative, the majority ordered the seller to restore to the buyer, under a theory of unjust enrichment, the net profit it gained by selling the steel to a third party for a price higher than the original contract price.

Apart from setting a precedent by recognizing the general availability of disgorgement damages as a remedy for breach of contract, the *Adras* case is also illuminating from other perspectives which are more pertinent to our discussion. First, in stark contrast to the first appeal, in which the pertinent provisions of ULIS were meticulously studied and applied by the Court, in the second hearing both the majority and the minority ignored the international context of the transaction. The Court failed to address the fundamental questions of whether and to what extent its approach could be justified under the ULIS-CISG or the potential effect of its judgment on the ability to promote uniformity and harmony in international trade.³³

The above questions can be answered hypothetically. One way to answer the questions would be to draw an analogy from the issue of concurrent tort liability. As pointed out by the Supreme Court in the *Pamesa* case, many courts and writers have acknowledged the legitimacy of allowing a tort action against a seller even when such action is based on conduct which at the same time amounts to a breach of contract. As we have seen, this approach is defended with reference to a distinction between a pure failure to perform a contractual obligation and conduct containing additional "tort" elements. Arguably, under the same logic, one could propose a distinction between a mere failure to deliver goods under an international sales contract and a case where such failure was followed by a further malfeasance, such as the unlawful reselling of the goods to a third party. In the *Adras* case, the subsequent action is clearly separable from the breach itself. Therefore, under a *Pamesa* analysis, the CISG could be interpreted as not to bar reliance (of any of the parties) on a cause of action in unjust enrichment.³⁴

³³ For this the Court has been heavily criticized by both Israeli and foreign scholars. *See, e.g.*, Arie Reich, *Headnote*, available at: <http://www.biu.ac.il/law/cisg/adresVsHarlowEng.htm>; Englard, *supra* note 31, at 47-48; and compare Schlechtriem, *supra* note 31.

³⁴ A number of Courts have ruled that the CISG does not apply to claims in unjust enrichment. This view was adopted by the Supreme Court of Switzerland (Swiss Federal Court, 7 July 2004, 4C.144/2004/1ma) and by the Greek Courts (see: Dionysios P. Flambouras, *Case Law of Greek Courts for the Vienna*

IV. The Principle of Good Faith

The role of good faith in the application of the CISG has been thoroughly discussed and debated by numerous scholars.³⁵ This part will review the role of good faith in Israeli law. It will then analyze the use of the good faith principle by the Israeli Supreme Court in the seminal case of *Eximin v. Itel Style Ferarri Textile (Eximin)*.³⁶ *Eximin* involved a dispute arising from an international sale of goods contract where the Supreme Court implemented a wholly new legal doctrine, based primarily on the principle of good faith.

A. Good Faith in Israeli Law

Good faith is considered one of the Israeli legal system's most important legal principles, especially in private law generally and in contract law more particularly. Israel is a 'mixed jurisdiction' that has been deeply influenced by the law and jurisprudence of both the Anglo-American and the Continental legal cultures.³⁷ This dual influence is clearly evident in private law and is most salient with respect to contract law. This field is today regulated almost entirely by statutory law which has completely replaced foreign sources of law (mainly English common law) which influenced Israeli contract law in the past.³⁸

CISG (1980) for International Sale of Goods, 2 NORDIC JOURNAL OF COMMERCIAL LAW 39 (2009). See also Schlechtriem, in his book (1998 edition), *supra* note 15, at p. 453).

³⁵ See, e.g., Troy Keily, *Good Faith and the Vienna CISG on Contracts for the International Sale of Goods (CISG)* 3(1) *Vindobona J. of International Commercial L. & Arbitration* 15 (1990); UN CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG) COMMENTARY 111-141 (Stefan Kröll, Loukas Mistelis & Pilar Perales Viscasilas eds., C.H. Beck Publishing: Germany 2011); Lisa Spagnolo, *Opening Pandora's Box: Good Faith and Precontractual Liability in the CISG*, 21(2) *Temple International & Comparative L. J.* 261 (2007); John Klein & Carla Bachechi, *Precontractual Liability and the Duty of Good Faith Negotiation in International Transactions*, 17 *HOUSTON J. OF INTERNATIONAL L.* 1 (1994).

³⁶ CA 3912/90 *Eximin SA v. Itel Style Ferarri Textile and Shoes Ltd.* [1993] *IsrSC* 47(4) 64. English text available at <http://cisgw3.law.pace.edu/cases/930822i5.html>. [hereinafter *Eximin Case*]

³⁷ For discussions of the Israeli system as a mixed jurisdiction see e.g. Gad Tedeschi & Yaacov S. Zemach, *Codification and Case Law in Israel*, in *THE ROLE OF JUDICIAL DECISIONS AND DOCTRINE IN CIVIL LAW AND MIXED JURISDICTIONS* 273 (Joseph Dainow ed., Louisiana State University Press: Baton Rouge 1974); Gabriela Shalev & Shael Herman, *A Source Study of Israel's Contract Codification*, 35 *LOUISIANA L. REV.* 1091 (1975).

³⁸ An official draft of such a civil code was first published in 2004, and after a revision presented to the Knesset in 2006. Ever since, the draft has been awaiting its approval. For commentary on the Israeli process of codification, see e.g. Aharon Barak, *The Codification of Civil Law*, 3 *Iyunei Mishpat (Tel Aviv Un. L. Rev.)* 5 (1973) (Hebrew); Uri Yadin, *Towards the Codification of the Civil Law in Israel*, 6 *Iyunei Mishpat (Tel Aviv U. L. Rev.)* 506 (1979) (Hebrew); Aharon Barak, *The Codification of Civil Law and the Law of Torts*, 24 *Isr. L. Rev.* 628 (1990). More recently, with regard to the Draft Civil Code promulgated in 2006, see: Alfredo M. Rabello, & Pablo Lerner, *The Project of the Israeli Civil Code: The Dilemma of Enacting A Code in A Mixed Jurisdiction*, in *LIBER AMICORUM GUIDO ALPA – PRIVATE LAW BEYOND THE NATIONAL SYSTEMS* 771 (Mads Andenas et al. eds., British Institute of International and Comparative Law Publishing: London 2007).

Two of these contract law statutes – the style and design of which clearly resemble continental codification – contain general rules and principles applicable to all contracts. Together, they form the basic infrastructure of the Israeli law of contract. While one of them deals solely with remedies for breach of contract,³⁹ the other – *The General Contracts Statute* – is a more comprehensive contract law code.⁴⁰ Articles 12 and 39 impose upon contracting parties a duty to act "in a customary manner and in good faith" not only in the exercise and performance of a contractual right or duty (Article 39) but in pre-contractual negotiations as well (Article 12(a)).

A violation of the obligation to act in good faith in the pre-contractual stage entitles the aggrieved party to compensation for any loss it had incurred following the negotiations (whether or not a contract had been concluded) or following the formation of the contract.⁴¹ Article 39, on the other hand, is silent regarding the remedy or sanction to be imposed for bad faith in the performance stage. These sanctions may vary widely, depending on the circumstances.⁴² The most frequently used remedies include the judicial broadening of a party's contractual duties or, alternatively, in the curbing of its power to exercise an apparently valid contractual right.⁴³

The good faith provisions of the *General Contract Statute* have been commonly applied in contract disputes. They have become important tools for enforcing norms of decency, fairness and social solidarity between contracting parties.⁴⁴ In *Eximin*, the Supreme Court used the good faith principle to make a major change in contract doctrine.

B. Good Faith in International Trade – The *Eximin* Case and the Birth of Comparative Negligence in Israeli Contract Law

The case concerned a contract between an Israeli manufacturer (hereinafter "seller") and a Belgian importer (hereinafter "buyer"). The buyer ordered the manufacturing and supply of 3,000 pairs of boots of a special design in order to export them to its customer, an American supplier. The required boots were made of jeans and had the sign "V" sewn

³⁹ Contracts (Remedies for Breach of Contract) Law, 5731-1970, 25 LSI 11 (1970-71) (Isr.). On the special characteristics of this statute, which to an extent are common to the Israeli civil legislation in general, see Yehuda Adar, *Legal Engineering in Israeli law: Codification and Unification of the Law of Remedies*, PUBLICATIONS OF THE SWISS INSTITUTE OF COMPARATIVE LAW, 69, 75-80 (Schulthess: Zurich, 2010).

⁴⁰ Contracts (General Part) Law, 5733-1973, 27 LSI 117 (1972-73) (Isr.). For a survey of the scope of this statute see Gabriela Shalev, *General Comments on Contracts (General Part) Law, 1973*, 9 ISRAEL L. REV. 274 (1974).

⁴¹ Contracts (General Part) Law, § 12(b). Breach of the duty of good faith negotiations may lead in exceptional cases to the awarding of expectation damages or specific enforcement. See, CA 6370/00 Kal Binyan Ltd. v. A.R.M Ra'anana Building and Leasing Ltd. [2002] IsrSC 56(3) 289; CA 986/93 Klemer v. Guy [1996] IsrSC 50(1) 185.

⁴² HCJ 59/80 Public Transportation Services in Be'er Sheva Ltd. v. the National Labour Court in Jerusalem [1980] IsrSC 35(1) 828, 837-838.

⁴³ For a detailed illustration of this pattern of operation of the principle at the performance stage, see Menachem Mautner, *Good Faith and Implied Terms*, in VOL. 3, CONTRACTS, 313, 360-364 (D. Friedmann & N. Cohen eds., Aviram: Tel Aviv 2003).

⁴⁴ There seems to be a wide consensus that the "good faith" principle has been much more predominant and influential than the "freedom of contract" principle. See e.g. Gabriela Shalev, *The Wild Horse – Where To? Or: What Happened to Public Policy?*, 2 KIRYAT HA-MISHPAT (Ono Academic College L. Rev.) 21 (2002).

into them, a symbol which at the time was a protected trademark of Levi's Jeans. The goods were supplied were shipped, as against the full payment, to the American customer. However, upon arriving at the United States, the goods were detained by the American customs authorities, due trademark infringement. The Belgian buyer then brought suit against the Israeli seller, demanding restitution of the full price. A compromise was reached between the parties in which the symbol was removed and the boots resold to the American customer at a reduced price. The issue facing the court was limited to whether the buyer was entitled to compensation for the balance between the actual sale price and the contract price of the original contract with the American company. The trial court held that the buyer was responsible for ignoring the problem which led to the failure of the original transaction.

As a first step in the analysis, the Supreme Court accepted the buyer's claim that the dispute was to be resolved (by way of analogy) under the rules of the CISG.⁴⁵ A further reason to give weight to the CISG, even though it had not yet become effective in Israel, the Court reasoned, was the need to promote uniformity and harmony in the field of international trade.⁴⁶

Using CISG Article 42(a) by analogy in interpreting ULIS Article 52(a) the Court held that the seller's obligation to transfer goods free from any right or claim of a third party included intellectual property rights, such as trademark infringement claims. Thus, the boots delivered by the seller were non-conforming goods. However, the Court recognized that the CISG explicitly excludes the seller's liability if at the time of formation "the buyer knew or could not have been unaware of the right or claim [of the third party]"⁴⁷ or if that right "results from the seller's compliance with . . . specifications furnished by the buyer".⁴⁸ Applying these provisions to the circumstances of the case, the Court concluded that both the seller and the buyer could not reasonably claim to have been unaware of the Levi trademark.⁴⁹ Furthermore, as the buyer had been active in deciding upon the exact design of the boots. It was, therefore, reasonable for the seller to regard the buyer as having assumed, at least in part, the risk of the goods not being in conformity with U.S. law.

Nevertheless, the Court refused to follow the lower courts' conclusion that under the circumstances the seller was allowed to *completely* rely on the buyer in this respect. As an experienced manufacturer, the seller should have been aware of possible trademark issues and "should have ascertained whether the importer acted properly, or, at least, should have raised the question."⁵⁰

The conclusion of the Court as to the question of liability of the seller therefore comprised two seemingly contradictory statements. On the one hand, as the buyer knew or had to know about the problem, his attempt to present the seller as being responsible for the whole loss originating from that problem must fail. On the other hand, given that

⁴⁵ Eximin Case, *supra* note 36, at para. 3(a).

⁴⁶ *Id.* at para. 3(e). The Court cited FH 36/84 Teichner v. Air France Airlines [1987] IsrSC 41(1) 589 (where the need to unify the international laws of trade and transport was also emphasized).

⁴⁷ CISG § 42(2)(a).

⁴⁸ CISG § 42(2)(b).

⁴⁹ Eximin Case, *supra* note 36, at para. 3(f).

⁵⁰ *Id.* at para. 3(g). The Court noted that its conclusions did not depend on whether the transaction was a C.I.F or a F.O.B. transaction. *Id.* at, para. 3(h).

both parties behaved unreasonably in ignoring the problem, imposing the whole responsibility for the loss on the buyer would also seem inappropriate. The appropriate solution, according to the Court, would therefore be to apportion the responsibility and liability for the loss between both parties.⁵¹ The Court explained:

The parties' behaviour shows that they did not trouble to cooperate with one another . . . [E]ach of them acted, apparently, as he saw fit, ignoring the damage that was likely to be caused and assuming that the other party would be liable for it. Each of the parties, in fact, foresaw the damage but did not trouble to clarify the risk of its happening to the other party, nor did it trouble to disclose it to the other and prevent the damage, even though it was clearly able to do so. To be sure, the lack of cooperation (or lack of disclosure) of the type that existed here does not exempt the party who must carry out an action from its duty, but the question is whether it is not sufficient to grant that party a partial defence.

Having identified the apportioning of the loss as the just result under the circumstances, the challenge facing the Court was to offer a legal basis for such an allocation. In rejecting the buyer's claim for full compensation, the Court reasoned that it was inconsistent with a reasonable interpretation of the parties' intention and the explicit defense provided by CISG Article 42(2). However, justifying the decision to nevertheless impose liability on the seller for *part of the loss* sustained by the buyer was clearly a much more challenging task for the Court.

In order to justify that part of its decision, the Court engaged in a thorough and lengthy analysis of the nature and content of the duty of good faith, both in contract law generally, and in the special context of an international contract for the sale of goods. The following is a summary of the Court's analysis:

- The duty to act in good faith in the performance of a contract is a legal norm which is aimed at securing to each of the parties the realization of their reasonable expectations of the contractual relationship, *even where such expectations are not perfectly protected by the concrete legal norms which govern that relationship.*⁵²
- On a practical level, each of the parties is under an obligation to take into account the other party's expectation under the contract. Thus, a party should refrain as far as possible from acting in a way which might frustrate that expectation. Moreover, under certain circumstances, *a party may be expected to take active steps in order to avoid unnecessary prejudice to the other party.*
- More concretely, if a party can *effectively and without undue burden or cost prevent a substantial risk* to the other party from being realized (such as, by bringing a matter to its attention), but nevertheless fails to take such steps, this may be deemed a violation of the obligation to act in good faith.⁵³
- In the context of an international sales contract between an exporter and an importer of goods, applying the good faith principle would mean, *inter alia*, that

⁵¹ *Id.* at para. 4(a).

⁵² See *id.* at paragraphs 4(b) and 4(j).

⁵³ *Id.* at para. 4(h).

*the exporter, being aware of a problem that might jeopardize the importer's ability to sell the goods, must warn the latter of the problem. This is especially so, if the exporter can assume that his own liability towards the importer would be excluded (as was the case in Eximin).*⁵⁴

- A violation of the duty of good faith in the performance of a contract *amounts to a breach of the contract itself*, and thus entitles the other party to remedies, including compensation for any foreseeable loss which is attributable to the breach.⁵⁵
- In addition, a violation of the obligation of good faith might bar a party from exercising her right to a remedy against the other party for breaching the contract. For example, when a bad faith conduct of one party (buyer) prevented the other party (seller) from fulfilling its obligations under the contract, the former may not be allowed to rely on the non-performance and thus may not be entitled to any remedy whatsoever.⁵⁶
- While most often the effect of bad faith would be of an absolute nature, that is, it would lead to the complete denial of a right or remedy; other cases may call for only a partial denial, or a reduction in the size of the violator's remedy.⁵⁷
- For example, when a party fails, in bad faith, to prevent the occurrence of a breach by the other party, the courts should be allowed, instead of completely releasing the latter from liability in damages, to apportion the loss caused by the breach between the parties. Indeed, a party's fault in failing to prevent its own loss should be taken into account not only when it takes place after breach (where it is regarded as a failure to mitigate damages) but also when it precedes the breach or coincides with it.⁵⁸
- Such apportionment should be carried out by the court taking into account and comparing both the degree of bad faith (or lack thereof) manifested in the conduct of each party as well as the causal contribution of each party to the occurrence of the loss suffered by the plaintiff.⁵⁹

Applying these principles to the case at hand, Chief Justice Shamgar and Justice Ya'acov Malz reached the conclusion that the buyer's appeal should be allowed in part, so as to allow the latter to recover fifty percent of the loss it had incurred.

⁵⁴ *Id.* at para. 4(b).

⁵⁵ *Id.*

⁵⁶ Or, at the least, would lose the right to a particular remedy (e.g., specific performance, rescission, etc.) the awarding of which would turn out to be unjust given that party's bad faith. In the Courts' own words: ". . . [T]he courts tend to attribute unequivocal and absolute implications to a lack of good faith. Thus, a party's lack of good faith may deprive him of a remedy or confer a remedy on the other party." *Id.* at para. 4(e).

⁵⁷ *Id.* at para. 4(d). (" . . . [I]f it is possible to deny a remedy completely in cases like the aforesaid, then a partial denial of damages is even more possible, and as I shall show below, it is also desirable."

⁵⁸ *Id.* at para. 4(d). In this context the Court referred to CISG § 77 (and to ULIS § 88), which deal with the duty to mitigate loss.

⁵⁹ *Id.* at para 4(q).

The dissenting opinion of Justice Eliezer Goldberg accepted the majority's factual determination that both parties could not have been unaware of the risk involved if the problem of trademark infringement would not be taken care of by the buyer or its customer. However, Justice Goldberg wondered how, under that assumption, the failing of the seller to warn the buyer about a problem of which he could not have been unaware of, could be regarded as failure to act in good faith. In the minority view, under the circumstances the seller did not violate norm of good faith in those circumstances.⁶⁰

Furthermore, the seller was not, under the minority view, since it had not breached the contract. Under the ULIS Article 52, the buyer is entitled to receive goods that are free from third party rights *only if buyer did not agree to receive them subject to such rights*. Given that the buyer ordered certain changes in the design of the boots, the buyer must be held to have accepted any risk of the goods supplied being in violation of a registered trademark. In other words, the buyer had implicitly agreed to receive the goods in the state in which they were actually supplied. Therefore, there was no legal cause upon which to base the sellers' liability in damages towards the buyer.⁶¹ It is worth noting, however, that the minority judge did not express any reservation against the introduction of a general doctrine of comparative fault into contract law, either generally or in the particular context of international sales.

C. The Interrelation of International Sales Law and Domestic Law – *Eximin* as a Test Case

The *Eximin* decision not only significant contributed to the elucidation of the duty of good faith in performance, it also stands as the precedent for establishing the defense of comparative negligence into Israeli contract law. What is most interesting, however, is the case involved a dispute which supposedly was decided according under the ULIS and the CISG. Are there any lessons to be learned about the interrelationship between the CISG and domestic law? The following analysis will offer a few of the lessons that may be learned from the *Eximin* litigation.

On the one hand, if a question ever arose as to the relevance and significance of the CISG to Israeli law – this question was clearly settled by the *Eximin* case. The case demonstrates the Supreme Court's willingness to implement international sales law in resolving international sales disputes. First, the Court in *Eximin* embraced the opportunity to apply international sales law. Second, and more importantly, the Court gave considerable weight to what it perceived as apparent changes in the international law of sales. It did not limit itself to the analysis of the pertinent ULIS provisions. The Court gave more weight to the CISG than to ULIS because it viewed the CISG as a more modern sales law. This testifies to the Courts approval of international efforts to advance uniformity in international trade, and its willingness to promote and assist such efforts. The same sympathetic approach towards the CISG was applied in subsequent cases.⁶²

On the other hand, the *Eximin* case raises serious questions as to the level of commitment of the Israeli domestic courts to the legal regime set forth in the CISG. This

⁶⁰ *Id.* (Goldberg, J., dissenting).

⁶¹ *Id.*

⁶² See, e.g., the Pamesa case, in which the Court relied heavily not only on ULIS but on the CISG as well, emphasizing its' impression that "No one can deny the importance of the approach embodied in these CISGs, which increases with the spread of globalization." Pamesa Case, *supra* note 9, at para. 20.

issue first becomes apparent by the manner in which the Supreme Court applied the principle of good faith. Given the international nature of the transaction, one could have expected the Court, prior to beginning its elaborate good faith analysis, to discuss a preliminary question, namely, to what extent, if at all, is the principle of good faith in general, and the duty of good faith as understood under the Israeli law of contract in particular, relevant and applicable to an international sales transaction? Instead the Court moved directly to a general moralistic analysis of the parties conduct in terms of fairness and good faith. Moreover, the only sentence which shows the Court's awareness of its authority to perform a good faith analysis is problematic. The Court stated that "the provisions of the [Israeli] Contracts Law [*General Contract Statute* Articles 12 and 39] also apply to the case before us, if not directly, then by virtue of Article 61(b) of the Contracts Statute."⁶³ Instead of trying to base its authority to impose a duty of good faith in the CISG, it looked for the answer "under the lamp-post", that is, within the boundaries of domestic law.⁶⁴

Professor Reich has argued that had the Court applied the CISG to the issue of good faith it would not have been able to reach the same result. First, under Article CISG 7(a), good faith is merely a principle of interpretation rather than a rule imposing a duty of good faith on the contracting parties.⁶⁵ Second, even assuming such a general obligation of good faith existed applying it under the circumstances of the case would have brought it into conflict with the specific excuse given the seller under Article CISG 42. A specific provision must be given priority over general notions of fairness and good faith or any other domestic norms. General principles and norms can only be relied upon to supplement the concrete rules and to fill internal gaps in the CISG.⁶⁶

One can argue against Professor Reich's assertion that the use of good faith in *Eximin* contradicts the express rule of Article 42. Even under the assumption that good faith notions should be used only in the interpretation of CISG's provisions, it is submitted that a "good faith oriented" interpretation of Article 42 CISG could justify the majority ruling in *Eximin*. The desired result could be achieved in two alternative ways. First, the Court could have offered a reading of the exemption granted the seller under Article 42(2) as including an implied term under which that excuse would not apply if the seller possessed actual knowledge of third party rights in the goods. Such an interpretation would exempt the seller from liability only in cases where the latter had constructive knowledge of the problem ("could not have been unaware" of the right), but not in those cases like *Eximin* where the seller seems to have possessed actual knowledge.⁶⁷

⁶³ *Id.* at para. 4(b). Article 61(b) of the Contracts Statute reads as follows: "The provisions of this Law shall, as far as appropriate and *mutatis mutandis*, apply also to legal acts other than contracts and to obligations not arising out of a contract". This provision was used by the judiciary to apply notions of good faith outside the field of contract law. However, it is questionable whether it can serve as a solid basis to import domestic concepts into the international context.

⁶⁴ For a similar critique of the Court see Reich, *supra* note 4, at 166-168.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ An interpretive technique similar to that offered in the text was adopted by the Supreme Court in CA 2299/99 Shfayer v. Diyur Laoleh Ltd. [2001] IsrSC 55(4) 213. There, based on notions of good faith, the Court narrowed the scope of a buyer's duty, under the domestic law of sales, to inform a seller of any nonconformity immediately upon discovering it. Contrary to the

Secondly, the Court could have reasoned that CISG Article 42 regulates the scope of the seller's duties upon formation and is silent as regards duties *after formation*. As such, the judicial recognition of such additional duties does not contradict, but rather complements Article 42.⁶⁸

Admittedly, however, the Court did not devote much effort to reconcile its good faith analysis with the explicit wording of either the CISG or the ULIS. Rather, as mentioned above, the Court simply assumed that the domestic duty of good faith applied to the case before it. Similarly, it devoted little effort to explaining how its finding of seller liability for not informing the buyer of a problem of which the latter must have been aware, did not contradict the express provisions of the CISG to which the Court alluded to earlier.⁶⁹

V. Contract Formation

It is an undisputed historical fact that the primary sources of Israeli contract law, i.e., the General Contracts Statute and the Remedies Statute⁷⁰ were greatly influenced, in terms of both structure and content, not only by civilian and common law concepts, but also in particular by the 1964 Hague Conventions on the Sale of Goods.⁷¹ This influence is most evident with respect to the rules governing formation. Indeed, the formation rules included in chapter 1 of the Israeli General Contract Statute are almost identical to those set forth in Annex I of the Convention relating to a Uniform Law on the Formation of Contracts for the International Sale of Goods (hereinafter: ULF).⁷² As most of the ULF rules on formation were carried on to the CISG,⁷³ there is a great deal of commonality between the Israeli law and the CISG rules on contract formation.

literal interpretation of the provision, the Court ruled that no such duty exists if the seller possessed actual knowledge of the defect.

⁶⁸ The Court might have hinted in this direction in paragraph 4(k), where it states that the imposition of an additional duty on a party to take simple acts to prevent problems arising after formation: "does not affect the basic allocation of risks between the parties. The International Sale of Goods Law does not anticipate a situation where both parties can efficiently and cheaply avoid a difficulty that arose subsequently. A risk of this kind is not defined in the law, and consequently there is no initial allocation for it. A subsequent allocation, in accordance with the lack of good faith of each of the two parties, does not therefore conflict with the initial allocation."

⁶⁹ The Court did express the view that the duties of the parties to inform each other of apparent risks "...are admittedly not stated expressly in the said articles, but they undoubtedly arise from them..." *Id.* at para. 4(b). However, the Court failed to explain or justify this assertion.

⁷⁰ See *supra*, notes 39 & 40.

⁷¹ See: Uri Yadin, *The Use of Comparative Law by the Legislator*, in ISRAELI REPORTS TO THE XI INTERNATIONAL CONGRESS OF COMPARATIVE LAW 10, 13 (Steve Goldstein ed., H. Sacher Institute for Legislative Research and Comparative Law: Jerusalem 1982). See also Shalev & Herman, *supra* note 37, at 1103.

⁷² 1 July, 1964, available at: <http://www.unidroit.org/english/conventions/c-ulf.htm>. The domestic chapter, however, is more concise, containing only 15 provisions in 11 Articles, while the ULF includes 25 provisions in 13 Articles. The substantial affinity between the two sources is pointed out by Zamir, *supra* note 4, at 502-503 and by Shalev, *supra* note 4, at 110-111.

⁷³ Helpful comparisons of CISG provisions with those of the Hague CISGs are available at <http://www.cisg.law.pace.edu/cisg/text/cisg-toc.html>. For further analysis and comparative

The *Aderet Shomron* case,⁷⁴ decided in 1990 by the Israeli Supreme Court, concerned the "battle of the forms" scenario.⁷⁵ A German manufacturer (seller) sold sewing equipment to an Israeli manufacturer of thread (buyer). In a subsequent contract, the buyer placed an order for spare parts and professional advice in order to overcome an apparent defect in the equipment. The price, quantity and other details concerning the second deal were communicated between the parties via a number of telex messages, following which the seller sent to the buyer an order confirmation. The seller attached its "general conditions of delivery and payment" to the confirmation. That form contained, *inter alia*, a jurisdiction clause granting the German courts exclusive jurisdiction over any dispute arising from the transaction. The spare parts were installed as against full payment, but the buyer alleged that they were defective and were negligently installed by the seller's representative, resulting in loss of profit to the buyer. The buyer then brought suit before an Israeli court, which summarily dismissed it on the basis of the jurisdiction clause.

The buyer appealed, claiming that the order confirmation – and the jurisdiction clause attached to it – though arriving at buyer's premises, was never actually accepted by him. Therefore, it could not form a part of the agreement between the parties. According to the buyer, the contract was formed prior to the confirmation reaching his premises.

The Supreme Court rejected the buyer's claim based upon the following observations. First, given the preliminary nature of the communications preceding the order confirmation, the contract could not have been concluded prior to its arrival. Second, since the confirmation did not completely conform to the buyers' previous communication, the confirmation could not form an acceptance of the buyer's offer. Rather, the confirmation was counteroffer made by the German seller to the Israeli buyer. As such, the decisive question was whether there was enough evidence of a subsequent acceptance on the part of the buyer?

The court held that a contract was formed under Articles 5 and 6 of the General Contracts Statute. Article 5 requires conveyance of a "notice of acceptance" to the offeror, and such a notice was apparently not given by the buyer. However, Article 6 provides an exception, according to which an *act or other conduct* manifesting the offeree's implicit consent may be considered a valid acceptance. The Court reasoned that while mere silence would not generally qualify as conduct amounting to acceptance, silence on the part of an offeree could be so construed, *if it was accompanied by other conduct which gave it such meaning*. Such was the case at hand. The buyer remained silent in face of the order confirmation, but went forward with the transaction. In doing so, the buyer signaled that his failing to approve the confirmation was not mere silence, but a "thundering silence" which could have reasonably been understood by the seller as a manifestation of the buyer's consent to its "general conditions".⁷⁶

case law discussion, see Larry A. DiMatteo et al., *The Interpretive Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence* 24 NORTHWESTERN J. OF INTERNATIONAL LAW & BUSINESS 299, Part III (2003-4).

⁷⁴ CA 65/88 *Aderet Shomron v. Hollingsworth G.M.B.H* [1990] IsrSC 44(3) 600 [hereinafter *Aderet Shomron Case*].

⁷⁵ See generally Maria del Pilar Perales Viscasillas, "Battle of the Forms" Under the 1980 United Nations CISG on Contracts for the International Sale of Goods: A Comparison with Section 2-207 UCC and the UNIDROIT Principles, 10 PACE INTERNATIONAL L. REV. 97 (1998).

⁷⁶ *Aderet Shomron Case*, *supra* note 74, at 610.

Although the judgment did not include any direct reference to the CISG, it reveals the close affinity between the international and the Israeli domestic rules on formation. If the issue were decided on the basis of the ULF or, if it were to be decided today, on the basis of the CISG, the same result would have been reached, using similar reasoning. The first parallel is to be drawn between Article 11 of the General Contracts Statute, and CISG Article 19(1) CISG. The latter provision states that: “A reply to an offer which purports to be an acceptance but contains additions, limitations or other modifications is a rejection of the offer and constitutes a counter-offer.” The parallel domestic rule provides that: “Acceptance involving an addition to or a limitation or some other variation of the offer is tantamount to a new offer.” Thus under both provisions, given the substantial modifications it included, the order confirmation would not be considered a valid acceptance but only a counteroffer.⁷⁷

The second parallel to be drawn concerns the question of whether there had been a valid acceptance of the seller's counteroffer. On this issue, CISG Article 18(1) reads as follows: “A statement made by or other conduct of the offeree indicating assent to an offer is an acceptance. Silence or inactivity does not in itself amount to acceptance.” Article 6(a) of the General Contracts Statute states that: “Acceptance may be by an act in implementation of the contract or by some other conduct if these modes of acceptance are implied in the offer.”

Notwithstanding the above similarities, there is also a clear difference between the two laws. The domestic norm does not expressly reject pure silence as acceptance, as does the CISG. However, as the *Aderet Shomron* case demonstrates, under Israeli contract law sheer silence would not be sufficient to constitute acceptance. The silence may amount to "acceptance by way of conduct" only when it is accompanied by an independent act or when the circumstances make it clear that the silence of the offeree is not neutral. A silence is not neutral when the surrounding circumstances (conduct, prior understandings, and trade usages) would reasonably allow the offeror to understand the silence as signaling acceptance.

VI. Conformity of Goods: Inspection and Notice

Conformity of goods is a major issue in sales law.⁷⁸ The seller's primary obligation is to deliver to the buyer goods which in terms of both quality and quantity conform to what was promised. Much less obvious, however, are the limits imposed by the law of sales on

⁷⁷ CISG Article 19(2) CISG makes a distinction between material and non-material additions to the offer; a distinction which is not found in Article 11 of the General Contract Statute. Under the CISG §19(2) a modification of an offer may nevertheless constitute valid acceptance, if it does not materially alter it, and if the offeror does not object to the modifications introduced. This means that under the CISG pure silence on the part of an offeree can be considered valid acceptance, while under the Israeli provision it cannot. It is likely, however, that in cases where the modifications in the offer are minor, sheer silence on the part of the original offeror may – even under Israeli law – be considered as concluding the contract.

⁷⁸ See generally EYAL ZAMIR, THE CONFORMITY RULE IN THE PERFORMANCE OF CONTRACTS (The Harry Sacher Institute for Legislative Research and Comparative Law: Jerusalem 1990) (Hebrew) ; Eyal Zamir, *Towards a General Concept of Conformity in the Performance of Contracts*, 52 Louisiana L. Rev. 4 (1990); See also Honnold, *supra* note 8, at 275-286; DiMatteo, *supra* note 73, at Part IV.

a buyers' right to rely on nonconformity in order to seek legal remedies. These limits, frequently described as "duties" or "obligations" of the buyer, are, in fact, legal defenses which the seller is allowed to raise in order to bar the buyer's claim.

The main defense, both under the CISG and the Israeli Sales Statute,⁷⁹ turns upon issues of inspection and notice. Although regulated under separate provisions, the burden of inspection and that of giving a prompt notice to the buyer are intimately linked to each other. Indeed, arguably, the first of the two burdens is subordinate to the second, in the sense that failure to inspect the goods in a reasonable time period will partially determine the buyer's execution of its primary duty to give a timely notice of nonconformity.

The following survey outlines the manner in which the burdens of inspection and notice are interpreted by Israeli courts. In light of the similarity between the CISG and ULIS provisions on the issues of inspection and notice,⁸⁰ cases decided on the basis of the older ULIS will also be reviewed. As emphasized elsewhere in this chapter, these cases, though formally decided under the ULIS, constitute valuable points of reference for Israeli courts interpreting the parallel CISG provisions.

A. The Inspection and Notice Burdens – Scope and Content

The main Israeli case on the burden of inspection is *Datalab Management Pty. Ltd. v. Polak*.⁸¹ Decided in 1989 by the Supreme Court, that case concerned a contract for the sale of sterile gauze pads between an Israeli producer (seller) and an Australian importer of medical equipment (buyer). An initial contract was concluded in 1976, following which the seller began delivery. The buyer paid the full consideration, only to discover that the first two shipments contained numerous defective units. Following the buyer's complaints, a second agreement was reached between the parties. According to that agreement, the whole merchandise was to be shipped back to Israel for re-examination and repair by the seller. The agreement also declared that no more than 1% of the reshipped merchandise should be defective.

On January 1978 a first consignment, containing about 10% of the total quantity paid for under the contract, was re-delivered to the seller. Four months later, the buyer informed the seller that 17% of the remaining merchandise were found defective. After a few failed attempts to bridge the gap between the parties, the buyer resold the pads to a local hospital for the full contract price. The buyer then sued the seller claiming full restitution of the purchase price as well as compensation for other consequential losses.

The trial court dismissed the buyer's claim based on ULIS Article 38(1). The court held that the buyer had failed to execute its duty to "examine the goods, or cause them to be examined, promptly". As a result, in accordance with Article 39(1), the buyer had also lost his right to any remedy for the alleged nonconformity.

The key question before the Supreme Court turned on the appropriateness of buyer's inspection under the circumstances. The buyer claimed that it could not have been reasonably expected to carry out the examination of approximately 10,000 packs (each containing 5 gauze pads) upon their delivery, since the end user of the pads was an Australian hospital, which only by gradual and ongoing use became aware of the

⁷⁹ *Supra* note 21.

⁸⁰ This obvious similarity was recognized by the Supreme Court in the Pamesa Case, *supra* note 9, at para. 23.

⁸¹ CA 306/85 *Datalab Management Pty. Ltd. v. Pollak International Ltd.* [1989] IsrSC 43(2) 309 [hereinafter *Datalab Case*].

magnitude of the problem. The Court held that under the circumstances both the inspection and the notice were carried out "within as short a period as possible, in the circumstances, from the moment when the act could reasonably be performed".⁸²

While accepting the claim that an intermediate buyer would not be required to carry out the inspection by itself if such an inspection might entail the impairment of the goods, the Court nevertheless rejected the buyers claim. When, as in the case at hand, an intermediate buyer is well aware of the existence of a previous defect, and where both parties made clear that the transaction would dependent upon an inspection of the goods by the buyer, the latter must make every effort to perform the inspection immediately upon delivery. The Court noted, this burden could have been carried out by a sample check of the pads, either by the buyer itself or by its customer. As a direct consequence of this failure to undertake a reasonably timely inspection, the buyer failed to notify the seller "promptly after he . . . ought to have discovered [the nonconformity]".⁸³

However, contrary to the lower court, and notwithstanding the buyer's failure to inspect in a timely manner, the Court did not regard the buyer's failure a sufficient reason to bar his right to restitution. While the buyer was indeed barred from seeking any remedy (including restitution) for the defective goods which were actually delivered to him, he was not so barred with respect to the merchandise which remained with the seller. Examining that question, the Court reasoned that in reselling the remainder of the merchandise in response to the buyer's refusal to accept it, the seller implicitly expressed his willingness to terminate the contract. Following such mutual termination, the seller was obliged to restore that part of the consideration which reflected the value of the undelivered merchandise.⁸⁴

It is worth noting that apart from implementing the "prompt inspection" requirement, the Court also interpreted it to be a stringent requirement. The court opined that:

[It] is intended to give more stability to commercial relationships and to minimize the losses which might accrue from too long a postponement of the giving of a notice . . . This way, the seller can go on with its economic activity, free from the worry that, with no time limit, the buyer might complain of a defect in the merchandise.⁸⁵

It should be noted that while the CISG replaced the requirement of a "prompt" notice with the requirement that a notice be given "within a reasonable time"⁸⁶ there was no substantial change as regards to the nature of the required inspection itself, and the need to carry it out "within as short a period as is practicable in the circumstances."⁸⁷ Arguably, therefore, the distinctions set forth in the *Datalab* case as regards the nature of

⁸² This being the definition of the term "promptly" under § 11 ULIS.

⁸³ ULIS § 39(1).

⁸⁴ *Datalab* Case, *supra* note 81, at paras. 5-7.

⁸⁵ *Id.* at para. 4, citing with approval Justice Ben-Porat in the case of *Solondz*, *supra* note 19, at 637.) This policy analysis gained recent support in the *Pamesa* Case, *supra* note 9, at para. 25.

⁸⁶ CISG § 39(1).

⁸⁷ CISG § 38. In our view this definition is not substantially different from the one adopted by ULIS § 38.

a reasonable and timely inspection, are still relevant today as guidelines for courts dealing with the duty of inspection under the CISG.⁸⁸

There were two other occasions on which Israeli courts dealt with the issue of the burden of inspection. In *Harel Insurance Co. Ltd. v. BTR Environmental Ltd.*,⁸⁹ a foreign supplier of fuel filters was sued by a local energy producer for the losses caused by a defect in one of the filters supplied to it, which caused an explosion.⁹⁰ On appeal, the Supreme Court dealt, *inter alia*, with the question of whether a notice was given "promptly" enough. The Court answered the question in the affirmative, taking into account the fact that given the size of the defect and its nature (a mere 50 mm welding defect) the nonconformity was undiscoverable by inspection at the time of delivery.⁹¹ Hence, the buyer had not failed to inspect the filter upon its arrival. Consequently, in informing the seller soon after discovering the defect, the buyer carried out its 'duty' to inform the seller "promptly" (under ULIS Article 38) and hence also "within a reasonable time after he has discovered it or ought to have discovered it" under CISG Article 38.⁹²

Another case, decided by the Tel-Aviv magistrate Court,⁹³ involved a dispute between two Israeli businesses. The Court, nevertheless, resorted to the CISG, in order to determine whether the buyer's claim had been barred due to his failure to notify the seller promptly upon delivery that the quantity of aluminum delivered exceeded the contract amount. As the merchandise was directly shipped to the buyer's customer in the United States, the buyer became aware of the extra quantity only at a later stage, hence the belated notice to the seller.

Citing first the relevant provision in the domestic Sales Statute which required inspection (and hence also notice) "promptly" upon delivery, the Court then turned to CISG Article 38(3), which allows the buyer to postpone inspection of the goods until their arrival at their final destination. Given the international context of the transaction, and the need to ship the goods out of the country, the judge found it not only helpful, but also legally permissible to rely on the CISG to fill a perceived gap in the domestic law.

B. The Seller's Power to Bar Buyer's Claim – Its Nature and Limits

As discussed above, Israeli case law has justified the strict burdens of inspection and notice, and the harsh consequences of failing to discharge them, by referencing the goal of protecting two main interests—the international seller's interest in certainty and finality and the societal interest in preventing avoidable injuries and losses.⁹⁴

⁸⁸ Indeed, in the Pamesa case, the seller tried to rely on the conservative approach in *Datalab* in order to reinforce his position that the buyer's claim should be barred. However, as we saw, the Court did not adhere to the ULIS and was willing to consider also the concepts and rules of the CISG which, on the issue of notice, are more lenient.

⁸⁹ *Supra* note 27.

⁹⁰ The case was discussed above in the context of the issue of concurrent liability.

⁹¹ *Datalab* Case, *supra* note 81, at para. 20.

⁹² As noted earlier, the Court of first instance applied the CISG, but the Supreme Court made clear that the transaction was still governed by ULIS. However, from the Courts' reasoning it is clear that the result would have been the same under the CISG.

⁹³ CC (TA) 11082/05 *Kalil Industries v. Rollteck Aluminum Yedidya Ltd.* (07.10.2008) *Nevo Legal Database* (by subscription) (Isr).

⁹⁴ See *supra*, text accompanying note 85.

However, given the harsh consequences of a belated notice to the seller, international sales law imposes limits on the seller's power to reject a buyer's claims through the defense of belated notice. The main limitation is found in CISG Article 40 which reads as follows: "The seller is not entitled to rely on the provisions of Articles 38 and 39 if the lack of conformity relates to facts of which [the seller] knew or could not have been unaware and which he did not disclose to the buyer."⁹⁵ The most elaborate judicial analysis of this provision to date was undertaken by the Israeli Supreme Court in the case of *Pamesa v. Mendelson*.⁹⁶ The case, the facts of which were presented earlier in this chapter,⁹⁷ involved a damage claim brought against a Spanish manufacturer of tiles (seller) by an Israeli importer (buyer). The buyer demanded compensation for consequential losses resulting from alleged defects in the tiles supplied by it to a local builder, which had sued the buyer for the costs of replacing the defective tiles.

Examining the contractual cause of action against the seller, the Court first discussed the seller's claim that under both the CISG and ULIS. It determined that under both laws the buyer's claim had to fail. This was apparently so, first of all, because the buyer had not informed the seller of the defects upon their discovery, and secondly, because more than two years had expired from delivery, so that in any event the claim was barred under either ULIS Article 39(1) or CISG Article 39(2).

As a first step in the analysis, the Court rationalized that prescription periods were not motivated merely by evidentiary considerations concerning the seller's ability to refute allegations, but mainly by substantive policy reasons. As a result, the limitations on a buyer's nonconformity claim were not procedural bars, but rather restrictions on the buyers' substantive right to sue. Citing with approval a previous decision of the Court which interpreted the one-year prescription period set forth in ULIS Article 49,⁹⁸ the Court stated:

The determination of a prescription period [in the CISG] ... is not required for the main reason that usually underlies prescription, which is the keeping of evidence, but for a quick determination of the legal position between the parties to the transaction. In order to achieve this purpose, this provision should be regarded as reflecting prescription as causing the actual right to expire.⁹⁹

⁹⁵ Cf. the almost identical formulation of ULIS Art. 40: "The seller shall not be entitled to rely on the provisions of Articles 38 and 39 if the lack of conformity relates to facts of which he knew, or of which he could not have been unaware, and which he did not disclose." For analyses of foreign case law interpreting Article 40 see, e.g.: FRITZ ENDERLEIN & DIETRICH MASKO, *INTERNATIONAL SALES LAW: UNITED NATIONS CISG ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS: CISG ON THE LIMITATION PERIOD IN THE INTERNATIONAL SALE OF GOODS: COMMENTARY* 164 (Oceana Publications: New York 1992); R.H. Graveson et al., *The Uniform Laws on International Sales Act 1967: a Commentary* 77 (Butterworths: London 1968); Schlechtriem, *supra* note 15, at 321-322; Alejandro M. Garro, *The Buyer's "Safety Valve" Under Article 40: What is the Seller Supposed to Know and When?*, 25 J. OF L. & COMMERCE 253 (2005).

⁹⁶ *Supra* note 9.

⁹⁷ *Supra* text accompanying notes 9-14.

⁹⁸ CA 132/85 Ameropa AG v. H.S.Y. HaMegader Steel Industries Ltd. [1987] IsrSC 41(4) 477.

⁹⁹ *Pamesa Case*, *supra* note 9, at para. 25.

Since it was clear that the buyer had failed to notify the seller either promptly upon discovery or within the two-year prescription period, the buyer in *Pamesa* was apparently barred from presenting any claim based on the nonconformity of the tiles supplied by the seller.¹⁰⁰ However, this could not settle the issue, since under CISG Article 40 which was cited, along with ULIS Article 40, the seller's defense did not apply if the seller knew or must have known of the facts giving rise to the alleged nonconformity. More concretely, the challenge facing the Court was to decide if the seller's awareness of defects in tiles sold to other Israeli importers was sufficient for Article 40 to apply.

The Court emphasized the close theoretical linkage between Article 40 and the principle of good faith. Based on the analysis of both legal scholarship and continental case law interpreting that provision, the Court reached the conclusion that: “[I]t is therefore clear that Article 40 was intended for cases of bad faith. ... [I]t is clear that the Article was not intended for cases where the seller did not disclose defects of which he was unaware in good faith.”¹⁰¹

A further rationale advanced by the Court for limiting the seller's immunity under the convention was based on a more concrete and pragmatic argument. The main goal of barring buyers' claims is to protect the seller's legitimate interest in being assured that, after the lapse of a two-year period, its liability for defects was terminated.¹⁰² However, such a rationale did not rationally apply if during that period the seller already became aware of an alleged defect in the goods it delivered to the buyer.¹⁰³ Hence, this exception to the seller's immunity from liability was explained not only by reference to the principle of good faith, but also on the independent ground that under the circumstances set forth in Article 40 granting such an immunity would be superfluous, in terms of achieving its concrete social goals.¹⁰⁴

The second interpretive move of the Court was to assert that in light of its being an exception to the 'basic and fundamental' duty of buyers to examine and inform sellers of defects as soon as possible,¹⁰⁵ the exception to that duty must be narrowly construed. The buyer's right to resort to Article 40, especially in cases where the buyer's notice was seriously delayed, is therefore limited. For example, in the case at hand, the buyer had notified the seller three years after becoming aware of the alleged defect, and only following a legal suit brought against it by the builder. In this context, the Court referred to Article 16 of the domestic Sales Statute. Under that provision, even where the seller

¹⁰⁰ *Id.* at para. 24.

¹⁰¹ *Id.* at para. 30.

¹⁰² The issue of concurrent tort liability was examined in Part III.

¹⁰³ The question of when the seller's awareness is examined is rather complex, and it was not discussed in the case, as deciding it was deemed unnecessary. This was so, for the seller's awareness was not proven at any point prior to its being informed by the buyer. *Pamesa Case*, *supra* note 9, at para. 44, citing Garro, *supra* note 95, at 256; PETER SCHLECHTRIEM, COMMENTARY ON THE UN CISG ON THE INTERNATIONAL SALE OF GOODS (CISG) 479-480 (2nd ed., 2005))

¹⁰⁴ *Id.* at paragraphs 31-33.

¹⁰⁵ In this the Court relied on a 1998 judgment of the Stockholm Chamber of Commerce, and on a scholarly article, in which a restricted approach to the interpretation of article 40 was taken, limiting it to "special" or "exceptional" circumstances. See *id.* at para. 34.

knew (or should have known) of the facts out of which the nonconformity arised, the buyer still owes a duty to inform him *immediately* after becoming aware of it.¹⁰⁶

In the specific circumstances of the case before it, the Court reached the conclusion that Article 40 did not apply. First, the seller had no reason to suspect that such defects existed, especially since the tiles were examined upon their arrival by the Israeli Institution of Standards and were found to be conforming.

Second, and most importantly in the Courts' eyes, although the seller was aware of some defects in other shipments of the same kind of merchandise, it was clearly not aware of any alleged defect in the tiles which it sold to the buyer. In the Court's view, proof of such an amorphous awareness was clearly insufficient for Article 40 to apply:

[I]n order to succeed in an argument based on Article 40 the buyer must at least prove that in the past the seller discovered defects of the kind being alleged... [G]iving a general notice about 'problems' in goods does not satisfy the requirement of giving notice in Article 39... It would appear to follow a fortiori that a general awareness of 'problems' that were discovered in the past, without any specific notice being given by a buyer with regard to specific goods, does not satisfy the requirements of Article 40.¹⁰⁷

Finally, the buyer himself behaved improperly in failing to notify the seller within a reasonable period of time after becoming aware of the defects. Just as the seller should not be allowed to conduct itself in bad faith (not notifying the buyer of known defects), the Court reasoned, so should be the case with the buyer. There is a need to encourage buyers to act diligently in informing sellers of nonconformities once they become aware of a nonconformity.

In *Intermas Nets v. Zilkha*,¹⁰⁸ the Court showed reluctance, under certain circumstances, to allow a seller to rely on Article 39 to bar a buyer's otherwise justified claim. The case involved a complex dispute between a Spanish manufacturer of nets and an Israeli importer and supplier of nets. The buyer brought suit before the Magistrate Court of Tel-Aviv. The Court was presented with the issue of whether the buyer, who held the defective merchandise for a period of time without notifying the seller, could still make a claim of nonconformity. Given that both Spain and Israel had adopted the CISG, the Court applies the CISG.¹⁰⁹ It held that even if the notice was not given "within a reasonable time" according to Article 39, the buyer's claim was not barred. This was due to the fact that at a later stage the seller expressed its willingness to consider the buyer's claim and sent its representative to examine the allegedly defective merchandise. Furthermore, at another time the seller had offered the buyer compensation. Under these

¹⁰⁶ Article 16 states: "Where the nonconformity arises out of facts which the seller knew or ought to have known at the time the contract was concluded and which he did not disclose to the buyer, the buyer shall be entitled to rely on it notwithstanding the provisions of section 14 or 15 or of any agreement, *provided that he gives notice of it to the seller immediately upon discovering it.*" (emphasis added).

¹⁰⁷ *Id.* at para. 45.

¹⁰⁸ CC (TA) 176684/02 *Intermas Nets s.a v. Zilkha Aharon* (15.08.2007) Nevo Legal Database (by subscription) (Isr.).

¹⁰⁹ *Id.* at para. 39.

circumstances, even if the buyer's claim had been barred under Article 39, the seller must be taken to have forfeited its right to raise such an argument.¹¹⁰

Conclusion

This chapter reviewed the status of the CISG in the Israeli legal system. As this survey revealed, the attitude of the Israeli courts towards international sales laws has in the past been rather ambivalent. On one hand, most of the Israeli cases reflect a sympathetic approach towards the idea of a uniform law of sales. At other times the courts have ignored the CISG without a sufficiently clear reason. Fortunately, on the last occasion in which the CISG was relied upon by the Supreme Court, its analysis reflected a serious effort both to explore and to implement it correctly. In the *Pamesa* case, the Israeli Supreme Court signaled its sincere commitment to the principles of international sales law and its ability to implement the CISG properly, and with considerable expertise.

¹¹⁰ *Id.* at para. 42.