Final award in case no. 6955 of 1993

Facts

Claimant contracted to purchase from defendant a quantity of goods. The contract incorporated by way of reference various standards and specifications. Under the contract, all of the goods were to be delivered to the claimant's subcontractor where they were to undergo a further processing.

The goods were delivered to the subcontractor where they were processed and packaged. Agents of the defendant were present during these procedures and issued a report on the quality of the procedures and recommendations for improvements. When the goods were delivered to the end purchaser, they were rejected as defective due to non-conformity to specifications, lack of identifying marking, lack of waterproofing and corrosion. The end purchaser requested that claimant replace the goods. Agents of both claimant and defendant carried out various inspections both at the end purchaser and at the subcontractor. Following the inspection of the residual goods at the subcontractor, defendant wrote to claimant to explain that the results of its laboratory inspection had shown that the goods were only stained, not corroded.

Claimant initiated arbitration relying on the arbitration clause in the sales contract which provided for ICC arbitration. The contract provided that the law applicable to the dispute was the law of the State of Illinois and the application of the 1980 UN Sales Convention was excluded. Claimant sought the current replacement value of the goods as of the date of the award or alternatively, their actual replacement cost. Claimant subsequently ordered a quantity of goods from company Z, its parent company, as replacement in order to obtain the release of samples from end purchaser.

The arbitral tribunal appointed experts who were to inspect the goods. They issued two reports relative to their inspection of the residual goods at the subcontractor and to their inspection of samples of the goods that had been shipped to the end purchaser.

Applying the Uniform Commercial Code (UCC), which has been adopted by the State of Illinois, the arbitral tribunal found that claimant had accepted the goods from defendant, but that did not imply that the goods conformed to the contract. Although claimant only became aware that there was a question of non-conformity (corrosion) after the goods had been delivered to the end purchaser, and communicated this to defendant in a conditional manner, it had given defendant notice of breach within a reasonable time. The corrosion was not a non-conformity which claimant should have discovered earlier. Claimant was entitled to revoke acceptance because the corrosion had been difficult to discover and it had relied on defendant's assurances as to conformity. In spite of the indefiniteness of claimant's communications to
defendant, the tribunal found that claimant had made an oral demand for replacement of the goods following the inspection at the subcontractor and had done so within a reasonable time. The tribunal also found that there was a trade usage allowing the goods to comply with the specifications as actually applied, rather than the exact wording. Further, claimant’s actions concerning access for inspections and acquiring samples did not amount to a material breach relieving defendant of its duties to claimant.

Having found that the goods were not in conformity with the contract due to corrosion, the tribunal examined the available statutory and contractual remedies and found that they were not mutually exclusive. Claimant had made “cover” purchases from its parent company so that the price paid could not be shown to be a reasonable one in the marketplace. Consequently, no damages could be recovered for the difference between the cost of the cover and the contract price. Defendant was ordered to pay claimant the contractual price of the goods and claimant was ordered to return the goods in their present condition.

**Excerpt**

I. LACK OF CONFORMITY

[...]

4. Compliance with Contractual Specifications

58 "The question arises as to just what it means for the goods to be in compliance with or to meet the criteria of a particular specification. At least two related, but nonetheless different meanings are possible here. One is that the goods must comply with the exact wording of the specification irrespective of how that specification is applied in the trade. This is the position urged by claimant throughout its brief. Another is that the language means that the goods must comply with the specification as actually applied by the specifying organization in plants supplying such goods to it. This is the position urged by defendant. For two reasons the tribunal believes that the second of these meanings is that intended by defendant and claimant in entering this contract. The first concerns additional language in the contract; the second concerns trade usage at specifier’s goods plants.” The tribunal concluded that additional contract language and trade usages supported this interpretation.

(...)

a. General requirements for establishing a usage of trade

59 "**UCC** Sect. 1-205(2) provides:

‘A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts ....’"

60 "Before dealing with the elements of usage of trade, it should be noted that usage of trade must not be confused with course of dealing, which concerns prior dealings between the parties (**UCC** Sect.1-205(1))... Usage of trade on the other hand concerns usages of a place, vocation, or trade, and its proof does not depend upon anything going on between the parties other than their participation in trading at the place, in the vocation, or in the trade in question. There are three elements in the **UCC** formulation of usage of trade: (1) regularity of observance, (2) in a place, vocation or trade, (3) justifying the expectation that the usage will be observed in the transaction. For a trade usage to be used in a case there is a fourth requirement: proof of the usage as a fact.

61 "**Regularity of observance.** Prior to enactment of the **UCC**, and to a considerable extent still respecting non-**UCC** law, usage of trade - or custom as it was more commonly called - was often said to have to be "ancient and
immemorial", "universal" or the like', to quote UCC Sect. 1-205, Comment 5. (These were ancient English tests). Comment 5 states that the ancient English tests are abandoned. It states that UCC Sect.1-205 provides for full recognition ‘for new usages and for usages currently observed by the great majority of decent dealers’. As examination of UCC Sect. 1-205(2) shows, the test now is related to whether there is such regularity of observance as to justify an expectation that it will be observed in the transaction in question. Thus whether there is sufficient regularity of observance is largely determined by the third element, discussed below.

62 "Place, vocation or trade. This language raises the question whether the usage of the specifying organization and defendant at approved goods plants is that of a place, vocation, or trade. Ordinarily one would expect to find more than two identifiable parties establishing a trade usage. But that is because ordinarily more than two identifiable parties are involved in business at a particular place, in a particular vocation, or in a particular trade. In this instance, however, the evidence (undisputed) is that [the] goods are made in only two places, in both of which the dominant party is the specifying organization, and a second permanent party is the defendant. Other customers are undoubtedly part of the 'trade', but the content of the usages are those established by the specifying organization with the acquiescence of defendant and its other customers who necessarily have to go along with them if they want defendant to make the goods. In this respect it may be noted that UCC Sect.1-205 Comment 7 states that the usage 'may be either general to trade or particular to a special branch of trade'.

(...)

63 "Justifying the expectation that the usage will be observed in the transaction. The preceding elements - regularity of occurrence and place, vocation, or trade - are to be tested by whether they justify the expectation that the usage will be observed in the transaction. Under the UCC (and indeed under older law), this does not require that both (or indeed, perhaps either)parties actually have such an expectation. UCC Sect. 1-205(3) provides that 'any usage of trade in the vocation or trade in which [the parties] are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of the agreement.' Thus the standard is an objective one; by engaging in the trade claimant is assumed to have the expectations generated by(proven) trade usages of that trade.

64 "Proof of trade usage as facts. The final requirement is that the usage be adequately proven as a fact. The trade usage pertinent to this case is the practice of the specifying organization to modify its specifications or standards. Defendant has proved as a fact to the satisfaction of the tribunal that the

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specifying agency has done this respecting identifying marking, waterproofing, and corrosion....

65 "The question remains whether these three examples are sufficient to establish as a fact that a trade usage exists meeting the requirements of UCC Sect. 1-205(2). The tribunal concludes that they are. This is in part because the trade usage harmonizes with the interpretation the tribunal otherwise places on the contract language. Thus the Illinois authorities cited by claimant refusing to find trade usages where they were in substantial conflict with the contract language or made substantial changes in the content of the contract are not persuasive. The trade usage is pertinent here because it confirms the contract, not because it modifies or contradicts the contract. The tribunal is also influenced by the experience of its members that practices such as those described are common to bureaucracies governed by extremely intricate rules which otherwise are too rigid for practical operation.

66 "Although the specific modifications can be stated as only three, one of them - the corrosion standard - affects all the goods defendant manufactures. They are thus more prevalent than may at first appear. The tribunal concludes that their existence justifies the parties' expectations that the usage would be observed in the contract .... [C]laimant need not actually have such an expectation, only that it would have had it been aware of these facts, as it should have been as a trader in this market."

[...]

Referring Principles:

I.2.2 - Trade usages