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>>> > **update**

Germany: Federal Supreme Court Determines Specific “Materiality Threshold” for Rescission of Contracts

If a defective product is delivered, German law grants the customer various rights against the seller, including subsequent performance, rescission of contract, reduction of the purchase price and damages. However, the right to rescind the contract does not apply “if the breach of duty is immaterial” (§ 323 para 5 German Civil Code). Until recently, no clear standard existed as to the question when a defect is to be considered as “immaterial”. The German Federal Supreme Court has now given some guidance on the issue of “materiality” and thereby created a higher level of legal certainty for both sellers and customers.

Previously, in applying the “materiality test”, courts have been using a general standard of reasonableness, i. e. an extensive weighing of the interests of the supplier and of the customer. The courts thereby took into account various aspects, including the costs required to cure the defect and its functional and esthetic effects, but also the degree of the supplier’s fault. Courts and legal literature assumed that the threshold of materiality was only exceeded where the costs to cure the defect amounted to 10 % or 20 % (in individual cases up to 50 %) of the purchase price. It is needless to say that in borderline cases, any prediction of a court ruling was impossible.

Facts of the case

In the case recently brought before the Federal Supreme Court, the customer had bought a new car for approx. € 30.000 from a car dealer. The customer complained

that electronic parking assistant did not function properly. The car dealer undertook several attempts but failed to repair the defect. The buyer then set a time limit to cure the defect, whereupon the car dealer took the position that the parking assistant functioned properly and refused any further repairs. The buyer was not willing to accept this and decided to abandon the purchase. He declared rescission of contract and sued for refund of the purchase price against return of the car.

The district court and the court of appeals dismissed the case. While they did agree with the plaintiff that the car had a defect, they did not allow rescission of contract. On the basis that the costs required to repair the electronic parking assistant would amount to approx. € 1.950 and thereby 6,5 % of the purchase price, the previous instances held that the defect was to be considered as “immaterial” in the sense of § 323 para 5 German Civil Code and that the contract was therefore not subject to rescission.



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The Decision by the Federal Supreme Court

The Federal Supreme Court overturned the judgment of the previous instances and awarded the plaintiff the right to rescind the car purchase (Judgment dated 28 May 2014, file no. VIII ZR 94/13). In applying the “materiality test”, the court started off in using the general standard to weigh the interests of the customer and of the seller. Then, in doing so, the court held that

“... as a general rule, within the weighing of interests on the basis of the individual circumstances, immateriality of a breach of duty can no longer be presumed if the costs required to remedy the defect exceed five percent of the purchase price”.

In its reasoning, the court held that with the introduction of the new § 323 para 5 German Civil Code in 2002 the legislator had not intended to tighten the requirements for a rescission of contract. Further, the court held that below the threshold of 5 % it can reasonably be expected for a purchaser to adhere to the contract and to be satisfied with a reduction of the purchase price and monetary damages. The court further held that the threshold of 5 % is also in conformity with the requirements of European Consumer Sales Directive (Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees).

In balancing the parties’ interests, the court also held that the 5 % threshold adequately protects the seller from any detrimental economic impacts of a rescission of contract, particularly since the rescission of contract additionally requires that the seller has previously been set a time limit and given the opportunity to render subsequent performance, i. e. to cure the defect by repairing it or by supplying a new object free of defects.

Key aspects

- First of all and evidently, the Federal Supreme Court has accomplished a higher degree of legal security for parties of a purchase contract and strengthened purchasers’ rights: As a general rule, only very minor defects result in an exclusion of the right to rescind the contract.
- It can be assumed that this standard will not only be applied in consumer related matters. Likely, the courts will apply this standard also to pure business to business transactions.
- Further, the relevance of the decision may go well purchase contracts, since the underlying rule of § 323 para 5 German Civil Code applies to all kinds of contractual relationships.
- However, the decision related to a “remediable defect”, i. e. a defect which can be cured. The court left open whether this same materiality threshold also applies to defects which cannot be cured. In such cases, the threshold may well be lower.
- Lastly, please note that, in addition to exceeding the materiality threshold, the right of rescission is subject to further statutory requirements. These requirements are accessible to contractual modification.
- Therefore, in drafting and negotiating business contracts under German law, special attention should be given to any clauses dealing with requirements that may lead to a rescission of contract.

How we can help?

Please contact Kai Graf v. der Recke at HAYER & MAILÄNDER who can help you with any queries on this topic.



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