# UNIVERSIDAD PANAMERICANA

## CAMPUS GUADALAJARA

**DAVID OBEY AMENT GÜÉMEZ**

# "COMPARATIVE LAW ANALYSIS OF THE CISG'S PRINCIPLES OF STRICT LIABILITY AND FULL COMPENSATION"

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# UNIVERSIDAD PANAMERICANA

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## DICTAMEN DEL TRABAJO DE TITULACIÓN

**C. DAVID OBEY AMENT GÜEMEZ**
P r e s e n t e.

En mi calidad de Presidente de la Comisión de Exámenes Profesionales y después de haber analizado el trabajo de titulación en la opción TESIS titulado: **"COMPARATIVE LAW ANALYSIS OF THE CISG´s PRINCIPLES OF STIRCT LIABILITY AND FULL COMPENSATION",** presentado por Usted, le manifiesto que reúne los requisitos a que obligan los reglamentos para ser presentado ante el H. Jurado del Examen Profesional, por lo que deberá entregar siete ejemplares como parte de su expediente al solicitar el examen.

Atentamente

EL PRESIDENTE DE LA COMISIÓN

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**MTRA. YURIXHI GALLARDO MARTÍNEZ**
Secretaria Académica de la Licenciatura en Derecho
Presente.

Por medio del presente hago de su conocimiento que DAVID OBEY AMENT GÜEMEZ, quien cursó la Licenciatura en Derecho, ha concluido satisfactoriamente su trabajo de tesis titulado: "COMPARATIVE LAW ANALYSIS OF THE CISG'S PRINCIPLES OF STRICT LIABILITY AND FULL COMPENSATION".

Manifiesto que después de haber sido dirigida y revisada por el suscrito, reúne todos los requisitos técnicos y académicos para solicitar fecha de Examen Profesional.

Agradezco de antemano la atención que puedan brindar al presente, reiterándome a sus órdenes.

A t e n t a m e n t e

**José Edgardo Muñoz López**
Director de Tesis

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| | |
|---|---|
| CISG | United Nations Convention on Contracts for the International Sale of Goods of 1980 |
| Convention | United Nations Convention on Contracts for the International Sale of Goods of 1980 |
| UNIDROIT | International Institute for the Unification of Private Law |
| ULIS | Uniform Law of International Sale |
| ULFC | Uniform Law on the Formation of Contracts for the International Sale of Goods |
| CISG-AC | CISG Advisory Council |
| Adras | Adras Construction Co. Ltd. |
| Harlow | Harlow & Jones GmbH |
| PICC | Principles of International Commercial Contracts |
| PECL | Principles of European Contract Law |
| OHADA | *Organisation pour l'Harmonisation en Afrique du Droit des Affaires* |
| *Op. cit.* | *Opere citato* |
| *Ibid.* | *Ibidem* |
| i.e. | That is |
| p. | Page |

| | |
|---|---|
| pp. | Pages |
| UNCITRAL | United Nations Comission on International Trade Law |
| UNCITRAL Convention on Independent Guarantees | Convention on Independent Guarantees and Stand-By Letters of Credit |
| ICC | International Chamber of Commerce |
| URCG | ICC Uniform Rules for Contract Guarantees of 1978 |
| URDG 458 | ICC Uniform Rules for Demand Guarantees of 1992 |
| URCB | ICC Uniform Rules for Contract Bonds of 1994 |
| URDG 758 | ICC Uniform Rules for Demand Guarantees of 2010 |
| ISP98 | International Standby Practices of the American Institute of International Banking Law & Practice |

## INTRODUCTION

In the world of international business transactions and commercial law, the United Nations Convention on Contracts for the International Sale of Goods of 1980 (hereinafter “CISG” or “the Convention”) stands out. It is an instrument to which most countries in the world have already adopted as the applicable law for the international sale of goods.

Within its provisions one can find principles and remedies applicable for the breach of a contract. Two main principles are worth mentioning in this regard: the principle of strict liability and the principle of full compensation. The present work intends to explain them and to apply them to two particular situations: the consequences of failing to comply with ancillary an obligation such as the provision of an independent bank guarantee, and the possibility to disgorge the profits made by the breaching party as the basis for compensation for breach of contract under the CISG.

As for the first main subject, independent guarantees have become a standard arrangement in international trade. The use of these guarantees has increased significantly since the 1960s and their frequency has grown exponentially ever since. The reasons for such development are numerous. First, independent guarantees have proven to be useful in connection with any kind of underlying transaction, such as in financial dealings, sales agreements or industrial projects. Second, the amounts at stake in modern transactions have increased significantly the risk factor for the parties concerned. In this regard, the parties’ determination to cover the risk of a breach of contract has provided the impetus for the extraordinary development of independent guarantees. In international industrial projects, for example, long-term contracts involving significant amounts are very common, and the question of whether the exporter (contractor) has performed its contractual obligations often embraces the determination of complex issues. Consequently, importers (owners) have resorted to independent guarantees in

order to ensure that performance claims can be compensated immediately and effectively by a third party guarantor.

The beneficiary of an independent guarantee may be the buyer (the owner or importer), meaning that the buyer's right to claim performance of a contractual or legal duty can be guaranteed. If the beneficiary was the seller (or the contractor or exporter) on the other hand, the seller's claim for payment of the purchase price can be guaranteed. Once it has been established, an independent guarantee creates rights and obligations between the beneficiary and the guarantor. These rights and obligations are "independent" from the underlying contract between the seller and the buyer, of which performance of certain obligations has been guaranteed.

However, a clause in the underlying contract requiring the issuance of an independent guarantee creates an obligation for the applicant to have the guarantor issue that guarantee for the beneficiary. This obligation to apply for the guarantee to the guarantor is enforceable under the law governing the underlying contract. Questions then arise as to the enforcement and effects of the applicant's obligation under the applicable law; in particular, regarding the failure to apply for an independent guarantee or doing it so in a defective manner. The aforementioned may entitle the other party to claim certain remedies but at the same time exclude others. These questions are to be answered in the light of the provisions of the Convention.

With regard to disgorgement of profits, the CISG's remedies available to the party aggrieved by a breach of contract seek to fully indemnify the harm caused, and when possible, to grant what was expected under the contract. Articles 45 and 61 of the CISG entitle the party suffering the breach of contract to claim damages as provided in Articles 74 to 77. This is in regard to all losses suffered as a consequence of the breach, regardless of whether the contract has been avoided or not.

In regard to these specific provisions on damages, Article 74 of the CISG stipulates the principle of full compensation. Pursuant to this principle an aggrieved party by a breach of contract is entitled to be placed in the same financial position it would have been had the other party not breached its obligations; it seeks to compensate an aggrieved party for all disadvantages suffered as a result of the breach. The compensation given by the party in breach shall therefore not only satisfy the expectation interest established between the parties, but also all damages caused to other interests as a result of the non-performance. In order to achieve this purpose, Article 74 of the CISG allows the aggrieved party to recover different types of loss, such as non-performance loss, incidental loss, consequential loss and loss of profits.

While it is undisputed that the purpose of Article 74 follows the principle of full compensation, its precise meaning is yet to be determined. In this work I submit that notion that the promisee must not be overcompensated cannot strictly be applied in the context of the Convention. In other words, it may be possible to take into account, especially when interpreting said provision in light of the principle of good faith pursuant to Article 7 (1) of the CISG, the benefit which the breaching party obtains from its breach when calculating and assessing damages.

In this regard, this part of the paper focuses on explaining the possibility of taking into account the profits made by the breaching seller in a second sale when calculating and assessing the damages the aggrieved buyer from the first breached contract is entitled to. This is done by: first, explaining the general point of view of courts and scholars to the possibility of a disgorgement of profits under the CISG (which is mainly against it); second, by defining and clarifying what disgorgement actually is, and how such a claim is actually possible under the CISG; and finally, by proposing and explaining two methods of calculation of damages that result in the aforementioned. Both of these methods consist in an interpretation of Article 74 of the CISG under the scope of the principle of good

faith. They are also compatible with the calculation methods found in Articles 75 and 76 of the CISG. Critics and arguments against the disgorgement of profits are also analyzed and contested.

Besides determining the parties' rights and obligations under the CISG with regard to the issuance of an independent guarantee and that a disgorgement of profits is possible under the CISG's principle of full compensation, this paper also has the underlying goal of promoting the applicability of the Convention in the international panorama. It may be a mandatory instrument of law, but it remains unknown in some state courts of some countries of Latin America, such as Mexico. Seeing how as time passes more countries are adhering to the application of the Convention, this is a subject matter that cannot simply continue to be ignored. As an expert on the subject has stated, "in view of the current state of affairs, the Latin American jurist must be prepared to apply the CISG".[1]

For the foregoing purposes, the present project has adopted as theoretical framework the method of interpretation stipulated in the very same Convention in its Article 7.[2] Furthermore, a functional method of Comparative Law has been applied, under which academic writings, court decisions and awards from arbitral tribunals from all around the world are analyzed and applied. Fictional scenarios are also used in order to understand more clearly what is submitted in this work.

[1] MUÑOZ, Edgardo, *Understanding the CISG System of Remedies from the Latin American Domestic Laws' Standpoint*, in Ingeborg Schwenzer, Cesar Pereira and Leandro Tripodi (eds.) CISG and Latin America, Regional and Global Perspectives, International Commerce and Arbitration Volume 21, Eleven International Publishing, 2006, p. 94.
[2] See pp. 12 and 13 below.

# 1. HISTORICAL BACKGROUND

## I. Harmonization of Commercial Law

Merchants from all around, who nowadays face a globalized world, have realized that limiting commercial customs and usages to domestic laws eventually leads to restraining their own business.[3] By doing so, they end up limiting their capacity to make a profit in the most efficient way possible, especially when concluding transactions with merchants from foreign countries.

By appealing to what can be considered as the basis of commerciality, reciprocity in trade and enforcement of the principle of consent,[4] merchants retook the tendency that first paved the way for commercial law during the Middle Ages. This led them to form and follow international usages and practices.[5] At the same time, and by taking into account different political, economic and legal systems from all around the globe, they also sought legal certainty and recognition for their acts, but now in an international sense.[6] In light of this, they resorted to international organizations to achieve this purpose.

"Just as medieval adjudicators sought to ascertain the conduct of merchants within the framework of business itself, a similar obligation was now upon the

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[3] SHAPIRO, Martin, "The Globalization of Law", in Indiana Journal of Global Legal Studies, Vol. 1, No. 1, Symposium: The Globalization of Law, Politics, and Markets: Implications for Domestic Law Reform, Fall 1993, Indiana University Press, available at http://www.jstor.org/stable/20644540, pp. 39-40.

[4] TRAKMAN, Leon E., *The Law Merchant: the evolution of commercial law*, Fred B. Rothman and Co., United States, 1983, p. 7.

[5] For example, before the INCOTERMS were a set of international rules brought to fruition by the ICC for the interpretation of the most commonly used trade terms in foreign trade, they were rules regarding transport of goods, allocation of risk and other usages and customs established and followed by merchants from all around the world. For more, see RAMBERG, Jan, Incoterms 2000 – *The Necessary Link between Contracts of Sale and Contracts of Carriage*, available at http://hrcak.srce.hr/file/32031, last accessed September 18, 2015. Also see, Incoterms® by the ICC, available at http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/history-of-the-incoterms-rules/, last accessed on September 19, 2015.

[6] TRAKMAN, Leon E., *op. cit.*, p. 21.

upholders of this modern international Law Merchant, to develop trade law on a similarly commercial foundation".[7]

Indeed, harmonization of the applicable law grants those who engage in international transactions a higher level of confidence in the worldwide market. Consequently, a same level of certainty can be appreciated in the results or outcome of the commercial activities and the way they are solved when a dispute arises; or in other words, a general consistency in substantive outcomes.

## II. Drafting of the United Nations Convention on Contracts for the International Sale of Goods (CISG)

Harmonization of the applicable law – and therefore of the results or outcome on the commercial activities and the way they are solved when a dispute arises – grants those who engage in international transactions a higher level of confidence in a worldwide market.[8]

Ever since the 1920's there have been various efforts focusing on the creation of a uniform commercial law.[9] In the year 1929, the International Institute for the Unification of Private Law (UNIDROIT) began the elaboration of an instrument for this area of law. This project was presided by a Committee lead by Sir Cecil James Barrington Hurst and other experts on law.[10] In 1934, said Committee submitted a

[7] *Ibid.*, p. 40.
[8] STEPHAN, Paul B., "The Futility of Unification and Harmonization in International Commercial Law", in University Of Virginia School of Law Legal Studies Working Papers Series, Working Paper No. 99-10, June 1999, p. 4, available at http://papers.ssrn.com/paper.taf?abstract_id=169209.
[9] *Ibid*., p. 3. Also see BONELL, Michael Joachim, *Introduction to the Convention*, in Bianca, Cesare Massimo and Bonell, Michael Joachim (eds.), Commentary on the International Sales Law, the 1980 Vienna Sales Convention, Guiffrè, Milan, 1987, p. 3.
[10] *Idem*.

preliminary draft of the first precedent of an international law on the sale of goods.[11] This first project was sent to the League of Nations for its revision.

During the following years, new drafts were made based on different reviews made by countries around the world. At the same time, the government of the Netherlands created a Special Commission with the task of further elaborating its text at The Hague.[12] This resulted in two new drafts. The first one was finished in 1956, and the second one, based on the reviews of the first one, was finished in 1963.[13] Regardless of this, UNIDROIT kept working on a separate draft at the same time, still on the subject of international sale of goods.

Both drafts received favorable reviews. Because of this, the government of the Netherlands convened a Diplomatic Conference in order to achieve its adoption. 28 States attended, as well as observers from four other States and six international organizations.[14] As a result, two official instruments were adopted by some of the attending States, which then entered into force in 1972. These instruments were the Uniform Law of International Sale (ULIS) and the Uniform Law on the Formation of Contracts for the International Sale of Goods (ULFC).[15]

Regardless of this, only a few countries chose to adopt the projects, and those who did, only did so under the condition of making reservations to many of their provisions.[16]

In 1966 the United Nations Commission on International Trade Law (UNCITRAL) was established, having as its main goal the “progressive harmonization and unification of the law in international trade by coordinating the work of organizations active in this field and encouraging cooperation among them,

[11] *Idem*.
[12] *Ibid*., p. 4.
[13] *Idem*.
[14] *Idem*.
[15] *Idem*.
[16] *Ibid*., pp. 4-5.

as well as promoting wider participation in existing international conventions and wider acceptance of existing model and uniform laws".[17]

After seeing that still many countries were reluctant to adopt the ULIS and ULFC (which was made known to UNCITRAL after it requested the Secretary-General of the United Nations to ask the State members of the UN if they intended to do so), UNCITRAL created a Working Group for the adequacy of those two instruments, based on the past experience of the ULIS and ULFC and the reviews made to them.

This Working Group was composed by fifteen representatives of countries from different regions of the world, which had a domestic law based on different legal systems such as common law, civil law, and even soviet law.[18] During its eleventh session, UNCITRAL decided to consolidate the two drafts into a single text, creating a Drafting Committee to that effect, who presented its final project in 1978 to the General Assembly of the United Nations.[19]

During the United Nations Conference on Contracts for the International Sale of Goods held in Vienna, two Committees composed by representatives of 62 States and of 8 international organizations were created. These new Committees were now in charge of drafting the final provisions of the new instrument, based on the project created by the Drafting Committee. On April 11 of 1980, the United Nations Convention on Contracts for the International Sale of Goods was promulgated and adopted, for it to later enter into force on January 1 of 1988.[20] This new instrument

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[17] See *General Assembly resolution 2205 (XXI) of December 17, 1966*, United Nations, available at http://daccess-dds-ny.un.org/doc/RESOLUTION/GEN/NR0/005/08/IMG/NR000508.pdf?OpenElement, last accessed on September 15, 2015.

[18] *Ibid*., p. 6.

[19] See *Resolution 33/93 of December 16, 1978*, United Nations, available at http://www.un.org/documents/ga/res/33/ares33r93.pdf, last accessed on September 15, 2015.

[20] See *CISG*, UNCITRAL, available at https://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html, last accessed on September 15, 2015.

was adopted by many countries of different legal systems, regardless of the fact that it allows making only a few reservations to its provisions.[21]

### III. Importance of the CISG

The provisions of the CISG apply to contracts for the sale of goods concluded between parties that have their place of business in two different Contracting States.[22] The CISG also applies when the rules of private international law lead to the application of the law of a Contracting State; or when the parties opt-in its application,[23] as long as no other international agreement containing provisions concerning the matter governed by the Convention has already been entered into between States in which the parties have their place of business.[24] As for the substantive matters covered by the CISG, its scope of application encompasses those contracts for the international sale of goods, save the exceptions expressed in its Article 2.[25]

This instrument provides a fair, modern and uniform regime for the regulation of contracts for the international sale of goods: from their formation to their completion, its fundamental principles, and the rights and obligations between the seller and the buyer.[26] All this while contributing significantly to the existence of legal certainty to this area of trade and the reduction of transaction costs. As

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[21] See CISG-AC, *Opinion No. 15*, *Reservations under Articles 95 and 96 CISG*, Rapporteur: Professor Doctor Ulrich G. Schroeter, University of Mannheim, Germany. Adopted by the CISG-AC following its 18th meeting, in Beijing, China on 21 and 22 October 2013.

[22] It must be noted that the CISG expressly allows in its Article 6 for the contracting parties to opt-out its application to their contract.

[23] DEL DUCA, Louis F. and DEL DUCA, Patrick, "Selected Topics Under the Convention on International Sale of Goods (CISG)2, in 106 Dickinson Law Review, Summer 2001, p. 214, available at http://www.cisg.law.pace.edu/cisg/biblio/delduca2.html.

[24] This is pursuant to Article 90 of the CISG. This provision also allows for any future convention to supersede the CISG. For more on the matter, see EVANS, Malcolm, *Article 90*, in Bianca, Cesare Massimo and Bonell, Michael Joachim (eds.), Commentary on the International Sales Law, the 1980 Vienna Sales Convention, Guifrrè, Italy, 1987, pp. 636-638.

[25] See Articles 1-5 of the CISG.

[26] BARRERA Graf, Jorge, *Instituciones de derecho mercantil*, Porrúa, México, 1999, p. 44.

explained by the Ministry of Commerce of the People's Republic of China, "the Convention is one of the most important international conventions that adjust and regulate purchasing and sales contracts in international goods trade, and one of the most successful uniform laws in international trade up to now".[27]

"Approximately 2,500 published court decisions and arbitral awards, an abundant number of scholarly writings, numerous conferences, and last but not least the Annual Willem C. Vis International Commercial Arbitration Moot show the prominent role the CISG plays in practice, legal academia, and legal education".[28]

Nowadays, 83 countries have adopted the CISG,[29] which indicates its success in regard to the harmonization of global commercial law. Mexico itself ratified the CISG on 29 December, 1987, and enacted it on 17 March of the following year by publishing it in its *Diario Oficial de la Federación*,[30] beginning to have effect until 30 of December, 1989.[31]

Regardless of its notoriety, and of the fact that its application is mandatory for parties located in signing countries, the CISG has had little use in some countries; especially in Latin America. Instead, parties tend to expressly opt-out the application of the Convention, designating the application of national laws in their contracts instead.[32] Not only has there been few reported CISG cases in Latin

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[27] Ministry of Commerce of the People's Republic of China, *China Contract Law and CISG Become more Consistent in Provisions on Contract Form and their Applicability*, February 25, 2013, available at http://english.mofcom.gov.cn/article/newsrelease/significantnews/201302/20130200038302.shtml.

[28] HACHEM, Pascal and SCHWENZER, Ingeborg. "The CISG – Successes and Pitfalls", in 57 American Journal of Comparative Law, Spring 2009, p. 458.

[29] *CISG Database,* Pace Law School, last access: 15 September, 2015, available at: http://www.cisg.law.pace.edu/cisg/countries/cntries.html.

[30] The *Diario Oficial de la Federación* or *D.O.F.* is the official vehicle of Mexico, through which it publishes and is made known its new laws , regulations, agreements , circulars, orders and other acts issued by the authorities of the Federation. For more see http://www.dof.gob.mx/nota_detalle.php?codigo=4726004andfecha=17/03/1988.

[31] BARRERA Graf, Jorge, *op cit*, p. 44.

[32] HACHEM, Pascal and SCHWENZER, Ingeborg, *op. cit.*, "The CISG – Successes and Pitfalls", p. 463.

American courts, but there has also been a lack of academic writings on the matter.[33]

Additionally, there are many reasons why previous attempts of unification projects of sales law failed to be successful, which nowadays still exist in some degree in regard to the CISG. One of these reasons is skepticism, in the sense that harmonizing different legal systems could result in a lack of legal certainty and discrepancy in regard to its application and to judicial and arbitral resolutions of any conflict that could arise.[34] The latter, due to the fear that there may be State courts and arbitrators who, lacking a global vision, may attempt to import old domestic preconceptions into the CISG.[35]

Against the aforementioned, the CISG itself cautiously establishes a solution in its own provisions. This problem is tackled with the principle of autonomous interpretation contained in Article 7(1) of the Convention, which states that its own provisions must be interpreted "with regard […] to its international character and to the need to promote uniformity in its application".

In other words, this principle states that the provisions of the CISG must be interpreted in an autonomous manner, regardless from any preconception that any domestic judicial system may have had adopted in regard to a particular subject matter. This is precisely in order to achieve a uniform interpretation of its provisions when defining the global case law and jurisprudence.

Courts and arbitral tribunals from all around the world have strictly followed this mandate, making it possible to establish a uniform understanding of the provisions of the Convention. For example, in 2006 the Higher Regional Court of Karlsruhe

[33] MUÑOZ, Edgardo, *op. cit.*, *Understanding the CISG System of Remedies from the Latin American Domestic Laws*, p. 94.
[34] HACHEM, Pascal and SCHWENZER, Ingeborg, *op. cit.*, "The CISG – Successes and Pitfalls", pp. 467, 468.
[35] *Ibid.*, p. 458.

based its decision on a "consolidated line of decisions".[36] Also, in 2009 the Foreign Trade Court of Arbitration of the Serbian Chamber of Commerce applied the CISG to a dispute under the basis that doing so "was in accordance with foreign judicial and arbitral practice, which should be taken into consideration for the purpose of achieving uniform application of the CISG, pursuant to Article 7 (1) CISG".[37] Further evidence can be appreciated in the UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods, where a number of decisions in regard to different provision have been compiled with aims of facilitating knowing the current stand on concrete subjects.[38] Scholarship authors are also very aware of this key principle contained in Article 7(1), and tend to work and study new subjects under this framework. There is for example the CISG Advisory Council, or CISG-AC, whose opinions are "guided by the mandate of Article 7 of the Convention as far its interpretation and application are concerned [which consists in giving] paramount regard to [the] international character of the Convention and the need to promote uniformity".[39]

Even if it was considered that a gap exists within matters governed by the provisions of the Convention, the very same CISG provides enough tools for correcting it. In order to be able to ensure uniformity, the CISG seeks to be applied without the need of resorting to domestic law, unless there is no other option left.[40]

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[36] See Germany 8 February 2006 Appellate Court Karlsruhe (Hungarian wheat case), available at http://cisgw3.law.pace.edu/cases/060208g1.html.

[37] See Serbia 28 January 2009 Foreign Trade Court of Arbitration attached to the Serbian Chamber of Commerce (Medicaments case), available at http://cisgw3.law.pace.edu/cases/090128sb.html

[38] *UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods*, United Nations Commission for International Trade Law, 2012.

[39] Established in Paris, France, in 2001, the CISG-AC is a private initiative supported by the Institute of International Commercial Law at Pace University School of Law and the Centre for Commercial Law Studies, Queen Mary, University of London, which aims at promoting a uniform interpretation of the CISG, conformed by scholars who look beyond the cooking pot for ideas and for a more profound understanding of issues relating to CISG. Its opinions have been taken into account not only by other experts of the medium, but even by courts and tribunals from around the world. For more, see CISG-AC, *Welcome to the CISG Advisory Council (CISG-AC)*, available at http://www.cisgac.com/index.php.

[40] HACHEM, Pascal and SCHWENZER, Ingeborg, *Article 7*, in Ingeborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, Oxford University Press, 2010, p. 142, paragraph 42.

Article 7(2) provides the use of the general principles contained all along the body of the CISG to successfully achieve gap-filling, such as the principle of full compensation, mitigation of damages, party autonomy and good faith.[41]

As mentioned above, resort to domestic law is available only as a last resort. Furthermore, it must be noted that this is only possible when dealing with matters that are not governed by the provisions of the CISG, or questions that have not been expressly defined by the Convention. On the contrary, issues concerning the validity of a contract, the transmission of property, assumption of debts, the effects of a contract on third parties, the issue of whether a court has jurisdiction or not, among others[42]… must be solved under the applicable domestic law.

In spite of it, in the past courts and arbitral tribunals have departed from the obligation contained in Article 7 of the CISG, deciding situations based on a domestic law provision instead of those provided by the CISG. For example, the Supreme Court of Israel incorrectly ruled in this sense in the case known as Adras Construction Co. Ltd. v. Harlow & Jones GmbH, of 2 November 1988.[43] The Israel Supreme Court found that Adras was entitled to restitution of the profits made by Harlow under the domestic laws of unjust enrichment without making any reference to the ULIS or the CISG.[44] Pursuant to Article 7 of the CISG, rulings and decisions such as this one must be avoided, criticized and disregarded by all other courts or

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[41] *Op. cit*., *UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods*, pp. 43-45. On the subject, also see KONERU, Phanesh, "The International Interpretation of the UN Convention on Contracts for the International Sale of Goods: An Approach Based on General Principles", in 6 Minnesota Journal of Global Trade, 1997.

[42] For case law on this issues, as well as for more examples of the applicability of domestic law parallel to the CISG, see *op. cit., UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods*, p. 25, paragraph 14.

[43] While this case was one where the ULIS was applicable to the controversy (a direct predecessor of the CISG, the principle interpretation contained in Article 7 of the CISG (or in this matter Article 17 of the ULIS) still governed the Court.

[44] For more see FRIEDMANN, Daniel, "Restitution of Profits Gained by Party in Breach of Contract", in 104 Law Quarterly Review (1988), pp. 383-388, available at http://cisgw3.law.pace.edu/cisg/biblio/friedmann.html. See also SCHLECHTRIEM, Peter, *Article 76*, in Peter Schlechtriem and Ingeborg Schwenzer (eds.), Commentary on UN Convention on International Sale of Goods, 2d edition, 2005 (English) ed., Oxford University Press, paragraph 3.

arbitral tribunals for the sake of the autonomous and uniform application of the Convention.

The CISG has had a notorious influence over international instruments that deal with similar matters; especially in regard with its substantive provisions and those concerning the gap-filling process.[45] Examples of these are the UNIDROIT Principles of International Commercial Contracts (PICC), the Principles of European Contract Law (PECL), the *Organisation pour l'Harmonisation en Afrique du Droit des Affaires* (OHADA) *Acte uniforme sur le droit commercial général*, among others.[46] This has been mainly because of two characteristics of the CISG that were found appealing to these other instruments. First, the drafters of the CISG sought to create a legal language independent from legal terms, concepts and other peculiarities that are specific to certain domestic legal systems. For example, instead of defining "goods" the way domestic systems usually do,[47] the CISG states what is to be understood as a "good" by listing and excluding in its Article 2 what cannot be understood as such.[48] Second, the drafters of the Convention tried to avoid dependencies on legal concepts that were included in domestic law systems merely because of historical reasons, and include modern terms that have nowadays proven to be efficient. Given that common law systems are a product of a continuous and progressive evolution provided by the system of legal precedents, the CISG has adopted its structure and general concepts of sales law for being considered best suited for the international unification of this part of law.[49] For example – and as it will be further analyzed as it comprises an important

[45] See HACHEM, Pascal and SCHWENZER, Ingeborg, *op. cit.*, "The CISG - Successes and Pitfalls", pp. 461-462. Also see SCHLECHTRIEM, Peter, "Basic Structures and General Concepts of the CISG as Models for a Harmonization of the Law of Obligations", in 10 Juridica International, 2005, pp. 27-34.

[46] HACHEM, Pascal and SCHWENZER, Ingeborg, *op. cit.*, "The CISG - Successes and Pitfalls", pp. 461-462.

[47] The Mexican Federal Civil Code in its second book (from Article 747 onwards), for example, establishes a classification and defines the existing types of goods.

[48] For more examples, see ZELLER, Bruno, "International Trade Law - Problems of Language and Concepts?", in 23 Journal of Law and Commerce, 2003, pp. 39-51.

[49] MAGNUS, Ulrich, "The Vienna Sales Convention (CISG) between Civil and Common law – Best of all Worlds?", in Journal of Civil Law Studies, Volume 3, Issue 1, Article 6, pp. 74-75, available at

part of this article – the CISG remedy mechanism does not follow the cause oriented approach that descends from the Roman civil law system regarding the subject of breach of contract.[50] Instead, the Convention adopts the principle of strict liability.[51] This does not mean that the drafters of the Convention sought to disfavor one legal family over the other. The CISG Working Group's objective was to find the best solution for each sales problem at an international level.[52] It simply found that some aspects of the international sale of goods could be better addressed by a rule that happened to have its origin in a specific law tradition.

As far as domestic law goes, the CISG served as an important model for the draft of China's Contract Law of 1999, adopting the latter most of the substantive provisions of the former. The main reason for this was because the provisions and objectives of the CISG shared China's interest in achieving the unification and perfection of its contract law as an answer to the need of the development of its market economy.[53] Influence of the CISG can also be appreciated on other countries such as Argentina, Brazil, Canada, Greece, among others.[54]

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http://digitalcommons.law.lsu.edu/cgi/viewcontent.cgi?article=1023&context=jcls. As for specific concepts (such as the remedy of price reduction and the mechanism of *Nachfrist*), it is considered by different authors that the CISG actually contains more civil law traits. See MAGNUS, Ulrich, *op. cit.*, pp. 81-86, and WESIACK, Max, *Is the CISG too much influenced by civil law principles of contract law rather than common law principles of contract law? Should the CISG contain a rule on the passing of property?*, Pace Law School Institute of International Commercial Law, June 2004, available at http://www.cisg.law.pace.edu/cisg/biblio/wesiack.html#b.

[50] See below Chapter 4. Also see *op. cit.,* MAGNUS, Ulrich, p. 75.

[51] *Idem*. Also see NICHOLAS, Barry, *Impracticability and Impossibility in the U.N. Convention on Contracts for the International Sale of Goods*, in Nina M. Galston and Hans Smit (eds.), International Sales: The United Nations Convention on Contracts for the International Sale of Goods, 1984, Chapter 5, pp. 5-12.

[52] FOUCHARD, Philippe, *Rapport de synthese*, in Yves Derains & Jacques Ghestin (eds.) La Convention de Vienne sur la Vente Internationale et les Incoterms, 1990, p. 163.

[53] For more see HAN, Shiyuan, *The CISG and Modernisation of Chinese Contract Law*, in International Trade/ADR in the South Pacific, pp. 67-80.

[54] For more see from various authors, *The CISG and its Impact on National Legal Systems*, Franco Ferrari (ed.), European Law Publishers, 2008.

Additionally, the *Lex Mercatoria*[55] tends to look at the provisions of the CISG when seeking a solution. This is because the Convention does not only contain solutions that have been deemed as the most efficient from both the civil law system and the common law system, but also because its provisions contain and express most of the general principles of law that the *lex mercatoria* endorses.[56]

[55] Defined by Ole Lando as when an arbitral tribunal will resolve based in a mixture of: laws from several legal systems that are deemed as the more appropriate, and partly a selective and creative process (mix from application of national laws, custom and usages of international trade and equity). For more information, see GOLDMAN, Berthold, *La lex mercatoria dans les contrats et l'arbitrage internationaux: réalité et perspective*, in The influence of the European communities upon private international law of the member states, 1981, pp. 209, 211 et seq.

[56] LANDO, Ole, "The Lex Mercatoria", in the British Institute of International and Comparative Law's International and Comparative Law Quarterly, 34, pp. 747-768.

## 2. STRUCTURE OF THE CISG

The CISG is divided into four main parts. The first part explains its sphere of application (Articles 1-6 and 10), where it is explained to which international sale of goods the Convention is to be applied. This part also contains some relevant general provisions (Articles 7-9 and 11-13) such as how the Convention and the parties' statements must be interpreted, what is to be considered as binding for the parties, and how contract formation takes place. The second part addresses in more detail the contract formation (Articles 14-24).

The third part of the CISG covers all substantive issues with regard to the obligations of the parties, dividing this into five chapters. Chapter one (Articles 25-29) explains relevant general provisions concerning matters such as when a fundamental breach can be considered to have occurred, and when can a contract be avoided, modified or terminated, as well as its requirements. Chapter two (Articles 30-52) lays down in detail the obligations by default of the seller; that is, besides those expressly established in the contract or that arise from usages of a certain market in international trade or from practices established between the parties. This includes the seller's obligation of the delivery of the goods and of any relevant documents, the conformity of the goods as to what was requested by the buyer, third party claims, and the remedies available for the buyer in the given case that the seller breaches the contract. Chapter three (Articles 53-65) sets forth the obligations by default of the buyer, which include paying the price for the goods, taking delivery of them, and the remedies available for the seller if the buyer is to breach the contract. Chapter four (Articles 66-70) establishes the passing of risk from one party to another, taking into account different possible scenarios and circumstances. Chapter five (Articles 71-88) explains provisions that are common to both the obligations of the seller and the buyer; for instance, the possibility of anticipatory breach and installment contracts, the right to claim damages and how to calculate them, the right to claim interests, exemptions for when a party is not to

be considered liable for a breach of contract, like *force majeure*, the effects of an avoidance of the contract, and a general obligation for both parties for the preservation of the goods.

The fourth and final chapter (Articles 89-101) contains general provisions explaining the CISG's nature as an international treaty, describing when it is to be considered enforceable once signed by a Contracting State, the possibility of making certain reservations or denunciation, and so forth.

## 3. BREACH OF CONTRACT AND THE PRINCIPLE OF STRICT LIABILITY

A breach of contract occurs when a seller or a buyer does not fulfill, or deficiently performs, what itself promised to do under the contract. This includes the obligations expressed under the provisions of the CISG when it is found to be applicable to a sale. In this regard, Articles 45 and 61 of the CISG[57] entitle the party aggrieved by a breach of contract to claim damages as provided in Articles 74 to 77. All of the different remedies available for the suffering party seek to fully indemnify the harm caused, and when possible, to grant what was expected under the contract. However, it is important to note that "any" kind of breach of contract entitles the non-breaching party to claim a remedy, regardless of the kind of breach – whether it was a breach caused by the delivery of non-conforming goods, delay in the delivery of the goods, or if it is a breach in regard to a main or an accessory obligation[58]– or the preponderance of the breach.[59] For example, a seller's failure to hand over the buyer the agreed assembling instructions is as much a breach of contract as the total non-delivery of the goods is.[60] Additionally, this liability also

[57] Article 45 states: If the seller fails to perform any of his obligations under the contract or this Convention, the buyer may: (…) (2) claim damages as provided in Articles 74 to 77.
Article 61 states: If the buyer fails to per for many of his obligations under the contractor this Convention, the seller may: (…) (2) claim damages as provided in Articles 74 to 77.

[58] A breach will ensue regardless of whether the obligation at stake is a main obligation or an ancillary one, whether it arises under the CISG provisions or the sales contract. *Op. cit.,* MUÑOZ, Edgardo, *Understanding the CISG System of Remedies from the Latin American Domestic Laws' Standpoint*, pp. 97, 98: "the CISG has a unitary breach of contract system that does not distinguish between remedies on the grounds of defect of title, non-conformity, delay, partial-performance or not-performance at all". Latin American countries provide different types of actions depending on the type of breach that has occurred. Generally, redhibitory and estimatory actions are available when goods are delivered with unnoticed or unknown defects; compensation against eviction is available for a buyer who was not able to prove having a better right of property against a third person regarding the goods it purchased in good faith; finally, the remedies of specific performance, avoidance of the contract and compensation for damages are available in cases of partial or total delay in the performance of the contract.

[59] This includes, for example, not complying with obligations that are not specifically addressed in the CISG but agreed between the parties, such as the obligation to establish an independent guarantee, under Articles 45(1)(b), 61(1)(b). See MÜLLER-CHEN, Markus, *Article 45*, in Ingeborg Schwenzer (ed.), Schlechtriem and Schwenzer Commentary on the UN Convention of the International Sale of Goods (CISG), 3rd Edition, Oxford University Press, 2010, p. 691, paragraph 5.

[60] MULLER-CHEN, Markus, *Articulo 45*, in Ingeborg Schwenzer and Edgardo Muñoz (eds.), Schlechtriem and Schwenzer: Comentario sobre la Convención de Viena de las Naciones Unidas sobre los Contratos de Compraventa Internacional de Mercaderías, 2011, p. 1217.

extends to cases where the breach is caused by a third person acting on behalf of a party under the contract, causing said party to be held liable for any damages caused.[61]

It follows from the principle of strict liability that the CISG does not require negligence or fault by the breaching party for it to constitute a breach of contract.[62] Instead, the mere occurrence of a breach entitles the other party to claim damages. This doctrine was developed in the tort law of the common law jurisdictions; first and mainly as a product of the decision reached in Rylands v. Fletcher in 1868 by the Exchequer Chamber and the House of Lords of England.[63] In itself, the principle at hand was developed in aims of dealing with extra-contractual or tort law situations where a person possesses a major source of danger to other people or other people's property.[64] This may include any mechanism, instrument, or substances that are dangerous in itself, whether because of the speed they are handled with, its explosive or inflammable nature, or because of the electric current that they transmit, or any other analogous reason.[65]

The CISG does not limit damages to situations involving a negligent or willful breach.[66] The concept of strict liability was expanded in the CISG for it to apply to within contractual relationships. The Convention seeks to promote efficiency in the global market by allowing the quick resolution of any conflict that may arise

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[61] SCHWENZER, Ingeborg, *Article 79*, in Ingeborg Schwenzer (ed.), Schlechtriem and Schwenzer Commentary on the UN Convention of the International Sale of Goods (CISG), 3rd Edition, Oxford University Press, 2010, p. 1077, paragraph 34.

[62] KIENE, Sörren, *German Country Analysis: Part II*, in Larry A. DiMatteo (ed.) International Sales Law, a Global Challenge, Cambridge University Press, 2014, p. 391. FABER, Wolfgang, *The CISG in Austria,* in Larry A. DiMatteo (ed.) International Sales Law, a Global Challenge, Cambridge University Press, 2014, p. 325. See Germany, 31 March 1998, Appellate Court Zweibrücken, (*Vine wax case*), available at http://cisgw3.law.pace.edu/cases/980331g1.html.

[63] *Rylands v. Fletcher*, in West's Encyclopedia of American Law, 2nd Edition, pp. 432-433.

[64] *Strict Liability*, Legal Information Institute, Cornell University Law School, accessed on June 2, 2016, available on: https://www.law.cornell.edu/wex/strict_liability.

[65] See for example Articles 1913 and 1914 of the Mexican Federal Civil Code.

[66] This is what is known in the common law tradition as the "unitary approach of strict liability". See SCHWENZER, Ingeborg, *et. al.*, *Global Sales and Contract Law*, Oxford University Press, 2011, p. 541, and ZWEIGERT, Konrad and KÖTZ, Hein, *Introduction to Comparative Law*, Oxford Clarendon Press, 1998, p. 503.

between a buyer and a seller. Accordingly, already several common law and some civil law systems include the principle of strict liability in the equation of damages for breach of contract.[67]

The contrary happens in most civil law systems. These systems are based on a fault principle[68] under which the breaching party is only liable for the damages incurred by his failure to duly perform the contract.[69] For example, Articles 97 and 99 of the Swiss Code of Obligations state that if an obligation is not performed at all, or done so in an unduly manner, the breaching party shall compensate the injured party for the damage arising therefrom, unless the breaching party proves that no fault is attributable to it at all. Likewise, Article 1101 of the Civil Code of Spain states that only those who breach a contract due to fraud,[70] negligence or by performing in a lately manner are liable for the damages caused. The Austrian Civil Code (ABGB[71]) states in its Articles 1323 and 1324 that damages for breach of contract are not recoverable unless the breach was caused intentionally or due to gross negligence.[72]

While the principle of strict liability is not expressly manifested in any Article of the CISG, it is reflected by *a contrario sensu* interpretation of its provisions. For example, Article 79(1) of the CISG states that a party is not to be held liable for the breach of any of his obligations under the CISG or the contract if he proves that said failure to perform was caused by an impediment beyond its control, i.e. *force*

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[67] Such as China, Argentina, Brazil, Canada and Greece. For more see FERRARI, Franco, "Comparative Ruminations on the Foreseeability of Damages in Contract Law", in 53 Louisiana Law Review, 1993.

[68] SCHWENZER, Ingeborg, *et. al*., *op. cit.*, *Global Sales and Contract Law*, p. 534. There were even assumptions when the CISG was published that civil jurist might read "fault" in its provisions. See LOOKOFSKY, Joseph, "Impediments and Hardship in International Sales: A Commentary on Catherine Kessedjian's "Competing Approaches to Force Majeure and Hardship", in 25 International Review of Law and Economics, 2005, p. 436, available at http://www.cisg.law.pace.edu/cisg/biblio/lookofsky17.html. Also see *op. cit.,* NICHOLAS, Barry, Chapter 5, pp. 5-12.

[69] MUÑOZ, Edgardo, *op. cit.*, *Understanding the CISG System of Remedies from the Latin American Domestic Laws*, p. 107.

[70] In the sense of deliberately causing the breach. Also known as *dolo* in Spanish.

[71] *Allgemeines Burgerliches Gesetzbuch*.

[72] Also known as *culpa* in Spanish.

*majeure*.[73] By interpreting this Article on the contrary, it can be seen how the CISG intends to *prima facie* hold liable the breaching party for any damages caused, without requiring that the suffering party proves the reason behind the breach. Additionally, pursuant to Article 35(3) a seller is not liable for the delivery non-conforming of the goods[74] if the buyer knew or could have not been unaware of their lack of conformity at the time of the conclusion of the contract. According to this, it can be inferred that a seller is to be held liable for non-conformity if the goods are not fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract or if they are not fit for the purposes for which goods of the same description would ordinarily be used.

The effects of the principle of strict liability in courts mainly consist in an absolute legal liability for an injury imposed on the wrongdoer regardless of its carelessness or fault. In this regard, negligence or fault in the breaching party is presumed in the contract law of civil legal systems,[75] bearing the obligor the burden of proving the absence of fault by means of lack of a link of casualty, by the occurrence of an event of *force majeure*, or by pointing out how the fault actually relies on the other party. [76] In addition, some civil law jurisdictions subject some remedies to demonstrating that the breaching party was at fault.[77] Under the principle of strict liability however, the non-breaching party only has a burden of proving that the breach of contractual obligations occurred.

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[73] These Articles contain the only exception the CISG allows regarding the strict liability principle. See below in the *second limitation to the strict liability rule*, p. 30.

[74] That is, if the goods depart from the description, quality or amount of what was the buyer was expected to receive under the contract.

[75] DE-CRUZ, Peter, *Comparative Law in a Changing World*, Routledge-Cavendish, 2007, p. 346, and LÓPEZ LÓPEZ, Ángel, *Artículo 45*, in Luis Díez Picazo y Ponce De León (eds.) La Compraventa Internacional de Mecaderias – Comentario Sobre la Convención de Viena, 1998, pp. 411-414.

[76] CHANDA, Soumyadipta and TIWARI, Rohit, *The Concept of No-Fault Liability in Contracts for the Sale of Goods*, Social Science Research Network, pp. 3-4, available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1898289.

[77] NICHOLAS, Barry, *Fault and Breach of Contract*, in Jack Beatson & Daniel Friedmann (eds.) Good Faith And Fault In Contract Law, 1995, p. 337, and GRAZIANO, Thomas Kadner, *Le Contrat en droit prive european - Exercices de comparaison*, LGDJ Second ed. 2010, pp. 332, 333.

Within the Convention, the strict liability principle has two types of limitations. First there is the foreseeability rule. Under this rule, parties can be held liable for breach of contract only for the damages that where foreseeable by the breaching party or that ought to have been known by it at the time of the conclusion of the contract.[78] It is important to understand that what is supposed to be foreseeable is "the possible consequences of a breach, not whether a breach would occur or the type of breach".[79] This, without the need for the claimant party to prove the foreseeability of the precise amount of the loss suffered.

Originally, the foreseeability rule was a product of the decision ruled by the House of Lords of England in Hadley v Baxendale, 9 Ex 341, 156 ER 145 (1854).[80] Before this, the general rule was that a party aggravated by a breach of contract is entitled to claim an amount that equals the damages it suffered, for the sake of putting said party in the same economical position it would have been if the contract had been thoroughly performed. However, in this court decision damages claimed where evaluated solely on the basis of the information available to the breaching party, in light of the facts and matters that that party knew or ought to have known.[81] The reasoning behind this decision was the idea that in order for

[78] For a better comprehension of its application and use in courts, see ICC Arbitration Case No. 8786 of January 1997 (*Clothing case*) and Hungary 2000 Supreme Court (*Mixing machine case*).

[79] *Op. cit., UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods*, p. 349, paragraph 33.

[80] It has been said that this ruling was a *transplantation of a foreign rule*. Apparently, the House of Lords of England were not the ones who came up with this innovative limit on the damages claimable by a plaintiff, but it instead arose from the American case law, which was based at the same time on the French *Code Civil*; specifically in Articles 1149, 1150 and 1151. See FERRARI, Franco, *op. cit*., pp. 1266, 1267.

[81] The facts of the case are as follows: A shaft in Hadley's (P) mill broke rendering the mill inoperable. Hadley hired Baxendale (D) to transport the broken mill shaft to an engineer in Greenwich so that he could make a duplicate. Hadley told Baxendale that the shaft must be sent immediately and Baxendale promised to deliver it the next day. Baxendale did not know that the mill would be inoperable until the new shaft arrived.
Baxendale was negligent and did not transport the shaft as promised, causing the mill to remain shut down for an additional five days. Hadley had paid 2 pounds four shillings to ship the shaft and sued for 300 pounds in damages due to lost profits and wages. The jury awarded Hadley 25 pounds beyond the amount already paid to the court and Baxendale appealed. The court held that in this case Baxendale did not know that the mill was shut down and would remain closed until the new shaft arrived. Loss of profits could not fairly or reasonably have been contemplated by both

any sort of damage to be considered as haven arisen from the breach of contract itself, both parties must have been able to foresee the possibility of the emergence of said damages during the conclusion of the contract.[82] This is because "if there were special circumstances under which the contract had been made, and these circumstances were known to both parties at the time they made the contract, then any breach of the contract would result in damages that would naturally flow from those special circumstances".[83]

Scholars have found two justifications for this rule. The first one implies that the desirability of an act (the breach that causes damages) needs to be taken into account, since "even outside law people often judge a person's action from the standpoint of whether he/she foresaw the consequences of his/her action".[84] Another more widely accepted justification "rests on [the rule's] function of allocating risk in a fair and reasonable manner".[85] In other words, if a party could have foreseen that a loss or damage was to occur in the future, it must have taken the necessary steps in order to avoid it, under the risk of being held liable for it.[86] Lastly, another justification that has been found is that this rule encourages commercial activity and promotes economic efficiency.[87] There are many reasons

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parties in case of a breach of this contract without Hadley having communicated the special circumstances to Baxendale. The court ruled that the jury should not have taken the loss of profits into consideration. For more, see Hadley v. Baxendale – Case Brief Summary, available at http://www.lawnix.com/cases/hadley-baxendale.html.

[82] In Latin America, there is an exception to the foreseeability rule. If a debtor causes a breach of contract with gross negligence (*dolo*), he is to be held liable not only for the foreseeable damages caused, but also for the unforeseeable damage caused by his breach. For more, see MUÑOZ, Edgardo, *op. cit., Understanding the CISG System of Remedies from the Latin American Domestic Laws*, p. 107.

[83] *Idem*.

[84] SAIDOV, Djakhongir, *The Law of Damages in International Sales, The CISG and other International Instruments*, Hart Publishing, 2008, pp. 101-102. Also see ATIYA, Patrick, *The Rise and Fall of Freedom of Contract*, Oxford, Clarendon Press, 1979, p. 432. Lastly, see HART, Herbert Lionel Adolphus and HONORE, Tony, *Causation in the Law*, 2nd edition, Oxford, Clarendon press, 1985, p. 254.

[85] *Idem*.

[86] See also SCHWENZER, Ingeborg, *op. cit.*, *Article 74*, p. 1001, paragraph 4, where she states that [the] *limitation of liability enables both parties* to estimate the financial risks arising from the contractual relationship and thus to insure themselves against possible liability.

[87] SAIDOV, Djakhongir, *op. cit.*, p. 101. See also SCHWENZER, Ingeborg, *op. cit*., p. 1001, paragraph 4, where she states that the foreseeability rule has the additional and economically

for this approach: it allows to manage possible risks when concluding and performing a contract; it avoids being held responsible for unusual or over the top losses; and, it saves transactions costs related to a possible litigation by avoiding explaining obvious consequences of a breach and by revealing facts helpful to a case in attempts to prove how the breach generated damages that went beyond those expected.[88]

This rule can be appreciated in the Convention in Article 35(3) where it is stated that a "seller is not liable under subparagraphs (a) to (d) of the preceding paragraph for any lack of conformity of the goods if, at the time of the conclusion of the contract, the buyer knew or could not have been unaware of such lack of conformity". This follows the principle of full compensation contained in Article 74, addressed later on in Chapter 6, under which a suffering party may only claim damages arising from the breach up to an amount equal to the loss, including loss of profit.

One must be careful in not confusing the concept of "causation" with the foreseeability rule stipulated in the CISG. Causation refers to the existence of a causality link between the act of the party who is responsible for the breach (on whose the fault is laid) and the damages suffered.[89] As conceived by most civil[90] and common law systems,[91] the claimant party must provide evidence of a "causal connection between the fault and nonoccurrence of the event that would have

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beneficial effect of stimulating the exchange of information between the parties by urging them to disclose any unusual risks to the other party when concluding the contract.

[88] For more, see WADDAMS, Stephen, *The Law of Damages*, 4th edition, Canada Law Book Inc., 2004, p. 569.

[89] This is later on addressed in Chapter 6 when explaining the requirements for claiming damages under the principle of full compensation.

[90] For example Articles 97 and 99 of the Swiss Code of Obligations, Articles 1223, 1225 of the Italian Civil Code, Articles 2104, 2106 and 2110 of the Mexican Federal Civil Code and Articles 1101-1103 of the Civil Code of Spain. See SAIDOV, Djakhongir, *Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods*, 2001, section II, 3, available at http://www.cisg.law.pace.edu/cisg/biblio/saidov.html#iii. See also GOTANDA, John Y., "Recovering Lost Profits in International Disputes", in 36 Georgetown Journal of International Law, 2004, pp. 68-82.

[91] *Ibid.*, p. 68.

generated the expected".[92] This is different from the requirement of fault in the breaching party, which, as it has already been mentioned,[93] is presupposed on the breaching party in most civil legal systems[94] and irrelevant in common law systems.[95] Accordingly, it could be said that a causation theory can be found within the CISG. The only burden of proof that the party claiming damages has is the burden of providing evidence of the damage suffered by the breach and of the causation between said breach and of the loss suffered. As professor Schwenzer stated, "the Convention leaves no room for theories on causation which limit the liability for damages to probable or not too remote sequences of events".[96] Certainly, under the CISG a breach of contract must be the reason *sine qua non* the loss occurred, regardless if it was a direct or indirect consequence of it.

The second limitation for the strict liability rule consists in the exemptions stipulated in Articles 79 and 80 of the CISG, under which a party in breach will not be held liable for the failure to perform his obligations. In this regard, it could be said that the CISG is not "absolutely strict" in regard to liability for breach of contract. "In certain exceptional circumstances, a promisor may be held not liable in damages for his failure to perform; particularly to the extent such non-performance is attributable to unforeseeable and unavoidable circumstances".[97] The Convention expresses a number of requisites to be fulfilled in order for these exceptions to take effect, without listing any concrete situation. These requirements mainly consist in dealing with a breach that was caused by an impediment beyond the control of a party and that was unforeseeable during the conclusion of the contract (in accordance to the foreseeability rule). Said impediment needs to be

[92] BERNARD, Thierry and VLASTO, Hedwige, *France*, in Transnational Litigation: A Practitioner's Guide, at FRA-107, 2003.
[93] See above, p. 27.
[94] RICO ÁLVAREZ, Fausto and GARZA BANDALA, Patricio, *Teoría General de las Obligaciones*, Porrúa, 5th ed., México, 2010, p. 382; MUÑOZ, Edgardo, *El Derecho de los Contratos y de la Compraventa in Iberoamérica*, Tirant Lo Blanch, 2015, p. 379.
[95] *Ibid*, p. 378.
[96] SCHWENZER Commentary, *op. cit.*, Article 74, p. 1015, paragraph 40.
[97] LOOKOFSKY, Joseph, *Article 74 Damages for Breach*, in Herbots, J. and Blanpain, R. (eds.), International Encyclopaedia of Laws – Contracts, Kluwer Law International , 2000, p. 152.

either impossible or unreasonable to overcome. Furthermore, this insuperable impediment needs to be the sole reason that caused the breach of contract for the party that seeks the exemption.

Concretely, Article 79 of the CISG focuses on cases of *force majeure*. In this regard, authors have listed a number of possible of situations in light of legal precedents. It must be kept in mind that the requirements abovementioned still need to be fulfilled. Example of said cases are natural phenomena and catastrophes, like earthquakes, floods, storms, epidemics, war and terrorism, State interventions, labor disputes, among others.[98]

On the other hand, Article 80 focuses on a party's non-liability for breach of contract in the circumstance where said breach was caused by the other party's acts or omissions.[99] This provision mainly focuses on sorting out the parties' rights for claiming damages when both sides have allegedly failed to perform, and on denying a party's claimed remedy when it was due to its own breach that the other refused to perform. An example of the former took place in the High Court of Klobenz, Germany, where it was found that a German buyer had forfeited its rights to a remedy for lack of conformity since it had already rejected without just reason the other party's offer to cure the defects.[100] An example of the latter can be appreciated in a case ruled by the High Court of München, Germany, where a German buyer was denied its claim for damages for the seller's refusal to make deliveries under Article 80, since said buyer unjustifiably withheld payments concerning prior deliveries.[101]

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[98] For more examples see SCHWENZER, Ingeborg, *op. cit.*, *Article 79*, pp. 1070-1073, paragraphs 16-21.

[99] Article 80: A party may not rely on a failure of the other party to perform, to the extent that such failure was caused by the first party's act or omission.

[100] CLOUT case No. 282, Oberlandesgericht Koblenz, Germany, 1997, available at https://documents-dds-ny.un.org/doc/UNDOC/GEN/V99/903/75/PDF/V9990375.pdf?OpenElement.

[101] The court held that the buyer's own failure to pay caused the seller to withhold delivery. CLOUT case No. 273, Oberlandesgericht München, Germany, 1997, available at

Having in mind all of the aforementioned, I analyze below an example about how the principle of strict liability applies to often considered ancillary obligations, and in particular, to the obligation to provide an independent guarantee in order to guarantee compliance with different terms of an underlying contract. As a matter of principle, a seller's failure to have the agreed independent guarantee issued by the guarantor in favour of the buyer constitutes a breach of contract. The following chapter focuses on explaining the parties' rights and obligations regarding the abovementioned obligation, as well as the effects of a breach of contract and how should said breach be treated pursuant to the provisions of the CISG.

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https://documents-dds-ny.un.org/doc/UNDOC/GEN/V99/903/75/PDF/V9990375.pdf?OpenElement.

# 4. INDEPENDENT BANK GUARANTEES AND THE CISG

## I. Introduction

Independent guarantees have become a standard arrangement in international trade. The use of these guarantees increased significantly since the 1960s[102] and their frequency has grown exponentially ever since.[103] The reasons for such development are various. First of all, independent guarantees have proven to be useful in connection with any kind of underlying transaction, for example, in financial dealings, sales agreements or industrial projects.[104] Second, the amounts at stake in modern transactions have increased the risk factor for the parties concerned significantly greater.[105] The parties' determination to cover the risk of a breach of contract has provided the impetus for the extraordinary development of independent guarantees.[106] In international industrial projects, for example, long-term contracts involving significant amounts of money are very common, and the question of whether the exporter (contractor) has performed its contractual obligations often embraces the determination of complex issues.[107] Importers (owners) have resorted to independent guarantees in order to ensure that performance claims can be compensated immediately and effectively by a third party guarantor.[108]

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[102] DELY, Filip, "The UN Convention on Independent Guarantees and Stand-by Letters of Credit", in 33 Foreign Law Year In Review, 1998, p. 831.

[103] KNEZEVIĆ, Mirjana and LUKIĆ, Aleksandar, "Bank Guarantees and their Representation in Bank Business Activities", in 64 Economic Insights - Trends and Challenges, 2012, p. 42: "Due to its non-accessoriness, abstractness and the fact that a fast and simple act of realization provides coverage for a great amount of risk, the bank guarantee is one of the most important instruments of security payments in the trading operation".

[104] BERTRAMS, Roeland I.V.F., *Bank Guarantees in International Trade 1*, ICC Publishing S.A. ed., Kluwer Law International, 1996: "the increasing wealth in the oil producing countries of the Middle East in this period enable these countries to conclude major contracts with Western firms on large scale projects, such as infrastructure improvements (roads, airports, harbors facilities), public works […]. It is to these developments that the origins and early demand for independent bank guarantees and specially those payable on first demand can be traced".

[105] FERNÁNDEZ-MASIÁ, Enrique, "Las Garantías Bancarias en el Comercio Internacional", in 1 Boletín Mexicano de Derecho Comparado, 2014, pp. 101, 103.

[106] KNEZEVIĆ, Mirjana and LUKIĆ, Aleksandar, *Economic Insights - Trends and Challenges*, 2012, p. 43.

[107] FERNÁNDEZ-MASIÁ, Enrique, *op. cit.*, pp. 102, 103.

[108] BERTRAMS, Roeland I.V.F., *op. cit.*, p. 2.

From the outset, independent guarantees have been a creation of the practice of international trade.[109] Most national systems have not enacted provisions of law dealing with independent guarantees expressly.[110] The validity and binding effect of an independent guarantee therefore directly rests on the general principle of freedom of contract and sanctity of contracts.[111] Their terms are negotiated between the guarantor – usually a bank – and its customer (the principal or applicant) pursuant to what was agreed in the underlying contract. Said terms are to be interpreted and construed by courts and arbitrators in accordance with the provisions of the applicable rules,[112] if any, or of the proper law of the guarantee,[113] which are usually domestic laws on agency (*mandat* in French or *mandato* in Spanish and Portuguese).[114]

In light of the absence of specific regulation at a national level, some international treaties projects sought to harmonize this international practice.[115] For instance, UNCITRAL drafted in 1995 the Convention on Independent Guarantees and Stand-By Letters of Credit (the "UNCITRAL Convention on Independent Guarantees").[116] In addition, uniform contract terms to which the parties may

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[109] *Ibid.*, p. 7.

[110] DELY, Filip, *op. cit.*, p. 833. With two notable exceptions: French law, Article 2321 of the Civil Code of 2006 and US Law, Article 5 of the Uniform Commercial Code with provisions on Stand-By Letters of Credit.

[111] FERNÁNDEZ-MASIÁ, Enrique, *op. cit.*, p. 133.

[112] See Article 3 of the URDG 758 containing their own rules of interpretation.

[113] See DELY, Filip, *op. cit.*, p. 838. Also see BERTRAMS, Roeland V.I.F., *op. cit.*, p. 8. Pursuant to Article 21 of the UNCITRAL Convention on Independent Guarantees, a guarantee is governed by the national law chosen in the guarantee or between the guarantor and the beneficiary. In the absence of such a choice, the guarantee is governed by the law of the State where the guarantor/issuer has that place of business at which the undertaking was issued pursuant to Article 22 of the UNCITRAL Convention on Independent Guarantees.

[114] This, regardless of the fact that practice is not entirely uniform considering the multiple fora which are available and the various systems of law which may apply in each forum, this state of affairs does not appear to have given rise to major difficulties.

[115] DELY, Filip, *op. cit.*, pp. 834, 835. Also, *op. cit.* FERNÁNDEZ-MASIÁ, Enrique, pp. 134-144.

[116] The UNCITRAL Convention on Independent Guarantees and Stand-By Letters of Credit of 1995 has been ratified by 8 States to date (Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama and Tunisia) and signed, but not ratified, by the U.S.A. *Situación actual, Convención de las Naciones Unidas sobre Garantías Independientes y Cartas de Crédito Contingente*, www.uncitral.org, accessed September 20, 2015, available at:

agree[117] have also flourished and enhanced the use and utility of independent guarantees. The International Chamber of Commerce ("ICC") has undertaken major private unification efforts in this area in the form of soft law or *lex mercatoria* instruments. The ICC has issued four major texts on independent guarantees: the ICC Uniform Rules for Contract Guarantees ("URCG") of 1978,[118] the ICC Uniform Rules for Demand Guarantees ("URDG 458") of 1992,[119] the ICC Uniform Rules for Contract Bonds ("URCB") of 1994[120] and the ICC Uniform Rules for Demand Guarantees ("URDG 758") of 2010.[121] Finally, the American Institute of International Banking Law and Practice has issued the International Standby Practices ("ISP98").[122]

The beneficiary of an independent guarantee may be either the buyer (the owner or importer), guarantying the buyer's claim of performance of a contractual or legal duty, or the seller (or the contractor or exporter), guarantying the seller's claim for payment of the purchase price.[123] Once it has been established, an independent guarantee creates rights and obligations between the beneficiary and the guarantor.[124] These rights and obligations are "independent" from the underlying contract between the seller and the buyer of which performance of certain obligations has been guaranteed.[125]

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http://www.uncitral.org/uncitral/es/uncitral_texts/payments/1995Convention_guarantees_status.html. The UNCITRAL Convention contains interesting and useful provisions in spite of the fact that it has not gained widespread acceptance yet.

[117] Article 1(a) of the URDG 758 states that the rules "*apply to any demand guarantee or counter-guarantee that expressly indicates it is subject to them*". And where a guarantee issued on or after 1 July 2010 states that it is subject to the URDG without stating whether the 458 1992 version or the 758 2010 version is to apply, the guarantee will be subject to the 758 2010 version (see Article 1(d) of the URDG 758).

[118] ICC Publication No. 325.

[119] ICC Publication No. 458.

[120] ICC Publication No. 524.

[121] ICC Publication No. 758.

[122] Also published as ICC Publication No. 590.

[123] O'DRISCOLL, Peter S., "Performance Bonds, Bankers' Guarantees, and the Mareva Injunction", in 7 Northwestern Journal of International Law and Business, 1985, pp. 380, 385.

[124] BERTRAMS, Roeland, *op. cit.*, I.V.F., p. 9.

[125] *Idem*.

However, a clause in the underlying contract requiring the issuance of an independent guarantee creates an obligation for the applicant to have the guarantor issue[126] that guarantee for the beneficiary. This obligation to apply for the guarantee is enforceable under the law governing the underlying contract. Questions then arise as to the enforcement and effects of the applicant's obligation under the applicable law. In particular, the failure to apply or a defective provision of an independent guarantee may entitle the other party to claim certain remedies but exclude others. These questions are to be answered in the light of the provisions of the CISG.

[126] In accordance with Article 4 of the URDG 758, a guarantee is issued when it leaves the control of the guarantor.

## II. Applicability of the CISG

The question of why would the CISG apply when dealing with an independent bank guarantee will now be addressed. As it has been mentioned, what is governed by the CISG is the obligation to apply for the guarantee. In other words, the obligation at hand is one that derives from the underlying sales contract and not from the guarantee contract itself. In this regard, the only requirement that needs to be fulfilled is that the sales contract is governed by the CISG. One scenario would be one where the parties have expressly agreed in their sales contract that the CISG will apply. Therefore, any dispute arising from any breach would lead to the applicability of the CISG. Another possible scenario would be the case where the rules of private international law lead to the application of the CISG pursuant to its Article 1(b). Here however, in the absence of an express agreement of the parties, "the applicable conflict of laws rules or arbitration rules respectively will regularly lead to the law at the place of business of the manufacturer as the party carrying out the characteristic performance under the warranty".[127] While this is what regularly happens, it must be kept in mind that merely because the place of business of one of the parties of an independent bank guarantee is located in a Contracting State does not mean that the CISG will apply.

## III. Notion and Features of Independent Guarantees

An independent guarantee[128] may be defined as a contract between a guarantor and a beneficiary,[129] whereby the guarantor[130] undertakes to pay the beneficiary a

[127] HACHEM, Pascal and SCHWENZER, Ingeborg, *Article 4*, in Ingeborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, Oxford University Press, 2010, p. 85, paragraph 24.

[128] In the law and practice of international trade "bank guarantee" and "guarantee" are the terms which have come to be generally accepted in spite of the fact that they are not free from ambiguity in many languages. They may therefore be regarded as a term of art in their own right.

[129] BERTRAMS, Roeland I.V.F., *op. cit.*, p. 12: "A guarantee is a contract between two parties, namely the guarantor/bank and the beneficiary." MEYER-REUMANN, Rolf, "Rights and

specified amount of money upon the beneficiary's demand in writing, provided that such demand is made within the period of validity of the guarantee and complies with the terms of the guarantee.[131]

The party upon whose request the guarantee has been issued, known as the principal, the applicant[132] or the account party, is not a party to the guarantee.[133] The guarantor is usually a bank,[134] but not necessarily. The guarantor may be an insurance company or any other entity or person, such as the parent company of the main debtor in the case of a parent company guarantee.[135]

An independent guarantee is different from a secondary or accessory guarantee. Independent guarantees give rise to a primary contract duty on the guarantor, which is independent from the underlying contract between the beneficiary of the guarantee and the latter's contracting party.[136] The guarantor's obligation to pay the agreed amount to the beneficiary is independent from the

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Obligations in the Event of Bank Guarantees Being Called in Governmental Projects", in 17 Arab Law Quarterly, 2001, p. 34.

[130] Article 2 of the URDG 758.

[131] GOODE, Roy, *Guide to the ICC Uniform Rules for Demand Guarantees,* International Chamber of Commerce, 1992, available at http://store.iccwbo.org/content/uploaded/pdf/ICC-Guide-to-ICC-Uniform-Rules-for-Demand-Guarantees-URDG-758.pdf. The UNCITRAL Convention defines a guarantee in Article 2(1) as follows: "*For the purposes of this Convention, an undertaking is an independent commitment, known in international practice as an independent guarantee or as a stand-by letter of credit, given by a bank or other institution or person ("guarantor/issuer") to pay to the beneficiary a certain or determinable amount upon simple demand or upon demand accompanied by other documents, in conformity with the terms and any documentary conditions of the undertaking, indicating, or from which it is to be inferred, that payment is due because of a default in the performance of an obligation, or because of another contingency, or for money borrowed or advanced, or on account of any mature indebtedness undertaken by the principal/applicant or another person*". Also see MEYER-REUMANN, Rolf, *op. cit.*, p. 34: "*According to Article 411 and Article 414* [of the United Arab Emirates- Commercial Transactions Law] *a bank guarantee is an undertaking according to which a bank undertakes to pay a customer's debt to a third party in accordance with the conditions, upon which the agreement is concluded and which are included in the guarantee*".

[132] See Article 2 of the URDG 758.

[133] BERTRAMS, Roeland I.V.F., *op. cit.*, p. 12.

[134] O'DRISCOLL, Peter, *op. cit.*, p. 381.

[135] Article 2(a) of the URDG 758.

[136] Article 5(a) of the URDG 758. Also see BERTRAMS, Roeland I.V.F, *op. cit.*, p. 56; O'DRISCOLL, Peter, *op. cit.*, pp. 384, 385 making reference to English case law on the legal nature of independent guarantees; DELY, Filip, *op. cit.*, p. 832.

beneficiary's right to invoke a breach of the underlying contract by its contracting party.[137] In other words, the guarantor's obligation is of a "documentary"[138] character, as it arises upon the presentation by the beneficiary of the documents or statements mentioned in the guarantee itself.[139]

On the contrary, a secondary or accessory guarantee[140] makes the guarantor liable to the beneficiary of the guarantee only if, when and to the extent that, the beneficiary's contracting party in the underlying contract has been found breaching said underlying contract.[141] In this sense, an accessory guarantee is similar to contracts existing in civil law and common law jurisdictions in which the guarantor assumes a liability only in case the principal debtor has defaulted or breached the underlying transaction.[142] In Spanish these accessory guarantees are known as "*fianzas*",[143] in French law as "*cautionnement*" and in Anglo-American law as "suretyship." Secondary guarantees are therefore twofold. Firstly, the guarantor's duty to pay arises only if, when and to the extent that, the principal debtor has defaulted. Secondly, the guarantor duty to pay is limited to the liability of the principal debtor. Accordingly, the guarantor may rely on all the defenses and objections that the debtor has under the terms of the underlying contract with the creditor-beneficiary, including as to the very existence and validity of the underlying contract.[144]

Because banks are generally reluctant to act as guarantors under terms that require the determination of fault or breach by a judge or arbitrator pursuant to a contract to which they are not a party (nor have they real incentive or interest to

[137] See Article 3 of the UNCITRAL Convention on Independent Guarantees.
[138] See Articles 6, 7 and 19 of the URDG 758.
[139] See Article 15 (a) of the URDG 758. Also see in relation to this BERTRAMS, Roeland I.V.F, *op. cit.*, p. 9.
[140] Also known as dependent guarantees in international trade.
[141] BERTRAMS, Roeland I.V.F, *op. cit.*, p. 3.
[142] FERNÁNDEZ-MASIÁ, Enrique, *op. cit.*, p. 126.
[143] *Ibid.*, p. 125.
[144] *Ibid.,* p. 130.

be), [145] international commercial practice produced "independent guarantees" where the guarantor's duty to pay the beneficiary would be independent to the underlying contract's proper performance.[146] The fundamental bargain to which the parties under the underlying contract have agreed is expressed by the maxim "pay first, litigate later".[147]

For the relevant purposes, "guarantee" will indicate an independent guarantee provided by a bank or other guarantor, which is paid pursuant to its own terms upon demand by the beneficiary, independent from any fault or breach by the principal.[148] Nonetheless, in international trade practice other terms are often used to refer to independent guarantees as well. For example, "first demand guarantee"[149] or "on demand guarantee," "demand guarantee",[150] "performance bonds"[151] and "stand-by letters of credit".[152]

[145] Article 5(a) URDG 758; BERTRAMS, Roeland I.V.F, *op. cit.*, p. 2.
[146] FERNÁNDEZ-MASIÁ, Enrique, *op. cit.*, p. 111. See also Article 5 URDG 758.
[147] BLAU, Werner and JEDZIG, Joachim, *Bank Guarantees to Pay upon First Written Demand in German Courts*, in 23 The International Lawyer, 1989, pp. 725, 725.
[148] See Article 2 UNCITRAL Convention on Independent Guarantees; FERNÁNDEZ-MASIÁ, Enrique, *op. cit.*, p. 127.
[149] This is a type of guarantee.
[150] The term *demand guarantees* was coined by the ICC as it issued its second and third sets of uniform rules in 1992 and 2010 under the title "Uniform Rules for Demand Guarantees" ("URDG") (ICC Publications No. 458 (1992) and No. 758 (2010)).
[151] *Performance bond* is another expression used to refer to a bank guarantee.
[152] The expression *stand-by letter of credit* adds further diversity to the terminology, and essentially refers to an independent bank guarantee used to guarantee payment obligations in the US. See DELY, Filip, *op. cit.*, p. 836.

## IV. A Party's Obligation to Provide an Independent Guarantee

The CISG does not require the parties to have a guarantor establishing an independent guarantee in order to cover the risk of a party's breach of contract.[153] However, this state of affairs does not preclude the parties from agreeing so. Article 6 of the CISG expresses the principle of party autonomy to tailor their contract,[154] under which parties are allowed to agree upon provisions that derogate from those of the Convention, or even to completely exclude its application with express and/or tacit agreement.[155] The provisions of the CISG governing the seller's obligations and the buyer's obligations apply only insofar as the contract does not contain other specific provisions.[156] As a result, the parties may agree upon the additional obligation to have a guarantor issuing an independent guarantee.[157] Where the contract as a whole falls within the scope of application of the CISG,[158] such additional obligations will also be subject to the CISG's rules since they are obligations arising from that CISG contract.[159]

Despite the fact the CISG allows verbal agreements[160] and the incorporation of obligations arising out of the parties' prior practices,[161] it is advisable for

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[153] Pursuant to Articles 30 to 44 of the CISG, the seller's obligations include the timely delivery of conforming goods, among others. In accordance with Articles 53 to 60 CISG, the buyer's obligations include the timely payment of the price and taking delivery of the goods.

[154] SCHWENZER, Ingeborg, *et al*., *op. cit.*, *Global Sales and Contract Law*, p. 65; HACHEM, Pascal and SCHWENZER, Ingeborg, *Article 6*, in Ingeborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, Oxford University Press, 2010, p. 106.

[155] See Greece 2009 Decision 4505/2009 of the Multi-Member Court of First Instance of Athens (*Bullet-proof vest case*), docket No. 4505/2009, available at http://cisgw3.law.pace.edu/cases/094505gr.html. Also see HACHEM, Pascal and SCHWENZER, Ingeborg, *op. cit.*, *Article 6*, p. 106, para. 8.

[156] WIDMER, Corinne, *Article 30*, p. 490; GARRO, Alejandro M. and ZUPPI, Alberto L., *Compraventa Internacional de Mercaderías*, AbeledoPerrot, 2012, p. 170.

[157] RAMBERG, Jan, *International Commercial Transactions*, ICC Norstedts Juridik AB, 4th ed., 2011, p. 47.

[158] The CISG applies to contracts for the international sale of goods when the parties to the contract have their places of businesses in different Contracting States (Article 1(1)(a)) or when the rules of private international law lead to the application of the law of a contracting state (Article 1(1)(b)).

[159] WIDMER, Corinne, *op. cit.*, p. 493.

[160] Articles 11 and 8 of the CISG.

[161] Article 9 of the CISG.

independent guarantee clauses of the underlying contract to be an express term.[162] These clauses will in principle be regarded as giving rise to a main contractual duty.[163] In some instances, the conclusion of the underlying contract is made conditional *inter alia* on all agreed guarantees having been duly provided.[164] The wording of the guarantee required by the underlying contract will be often set out in an appendix to that contract.

When the underlying sales contract is null and void, or voidable for duress, undue influence, mistake, or any other legal grounds admissible under its applicable law,[165] that contract's independent guarantee clause will most likely follow the same fate. As such, the party who had provided the guarantee may claim that the guarantee should be handed back.[166] However, because the guarantee issued by the guarantor is independent from the underlying contract, the fact that the latter is null and void does not necessarily operate so as to void the guarantee itself. The guaranty will remain valid until its own expiration event[167] or date.[168]

As mentioned above, the main purpose of independent guarantees is to enable the beneficiary to obtain immediate payment without proving default or breach of the underlying contract.[169] In practice, the parties go further as to specify the type of breach or default that the independent guarantee intends to cover. In the context of international sales of goods, these include the following. One option parties can

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[162] BERTRAMS, Roeland I.V.F, *op. cit.*, p. 66.
[163] See Section IV below.
[164] *Idem*: When the parties to the underlying relationship have agreed that the principal debtor is to furnish a guarantee payable on certain terms and conditions, that agreement constitutes a condition precedent in the sense that the obligations of the other party are suspended until the issuance of the guarantee.
[165] The CISG will not apply to these issues as they fall outside its scope of application in accordance with Article 4(a).
[166] See Section VI below.
[167] Article 2 of the URDG 758 state that Expiry event means an event which under the terms of the guarantee results in its expiry, whether immediately or within an specific time after the event occurred.
[168] *Ibid.,* pp. 236, 237. See also DELY, Filip, *op. cit.*, p. 841 and *op. cit,* MEYER-REUMANN, Rolf, p. 29.
[169] FERNÁNDEZ-MASIÁ, Enrique, *op. cit.*, p. 110.

contract for is a tender or bid guarantee, sometimes also called “initial guarantee”, which is required for bidders taking part in a tender, especially a public tender.[170] This type of guarantee is intended to protect the beneficiary against the risk that the bidder, in spite of having tendered successfully, will fail to sign the contract or to sign it in a timely manner or fails to procure an additional performance guarantee.[171] Another, the delivery guarantee (or bond), is intended to protect the beneficiary against the risk that the seller/exporter fails to deliver the goods.[172] This type of guarantee does not cover the whole risk relating to performance but only delivery;[173] this has given rise to further types of guarantees which specifically cover the risk of defects in the goods or further risks. Alternatively, parties can contract for a performance guarantee (or bond), aiming to protect the beneficiary against the risk that the seller/exporter fails to perform its contract duties,[174] like the delivery of conforming goods under the contract or the applicable law.[175] Such a guarantee may or may not, according to its terms, cover breaches of warranty; where it does not, a warranty guarantee may be issued as well.[176] The maintenance guarantee (or warranty) is intended to protect the beneficiary against the risk that the seller/exporter fails to perform its contract duties with respect to warranty,[177] maintenance or other activities to be performed after completion of the works or delivery of conforming goods, such as training or further activities regarding the commercial operation of a plant or machinery.[178] The advance payment (or repayment) guarantee (or bond) purports to protect the beneficiary

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[170] *Idem*, p. 115.
[171] RAMBERG, Jan, *op. cit.*, p. 47. Also see BLAU, Werner and JEDZIG, Joachim, *op. cit.*, p. 725. For a sample, see https://www.ubs.com/ch/en/swissbank/corporates/finance/trade_exportfinance/bankgarantie/mustertexte.html
[172] For a sample, see *idem*.
[173] FERNÁNDEZ-MASIÁ, Enrique, *op. cit.*, pp. 115, 116.
[174] RAMBERG, Jan, *op. cit.*, p. 47.
[175] MEYER-REUMANN, Rolf, *op. cit.*, p. 28.
[176] For a sample, see https://www.ubs.com/ch/en/swissbank/corporates/finance/trade_exportfinance/bankgarantie/mustertexte.html
[177] *Op. cit.,* BLAU, Werner and JEDZIG, Joachim, p. 725.
[178] For a sample, https://www.ubs.com/ch/en/swissbank/corporates/finance/trade_exportfinance/bankgarantie/mustertexte.html. See also on the subject FERNÁNDEZ-MASIÁ, Enrique, p. 116.

against the risk that the seller/exporter fails to perform its contract duties, making it so that the advance payment made by the beneficiary is to be reimbursed by the seller/exporter. The retention guarantee seeks to protect the beneficiary against the risk that the seller/exporter fails to effect full performance of its contract duties after the beneficiary has released full payment for the works or part of the works without withholding retention monies. Finally, the payment guarantee or stand-by letters of credit intend to protect the seller against the risk that the buyer will fail to pay the contract price.[179]

Since the principle of freedom of contract operates also at the level of the independent guarantee (and not only at the level of the underlying contract), the parties are able to freely structure the payment mode of the guarantee's monies.[180] Depending on the circumstances, the parties may choose a direct guarantee or an indirect guarantee. A direct guarantee involves three parties, the principal, the guarantor and the beneficiary.[181] The principal is the seller that instructs the guarantor to issue the guarantee.[182] The guarantor is the bank or other entity or person issuing the guarantee.[183] The beneficiary is the buyer for whose benefit the guarantee is issued.[184] In a CISG contract, the seller and the buyer have places of businesses in different countries. The guarantor (a bank) will usually be located in the seller's country. In such case, a second bank called the "advising bank" will usually be involved in the guarantee in the buyer's country, as the guarantor's agent.[185] The advising bank does not have a contractual relationship with the beneficiary to which it does not assume any contractual obligations.[186] Its task is limited to transmitting documents from and to the beneficiary, verifying that the

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[179] *Op. cit.,* DELY, Filip, p. 833. For a sample, see https://www.ubs.com/ch/en/swissbank/corporates/finance/trade_exportfinance/bankgarantie/standbyl_c.html

[180] BERTRAMS, Roeland I.V.F, *op. cit.*, p. 64.

[181] *Ibid.,* p. 13. Also see *op. cit.,* FERNÁNDEZ-MASIÁ, Enrique, pp. 117, 118.

[182] BERTRAMS, Roeland I.V.F, *op. cit.*, p. 13.

[183] *Idem*.

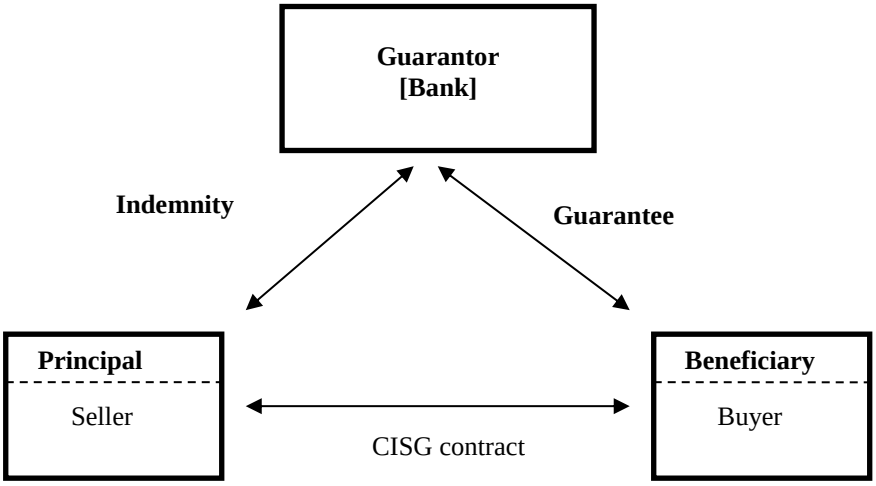
[184] *Idem*.

[185] See Article 10(a) URDG 758. Also see *Ibid.*, p. 14.

[186] See Article 10(c) URDG 758. Also see *idem*.

terms of the guarantee[187] are complied with before any amount is made available to the beneficiary on behalf of the guarantor. In such a case, the beneficiary has a contractual relationship only with the issuing bank and can claim payment of the guarantee only from the issuing bank.[188]

DIRECT GUARANTEE

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In the case of indirect guarantees, the bank in the seller's country may also instruct a bank in the buyer's country to issue the guarantee. The former bank is then said to be the "first" or "instructing bank" and the latter the "second" or "issuing bank".[190] The issuing bank usually requests an undertaking by the instructing bank to be reimbursed of all costs. Such undertaking has the nature of a guarantee and is known as a counter-guarantee.[191]

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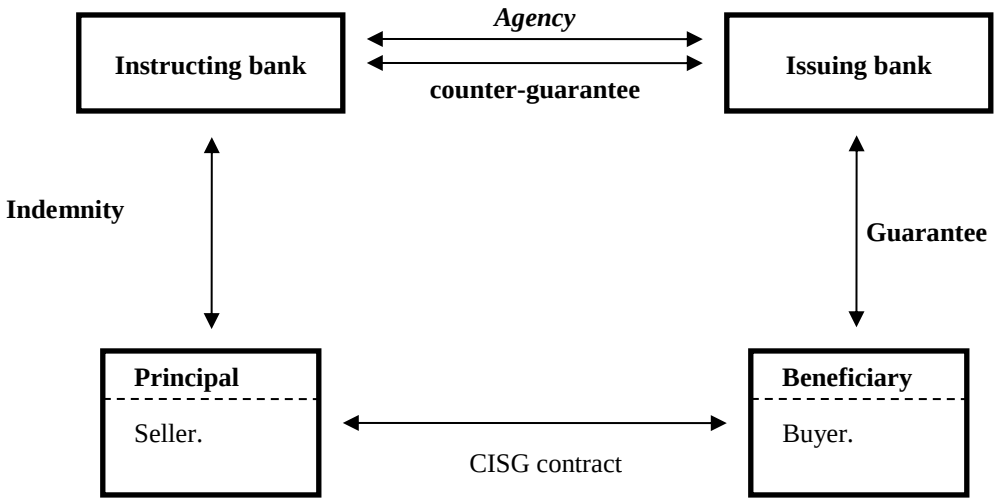
[187] See Article 10(b) URDG 758 for an example of a case of verifying the authenticity of the beneficiary's signature on a demand.
[188] *Idem*.
[189] This illustration was created by the author.
[190] *Ibid.*, p. 15. Also see FERNÁNDEZ-MASIÁ, Enrique, *op. cit.*, p. 118.
[191] See Article 5(b) of the URDG 758. Also see *Ibid.,* p. 119, and BERTRAMS, Roeland I.V.F, *op. cit.*, pp. 15, 16. See also an explanation of the distinction between direct and indirect guarantee

INDIRECT GUARANTEE




[192]

In addition, the terms of the guarantee will then determine the formal and substantive requirements to be met by the beneficiary under the guarantee when demanding payment.[193] For instance, the so called "(on) first demand guarantees" are payable simply against the presentation of a demand for payment by the beneficiary.[194] It is possible as well to agree that the beneficiary is required under the terms of the guarantee to state that the applicant – usually the seller – is in breach under the underlying relationship (the CISG contract).[195] This guarantee in essence remains a first demand guarantee. This is because the beneficiary is not in principle bound, absent any language to that effect, to prove that its statement is

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with or without instructions to a third-party bank by the Swiss bank UBS , available at https://www.ubs.com/ch/en/swissbank/corporates/finance/trade_exportfinance/bankgarantie/garantie/direkte_indirektegarantien.html.

[192] This illustration was created by the author.

[193] FERNÁNDEZ-MASIÁ, Enrique, *op. cit.*, p. 121. See Article 15(1) of the UNCITRAL Convention on Independent Guarantees. Also see DELY, Filip, *op. cit.*, p. 842.

[194] RAMBERG, Jan, *op. cit.*,p. 47. See also *op. cit.,* FERNÁNDEZ-MASIÁ, Enrique, p. 121.

[195] Which is the rule, absent any different express agreement of the parties, under the URDG 458 and 758. See GOODE, Roy, *op. cit.*, pp. 32, 33.

accurate, and the bank is not entitled to request such proof.[196] That being said, the requirement to state that the applicant – usually the seller – breached the underlying contract is believed to be adequate to inhibiting unjustified demands and to strike a fair balance between a pure on-demand guarantee and a guarantee requiring evidence of breach in the form of, for example, a judgment or an arbitral award.[197] Moreover, an inaccurate statement made by the beneficiary may be relied upon by the applicant in a later judicial or arbitral proceedings against the beneficiary.

## V. Remedies for Breach of a Party's Duty to Provide an Independent Guarantee

A party's failure to perform any of its obligations entitles the other party to claim the legal remedies available pursuant to Articles 45 and 61 of the CISG.[198] According to the principle of strict liability,[199] a breach will ensue regardless of whether the obligation at stake is a main obligation or an ancillary one, or whether it arises under the CISG provisions or the sales contract. In this regard, a seller's failure to have the agreed independent guarantee issued by the guarantor and delivered to the beneficiary – the buyer – constitutes a breach of contract.[200] Accordingly, the injured party will be entitled to the remedies afforded by the CISG. These remedies include: a request for specific performance [A], the avoidance of the sales contract [B] and damages [C].

### *A. Specific Performance of an Obligation to Provide an Independent Guarantee*

[196] FERNÁNDEZ-MASIÁ, Enrique, *op. cit.*, p. 122.
[197] GOODE, Roy, *op. cit.*, p. 34.
[198] GARRO, Alejandro M. and ZUPPI, Alberto L., *op. cit.*, p. 285.
[199] See above Chapter 4.
[200] MULLER-CHEN, Markus, *op. cit.*, *Articulo 45*, p. 1217.

The CISG gives a party the remedy to require performance by the other party of its obligations, unless the former had opted for a different remedy that is inconsistent with specific performance, such as the avoidance of the sales contract.[201] Possible breaches that may give rise to the remedy of specific performance include the failure to deliver the goods, related documents or their defective delivery, and other contractually accepted obligations,[202] such as the obligation of by the seller or the buyer to provide an independent guarantee.[203]

When the buyer has received nonconforming goods, Article 46(2) of the CISG grants the buyer a right to request the delivery of substitute goods only if the lack of conformity constitutes a fundamental breach. In other words, it is possible to make said request only if keeping the nonconforming goods substantially deprives the buyer of what it was entitled to expect under the contract and when this deprivation was foreseeable by the seller at the conclusion of the contract.[204] The rationale for requiring such a high standard of breach of substantial deprivation for the delivery of substitute goods assumes that the non-conforming goods have already been shipped and transported to the buyer's place of business or to the place where the goods are intended to be resold or used. In that case, the delivery of substitute goods is considered a *ultima ratio* remedy, available only to the extent that other remedies that do not require a fundamental breach such as repair of the goods (Article 46(3) of the CISG), the reduction of the price (Article 50 of the CISG) or/and damages (Article 74 of the CISG), would not fully remedy or compensate the seller's breach.[205]

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[201] Articles 46, 61 and 62 of the CISG. See also GARRO, Alejandro M. and ZUPPI, Alberto L., *op. cit.*, p. 287.
[202] MÜLLER-CHEN, Markus, *Article 46*, in Ingerborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, 2010, p. 707.
[203] HERMAN, Shael, "Specific Performance: a Comparative Analysis", in 7 Edinburgh Law Review, 2003, pp. 5, 196, 204.
[204] Article 25 of the CISG. Also, see above Chapter 4 for an explanation on the requirement of foreseeability.
[205] MÜLLER-CHEN, Markus, *op. cit. Article 46*, pp. 712, 713.

In the case of the obligation of establishing an independent guarantee with terms that depart from the specifications of the underlying sales contract, the beneficiary (the buyer for example) may require the applicant (the seller for instance) to have the guarantor issue a substitute conforming guarantee or to amend its nonconforming terms, with the beneficiary's consent.[206] Since the issuance of a new bank guarantee does not implicate the hazards or expenses generally involved in the shipment and transportation of substitute goods, no reason exists to subject the buyer's claim to provide a new conforming independent guarantee to the requirements of Article 46(2) of the CISG, *i.e.* the existence of a fundamental breach. In this context, the basis for the beneficiary's claim would be Article 46(1) CISG.[207]

A party may nevertheless be exempted from performing its obligation to provide a bank guarantee due to an impediment beyond its own or the guarantor's control that was unforeseeable and unavoidable either by the applicant or the guarantor pursuant to Article 79(1)(2)(a)(b) of the CISG.[208]

i. Fixing an Additional Period of Time to Provide an Independent Guarantee

For the sake of goodwill among the parties or for its own benefit, a buyer may fix an additional period of time for performance by the seller of any contractual or statutory obligations pursuant to Article 47(1) of the CISG.[209] The setting of an

[206] Article 11(b) of the URDG 758.
[207] Article 46(1) of the CISG establishes the general right of the buyer to require performance by the seller of his obligations unless the buyer has resorted to a remedy which is inconsistent with this requirement.
[208] BRUNNER, Christoph, *Force Majeure and Hardship under General Contract Principles: Exemption for Non-performance in International Arbitration*, Kluwer Law International, 2008, p. 187 § 18: "*the obligor has basically no control over these third parties. Paragraph 2 thus only applies if the third party independently discharges a performance obligation of the obligor. Firstly, this is the case for transport companies or banks, inasmuch as they independently perform certain obligations of the seller or the buyer (e.g., to transport the goods, to transfer the money to the seller's bank, to open a letter of credit or to establish a bank guarantee)*".
[209] GARRO, Alejandro M. and ZUPPI, Alberto L., *op. cit.*, p. 286.

additional period of time also works for the contractual obligation to provide a conforming independent guarantee. In the case of a seller's breach of the obligation to deliver the goods, Article 47(1) of the CISG is of paramount importance. Pursuant to this provision, a repeated failure to deliver the goods within the additional period of time fixed by the buyer will automatically entitle the buyer to declare the avoidance of the contract pursuant to Article 49(1)(b) of the CISG. However, those legal consequences do not follow from the breach of other types of obligations by the seller. In particular, if the seller breached its obligation to have a guarantor issue an independent guarantee, the buyer's right to avoid the contract depends only on whether or not the breach of contract is 'fundamental' within the meaning of Article 25.[210] The fixing of an additional period of time and the repeated failure is of no consequence in that regard. However, fixing an additional period of time may become important in cases where the breach of an obligation to provide an independent guarantee represents a fundamental breach pursuant to the terms of the sales contract. For instance, when the sales contract provides that failure to provide the independent guarantee to the buyer would lead to the termination of the contract,[211] but the buyer initially chooses, after the first failure, not to request the strict performance of that obligation. The buyer's conduct would lead to a failure to declare avoidance of the contract within the time limit required by Article 49(2)(b)(i) of the CISG.[212] If the buyer then wishes to pursue the termination of the contract, he may regain the initially lost right to avoid the contract by fixing an additional period of time for the seller to provide the guarantee. Other remedies available to the buyer (besides avoidance of the contract) never depend upon the formal step of an additional period of time, like the right to require performance (Article 46 of the CISG) and generally the right to claim damages (Article 45(1)(b) of the CISG).

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[210] See Section B below.

[211] BERTRAMS, Roeland I.V.F, *op. cit.*, p. 66: "*When the parties to the underlying relationship have agreed that the principal debtor is to furnish an guarantee payable on certain terms and conditions, that agreement constitutes a condition precedent in the sense that the obligations of the other party are suspended until the issuance of the guarantee*".

[212] MÜLLER-CHEN, Markus, *Article 47*, in Ingerborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, 2010, p. 725.

In all cases, the additional period of time fixed by the buyer must be for a reasonable length of time as determined by the circumstances (Article 47(1) of the CISG). In the context of an obligation to have a guarantor issue an independent guarantee, the banking practices at the seller's place of business, bank holidays, the type of guarantee agreed upon and its payment structure, *i.e.* whether the guarantee is a direct or indirect guarantee must be given due regard. In this line of thought, the issuance of an indirect guarantee may need a longer additional period of time because of the involvement of the issuing bank at the buyer's place of business and the counter-guarantee in place for the instructing bank. The buyer will be bound to hold any other remedy during the additional period of time unless the seller informs that it does not intend to perform during such period (Article 47(2) of the CISG).

ii. Possibility to Request an Opportunity to Remedy an Independent Guarantee

Pursuant to Article of the 48 CISG, the seller may request of the buyer the opportunity to remedy a defective performance of its obligations if the seller can do so without unreasonable delay or without causing an unreasonable inconvenience or uncertainty to the buyer.[213] There is no express corresponding buyer's right to remedy a defective performance of its obligation after the due date. However, this right constitutes a principle upon which the CISG is based (Article 7(2) of the CISG), and thus should be extended to the buyer. The right to remedy at one's own expenses exists for every type of breach of contract. It includes a violation of any agreed obligation like the provision of an independent guarantee.[214]

[213] GARRO, Alejandro M. and ZUPPI, Alberto L., *op. cit.*, p. 216.
[214] MÜLLER-CHEN, Markus, *Article 48*, in Ingerborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, 2010, p. 735.

Article 48(1) of the CISG provides that the seller's opportunity to remedy does not exist until after the due date of the delivery of the goods. Prior to this time, the curing of defects is regulated by Articles 34 and 37 of the CISG, under the basis of an early performance of a party's obligations. However, if a seller is required to provide an independent guarantee by a particular date in order to secure punctual and proper delivery of the goods and he fails to do so by that date, or if the terms of the guarantee do not correspond to the specification in the underlying sales contract, the date for exercise of the right to remedy by subsequent performance is moved from the delivery date to the date on which the duty in question was to be performed.[215]

The way a seller is to remedy his failure follows the nature of the obligation breached. Accordingly, a defective bank guarantee can be replaced by a new guarantee.[216] The precondition is always that the failure is of a nature that allows itself to be remedied. Whether the seller is able to remedy its breach without "unreasonable delay", "unreasonable inconvenience", or "unreasonable uncertainty of reimbursement of expenses" for the buyer cannot be decided as a general principle, but shall be answered only on the basis of the circumstances of each individual case.[217] In the case of an obligation to provide an independent guarantee, the seller's steps to remedy its failure to comply on time will always suit the buyer. Unless the buyer has already acquired the right to avoid the contract with regard to a different obligation, it is unlikely that the buyer may argue that the provision of a new independent guarantee, after its due date, causes him any inconvenience or uncertainty. Consequently, a seller will be usually entitled to remedy its failure to provide a proper independent guarantee under Article 48(1)(2) of the CISG.

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[215] *Idem*.
[216] *Ibid.,* p. 736.
[217] *Ibid.*, pp. 736, 737.

### *B. Avoidance of the Underlying Contract Caused by Failure to Provide an Independent Guarantee*

In accordance with Article 49 of the CISG, a party may declare the sales contract avoided to the extent the other party's failure to perform any of its obligation amounts to a fundamental breach. A breach is fundamental if it results in such a detriment to the suffering party as to substantially deprive it of what it was entitled to expect under the contract, and such result was, or ought to be, foreseeable for the breaching party.[218] In principle, whether a CISG contract may be avoided because of a seller's failure to hand over proper documents related to the goods, is to be decided according to principles similar to those applicable to delivery of non-conforming goods.[219] For instance, if the seller fails to deliver documents that entitle the buyer to dispose of the goods or documents of title such as bills of lading, load notes, warehouse warrants, etc., or if there are defects in their content, then an objectively serious defect may exist.[220] In that case, a fundamental breach can occur. However, in the case of a seller's failure to provide an independent guarantee, the question of whether there has been a fundamental breach of contract depends on the objective importance of that breach in the context of the particular contract pursuant to Article 25 of the CISG, and on whether the defect can be remedied within a reasonable period in accordance with Article 48(1)(2) of the CISG.[221] The rule of fixing an additional period of time under Article 49(1)(b) applies only to the failure to deliver the goods. In all other cases, when the breach is interpreted as being of a fundamental nature, Article 49(1)(a) leads to diverse solutions that are appropriate to individual cases.[222]

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[218] Article 25 of the CISG.

[219] CISG-AC, *Opinion No. 11*, *Issues Raised by Documents under the CISG Focusing on the Buyer's Payment Duty*, CISG-AC (ed.), CISG-AC, 2012, paragraph 3.5. See also MÜLLER-CHEN, Markus, *Article 49*, in Ingerborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, 2010, p. 751.

[220] CISG-AC, *Opinion no 5*, *The buyer's right to avoid the contract in case of non-conforming goods or documents*, CISG-AC (ed.), CISG-AC, 2005, paragraph 4.7.

[221] See MÜLLER-CHEN, Markus, *op. cit.*, *Article 49*, p. 752 and *op. cit.,* CISG-AC, *Opinion no 5, The buyer's right to avoid the contract in case of non-conforming goods or documents*, comment 4.9. Also see section A, ii above.

[222] MÜLLER-CHEN, Markus, *op. cit.*, *Article 49*, p. 752.

In my view, a failure to provide an independent guarantee is unlikely to constitute a fundamental breach. As stated above, independent guarantees are intended to cover the risk of different types of breach of contract or default. Coverage against that risk cannot, by default, constitute a party's main expectation under a sales contract.[223] A seller's main expectation under a sales contract is to be paid for the value of the goods it sells. A buyer's main expectation under a sales contract is to obtain and be able to dispose or use the goods in conformity with the contract and the CISG. Parties do not enter into a sales contract to be covered against the possibility of seeing their main expectations under the sales contract unfulfilled.

Of course, pursuant to the principle of freedom of contract contained in Article 6 of the CISG, the parties may stipulate that, for example, the seller has an immediate right to contract avoidance should the buyer fail to provide an independent guarantee. Indeed, there may be cases where a party would not have entered into a sales contract but for the other party's agreement to provide an independent guarantee. But that would need to be an express term or need to stem from the parties' implied intent according to Article 8(2)(3) of the CISG, from prior practices between the parties or from a trade practice in the industry according to Article 9(1)(2) of the CISG. It is not a coincidence that parties who place great importance on being covered against the risk of breach or default – for instance, governments acting as private parties – will expressly subject the contract's existence to a condition precedent or subsequent, consisting in the proper issuance of an independent guarantee by a guarantor bank and its acceptance by the beneficiary.[224]

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[223] The expectation interest refers to the economic benefits the creditor expects to obtain from the performance of the contract. MUÑOZ, Edgardo, *op. cit.*, *Understanding the CISG System of Remedies from the Latin American Domestic Laws' Standpoint*, p. 107.

[224] BERTRAMS, Roeland I.V.F, *op. cit.*, p. 66: When the parties to the underlying relationship have agreed that the principal debtor is to furnish an guarantee payable on certain terms and conditions, that agreement constitutes a condition precedent in the sense that the obligations of the other party are suspended until the issuance of the guarantee.

When the parties agree that an independent guarantee is to be provided punctually before the performance of the obligation relevant to the guarantee, the question arises as to whether it may be inferred from the failure to provide the guarantee that the applicant will not perform the obligation guaranteed. For example, if the parties agree that the seller is to provide a delivery guarantee on September 4, prior to the delivery of the goods on September 28, some may argue that a fundamental breach exists if the seller fails to provide the guarantee in time and it follows that he will not deliver the goods either. In this case, however, the breach whose fundamentality is analysed must take into account the failure to deliver the goods or the possibility of said failure, and not the failure to provide the guarantee as such. This hypothetical falls into the realm of Article 72 of the CISG, which entitles a party to declare the contract avoided if, prior to the date of performance, it is clear that one of the parties will commit a fundamental breach.

Another example is the case where the buyer is contractually obliged to provide the seller with a payment guarantee or stand-by letter of credit, securing the seller against the buyer's failure to pay the price. If the buyer fails to provide the seller with such a guarantee, the seller is entitled to suspend the performance of his obligations until the buyer gives assurances.[225] Some authors argue that if time is of the essence under the contract, the seller may be entitled to avoid the contract for fundamental breach of contract by the buyer.[226] Again, in this case the breach that eventually reaches a "fundamental" level is not the failure to provide the stand-by letter of credit or payment guarantee, but the failure to pay the price as such, or the possibility of such failure, pursuant to Article 72(1) of the CISG. In addition, a scholar submits that

> (…) where the failure to open a letter of credit or provide a bank guarantee cannot in itself be regarded as a fundamental [breach] of contract, the seller may set an additional

[225] See Section V below.

[226] MOHS, Florian, *Article 64*, *in* Ingeborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, 2010, p. 898.

> period of time for the buyer to open the letter of credit or provide the guarantee, failing which the seller will then be entitled to avoid the contract under Article 64(1)(b) without needing to show a fundamental breach of contract.[227]

Regardless of this, it is now submitted that this is an incorrect approach. The author refers to two different instruments that deserve different treatment. A bank guarantee applied by the buyer, also known as "payment guarantee" or "stand-by letters of credit",[228] intends to cover the seller against the risk that the buyer fails to pay. The amount of the payment guarantee or stand-by letter of credit does not necessarily need to match the purchase price.[229] Contrary to a commercial letter of credit, a payment guarantee may be considered neither a part of the buyer's obligations to pay the price under Article 53 of the CISG, which is the treatment given to a letter of credit when time is of the essence in documentary sales of commodities,[230] nor an act to enable payment under Article 54 of the CISG. Although some authors disagree with this opinion,[231] the provision of an

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[227] *Idem*.

[228] The author clearly talks about "payment guarantee" when he talks about "bank guarantee" since his commentary regards Article 64 CISG remedies for the buyer's breach of contract.

[229] Actually, the amount of the guarantee may change over the time. In accordance with Article 13 of the URDG 758 a guarantee may provide for the reduction or increase of its amount on specified dates or on the occurrence of a specified event which under the terms of the guarantee results in the variation of the amount.

[230] SCHROETER, Ulrich, *Article 25*, in Ingeborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, 2010, pp. 431, 432.

[231] In opposition to this view, the Secretariat's Commentary, the UNCITRAL Digest some authors and arbitral tribunals have considered that a buyer's application for an independent bank guarantee constitutes steps to enable payment to be made under Article 54 of the CISG. In this regard see UNCITRAL, *Article 50, draft counterpart of CISG Article 54*, in Secretariat Commentary on the 1978 Draft of the CISG, 1978, paragraph 3; *op. cit., UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods*, p. 264; OSUNA-GONZÁLEZ, Alejandro, "Buyer's Enabling Steps to Pay the Price: Article 54 of the United Nations Convention on Contracts for the International Sale of Goods", in 25 Journal of Law and Commerce, 2006, pp. 299, 303. Arbitration Court of the Chamber of Commerce and Industry of Budapest, Hungary, 17 November 1995, available at http://www.unilex.info/case.cfm?pid=1anddo=caseandid=217andstep=Abstract: "*Since, in accordance with Article 54 CISG, the buyer's obligation to pay the price includes taking such steps and complying with such formalities as may be required under the contract to enable payment - such as the issuance of a bank guarantee - the buyer's failure to secure payment constituted a breach of its obligation to pay the price*". Appellate Court München Germany, 8 February 1995 [7 U 1720/94], available at http://www.cisg.law.pace.edu/cisg/wais/db/cases2/950208g1.html: "*The court held that the bank guarantee was agreed upon to cover an obligation to pay and dismissed the [seller's] argument that the bank guaranty should serve as a penalty for not taking delivery by the [buyer]*".

independent guarantee results from a different contractual obligation.[232] As put by Bertrams:

> A documentary credit is a means of payment of the purchase price and its utilisation occurs in the ordinary course of events, in contemplation of performance as envisaged by the parties, whereas a guarantee provides security and contemplates payment of compensation in the unexpected event of non-performance of the principal contract. From the account party's viewpoint this difference is crucial. In the case of a documentary credit, utilisation serves his interest, since he will thereby obtain the goods that he intended to obtain. In contrast, payment of the bank guarantee pursuant to a valid call under the guarantee merely results in the account party's duty to reimburse the bank without any corresponding advantage….[233]

Accordingly, a failure to provide an independent guarantee will not fall into the scope of Article 64(1)(b) of the CISG since such failure does not amount to failing to pay the price.

### *C. Damages*

Liability for damages arises when a seller or a buyer breaches any of his obligations under the sales contract or the CISG.[234] This breach does not have to be a fundamental one under Article 25 of the CISG. The breach of any obligation by one of the parties, including the obligation to provide an independent guarantee, [235] triggers the right to damages that, under the principle of full compensation, shall be equal to the financial loss suffered by the other party because of the breach.[236] Therefore, in said cases damages recoverable are not

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[232] See section III above.
[233] BERTRAMS, Roeland I.V.F, *op. cit.*, p. 57.
[234] Article 74 of the CISG.
[235] BERTRAMS, Roeland I.V.F, *op. cit.*, p. 66: "*if the correct guarantee has not been issued in time, the other party is ordinarily […] entitled to damages*". Also see EL-SAGHIR, Hossam A., *The Interpretation of the CISG in the Arab World*, in André Janssen and Olaf Meyer (eds.) CISG Methodology, 2009, pp. 366, 367, where the author is referring to an arbitral tribunal which awarded damages to one party in light of the other party's breach of its contractual obligations by not extending the bank guarantee.
[236] HACHEM, Pascal and SCHWENZER, Ingeborg, *The Scope of the CISG Provisions on Damages, Contract Damages*, in Djakhongir Saidov and Ralph Cunnington (eds.), Domestic and International Perspectives, Hart Publishing, pp. 92, 93.

related or limited to the amount of the guarantee. The type of financial losses recoverable under the CISG include non-performance loss, incidental loss, and consequential loss resulting from the breach[237] of the obligation to provide the guarantee,[238] which is independent from the breach of the obligation that was intended to be guaranteed. For instance, where the delivery of the goods is subject to the issuance of a payment guarantee by the buyer's bank, any extra storage cost resulting from a deferred delivery of the goods because the buyer failed to provide the payment guarantee on time shall be recoverable by the seller as damages.[239]

On the other hand, damages arising out of the guarantor's temporal or definite refusal to pay the guarantee's amounts to the beneficiary are not recoverable under the sales contract against the applicant party. This case cannot be considered as a breach of the sales contract if, for example, the seller has provided the agreed guarantee and the guarantor has refused or delayed payment to the buyer for reasons that could only be described as frivolous, untenable or spurious.[240] Any damage arising in such a case is recoverable under the guarantor and beneficiary's legal relationship only, and therefore, the CISG's provisions will not apply under the premise that they govern the underlying sales transaction.

## VI. Right to Withhold Performance

Article 71(1) of the CISG entitles a party to withhold the performance of its obligations, when it becomes apparent that the other party will not perform a substantial part of its obligations.[241] A party's right to withhold performance applies

[237] SCHWENZER, Ingeborg, *op. cit.*, *Article 74*, p. 1006.
[238] ZELLER, Bruno, *Damages under the Convention on Contracts for the International Sale of Goods*, Oxford University Press, 2nd ed., 2009, p. 70: "*a breach can occur even if it is not laid down explicitly in this Convention*".
[239] SCHWENZER, Ingeborg, *op. cit.*, *Article 74,* p. 1009.
[240] BERTRAMS, Roeland I.V.F, *op. cit.*, p. 244.
[241] GARRO, Alejandro M. and Zuppi, Alberto L, *op. cit.*, p. 290.

to concurrent performance by both parties: to the agreed performance by the debtor first and to the performance by the creditor first.[242]

It has been generally held that the right of suspension applies only to reciprocal obligations.[243] In other words, a creditor is only entitled to withhold performing that obligation which constitutes the counterpart of the debtor's obligation that is likely to be unfulfilled. However, this right to suspend performance may also be extended to interdependent obligations as well. For instance, to those obligations that a party would not have agreed on if the performance of a specific – probably nonreciprocal – obligation had not been promised in return.[244]

In the context of independent guarantees, various questions arise in different scenarios. A seller may be required to provide a delivery guarantee or performance guarantee prior or concurrently to the buyer's payment of the price. The question thus arises as to whether failing to provide said independent guarantee entitles the buyer to withhold a related counter-obligation or even an interdependent payment obligation. In the same hypothetical, a seller, who shall provide the independent guarantee prior or simultaneously to the payment of the goods, may learn that the buyer will not have the financial capacity to meet its payment obligation under the contract. The question then arises as to whether the seller may withhold its independent guarantee obligation or its (reciprocal) delivery of goods obligation or both. The same applies to a buyer's contractual obligation to furnish a payment guarantee or stand-by letter of credit prior or simultaneously to the delivery of the goods or the documents representing them. May the buyer withhold its obligation to provide such guarantee or even its interdependent payment obligation if the buyer learns that the delivery of goods will be delayed? These questions will be

[242] FOUNTOULAKIS, Christiana, *Article 71*, in Ingeborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, Oxford University Press, 2010, p. 951.
[243] *Ibid*. p. 950.
[244] *Idem*.

addressed below after a brief review of the requirements for suspension under the CISG.

Article 71 of the CISG requires the existence of threat in regards to a future failure to perform. This provision specifies the situations giving rise to an imminent breach of contract. A party's inability to perform shall be due to a "serious deficiency in his ability to perform, its creditworthiness or to its own conduct in preparing performance".[245]

A serious deficiency in the ability to perform relates to factual elements such as strikes or impossibilities due to natural events as well as to legal impediments like failures due to government laws or action.[246] Usually, information available about basic market conditions or market developments that could possibly endanger performance constitutes no impediment within the meaning of Article 71(1)(a) of the CISG.[247]

Serious deficiency in creditworthiness relates to insolvency and similar events or by cessation of payment.[248] Whether a failure to furnish a payment guarantee by the buyer may qualify as grounds for suspension of the seller's obligation to deliver the goods or not, will depend on the circumstances, as further explained.

Finally, doubts about the debtor's ability to perform its obligations due to its own conduct in preparing performance may include, for example, the seller's failure to source the raw or auxiliary materials, licenses, export permits, proper package, components or the like that are needed to accomplish its obligation to deliver the goods, in conformity with the contract or the CISG.[249] As further discussed in this

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[245] NYER, Damien, "Withholding Performance for Breach in International Transactions: an Exercise in Equations, Proportions or Coercion?", in 18 Pace International Law Review, 2006, pp. 29, 76.
[246] FOUNTOULAKIS, Christiana, *op. cit.*, *Article 71,* p. 955.
[247] *Idem*.
[248] *Idem*.
[249] *Ibid,* p. 956.

section, the seller's failure to furnish a delivery guarantee or performance bond may allow the buyer to withhold performance of a correlated contractual obligation, like furnishing a payment guarantee. However, such failure may be insufficient to indicate that the seller will be unable to deliver conforming goods under the contract or the CISG.

A party's failure must relate to a substantial part of that party's obligations. The standard of failure is, nevertheless, lower than the fundamental breach standard stipulated in Article 25 of the CISG.[250] This is due to the fact that the remedy granted by Article 71 of the CISG is one of a preventive nature. The contract's main obligations may have not been performed yet and the suspension of a party's obligation, *per se*, does not lead to the avoidance of the contract. What may be considered a substantial part of a party's obligation has to be determined in light of the sales contract's provisions as a whole and the creditor's reasonable expectations under the contract that were known or ought to be known by the other party.[251]

Against this background, the buyer will be entitled to withhold an agreed obligation to provide a stand-by letter of credit if the seller has already failed to perform a related counter-obligation to provide a delivery guarantee or performance guarantee. On the other hand, a buyer may be entitled to withhold its obligation to pay the price in light of a seller's failure to perform an interdependent obligation to provide a delivery guarantee if such failure indicates a threat that the seller will not perform its main obligation to deliver conforming goods. This could happen in the case where the seller has failed to comply with the obligation to deliver conforming goods in the past – which will be considered a substantial part – and the guarantee requested is precisely intended to cover the risk that such failure repeats. The buyer could also withhold its interdependent obligation to pay the price if the contract expressly provides for payment against a delivery

[250] *Ibid*, p. 954.
[251] *Idem*.

guarantee or performance guarantee and the seller is late in performing such an obligation.

A seller's provision of a performance guarantee or delivery guarantee against a stand-by letter of credit by the buyer can be withheld until the buyer's provision of the stand-by letter of credit. If the seller is required to provide the performance guarantee or delivery guarantee first, it may only withhold performance when, for instance, it obtains reliable information that the buyer's usual guarantor is in bankruptcy or has refused to issue the independent guarantee for the buyer.

Where the buyer has already provided a stand-by letter of credit correlated to the seller's performance guarantee, the seller is unlikely to have grounds to withhold its obligation to provide the performance guarantee based on a threat that the buyer will not pay the purchase price. In that scenario, the seller could eventually demand the payment guarantee if the buyer also calls the performance guarantee. Depending on the value of the respective guarantees, it could be said that both parties have temporarily set off.

If no stand-by letter of credit is required from the buyer, the seller will not be entitled to withhold the provision of a contractual independent guarantee if the payment of the purchase price is conditioned to the provision of the seller's independent guarantee. The seller may only withhold the provision of an independent guarantee based on the future threat of never receiving the interdependent obligation of payment, which could be, for example, due to the fact that the buyer has become insolvent or bankrupt, or because the transaction required the buyer's bank or parent or government approval to finance the transaction but the seller learns from reliable sources that the buyer has not obtained such approval. The seller could also withhold its interdependent obligation

to deliver the goods if the buyer fails to provide a valid payment guarantee prior to delivery of the goods as agreed by the parties.[252]

Similarly, the buyer may withhold its contractual obligation to provide a stand-by letter of credit if the seller breaches its obligation to furnish a delivery or performance guarantee first. Where the buyer is contractually bound to provide a stand-by letter of credit first, only a real threat that the seller will not furnish a correlated delivery guarantee or performance guarantee may entitle the buyer to withhold the provision of a stand-by letter of credit. A real threat may emerge when, for example, the financing bank has cut the seller's credit line or when the parent company that usually acts as the guarantor has announced its liquidation or insolvency.

The buyer could also withhold a contractual obligation to furnish a stand-by letter of credit, as well as its main obligation to pay the price, if it learns from reliable sources that the seller will not perform its obligation to deliver the goods. This may be the case when the goods in question have been destroyed before delivery and the seller is definitely prevented from performing its obligation to deliver the goods.

A party's imminent failure to perform a substantial part of its obligation due to *force majeure* or impossibility under Article 79 of the CISG, does not preclude the

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[252] See *op. cit., UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods*, p. 333; Arbitration Court of the Chamber of Commerce and Industry of Budapest, Hungary, 17 November 1995, available at http://www.unilex.info/case.cfm?pid=1anddo=caseandid=217andstep=Abstract: "*A Hungarian seller and an Austrian buyer that had a longstanding business relationship concluded a contract according to which the seller had to make several deliveries of mushrooms to the buyer. The buyer would secure payment for deliveries by a bank guarantee in favor of the seller which should be valid until a certain date. The said guarantee, however, was neither given by the buyer nor requested by the seller before that date. The seller started to deliver the goods, but as the buyer failed to make payment, stopped further deliveries and declared the contract avoided. On a later date, the parties agreed that the seller would resume delivery on condition that the buyer provide the required guarantee. The buyer finally sent a guarantee which however bore the expiry date originally agreed upon and therefore was no longer valid. The Court held that the seller was entitled to withhold performance of its obligation as the buyer had not given adequate assurance of payment of the price through a valid bank guarantee (Article 71(1)(b) CISG)*".

other party's right to withhold performance if the requirements of Article 71 of the CISG are met.[253]

A question of major practical relevance is whether a party who has already performed its contractual obligation to provide an independent guarantee may order the guarantor to stop payment when it learns that the other party will not perform a correlated or an interdependent obligation. In other words, is a party entitled to stop the performance of the guarantor after its own performance, pursuant to Article 71(2) of the CISG and in the context of independent guarantees?

Some scholars submit that the abovementioned right to stop performance only operates on the seller's benefit and in relation to the delivery of goods. This, under the argument that during the Vienna Conference and the drafting of the CISG, the buyer's right to stop payment after being ordered was discussed but not included.[254] It is submitted, on the contrary, that the right of a party to stop the guarantor from paying the guarantee may be possible under the contract between the principal and the guarantor, and that such possibility cannot have any negative effects under the CISG. In other words, if the terms of the guarantee allow the principal to withdraw the guarantee, or at least to stop payment of its monies in light of the beneficiary's imminent threat of failure to perform the underlying contract, the principal may rely on the exoneration afforded by Article 71(2) of the CISG. In that case, the principal will not incur in any breach under the underlying sales contract. In principle, the guarantor undertakes a duty to deliver a guarantee to the beneficiary in accordance with the instructions received from the principal. The guarantor has a duty to follow the instructions received from the principal and to advise him on limited and special aspects. Furthermore, the guarantor is bound to inform the principal immediately when it becomes aware that the beneficiary

[253] See BRUNNER, Christoph, *op. cit.*, p. 376. Also see FOUNTOULAKIS, Christiana, *op. cit.*, *Article 71*, p. 955.
[254] *Idem*.

intends to make a demand,[255] and always has a duty to do so before making payment. But a guarantor is not required to hold payment until the principal has been made aware of the demand or its reasons.[256] Under the terms of the contract with the principal, the guarantor is bound to pay the guarantee only where the demand is in accordance with the terms of the guarantee, or is complying in URDG 758 parlance.[257]

But that hypothetical guarantee, which terms could allow the principal to withdraw the guarantee or at least to stop payment of its monies in light of the beneficiary's imminent threat of failure to perform the underlying contract, may not be called an independent guarantee. Those terms would work against the very nature of an independent guarantee. Under most independent guarantees the guarantor has a duty to pay the guarantee upon the beneficiary's demand for payment from the time the guarantee has entered into force until the expiry date or event.[258] The express terms of the guarantee generally describe the case(s) in which the beneficiary is entitled to receive payment and any documents that may need to be provided alongside.[259] Not infrequently the guarantee contains ambiguous terms, especially terms which appear to refer to the main commercial contract, by expressions such as "if the seller has failed to perform his delivery obligation". In such case, the guarantor may request the beneficiary to sign a statement declaring that the condition or requirement expressed by such clause is met.[260]

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[255] Article 16 of the URDG 758; Article 17 of the URDG 458. See also DELY, Filip, *op. cit.*, p. 835.
[256] *Idem*.
[257] Article 2 of the URDG 758: Complying presentation under a guarantee means a presentation that is in accordance with, first, the terms and conditions of the guarantee, second, these rules so far as consistent with those terms and conditions and, third, in the absence of a relevant provision in the guarantee or these rules, international standard demand practice.
[258] BLAU, Werner and JEDZIG, Joachim, *op. cit.*, p. 726. O'DRISCOLL, Peter, *op. cit.*, p. 382.
[259] See Article 19 of the URDG 758.
[260] See Article 15 (b) of the URDG 758. Also see RAMBERG, Jan, *op. cit.*, pp. 47, 48.

Where the demand of payment is noncompliant, the guarantor has a duty to the principal to refuse to pay.[261] But where the demand is compliant, and there are no circumstances from which neither an inference of irregularity,[262] nor a fraudulent demand is to be found, the guarantor has a duty to pay in accordance with the terms of the guarantee.[263] In the case of demand guarantees, the beneficiary's demand will be sufficient to trigger the guarantor's obligation to pay the guarantee. At that point, it is impossible for the principal to stop the guarantor from paying.[264] The guarantor has a duty to pay even if the beneficiary is in breach under the terms of its contract with the principal.

In most scenarios, a principal will only be able to request a State court or arbitral tribunal to order the guarantor to stop payment of the guarantee if the beneficiary's demand is fraudulent.[265] The guarantor is entitled to refuse payment when a demand is fraudulent under its relationship with the principal.

National courts and tribunals interpret the notion of fraudulent demand in accordance with the law applicable to the guarantee[266] and thus the concepts are

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[261] BLAU, Werner and JEDZIG, Joachim *op. cit.*: "*[u]nder German law, the contract between the contractor and the bank by which the bank was instructed to give the Guarantee is deemed to impose an obligation on the bank to protect the contractor against damage. Certainly, in case of an abuse, the contractor is damaged when the bank pays to the beneficiary and the contractor has to reimburse the bank promptly thereafter. Therefore, it is argued that the bank not only has a right to refuse payment in cases of abuse but, in regard to the contractor, has the obligation to do so*".

[262] Article 24(a)(b) of the URDG 758.

[263] Article 20(b) of the URDG 758. Also see O'DRISCOLL, Peter, pp. 387, 388: "*Commenting the leading English case in the field of performance bonds Edward Owen Engineering Ltd. v. Barclays Bank International Ltd. [1978] 1 Q.B. 159, where Lord Denning from the Court of Appeals held that "[a] bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice*"".

[264] Article 20(b) of the URDG 758; BLAU, Werner and JEDZIG, Joachim, *op. cit.*, p. 726; MEYER-REUMANN, Rolf, *op. cit.*, pp. 32, 33.

[265] GOODE, Roy, *op. cit.*, p. 23. O'DRISCOLL, Peter, *op. cit.*, p. 384.

[266] Austria Supreme Court Decision of 28 July 1999 [7 Ob 204/99x], (*Pipe case*), available at http://cisgw3.law.pace.edu/cases/990728a3.html: "*the Court of First Instance and the Court of Appeal only ignored that the guarantee document itself recites a choice-of-law. It is stated in this*

not uniform.[267] Generally, there is a fraudulent demand when such is manifestly contrary to the prohibition against abuse of legal and contractual rights and thus represents a gross and qualified breach of the rules of good faith.[268] But a demand that is in contradiction with the parties' respective rights and duties under the sales contract is not *per se* fraudulent.[269] Accordingly, the right to stop payment of the guarantee in light of Article 71(2) of the CISG could not be automatic even if the other party has failed to perform a correlated or interdependent obligation. It is important to remember that the fundamental bargain to which the parties under that sales contract have agreed is expressed by the maxim "pay first, litigate later",[270] and such term is also part of the contract between the principal and the bank.

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*document that "Austrian law is applicable to this bank guarantee" […] on which the Court of Appeal based its decision, it is argued, in accordance with the preceding considerations, that the right to withdraw a bank guarantee has to conform with the law which is decisive for the contractual relationship*."

[267] For jurisprudential overview of what constitutes a fraudulent demand in various jurisdictions see BERTRAMS, Roeland I.V.F, *op. cit.*, p. 260; GOODE, Roy, *op. cit.*, p. 23; For jurisprudential overview of what constitutes a fraudulent demand in the United States, United Kingdom, Canada and Australia, and under the United Nations Convention on Independent Guarantees and Standby Letters of Credit, see XIANG, Goa and BUCKLEY, Ross P., "A Comparative Analysis of the Standard of Fraud Required Under the Fraud Rule in Letter of Credit Law", in 13 Duke Journal of International and Comparative Law, 2003, p. 293. For jurisprudential overview of what constitutes a fraudulent demand in Germany see BLAU, Werner and JEDZIG, Joachim, *op. cit.*, p., 727: "*German courts refuse to issue preliminary injunctions in cases where the call of the Guarantee is only "unjustified." Apart from these cases, they are prepared to grant injunctive relief only in the rare cases of a "manifest abuse," which in practice seems to be very similar to the concept of "fraud." Such a manifest abuse is established only if the absence of any entitlement on the basis of the underlying contract is irrefutably proven*".

[268] BERTRAMS, Roeland I.V.F, *op. cit.*, pp. 273, 274. GOODE, Roy, *op. cit.*, p. 23.

[269] O'DRISCOLL, Peter, *op. cit.*, pp. 389, 390. Commenting the English case of *Bolivinter Oil S.A. v. Chase Manhattan Bank* [1984] 1 Lloyd's L.R. 251, 1983, where it was held that it was "*clearly debatable whether Horns [...].acted fraudulently in making their claim on the CBS guarantee or whether they[…] merely acted in breach of their release agreement with Bolivinter. Such knowledge is quite insufficient to justify a Court in preventing Chase and CBS complying with their contractual obligations*"; Austria Supreme Court Decision of 28 July 1999 [7 Ob 204/99x], (*Pipe case*), available at http://cisgw3.law.pace.edu/cases/990728a3.html: "*The recipient could not be accused of acting fraudulently or in abuse of law as long as it was not definitely proven that it was not entitled to claim the purchase price. The affirmation or the negation of the clearness of the evidence to be brought by [Buyer] to prove an abuse of law was in any case an act of consideration of evidence carried out by a judge although the clearness of the guarantee's abuse could not be assessed entirely without legal considerations*". See also BLAU Werner and JEDZIG, Joachim, *op. cit.*, p. 727.

[270] *Idem*.

Pursuant to Article 19 (1)(c) of the UNCITRAL Convention on Independent Guarantees, a demand is fraudulent when, for example, it is made to cover one risk, whereas the guarantee covers another.[271] Accordingly, situations that may entitle the principal to request stoppage of payment by the guarantor could include the buyer's demand to pay a delivery guarantee when the buyer actually intends immediate compensation for some defects discovered in the goods at the time of taking delivery. It is similarly fraudulent when a force majeure event exempts the principal from liability or the beneficiary's conduct is the cause of the damage complained of.[272] A seller could request its guarantor to stop payment of a delivery guarantee to the buyer if an impediment under Article 79 of the CISG prevents the seller from performing its obligation to deliver. In a tender bond, the demand is considered fraudulent when the beneficiary has awarded the tender to a bidder other than the principal on whose instructions the guarantee was issued. It is important to note that fraud in these situations does not require intention to cause harm or malice, because that is not a requirement of unconscionable conduct under most laws.[273]

According to Article 71(3) of the CISG, the right of suspension or stoppage ceases to apply as soon as the debtor provides adequate assurances that it will perform. For example, if the buyer fails to provide the seller with a payment guarantee, the seller is entitled to withhold the performance of his obligations until the buyer gives assurances.[274] These assurances may consist of other types of means to secure the underlying transaction such as mortgages, liens, chattel mortgage, assignments, among others.[275]

## VII. Restitution

[271] DELY, Filip, *op. cit.*, p. 842. See also, MEYER-REUMANN, Rolf, *op. cit.*, p. 33.
[272] Article 19 (2)(d) of the UNCITRAL Convention on Independent Guarantees.
[273] BERTRAMS, Roeland I.V.F, *op. cit.*, p. 273.
[274] MOHS, Florian, *op. cit.*, p. 898.
[275] FOUNTOULAKIS, Christiana, *op. cit.*, *Article 71*, p. 964.

In case of avoidance of the underlying contract, Article 81(2) entitles a party who has performed its obligation to provide an independent bank guarantee to claim its return from the other party. If the guarantee's moneys have already been paid without legal grounds at the time of avoidance, the reimbursement of such moneys may be claimed in accordance with the rules of unjust enrichment of the proper law.[276]

[276] Appellate Court München Germany, Decision of 8 February 1995 [7 U 1720/94], available at http://www.cisg.law.pace.edu/cisg/wais/db/cases2/950208g1.html: "*although the CISG will normally apply to German-Italian sales, it does not regulate the seller's rights concerning bank guaranties. The court, applying its rules of private international law, determined that German law was applicable. The court found the [seller] to have been unjustifiedly enriched according to 812(1) 1 German Civil Code since the [seller] obtained the payment of the bank guarantee without legal grounds*".

## 5. THE PRINCIPLE OF FULL COMPENSATION

All of the different remedies available for the suffering party seek to fully indemnify the harm caused, and when possible, to grant what was expected under the contract. As stated before in this work, Articles 45 and 61 of the CISG entitle the party suffering from the breach of contract to claim damages as provided under Articles 74 to 77.[277] This is in regard to all losses suffered as a consequence of the breach, regardless of whether the contract has been avoided or not.[278]

In regard to these specific provisions on damages, Article 74 of the CISG stipulates the principle of full compensation. Pursuant to this principle an aggrieved party by a breach of contract is entitled to be placed in the same financial position it would have been had the other party not breached its obligations.[279] In other words, this principle seeks to "compensate an aggrieved party for all disadvantages suffered as a result of the breach".[280] The compensation given by the party in breach shall therefore not only satisfy the expectation interest established between the parties,[281] but also all damages caused to other interests as a result of the non-performance.[282] In order to achieve this purpose, Article 74 of the CISG allows the aggrieved party to recover different types of loss, such as non-performance loss, incidental loss, consequential loss and loss of profits.[283]

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[277] These provisions entitle only the buyer or the seller in breach, not any third person that may have suffered a loss as a consequence of the breach. Said damages can only be claimed under the applicable domestic law.

[278] This is contrary to what was foreseen in Article 82 of the ULIS, in which a distinction was made from damage caused when the contract was avoided and when it was not avoided. See KNAPP, Victor, *Damages in General*, in Bianca, Cesare Massimo and Bonell, Michael Joachim (eds.), Commentary on the International Sales Law, the 1980 Vienna Sales Convention, Guifrrè, Italy, 1987, pp. 538, 539.

[279] *Op. cit*. CISG-AC, *Opinion No. 6 Calculation of Damages under CISG Article 74*, comment 1.1.

[280] *Idem*.

[281] This follows the aforementioned theory of *Dannum Emergens* and *Lucurm Cesans*, leaving the possibility to claim not only the remedy of specific performance but also any damages that may have been caused regarding any possible loss of profit. See MUÑOZ, Edgardo, *op. cit.*, *El Derecho de los Contratos y de la Compraventa en Iberoamérica*, pp. 411, 412.

[282] SCHWENZER, Ingeborg, *op. cit., Article 74*, p. 1000, paragraph 3.

[283] *Ibid.,* p. 1006, paragraph 20.

This goal of fully compensating the aggrieved party can be seen in most domestic laws of the world.[284] Both civil law and common law jurisdictions seek to comply with this principle, regardless if they do so by applying different theories of remedies for breach of contract.[285] Legal systems around the world have their own ways of claiming losses caused by a breach of contract. Namely, two ways tend to be the most common: claiming damages as a monetary recovery for injuries suffered, and *restitutio in integrum*.[286] Common law jurisdictions[287] prefer to grant monetary damages in order to place the injured party in the same economical position it would have been had the contract been performed.[288] The method of determining the sum of money itself depends on the specific circumstances of the case, such as whether the claimant has terminated the contract or on whether there has been a total or partial breach.[289] Also, courts or juries can discretely determine the amount of money to be awarded.[290] In this regard, what a claimant would generally have to prove is: that there was causation; that the damage was foreseeable;[291] and, with a reasonable degree of certainty, the lost profits.[292]

On the contrary, civil law jurisdictions[293] tend to prefer a specific performance remedy instead of a claim for damages, leaving damages as a secondary remedy.[294] These legal systems base the remedies for breach of contract in the theories of *Dannum Emergens* and *Lucrum Cesans*. The former theory focuses on

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[284] *Op. cit*., CISG-AC*, Opinion No. 6 Calculation of Damages under CISG Article 74*, comment 1.2.
[285] MUÑOZ, Edgardo, *op. cit.*, *El Derecho de los Contratos y de la Compraventa en Iberoamérica*, p. 404. See also SCHWENZER, Ingeborg, *op. cit. Article 74*, p. 1000, paragraph 2.
[286] KNAPP, Victor, *op. cit.*, p. 540.
[287] Such as Australia, Canada, England, and the United States. See COLLINS, Hugh, *The Law Of Contract,* Cambridge University Press, 3d edition, 1993, pp. 374, 375; FRIDMAN, G.H.L., *The Law Of Contract In Canada*, Carswell, 3d edition, 1994, pp. 558-560; DUNN, Robert L., *Recovery Of Damages For Lost Profits*, Lawpress Corp., 5th edition, volume I, 1998, comment 1.1; CARTER, J.W. and HARLAND, D.J., *Contract Law In Australia*, Butterworths, 4th edition 2002, p. 2105.
[288] GOTANDA, John Y., *op. cit.*, Recovering Lost Profits in International Disputes, p. 64.
[289] *Ibid.,* p. 65.
[290] *Ibid.,* p. 72.
[291] See above Chapter 4.
[292] *Ibid.*, p. 71. Also see below.
[293] Such as France, Mexico, Russia and China. *Ibid.,* p. 73.
[294] *Ibid.,* p. 63. Also see WESIACK, Max, *op. cit.*, section 3, part b): although some countries, such as Germany, South Korea and Switzerland, have lately preferred a claim for damages to the remedy of specific performance. See *ibid.* pp. 63, 64.

giving the promisee what it was promised under the contract. The latter focuses on the gains the promisee was prevented from obtaining due to the breach of contract.[295] In these systems, what a claimant generally needs to prove is that there was a breach of the agreement, as well as reasonable certainty that there were lost profits caused by the breach of contract.[296] Furthermore, just as it occurs in common law, judges are given the task of calculating the damages in the way they deem appropriate. However, contrary to common law judges or juries, civil law judges must only base their calculation on the proof presented by the parties, and cannot rule based on equity.[297]

Turning the view back to the Convention, the principle of full compensation was included in Article 74 with aims of avoiding the implementation of a specific method of calculation of damages for breach of contract.[298] This follows the general world tendency regarding claims for damages, and allows the parties and the tribunal to calculate the damages suffered in any way it deems appropriate, as long as the aggrieved party is placed in the same pecuniary position it would have been in had the breach not occurred and had the contract been properly performed.

Furthermore, Article 74 of the CISG also lays down the conditions needed for the aggrieved party to claim its damages, as well as those under which the party in breach can be held liable for. Specifically, these conditions are: the existence of a breach of contract caused by the seller or the buyer; that a loss is suffered by the other party; and the existence of a link of causality between the damages caused and the loss suffered.[299] In this regard, “the party in breach is liable only for the

[295] MUÑOZ, Edgardo, *op cit*, *El Derecho de los Contratos y de la Compraventa en Iberoamérica*, pp. 411, 412.
[296] GOTANDA, John Y., *op. cit.*, *Recovering Lost Profits in International Disputes*, pp. 77, 78.
[297] *Ibid.,* p. 78.
[298] GOTANDA, John Y., *op. cit.*, *Recovering Lost Profits in International Disputes*, p. 80.
[299] For more on causation and causality, see SAIDOV, Djakhongir, *op. cit.*, *The Law of Damages in International Sales, The CISG and other International Instruments*, p. 79 and SAIDOV, Djakhongir, *op. cit.*, *Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods*, section II, 3.

loss suffered by the injured party as a consequence of that breach".[300] This shows the correlation existing between the principle of full compensation and the principle of strict liability discussed in Chapter 4 of the present paper. Because of this, the same limitations exist for the principle of full compensation: the foreseeability of the loss and the exemptions provided in Articles 79 and 80 of the CISG.[301]

A party who wishes to claim damages under Article 74 of the CISG has the burden to prove with a reasonable degree of certainty that it suffered a loss and the extent of said loss, "but need not do so with mathematical precision".[302] The Convention appeals in this regard to the standard of a reasonable person.[303] The claimant party is not forced to prove every detail of the loss it suffered, as long as it is able to prove that a loss was actually suffered.[304] Moreover, the aggrieved party must also limit its claim for damages to those that were foreseeable at the time of the conclusion of the contract.[305]

Besides a general rule for the calculation of damages laid in Article 74, there are actually two methods of calculation of damages foreseen in Articles 75 and 76 of the CISG created specifically for calculating non-performance losses.[306] However, these methods are not mandatory, and the aggrieved party can still choose to apply Article 74 instead.

When applying Articles 75 and 76, the abovementioned requirement of Article 74 of proving with reasonable certainty the suffering of a loss does not longer

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[300] *Idem*.
[301] See above Chapter 4 of the present paper.
[302] *Op. cit.,* CISG-AC, *Opinion No. 6 Calculation of Damages under CISG Article 74*, comment 2. See also Russia, 6 June 2000, *Arbitration proceeding 406/1998*, available at http://cisgw3.law.pace.edu/cases/000606r1.html; Germany, 18 November 2008, Appellate Court Brandenburg, (*Beer case*), available at http://cisgw3.law.pace.edu/cases/081118g1.html.
[303] That is, as to when any reasonable person could see that the aggrieved party suffered a loss.
[304] Belgium, 20 September 2005, Commercial Court Hasselt*, J.M. Smithuis Pre Pain v. Bakkershuis*, available at http://cisgw3.law.pace.edu/cases/050920b1.html.
[305] For an explanation of foreseeability, see above in Chapter 4.
[306] That is, when an avoidance of the contract has occurred. Article 74, on the other hand, can be applied in order to calculate all types of losses, such as non-performance loss, incidental loss, consequential loss and loss of profit.

exist.[307] Instead, these provisions provide specific requirements for them to be applied. On the one hand, Article 75 allows a party to calculate its damages by taking into account the difference existing between the price paid in a substitute transaction minus the price agreed in the breached contract. This is to be understood as facilitation in favor of the aggrieved party by a breach of contract, and not as a mandatory way to calculate damages. Two requirements can be drawn out from this Article; the first one consisting in the existence of a breach of contract. As for the second one, a substitute transaction must have taken place. Scholars and tribunals have stated that in order for a substitute purchase to be considered as such, two elements must be found. First, there must exist a clear connection between the substitute transaction and the product of the breached contract.[308] In other words, the substitute product must fulfill the purpose of the substituted one, such as, for example, complying with purchase orders of the buyer's customers. The second element consists in making the purchase within a reasonable time[309] and in a reasonable manner;[310] if this was to be done otherwise, there could exist the risk of not complying with the obligation of mitigating damages pursuant to Article 77.[311]

On the other hand, Article 76 allows for an alternative method of calculating damages for the given situation where the contract has been avoided but no substitute transaction took place. Said provision allows the suffering party to calculate its damage by taking into account the difference between the price in the

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[307] *Op. cit.*, CISG-AC, *Opinion No. 8 Calculation of Damages under CISG Articles 75 and 76*, comment 1.2.2.

[308] China International Economic and Trade Arbitration Commission, People's Republic of China, 30 November 1997 (*Canned oranges case*), available at http://cisgw3.law.pace.edu/cases/971130c1.html.

[309] Højesteret, Denmark, 17 October 2007 (*Zweirad Technik v. C. Reinhardt A/S*), available at http:// cisgw3.law.pace.edu/cases/071017d1.html; also see Hof van Beroep Antwerp, Belgium, 22 January 2007 (*N.V. Secremo v. Helmut Papst*), available at http://cisgw3.law.pace.edu/cases/070122b1.html.

[310] Regardless of small differences in the kind or quality of the product. See Arbitration Court of the International Chamber of Commerce, 1995 (*Arbitral award No. 8128*) Unilex.

[311] See CLOUT case No. 427 [*Oberster Gerichtshof, Austria, 28 April 2000*]. See also CLOUT case No. 645 [*Corte di Appello di Milano Italy, 11 December 1998 (Bielloni Castello S.p.A. v. EGO S.A.)*]

breached contract and the market price of the goods. In this regard, the concept of market is to be understood as a "community of suppliers and acquirers of goods and services, where the level of demand at a given time drives prices up or down".[312] Therefore, in regard to the sale of goods, the market price will be the amount of money that suppliers or acquirers of certain goods are willing to pay or charge for them.[313] Pursuant to Article 76(1) of the CISG, the relevant market price is the one charged at the time of avoidance of the contract. Should the requirement of avoidance not be met, Article 74 of the CISG allows a party to rely on the market price charged at the time when the promisor's final and definite refusal to perform took place.[314]

As for the calculation of damages and the specific remedies for achieving full compensation, a problem arises when applying the theory of disgorgement of profits (also known as gain-based damages) as the chosen remedy. Is said remedy really possible under the CISG? If so, is it possible to claim it every time there is a breach of contract? What would be the legal basis for such a claim under the provisions of the CISG? By taking into account the principle of full compensation, the following chapter focuses on answering these questions.

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[312] BRIDGE, Michael G., *The Market Rule of Damages Assessment*, in Djakhongir Saidov and Ralph Cunnington (eds.) Contract Damages, Domestic and International Perspectives, Hart Publishing, 2008, p.438.

[313] For an alternate definition, see SCHWENZER, Ingeborg, *op. cit.*, *Article 76*, in Ingeborg Schwenzer (ed.), Schlechtriem and Schwenzer Commentary on the UN Convention of the International Sale of Goods (CISG), 3rd Edition, Oxford University Press, 2010, p. 1038, paragraph 4: "*the price generally charged for goods of the same kind, traded in the same businesses under comparable circumstances at a particular location*".

[314] *Ibid*., p. 1037, paragraph 2.

# 6. DISGORGEMENT OF PROFITS UNDER THE CISG

## I. Introduction

While it is undisputed that the purpose of Article 74 follows the principle of full compensation, its precise meaning is yet to be determined.[315] In particular, a leading expert in this area has advanced that "the notion that the promisee must not be overcompensated cannot strictly be applied in the context of the Convention".[316] In other words, it may be possible to take into account the benefit the breaching party obtains from its breach when calculating and assessing damages.[317]

This next part of the essay focuses on explaining the possibility of taking into account the profits made by a breaching seller in a second sale when calculating and assessing the damages the aggrieved buyer from the first breached contract is entitled to. This is done first by explaining the general point of view of courts and scholars about the possibility of a disgorgement of profits under the CISG (which is mainly against it), and afterwards by explaining two methods of calculation of damages that result in something equivalent to disgorgement of profits. These proposed methods are achieved by applying the principle of good faith contained in Article 7 of the CISG to the Convention's provisions on damages. Likewise, the proposed remedy of disgorgement is analyzed under the concept of unjust enrichment and the theory of efficient breach of contract.

## II. General View

[315] *Ibid.*, p. 1001, paragraph 5.
[316] *Ibid.,* p. 1002, paragraph 8
[317] *Idem.* Also see SCHMIDT-AHRENDTS, Nils, "Disgorgement of Profits under the CISG", in Ingeborg Schwenzer and Lisa Spagnolo (eds.), State of Play, The 3rd Annual MAA Schlechtriem CISG Conference, 2012, section 3.3.

Disgorgement of profits is to be understood as “a remedy requiring a party who profits from illegal or wrongful acts to give up any profits he or she made as a result of his or her illegal or wrongful conduct”.[318] In other words, this concept refers to a way of claiming damages by calculating them according to the profits made by the party in breach. For the sake of a better understanding of this concept and of what it is proposed in the thesis, I would like to put forward the next example. Imagine a situation where a wine producer agrees to sell 10,000 bottles of its product to a distributor. As time passes, the wine producer finds a second buyer who is willing to pay more than the first buyer; so much more, that the wine producer could even make a larger profit, even if it has to indemnify the first buyer for damages caused by the breach of contract. The question that remains is: is it possible to take into account the profits made by the wine producer in its second sale, even if that could lead to a possible overcompensation of the first buyer?

A disgorgement of profits could basically mean to “skim off the profits made by the breaching party”.[319] However, there must be a legal basis for such method to calculate the breaching party’s damages. In the following sections I address different justification and reasons supporting such methodology.

The general view regarding this issue under the CISG is that a claim such as this must be rejected. The CISG-AC states that Articles 74 to 76 of the CISG, where the contours of the scope of compensation are defined, preclude placing the aggrieved party in a better position than that it would have enjoyed if the contract had been properly performed.[320] Seeing how the principle of full compensation seeks to fully indemnify the aggrieved party for every loss caused by the breach of contract, it is said that it becomes irrelevant to take into account the benefits

[318] *Disgorgement*, Legal Information Institute, Cornell University Law School, accessed on April 21, 2016, available on: https://www.law.cornell.edu/wex/disgorgement.
[319] SCHMIDT-AHRENDTS, Nils, *op. cit.*, section 4.1. The author refers to and understands disgorgement just as that. The present paper rejects this view.
[320] *Op. cit.*, CISG-AC, *Opinion No. 6 Calculation of Damages under CISG Article 74*, paragraph 9. See also *op. cit.* CISG-AC, *Opinion No. 8 Calculation of Damages under CISG Articles 75 and 76*, paragraph 1.3.1.

received or gains made by the breaching party, instead of the loss suffered by the injured party.[321] In this regard, it has been argued that allowing a disgorgement of profits as a way for claiming damages for breach of contract could easily lead to overcompensation.[322]

## III. Disgorgement under the Principle of Good Faith

### *A. The Principle of Good Faith*

Article 7 of the CISG provides that in the interpretation of the Convention, regard is to be had to the observance of good faith in international trade. In a strict sense, good faith has not been properly fixed to a single definition by authors or courts. Instead, this concept has been understood in cases as to the opposite of acting in bad faith, through concepts such as injustice, fairness, fair conduct, reasonable standards of fair dealing, decency, reasonableness, decent behavior, a common ethical sense, a spirit of solidarity, community standards of fairness and "honesty in fact".[323]

The good faith principle is also contained in several other provisions of the Convention, and consequently, inherent to the parties acts, rights and obligations.[324] For instance, Article 16(2)(b) of the CISG prevents a party from revoking an offer where it was reasonable for the other party to rely upon the offer being irrevocable. Article 29 of the CISG allows a party to deviate from an agreed

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[321] SAIDOV, Djakhongit, *op. cit.*, *The Law of Damages in International Sales, The CISG and other International Instruments*, p. 33.
[322] SCHMIDT-AHRENDTS, Nils, *op. cit.*, section 2. Also SCHWENZER, Ingeborg, *op. cit.*, *Article 74*, p. 1017, paragraph 43.
[323] See LÜCKE, H. K., *Good Faith and Contractual Performance*, in P. Finn (ed)., Essays on Contract, 1987, The Law Book Company Limited, Sydney, p. 160. Also see KEILY, Troy, "Good Faith and the Vienna Convention on Contracts for the International Sale of Goods (CISG)", in 3 Vindobona Journal of International Commercial Law and Arbitration, Issue 1 (1999) 15-40, section 2.
[324] See ZELLER, Bruno, *Good Faith - The Scarlet Pimpernel of the CISG*, 2000, available at http://www.cisg.law.pace.edu/cisg/biblio/zeller2.html, part 2, sections (ii) and (iv).

non-oral modification clause to the extent that it relied on the other party's conduct that the latter would not assert its rights under that provision. Moreover, Article 40 of the CISG bars the seller to rely on the buyer's failure to examine the goods and give notice of non-conformity under Articles 38 and 39 of the CISG, if the seller knew or could have not been unaware of that lack of conformity.

It must be noted however, that at first sight the principle of good faith applies only to the interpretation of the provisions of the CISG, and is not intended to be used to integrate new obligations to the parties' contract or to interpret the parties' statements and conduct. For the latter, one must abide to what Article 8 states, and for the former, "Article 7(1) does not impose an obligation of good faith on contracting parties, but merely requires provisions of the CISG to be interpreted in good faith".[325] This view was mainly conceived due to the opposition of some countries during the drafting of the Convention (specially from the common law tradition), and their resilience of imposing to the parties an abstract principle which could mean "different things to different people in different moods at different times and in different places";[326] or in other words, a principle which was accompanied by an uncertain amount of obligations for the parties.

In spite of the above, through the application of the CISG to concrete cases over the time, it has been recognized that when interpreting the provisions of the CISG under the principle of good faith, said principle imminently affects the parties' rights and obligations.[327] In light of this, some courts[328] and scholars[329] have, for

[325] *Idem*, section 5, a. In this regard, the Secretariat Commentary states that the principal of good faith is, however, broader than these examples and applies to all aspects of the interpretation and application of the provisions of this Convention. UNCITRAL, Text of Secretariat Commentary on article 6 of the 1978 Draft, draft counterpart of CISG Article 7, Interpretation of Convention, in Secretariat Commentary on the 1978 Draft of the CISG, 1978, pp. 17, 18.

[326] BRIDGE, Michael G., "Does Anglo-Canadian contract law need a doctrine of good faith?", in 9 Canadian Business Law Journal 385, 1984 , p. 407.

[327] In support of this, see MAZZOTTA, Francesco G., *Good Faith Principle: Vexata Quaestio*, in Larry A. DiMatteo (ed.) International Sales Law, A Global Challenge, Cambridge University Press, 2014, p. 132: "*Therefore, despite the limiting wording of Article 7(1), the good fiath concept has been applied, de facto, to the conduct of the contracting parties*".

[328] See Poland, 27 January 2006, Supreme Court, (*Metallurgical sand case*), available at http://cisgw3.law.pace.edu/cases/060127p1.html. See also Germany, 28 February 1997,

example, made use of the principle of good faith to uphold that the declaration of avoidance required by Article 75 and 76 CISG is unnecessary where the debtor has finally and definitely refused to perform.

In another case, a seller had repeatedly made statements to the buyer from which the latter could reasonably infer that the seller would not raise the defense of late notice. Upon this, the buyer refrained from taking legal action not only against its own customer, but also against seller. In light of this, an Austrian Arbitral Tribunal decided that pursuant to Articles 7(1) and 7(2) of the CISG and, by analogy, the reliance concept expressed in Articles 16(2)(b) and 29(2) of the CISG, the principle of estoppel barred the seller's defense of late notice that it later tried to invoke. “The Tribunal [referred] to this as the prohibition of *venire contra factum proprium*: a special application of the general principle of good faith, one of the "general principles on which the Convention is based”.[330]

In another case, the High Court of München, Germany, found that after two and a half years since the breach of contract, a buyer had lost its right to declare its avoidance. As a consequence, the Court dismissed the buyer’s claim for damages against the seller under Articles 45(1)(b), 45(2), 49(1)(a) of the CISG. The Court found that allowing the buyer to declare the contract avoided after such a long time would violate the principle of good faith contained in Article 7(1) of the Convention.[331]

In this sense, the abovementioned scholarship and cases reflect the general understanding that the parties shall conduct themselves in accordance with the principle of good faith during the conclusion of a contract and its performance. As stated by a scholar, “if good faith in international trade were to be promoted by a

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Appellate Court Hamburg, (*Iron molybdenum case*), available at http://cisgw3.law.pace.edu/cases/970228g1.html.

[329] HACHEM, Pascal and SCHWENZER, Ingeborg, *op. cit.*, *Article 7*, p. 129, paragraph 19.

[330] Arbitral Tribunal, Vienna, Austria, 15 June 1994, SCH-4318. Case law on UNCITRAL texts (CLOUT) abstract no. 94.

[331] Germany 8 February 1995 Appellate Court München [7 U 1720/94], (*Automobiles case*), available at http://cisgw3.law.pace.edu/cases/950208g1.html.

liberal application of the provisions of the Convention, how else can a judge promote "good faith" in trade other than by requiring the parties to behave in good faith? Stated differently, good faith cannot exist in a vacuum and does not remain in practice as a rule unless the actors are required to participate".[332] One could be led to think that while the principle of good faith was included in the CISG only for the interpretation of its provisions and not as an obligation, the drafters of the Convention indirectly intended to impose "good faith" on the conduct of the parties by requiring "good faith" in interpretation only.[333]

### *B. Disgorgement of Profits under the CISG*

Having the principle of good faith in mind let us now revisit the possibility of a disgorgement of profits under the CISG. As stated before, the general view holds that the principle of full compensation seeks to compensate the aggrieve party for its losses, and that therefore, there is no point in looking at the profits made by the party in breach.[334] However, pursuant to the principle of good faith, the benefits received by the breaching party cannot be simply overlooked. This is because in some cases damages "reflecting gains made by the breaching party may be an appropriate way of implementing the compensatory purpose of damages".[335] In other words, there are some cases in which the only way of fully compensating the aggrieved party is by granting a claim for disgorgement of profits. It is proposed in this work that one of those cases is when the seller breaches the contract by opting to sell the goods promised to the buyer to a third party. In this scenario, the injured buyer has a legitimate interest in preventing the seller from benefiting from its breach. A leading scholar on the CISG has stated that the targeting of the profits made by a breaching party is possible and necessary when "the seller sells the

[332] KONERU, Phanesh, *op. cit.*, p. 140.
[333] *Idem*.
[334] See SAIDOV, Djakhongir, *op. cit.*, *The Law of Damages in International Sales, The CISG and other International Instruments,* p. 29.
[335] *Ibid.,* p. 33.

goods a second time and realizes a higher profit than agreed to under the contract with the first buyer".[336] Under this type of situations, which are also known as an efficient breach of contract, the seller's profits from the second sale exceed the damage to be paid to the first buyer.

As for the reason of why the aggrieved party has a legitimate interest in evading the breach of contract, the following must be taken into consideration. What the buyer expects to receive under the contract are goods that fulfill the agreed terms between the parties, and not compensation in the way of damages for non-delivery. The principle of good faith may only enlarge the methods of damages' calculation in accordance with the principle of full compensation where exists an assumed loss that cannot be quantified but on the basis of the profits made by the breaching party. In this regard, the principle of full compensation must not be limited to the pecuniary loss suffered as shown in the balance sheet.[337] There must be exceptions to compensate the "non-pecuniary" losses. "If one confines damages to the economic loss caused by the non-performance, one ignores the fact that the aggrieved party has paid the price precisely to obtain the correct performance of the contract".[338] These losses should therefore be considered as pecuniary losses, even if they are non-pecuniary in essence. However, seeing that there is no way of calculating exactly how much the first buyer would have made with the goods he did not received,[339] disgorgement serves as a way of generally assuming that what the seller obtained in profits is what the first buyer could have gained from the goods. "The buyer should also be entitled to claim monetary compensation for the value of the goods themselves of which it was deprived. This

[336] SCHWENZER, Ingeborg, *op. cit.*, *Article 74*, p. 1017, paragraph 43. Arguing the same SCHMIDT-AHRENDTS, Nils, *op. cit.*, section 4.1. However, the author refuses to call this a claim for disgorgement of profits. He states that the profits made by the seller in the second sale actually indicate what the first buyer himself could have made by reselling to a third party.

[337] HACHEM, Pascal and SCHWENZER, Ingeborg, *op. cit.*, *The Scope of the CISG Provisions on Damages, Contract Damages*, p. 94: "*Generally, all other losses of the aggrieved party that do not directly appear on the balance sheet are simply deemed to be non-pecuniary and thus not compensable*".

[338] *Idem*.

[339] In case for example, where the buyer had pre-orders from his customers, but not in relation to all of the good it was to acquire from the breaching seller.

value should foremost be determined by what the buyer could have done with the goods, had they been delivered".[340]

Going back to the mock case posed in section II of the present Chapter,[341] imagine that not only the seller opted to sell to another buyer in order to acquire a higher profit, but that also said resale would affect directly the first buyer's market. It could happen that the second buyer is in fact the first buyer's main competitor. It could also be that the wine sold is in fact one of a kind; one that has won many prices and is preferred by customers from all around the world due to its high-quality and prestige. The aggrieved buyer is prevented from a resale opportunity. It may be impossible for the buyer to obtain equal goods that may allow it to make similar profits with different costumers. It can be appreciated how the first buyer truly holds a legitimate interest in avoiding the breach of contract, and how awarding damages calculated solely on the basis of the price of the promised goods in the breached contract – either by applying Articles 75 or 76 of the CISG, or by calculating damages on the basis of past sales – would not be enough to compensate the loss actually suffered. If the seller was to keep the profits made in the second contract, it would profit beyond what the parties negotiated as the risk for breach of contract. In other words, when concluding a contract, a seller covers its risk against falling prices, but assumes the risk that prices will increase. On the other hand, when the buyer agrees on the contract price it ensures against the risk of raising prices, but assumes the risk that market prices may decline after the conclusion of the contract.[342] It is important to remember that "the aggrieved party is entitled to be compensated for the value of its unrealized contractual expectation in order to receive the benefit of the bargain".[343] So, if we have that the seller decided to breach the contract and resell to another buyer, the seller is therefore

[340] SCHMIDT-AHRENDTS, Nils, *op. cit.*, section 4.1.
[341] Where a wine producer agrees to sell 10,000 bottles of its product to a distributor, but at the end the producer sells to a second buyer who is willing to pay more than the first buyer; in order to make a larger profit.
[342] GOTANDA, John Y., "Dodging Windfalls: Damages Based on Market Price, Actual Loss, and Appropriate Awards", in Villanova Public Law and Legal Theory Working Paper Series, 2015, p. 6.
[343] *Op. cit.*, CISG-AC, *Opinion No. 6 Calculation of Damages under CISG Article 74*, comment 3.1.

depriving the first buyer from the opportunity to resale the goods at the higher market price. Said opportunity is the expectation interest existing at the conclusion of the contract, and it is precisely what a disgorgement of profits would be intending to indemnify pursuant to the principle of full compensation.

Courts and tribunals can find a justification for this approach in their mandate to interpret the Convention's provisions in accordance with the principle of good faith and in a party's duty to perform a CISG contract in good faith. Specifically, a Court may use the principle of good faith in order to interpret the notion of full compensation in Article 74 of the CISG in an extensive manner.

In 1995, the Court of Appeals of Grenoble, France, already took the approach proposed.[344] In said case, the seller, a French jeans manufacturer agreed to make various deliveries to the buyer in the United States of America. In the contract it was specified that the jeans purchased were to be sent and sold only in South America and Africa. This was because the seller was already "bound by contracts with many foreign distributors and that, more specifically in the case of Spain where the brand name "Jeans Bonaventure" is sought after, it has an interest in not allowing a parallel network of sale [parallel imports]".[345] During the negotiations preceding the contract and its performance, the seller repeatedly demanded proof of the destination of the goods sold. Amidst of the second delivery, proof arose that the buyer had actually been shipping the jeans to Spain. Amongst other claims, the seller claimed a sum of 10,000 francs for abusive and unjustified actions regarding the conduct of the buyer, that were only made worse by the judicial position taken at trial.

In the end, besides rejecting all of the buyer's remedies, the Court ordered the buyer to pay 10,000 French francs for abuse of process, since "the conduct of the buyer, contrary to the principle of good faith in international trade laid down in

[344] Appellate Court Grenoble (*BRI Production "Bonaventure" v. Pan African Export*) France 22 February 1995, available at http://cisgw3.law.pace.edu/cases/950222f1.html.
[345] *Idem*.

article 7 CISG, aggravated by the adoption of a judicial stand as plaintiff in the proceedings, constituted abuse of process".[346] This was because the Court found a justification for the seller's claim for 10,000 francs not only in what it argued, but also in the inconvenience caused by the trial. As a scholar has well stated in regard to this case, "it can be argued that profits made by the buyer by reselling the goods in Spain would constitute an appropriate measure of recovery of compensatory damages particularly considering that they would most likely be reflective of profits the seller lost as a result of the breach".[347] The Court based its rule of damages on the principle of good faith of the Convention, and implicitly took into account the intention of the buyer to breach the contract and the legitimacy of the seller on avoiding it.

In a more recent CISG case,[348] the Stockholm Chamber of Commerce reached a similar conclusion. A Brazilian seller agreed to sell a number of high accuracy and quality pressure sensors to a Chinese buyer, in order for them to be integrated and used on the buyer's new series of pressure transmitters. Along with said agreement, the parties also agreed for the seller to license the buyer on a non-exclusive basis to use and to integrate these pressure sensors to the buyer' s new products to be sold in Asia. The parties included in the contract a confidentiality clause, since the performance of the agreement meant that the seller would expose confidential information to the buyer. Under said clause, the parties agreed not to obtain any of the other party's rights to the confidential information.

On later arbitration proceedings, the seller raised, among others, a counter claim for the breach of the confidentiality clause. To this, the seller argued that not only "the buyer never had the genuine intention to perform its obligations under the Agreement", but that it actually only "entered into the Agreement as a tactical step to obtain access of seller's confidential and proprietary technology in order to

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[346] *Idem*.
[347] SAIDOV, Djakhongir, *op. cit.*, *The Law of Damages in International Sales, The CISG and other International Instruments,* p. 35.
[348] Stockholm Chamber of Commerce Arbitration, Award of 5 April 2007, (*Pressure sensors case*), available at http://cisgw3.law.pace.edu/cases/070405s5.html#ii.

develop, manufacture and sell the pressure sensors which will directly compete with those manufactured and sold by seller".[349] The seller claimed that based on the information given to the buyer, it had begun to manufacture and sell devices that incorporated proprietary technology. The proof offered on this matter consisted in tests conducted by the seller on the buyer's sensors. These tests concluded that "the signal responses exhibited by [the] buyer's sensors are identical or substantially similar to those exhibited by [the] seller's sensors […] such identity or substantial similarity is unlikely, unless [the] buyer's sensors incorporate[d] [the] seller's proprietary technology, including its software".[350] Furthermore, the seller also claimed that the buyer provided a third party Chinese manufacturer access to said technology. To this, the arbitrator found that "it would stretch incredulity too far to conclude that all the similarities were the result of chance. Therefore [he] conclude[d] that the buyer did copy the seller's confidential information and that this was a breach of the agreement entitling the seller to relief".[351] In the end, the arbitrator granted the seller an award for damages that equal the amount of profits the buyer made within the 24-month period within which the buyer used the seller's technology. While the arbitrator did not make a reference to any specific CISG provision for awarding damages, he did state that he considered all the facts of the case.

It is important to note that the language of the Convention does not expressly prohibit a claim for disgorgement of profits. As mentioned before, scholars have arrived to the conclusion that disgorgement is not allowed under the CISG by assuming that allowing said claim risks overcompensating the claimant,[352] and that in that regard, the principle of full compensation would be infringed. However, as it already has been explained, in scenarios such as the one posed, a disgorgement of profits is the only way under which a party can be fully compensated. In this order of ideas, it can be seen how not only disgorgement is not prohibited, but it is

[349] *Idem*.
[350] *Idem*.
[351] *Idem*.
[352] See Section II of the present Chapter.

in reality pursuant to the principle of full compensation and therefore allowed under the CISG.

Even if one was to keep arguing that disgorgement would give rise to a windfall in favor of the claimant party, consequently violating the principle of full compensation, the following must be kept into consideration. If an efficient breach of contract was to occur, a windfall would still happen in benefit of the breaching party. This poses the question of who really should keep said windfall? If one was to look at things from the point of view of the principle of good faith, it would seem unfair to allow the breaching party escape liability simply because the breaching party's wrongful act made it difficult for the other party to proof its damages with absolute certainty. [353] This would create an inconvenience for international commercial transactions. The answer to this question therefore lies in the need of preventing breaches of contract. "If damages in these cases were to be denied, all the breaching party would have to face would be the avoidance of the contract […], thus merely depriving it of the purchase price". [354] The proposed remedy encourages the performance of contracts and discourages breaches, by making it clear to the breaching party that it will not be allowed to profit out of breaking the risk equilibrium assumed by the parties at the contract's conclusion.[355] In this order of ideas, if a seller was to be always allowed to earn additional profit by opting for the breach of contract instead of performing according to it, the allocation of risk that was bargained-for at the conclusion of the contract[356] would be altered. As a scholar well stated, "the seller retains its protection against failing prices but it is still able to take advantage of rising prices".[357]

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[353] *Op. cit.*, CISG-AC, *Opinion No. 6 Calculation of Damages under CISG Article 74*, comment 2.4.
[354] HACHEM, Pascal and SCHWENZER, Ingeborg, *op. cit.*, *The Scope of the CISG Provisions on Damages*, Contract Damages, p. 95.
[355] In the same line of thought, see GOTANDA, John Y., "Dodging Windfalls: Damages Based on Market Price, Actual Loss, and Appropriate Awards", in Villanova Public Law and Legal Theory Working Paper Series, 2015, p. 7.
[356] See above when it was explained in what does this risk consist on.
[357] *Ibid.*, p. 5. The author is referring to a seller who breaches a contract due to rise in the market price, when it had concluded a contract with a buyer when the market price was lower. However, the argument works the same way in the cases of efficient breach and disgorgement of profits.

Another argument that may be brought up against the disgorgement of profits is that said claim could encourage the aggrieved party to decline its obligation of mitigating damages after the breach of contract.[358] It is argued that if the buyer is entitled to relief in the disgorgement measure, it could refuse making a substitute transaction for the goods not delivered, in hopes of obtaining more profit after making its claim of disgorgement.[359] It is important to note that the obligation of mitigation persists regardless of the availability of the disgorgement of profits. The fact that a buyer makes a cover transaction in order to comply with this obligation does not impede a claim for disgorgement. As explained below, when a party is entitled to recover losses under Articles 75 and 76, it may choose to claim damages under article 74 instead.[360]

### *C. Calculating Damages in a Claim of Disgorgement*

As mentioned above,[361] Article 74 of the CISG was drafted with aims of avoiding the implementation of a specific method of calculation of damages for breach of contract. In other words, this provision allows the parties and the tribunal to calculate the damages suffered in any way it deems appropriate, as long as the aggrieved party is fully compensated. In a case where the contract was breached and the aggrieved party had a legitimate interest in there not being a breach, there is no reason of why a tribunal would not consider a calculation of damages following a disgorgement of profits.

In this regard, Articles 75 and 76 of the CISG do not constitute an impediment

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[358] This obligation is stipulated in Article 77 of the CISG, which states that a party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated.

[359] MCCAMUS, John D., "Disgorgement for Breach of Contract: A Comparative Perspective", in 36 Loyola of Los Angeles Law Review, 2003, p. 950, available at http://digitalcommons.lmu.edu/cgi/viewcontent.cgi?article=2362&context=llr.

[360] See below Part C of the present Section.

[361] See Chapter 6.

for the abovementioned. While it is true that the situation posed[362] deals with breach and avoidance of a contract, said provisions are not mandatory to be followed. The aggrieved party can still choose to apply Article 74 instead.[363]

In accordance to the principle of full compensation, a party shall receive an amount of damages equal to its actual loss; no more and no less. A party is entitled to receive an indemnity only for the loss it is able to prove, calculated either by any means it deems appropriate (pursuant to Article 74 of the CISG), by means of concrete evidence (Article 75 of the CISG) or by means of abstract evidence (Article 76 of the CISG). In this regard, courts and scholars have understood that a way to concretely prove and calculate an indemnity for breach of contract is to compare the price of the breached contract with the price of the substitute transaction carried out by the party who endures the breach.[364] However, the principle of good faith should allow parties and adjudicators to consider a different way to interpret what a concrete method of calculating an indemnity can consist of.

### i. The Concrete Method of Calculation of Damages

Courts and CISG scholars submit that the suffering party's damages must generally be calculated concretely.[365] For example, a buyer's loss for non-delivery should be, in principle, calculated by the difference between the price of the goods in the breached contract and the price of the goods in any replacement purchase concretely made by the buyer pursuant to Article 75 of the CISG.

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[362] The example of a sale of wine bottles and efficient breach of contract.
[363] See Chapter 6.
[364] See *op. cit.,* CISG-AC, *Opinion No. 8 Calculation of Damages under CISG Articles 75 and 76*, comment 2.1.1; KNAPP, Victor, *op. cit.*, p. 550, paragraph 2.2; China 7 May 1997 CIETAC Arbitration proceeding, (*Horsebean case*), available at http://cisgw3.law.pace.edu/cases/970507c1.html; China 30 November 1997 CIETAC Arbitration proceeding, (*Canned oranges case*), available at http://cisgw3.law.pace.edu/cases/971130c1.html.
[365] See for example Germany 26 November 1999 Appellate Court Hamburg (*Jeans case*), available at http://cisgw3.law.pace.edu/cases/991126g1.html. Also see SCHWENZER, Ingeborg, *op. cit.*, *Article 74*, p. 1016, paragraph 41.

In this sense, it is now argued that an alternate concrete method of calculation to the one stated in Article 75 of the CISG can also be achieved under Article 74, by comparing the price of the infringed contract with the price of the second sale carried out by the breaching seller. This follows the ruling of the Supreme Court of Austria, under which it was held that damages recovered under Article 74 may be calculated in much the same way they would be calculated under Article 75.[366] Likewise, when a party might be entitled to recover losses under Articles 75 and 76, it may still choose to claim damages under article 74 instead.[367] Therefore, if an aggrieved party fails to satisfy the conditions for the application of Article 75 it may nevertheless recover damages under article 74, but still using the method contained in the former Article, as long as the requirements of Article 74 are fulfilled.

This alternative interpretation of the concrete method of calculation should be applied in scenarios where the seller greedily resells goods a second time. As a matter of good faith, it would only appear reasonable to replace the breaching party with the suffering party in the second transaction, so that the suffering party receives the profits made by the breaching party.

Applying the abovementioned to the example of the case of the wine producer would mean that the buyer can make a claim for disgorgement of profits pursuant to Article 74 CISG, using a concrete calculation method similar to the method laid out in Article 75. In this sense, there would not be the need for a substitute transaction to have taken place. Instead, the price of the second sale would be the one being taken into account for the calculation of damages of the first buyer.

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[366] Austria, 28 April 2000, Supreme Court, (*Jewelry case*), available at http://cisgw3.law.pace.edu/cases/000428a3.html.
To calculate the damages, the seller could choose between Article 75 (substitute transaction) and Article 76 CISG (current price). But neither Article 75 nor Article 76 prevent the seller from claiming damages under Article 74 even if the contract is avoided.

[367] *Idem*.

ii. The Abstract Method of Calculation of Damages

The CISG also allows the calculation of the suffering party's loss in an abstract manner.[368] For example, when no substitute transaction has taken place, Article 76 of the CISG allows the suffering party to calculate its damage by taking into account the difference between the price agreed in the breached contract and the market price of the goods. But the abstract method to calculate damage is not exclusive to Article 76. As submitted by a leading scholar, in cases where Article 76 may be applied, a party may still rely on Article 74 of the CISG in order to calculate its non-performance loss abstractly[369].

This would mean again following the reasoning used by the Supreme Court of Austria under which it allowed to calculate damages under Article 74 by following the method found in Article 76.[370] Likewise, when a party might be entitled to recover losses under Article 76, it may choose to claim damages under article 74 instead.[371] In this order of ideas, if an aggrieved party fails to satisfy the conditions for the application of Article 76, it may nevertheless recover damages under article 74, but still using the method contained in Article 76. It is true that when some of the requirements in article 76 are not met, claims have to be brought under Article 74 of the CISG.[372] However, this does not mean that the method stipulated in Article 76 cannot be used under Article 74, as this provision allows the application of any method of calculation of damages the claimant party and the tribunal deem appropriate.

This alternate method of calculation of damages would consist in comparing the

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[368] See HACHEM, Pascal and SCHWENZER, Ingeborg*, op. cit.*, *The Scope of the CISG Provisions on Damages, Contract Damages*, p. 96. Also see SAIDOV, Djakhongir, *op. cit.*, *The Law of Damages in International Sales, The CISG and other International Instruments*, p. 188.

[369] HACHEM, Pascal and SCHWENZER, *op. cit.*, p. 96. Also, SCHWENZER, Ingeborg, *op. cit.*, *Article 74*, p. 1016, paragraph 41.

[370] *Op. cit.*, Austria, 28 April 2000, Supreme Court, (*Jewelry case*), available at http://cisgw3.law.pace.edu/cases/000428a3.html.
Article 76 does not prevent the seller from claiming damages under Article 74 even if the contract is avoided.

[372] SCHWENZER, Ingeborg, *op. cit.*, *Article 76*, p. 1038, paragraph 4.

price of the infringed contract with the price of a hypothetical market for the goods involved. The price paid by the second buyer works as a general assumption that what he paid is actually the current market price for the goods, and therefore, what the buyer himself could have made by reselling the goods to any third party. As mentioned before,[373] this calculation of damages on the basis of a market price can be justified because the injured party losses an opportunity to make a profit from the market movements; an opportunity that the breaching party keeps to itself by breaching the contract.[374]

iii. Burden of proof

Following up on these alternate methods of calculation of damages, the burden still exists on the first buyer of proving with reasonable certainty that it suffered a loss. In order for these methods to work, the buyer must prove what it would have done with the goods had it acquired them. Given that this would create problems when trying to reach an exact amount – especially in cases were the buyer had made no pre-orders with its own customers – an alternative route is needed. Pursuant to the principle of good faith, and seeking to be able to fully indemnify the aggrieved party,[375] it seems justifiable to look at what the breaching seller was able to do with the goods. This means that the profits made by the seller shall be taken as evidence of the profits the claiming buyer could have made with the goods.[376] This of course does not deprive the seller from its right to prove that the buyer could not have used the goods as profitable as it did. What it does instead is imposing the risk of uncertainty on the breaching party whose breach gave rise to

[373] See above in Part B of the present Section.
[374] See SAIDOV, Djakhongir, *op. cit.*, *The Law of Damages in International Sales, The CISG and other International Instruments*, p. 190; SCHMIDT-AHRENDTS, Nils, *op. cit.*, section 4.1.
[375] To this, the CISG-AC stated that the breaching party should not be able to escape liability because the breaching party's wrongful act caused the difficulty in proving damages with absolute certainty. *Op. cit.*, CISG-AC, *Opinion No. 6 Calculation of Damages under CISG Article 74*, comment 2,4.
[376] In the same line of thought, see SCHMIDT-AHRENDTS, Nils, *op. cit.*, section 4.1.

the uncertainty.[377]

As for the requirement of foreseeability,[378] it is not difficult to prove in cases such as the one posed. As argued before, at the time of the conclusion of the contract both parties are aware of the risk for breach of contract.[379] Since that moment, both parties understand that said risk in itself becomes part of the expectation interest, and are therefore subject to compensation for breach of contract in the way of damages. If things go as expected during the conclusion of the contract, one of the contracting parties would be benefited, either by forcing the buyer to buy at a higher price than the market price, or by the buyer reselling to his own customers at a price higher from what it paid. It is therefore foreseeable if the parties are deprived of said opportunity of taking advantage of a rise or decrease of the price of the goods.

### *D. Disgorgement of Profits and the Theory of Efficient Breach of Contracts*

It should be clear by now that the proposed claim for disgorgement of profits goes against the economic theory of efficient breach. This theory aims to encourage contract breaches as long as it results in an efficient behavior.[380] For example, if a seller finds a second buyer who is willing to pay a lot more that the

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[377] This has already happened before in United States, (*Mid-America Tablewares, Inc. v. Mogi Trading Co*.), U.S.Court of Appeals (7th Cir.), 1996, 100 F.3d p. 1353, where the court held the plaintiff was entitled to damages for lost profits, because the defendant contractor could have anticipated them and bore the risk of uncertainty in establishing damages as the breaching party.

[378] While it is true that said requirement does not apply for Articles 75 and 76 of the CISG, the proposed claim of disgorgement is based in Article 74, which does require it.

[379] As stated above: a seller covers its risk against falling prices, but assumes the risk that prices of the goods sold will increase, while the buyer agrees on the contract price ensuring against the risk of raising prices, but assuming the risk that the price of the good may decline after the conclusion of the contract.

[380] In Law and Economics and Contractual Law, efficiency is achieved when it is impossible to make one party better off without making someone worse off. See PETTINGER, Tejvan, *Pareto Efficiency*, Economics Help, 2012, available at https://www.economicshelp.org/blog/glossary/pareto-efficiency/. Also see HEYNE, Paul, *Efficiency*, Library of Economics and Liberty, 2008, available at http://www.econlib.org/library/Enc/Efficiency.html.

first buyer, then it should do so under this theory. Given that the second buyer places a higher value on the goods, and provided that the first buyer will be compensated for lost profits and expectation damages, then the net wealth of society would be benefited for the breach of contract.[381]

This is where the contradiction against disgorgement becomes apparent. I have stated in the present paper that disgorgement of profits is the only way in which the aggrieved party can be fully compensated for every damage suffered. Under the efficient breach theory, it has been argued that there is no inconvenience in committing the abovementioned breach, since it is possible to pay the first buyer the contracted price and the lost profits it suffered with is clients, covering all losses suffered. This would fully compensate the aggrieved buyer, since it would still receive what it expected to receive under the contract and from the resale.[382] However, as stated above, the principle of full compensation must not be limited to the pecuniary loss suffered as shown in the balance sheet. Disgorgement as a remedy serves as a way to indemnify for what the parties negotiated as the risk for breach of contract, by generally assuming that what the seller obtained in profits is what the first buyer could have gained from the goods. Additionally, in the scenario posed in of the sale of wine bottles, for example, it would be a costly and extremely difficult task to calculate what the first buyer could have made with the goods without taking into account the profits made by the seller.[383]

An efficient breach of contract tends to cause costs that actually bring inefficient results. There are usually costs that result from the reallocation of goods, time and costs spent on looking for a new seller, negotiations with the customers of the buyer that ended up without product, or who may end accepting a substitute product, among others. There are also the costs that will arise from the dispute between the first buyer and the seller up until it is resolved (especially if there is not a clear rule in the proceedings of who will bear them, or if they are meant to be

[381] MCCAMUS, John D., *op. cit.*, p. 950.
[382] GOTANDA, John Y., *op. cit.*, "Dodging Windfalls: Damages Based on Market Price, Actual Loss, and Appropriate Awards", p. 7.
[383] See above Chapter 7, Section III, Part C, Subpart iii.

divided between the parties).

Lost profits are usually difficult to prove, particularly when dealing with goods so unique as may be the case with award-winning wine,[384] when no pre-orders have been made for the reselling of the goods, or when dealing with a new business that has no record of sales to compare prices with. On the contrary, the remedy of disgorgement and the ways of calculating damages under the concrete and abstract methods proposed in the present paper only require knowing the price at which the seller sold the goods to the second buyer.

As mentioned before,[385] and contrary to the theory of efficient breach, allowing the remedy of disgorgement encourages contractual performance. Disgorgement of profits is a convenient tool for protecting the parties' interests in the performance of the contract, providing incentive to respect their contractual obligations by respecting the principle of *pacta sunt servanda*.[386]

### *E. Disgorgement by means of a Claim for Unjust Enrichment*

Other scholars have suggested that a claim for disgorgement of profits is possible in the same type of situations as the one at hand. However, instead of only applying Article 74 of the CISG to reach this outcome, they have argued that Article 84[387] should be applied instead.[388] Said provision requires the restitution of

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[384] See example above in Chapter 7, Section III, Part B.
[385] See above Chapter 7, Section III, Part B.
[386] See SCHMIDT-AHRENDTS, Nils, *op. cit.*, section 3.1.2.
[387] Article 84 states that: "(1) If the seller is bound to refund the price, he must also pay interest on it, from the date on which the price was paid. (2) The buyer must account to the seller for all benefits which he has derived from the goods or part of them:
(a) if he must make restitution of the goods or part of them; or
(b) if it is impossible for him to make restitution of all or part of the goods or to make restitution of all or part of the goods substantially in the condition in which he received them, but he has nevertheless declared the contract avoided or required the seller to deliver substitute goods."
[388] See KONERU, Phanesh, *op. cit.*, p. 128; *op. cit.,* SCHMIDT-AHRENDTS, Nils, section 4.2; and CHENGWEI, Liu, *Remedies for Non-performance - Perspectives from CISG, UNIDROIT Principles and PECL*, available at

the parties' performance in case of avoidance of a contract, or in other words, the restitution of the goods or payment in cases of an unwinding of a contract. In this regard, since Article 84 contains the general principle of the CISG of unjust enrichment,[389] under which a party cannot keep what it received from the other party nor the interest or benefits that it has produced, it has been argued that said principle can be applied by analogy to other cases besides the one foreseen in this provision.[390]

Respectively, scholars have stated on the subject that "by applying the general principle of "unjust enrichment" in Art. 84 […], the aggrieved party would be made whole and the party in bad faith disgorged of all unduly received benefits".[391]

"It is summited that in this case [referring to BRI Production "Bonaventure" v. Pan African Export],[392] the buyer is indeed obliged to account to the seller for the profits, yet not under Article 74 CISG, but under Article 84(2) CISG which should be applied by analogy to cases where a seller (and not the buyer) declared the contract avoided".[393]

> The broader and primary goal of the Convention is to compensate the aggrieved party fully. Once this goal is accomplished, if there is still unjust enrichment on the part of the breaching party, such unjust enrichment should be disgorged depending on the facts. […] This analysis not only satisfies the general principles of full compensation, but also promotes good faith and reasonable behavior between the parties in international trade, thereby fulfilling the mandates of Article 7.[394]

The abovementioned point of view is respectfully rejected. Even if Article 84 of the CISG endorses the principle of unjust enrichment, it would be wrong to try to

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http://www.jus.uio.no/pace/remedies_for_non_performance_perspectives_from_cisg_upicc_and_pecl.chengwei_liu/18.6.html#_1011, paragraph 1138.

[389] HACHEM, Pascal and SCHWENZER, Ingeborg, *op. cit.*, *Article 7*, p. 139, paragraph 35.

[390] This is pursuant to Article 7(2) of the CISG, which states that questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

[391] CHENGWEI, Liu, *op. cit.*, paragraph 1138.

[392] See above Part B of the present Section.

[393] SCHMIDT-AHRENDTS, Nils, *op. cit.*, section 4.2.

[394] KONERU, Phanesh*, op. cit.*, p. 129.

apply in this type of situations. This is because said general principle is only applicable to the unwinding of the contract. Compensation of damages is a matter expressly dealt with by the CISG's provisions on damages; and in this specific case, by the remedy of disgorgement found in Article 74 when interpreted under good faith.

Seeing that their effects are similar, it may exist confusion in regard to the concept of disgorgement of profits and claims for unjust enrichment. Unjust enrichment refers to profits made without the right to do so (without legitimacy). For example, the interests made from the money received in contract declared null and void are to be given back to the buyer, since there is no existing contract that entitles the seller to take said money in the first place. On the contrary, the seller is entitled under a valid contract to the profits made with a second buyer, regardless of breaching the contract with the first buyer. This is precisely why a claim of disgorgement of profits cannot be applied pursuant to the principle of unjust enrichment. Furthermore, this is why some jurisdictions, which qualify a claim for disgorgement as a contractual claim, are likely to find that claims for unjust enrichment are not available under the CISG, since the contract itself is governed by said Convention.[395]

Another approach that has been used in order to allow unjust enrichment claims is to base them under the applicable national law. It is true that Article 7 of the CISG requires the tribunal to resolve any questions concerning matters that are not expressly settled in the Convention in conformity with the general principles on which it is based or, in the absence of such, in accordance with domestic law. However, damages for breach of contract are a matter governed by Articles 74-77 of the CISG, and the scope of damages recoverable is a question that has

[395] SCHMIDT-AHRENDTS, Nils, *op. cit.*, section 3.1.4. For more on the matter, see GRANTHAM R.B. and RICKETT, C.E.F., "Disgorgement for Unjust Enrichment?", in The Cambridge Law Journal, Vol. 62, No. 1 (Mar., 2003), pp. 159-180, available at http://www.jstor.org/stable/pdf/4508974.pdf?_=1462400492340.

expressly been defined.[396] According to the foregoing, there is no need to resort to the general principle of unjust enrichment. In this order of ideas, "the view that only the actually accrued interest should be paid out because the equalization of benefits under Article 84(1) resembles a claim for unjustified enrichment cannot be followed".[397]

Scholars and courts have found that claims for unjust enrichment as damages are actually a matter preempted by the CISG.[398] Said claim simply is not foreseen by the Convention in its provisions for damages for breach of contract. "It is therefore safe to say that the so-called "restitution interest", which focuses not on the injured party's loss but on the breaching party's gain in order to prevent that party from being unjustly enriched, is not protected by [the CISG]".[399] The only case law that has actually allowed a claim for unjust enrichment as damages has done so under domestic law.[400] Although this case was not a CISG case, but an ULIS case, the provisions of the former were modeled after the latter some Courts tend to look over the ULIS' cases as a valid reference source. In said case, an Israeli buyer sued a German seller for breach of contract. The buyer, however, had lost his remedies under ULIS by lapse of time and lack of notice, and as a consequence lost the litigation proceedings. Afterwards, the buyer started a new litigation where it argued that the seller, by not performing the contract and not being liable under ULIS, was unjustly enriched. In this new litigation, the Israel Supreme Court found that the buyer was entitled to restitution of the profits made

[396] Pursuant to the CISG-AC, the contours of the scope of compensation are well defined in Articles 74-76 of the CISG. Concretely, these provisions preclude placing the aggrieved party in a better position than that it would have enjoyed if the contract had been properly performed. *Op. cit*., CISG-AC, *Opinion No. 6 Calculation of Damages under CISG Article 74*, comment 9; *op. cit*., CISG-AC, *Opinion No. 8 Calculation of Damages under CISG Articles 75 and 76*, comment 1.3.1.

[397] FOUNTOULAKIS, Christiana, *Article 84*, in Ingeborg Schwenzer (ed.) Schlechtriem and Schwenzer: Commentary on the UN Convention on the International Sale of Goods, Oxford University Press, 2010, p. 1138, paragraph 21.

[398] In United States, 23 December 2009, Federal District Court, Arkansas (*Electrocraft Arkansas, Inc. v. Electric Motors, Ltd et al*.), the Court held that an unjust enrichment claim is a matter preempted by the provisions on remedies for breach of contract under the CISG.

[399] SAIDOV, Djakhongir, *op. cit.*, *The Law of Damages in International Sales, The CISG and other International Instruments*, p. 33.

[400] Supreme Court of Israel, 2 November 1988 (*Adras Construction Co. Ltd. v. Harlow & Jones GmbH*).

by the seller under the domestic laws of unjust enrichment, without ever making any reference to the ULIS.

It is worth noticing that this decision was widely criticized by various scholars, who considered that the Supreme Court of Israel applied "a remedy under domestic law which is inconsistent with the [ULIS]".[401] Contrary to unjust enrichment, and as mentioned above, disgorgement is a subject matter that can be found within the scopes of Article 74 and the principle of full compensation. Therefore, in order to maintain the goal of the CISG to provide uniformity in international trade law[402] pursuant to its Article 7(1), decisions seek answers in domestic law when there is no need to do so must be avoided.

[401] SCHLECHTRIEM, Peter, *op. cit.*, *Article 76*, paragraph 3. Also see FRIEDMANN, Daniel, *op. cit.*, pp. 384-388; and ADAR, Yehuda, *Israel*, in Larry A. DiMatteo (ed.), International Sales Law, A Global Challenge, Cambridge University Press, 2014, p. 523.
[402] See above Chapter 2, Section III.

## CONCLUSIONS

The CISG must not be left behind when analyzing and studying international commercial law. It is a mandatory body of law; one which contains relevant elements from the law systems from all around the world within its provisions. In this regard, this work has focused on explaining two founding principles of the Convention apropos of the occurrence of a breach of a contract, which are the principle of strict liability and the principle of full compensation.

The first main chapter of this paper explained the parties' rights and obligations regarding the application for an independent guarantee, as well as the effects of a breach of contract and how should said breach be treated pursuant to the provisions of the CISG. A party's obligation to have a guarantor issuing an independent guarantee will be subject to the CISG's rules where the underlying contract as whole falls into the CISG's scope of application. Accordingly, a party's failure to provide the agreed independent guarantee to the beneficiary constitutes a breach of contract. In this regard, the injured party is therefore entitled to the remedies afforded by the CISG.

The CISG offers an effective legal framework for the enforcement of a party's obligation to provide an independent guarantee under an international sale of goods contract. Its system of remedies strikes a balance between a party's right to obtain coverage against the risk that the other party fails to perform his contractual obligations and the economic benefit of maintaining the international sales contract alive in spite of the occurrence of a breach. In this line of thought, the beneficiary will always be entitled to request the applicant to have the guarantor issuing a substitute conforming guarantee or to amend its nonconforming terms. On the other hand, the fixing of an additional period of time to provide an independent guarantee and the repeated failure will not lead to the automatic avoidance of the sales contract. A party's right to avoid the contract will depend only on whether or

not the breach of contract is “fundamental” within the meaning of article 25 or pursuant to the contract terms. In addition, a seller will be generally entitled to remedy his failure to provide a proper independent guarantee under article 48(1)(2) of the CISG, since it is unlikely that a late provision can cause the buyer any inconvenience or uncertainty.

Similarly, it is unlikely that a failure to provide an independent guarantee may constitute a fundamental breach because parties do not enter into a sales contract with the aim to be covered against the possibility of seeing their main expectations under the sales contract unfulfilled. The latter is part of the normal business’ risk taken by traders. That being said, the parties may stipulate that, for example, a party has an immediate right to contract avoidance should the other party fail to provide the independent guarantee agreed.

The failure to comply with a contractual obligation to provide a guarantee may anticipate that the applicant will not perform the obligation guaranteed. This may entitle the beneficiary of the guarantee to declare the contract avoided if it becomes clear that the applicant will commit a fundamental breach with respect to the obligation guaranteed pursuant to article 72 of the CISG. In those instances, however, the breach whose fundamentality is analyzed regards the failure to comply with the obligation that was intended to be guaranteed or the probability its occurrence (and not the failure to provide the guarantee).

The breach of an obligation to provide an independent guarantee triggers the right to claim damages that shall be calculated up to an amount equal to the financial loss suffered by the other party because of the breach. The amount of damages recoverable is not limited to the amount of the guarantee and is independent from the damages resulting from the breach of the obligation that was intended to be guaranteed.

Depending on whether the threat of a future breach meets the requirements of article 71 of the CISG, a party's failure to provide the independent guarantee will entitle the other party to suspend a related counter-obligation or even an interdependent obligation. Similarly, a party required to provide an independent guarantee prior or simultaneously to the obligation guaranteed may suspend performance if there is a clear threat that the other party will not perform a correlated obligation.

The very nature of independent guarantees makes it almost impossible for a party to stop performance after performance under article 71(2) of the CISG. The principal will only be able to request a State court or arbitral tribunal to order the guarantor to stop payment of the guarantee if the beneficiary's demand is fraudulent. But a demand that is in contradiction with the parties' respective rights and duties under the sales contract is not per se fraudulent. Accordingly, the right to stop payment of the guarantee in light of article 71(2) of the CISG cannot be automatic even if the other party has failed to perform a correlated or interdependent obligation.

The second main part of this work focused on arguing the possibility of a disgorgement of profits as a remedy pursuant to Article 74 of the CISG, when dealing with situations where a seller breaches a contract with a first buyer who has a legitimate interest in evading the breach of contract, in order to sell the goods a second time and consequently obtaining a larger amount of profit. This view has been criticized by various authors under the assumption that this leads to an overcompensation of the aggrieved party by a breach of contract, and in that regard, to a violation of the principle of full compensation.

While it is undisputed that the express wording of Article 74 does not stipulate this possibility, it is also true that the language of the Convention does not expressly prohibit it. Disgorgement of profits can therefore be found in Article 74 when making an interpretation pursuant to the principle of good faith contained in

Article 7(1) of the very same Convention. Courts and tribunals are bound to follow this type of interpretation. Furthermore, it is argued that only by making this interpretation would it be possible to fully indemnify the aggrieved party in the posed scenario. This is because the principle of full compensation must not be limited to the pecuniary loss suffered as shown in the balance sheet. Disgorgement serves as a way to indemnify for what the parties negotiated as the risk for breach of contract, by generally assuming that what the seller obtained in profits is what the first buyer could have gained from the goods.

Furthermore, if the seller was to keep the profits made in the second contract, it would profit beyond said negotiated risk for breach of contract. This opportunity is the expectation interest existing at the conclusion of the contract, and it is precisely what a disgorgement of profits would be intending to indemnify pursuant to the principle of full compensation.

Some authors argue that allowing a claim for disgorgement of profits creates a windfall of profits that the aggrieved party should not receive. However, why should the party in breach receive it? It seems unfair to allow the breaching party escape liability simply because the breaching party's wrongful act caused made it difficult for the other party to proof its damages with absolute certainty. This would create an inconvenience for international commercial transactions. The answer therefore lies in the need of preventing breaches of contract.

The argument against disgorgement of profits consisting in that said claim could encourage the aggrieved party to decline its obligation of mitigating damages after the breach of contract is unfounded. This obligation of mitigating damages persists regardless of the availability of the disgorgement of profits. The fact that a buyer makes a cover transaction in order to comply with this obligation does not impede a claim for disgorgement.

As for the method of calculating damages under a claim for disgorgement, two methods have been proposed in the present paper, both under Article 74 of the CISG: a concrete method and an abstract method. In regard to the latter, what needs to be done is to compare the price of the infringed contract with the price of the second sale carried out by the breaching seller. As for the former, what needs to be done is to compare the price of the infringed contract with the price of a hypothetical market for the goods involved. The price paid by the second buyer works as a general assumption that what he paid is actually the current market price for the goods, and therefore, what the buyer himself could have made by reselling the goods to any third party.

The burden still exists on the first buyer of proving with reasonable certainty that it suffered a loss. However, this may result difficult in the proposed scenario. Therefore, pursuant to the principles of full compensation and good faith, it seems justifiable to take the profits the seller made as evidence of what the claiming buyer could have obtained with the goods. The seller is still entitled to prove that the buyer could not have used the goods as profitably as it did. What it does instead is imposing the risk of uncertainty on the breaching party whose breach gave rise to the uncertainty.

As for the foreseeability requirement, at the time of the conclusion of the contract both parties are aware of the risk for breach of contract. This risk consists in the possibility of the price of the goods sold could rise or descend at any moment. Then, one of contracting parties would be benefited, either by forcing the buyer to buy at a higher price than the market price, or by the buyer reselling to his own customers at a price higher from what it paid.

It also has been argued that the theory of efficient breach must not be allowed. Under said theory, the aggrieved party is not fully compensated. Instead, the only way of fully compensating said party would be under the remedy of disgorgement of profits, since only then the apparent non-pecuniary damages would be

indemnified. Additionally, the reader must also keep in mind that arguing the principle of unjust enrichment is not the proper way of achieving a disgorgement of profits under the CISG. Said principle is reserved only for unwinding of contracts, pursuant to Article 84.

## PROPOSALS

The present work has two main proposals in light of the two main substantive subjects presented. The first one, consists in an explanation of how the CISG's provisions contribute to the effective enforcement of the fundamental bargain to which the parties under an international sales contract agreed to with the stipulation of an independent guarantee clause, which consists in paying first, and litigating any possible dispute later.

As for the second proposal, it is argued that a disgorgement of profits as a remedy can be found within the scope of Article 74 of the CISG, following an interpretation under the principle of good faith. This claim is to be applied in scenarios where a seller has breached a contract with a first buyer and resold the goods to a second buyer, in order to make more profit. The principle of good faith allows an enlargement of the methods of damages' calculation in accordance with the principle of full compensation in these type of situations, where there is an assumed loss that cannot be quantified but on the basis of the profits made by the breaching party.

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