

ELEVENTH ANNUAL

WILLEM C. VIS INTERNATIONAL COMMERCIAL ARBITRATION MOOT

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# MEMORANDUM FOR RESPONDENT

**On Behalf of:**

**Medi-Machines, S.A.**

415 Industrial Place  
Capitol City  
Mediterraneo

**RESPONDENT**

**Against:**

**Equapack, Inc.**

345 Commercial Avenue  
Oceanside  
Equatoriana

**CLAIMANT**



COLUMBIA UNIVERSITY SCHOOL OF LAW

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## LIST OF ABBREVIATIONS

§/§§	Section/Sections
AG	Amtsgericht [Petty District Court] (Germany)
Austl.	Australia
Austr.	Austria
Arb.	Arbitration
Art./Arts.	Article/Articles
Bankr.	Bankruptcy
Bel.	Belgium
BGH	Bundesgerichtshof [Federal Supreme Court] (Germany)
Can.	Canada
Cir.	Circuit
CISG	UN Convention on Contracts for the International Sale of Goods of 11 April 1980
Cl. Ex.	Claimant's Exhibit
Cl. Mem.	Claimant's Memorandum
Clarification	Clarifications given in Procedural Order No. 3
Co.	Company
cf.	compare favorably
Confidentiality letter	Letter Langweiler to Presiding Arbitrator, confidentiality
Corp.	Corporation
Ct.	Court
Den.	Denmark
Dev.	Development
Dist.	District
E.D.N.Y.	Eastern District of New York [Federal Trial Court] (USA)
Ed.	Edition
ed./eds.	Editor/Editors
e.g.	Exemplum gratii [for example]
Eng'g	Engineering
Expert's Report	Report of Eur.Ing. Franz van Heath-Robinson of 6 August 2003

F.Supp.	Federal Supplement
Fed.	Federal
Fin.	Finland
Fr.	France
Ger.	Germany
HG	Handelsgericht [Commercial Court] (Switzerland)
ICC	International Chamber of Commerce
ICJ	International Court of Justice
id.	idem [the same]
i.e.	id est [that is]
Int'l	International
Ins.	Insurance
LCIA Rules	Rules of the London Court of International Arbitration
LG	Landgericht [District Court] (Germany)
Ltd.	Limited
Mfg.	Manufacturing
Neth.	Netherlands
N. of Arb.	Notice of Arbitration
No.	Number
NY Convention	United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 7 June 1959
NZ	New Zealand
OGH	Oberster Gerichtshof [Supreme Court] (Austria)
OLG	Oberlandesgericht [Court of Appeal] (Germany)
para./paras.	paragraph/paragraphs
Proc.	Procedural
Pty. Ltd.	Proprietary Limited
Rep.	Report
Ry.	Railway
SBGH	Schweizerisches Bundesgericht [Federal Supreme Court] (Switzerland)
Sec. Comm.	Secretariat Commentary to the 1978 draft of the CISG
Security for costs letter	Letter Fasttrack to Presiding Arbitrator, security for costs

SIAA	Singapore International Arbitration Act
SIAC	Singapore International Arbitration Centre
SIAC Rules	Arbitration Rules of Singapore International Arbitration Centre
SIAC Reminder Letter I	SIAC first reminder letter to Medi-Machines, 6 March 2003
SIAC Reminder Letter II	SIAC second reminder letter to Medi-Machines, 13 March 2003
SIAC Reminder Letter III	SIAC third reminder letter to Medi-Machines, 20 March 2003
SA	Société Anonyme (France)
SpA	Societate per Azioni (Italy)
S.r.l.	Societate a Responsabilitate Limitata
SMA	Society of Maritime Arbitrators
S.D.N.Y.	Southern District of New York [Federal Trial Court] (USA)
St. of Defense	Statement of Defense
Switz.	Switzerland
UK	United Kingdom
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCITRAL Model Law	UNCITRAL Model Law on International Commercial Arbitration 1985
UNIDROIT	International Institute for the Unification of Private Law
UNIDROIT Principles	UNIDROIT Principles of International Commercial Contracts 1984
USA	United States of America
v.	versus [against]
Vol.	Volume
WIPO Rules	Rules of the World Intellectual Property Organization Arbitration and Mediation Center

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## **SUMMARY OF ARGUMENT**

### **PART ONE: THE MACHINES CONFORMED TO THE CONTRACT.**

The Machines conformed to the terms of the contract, which did not require the ability to pack salt and did not specify a particular processing speed. The Machines were fit for their ordinary purposes, as they were able to pack a wide range of products at a reasonable speed. They were also appropriate for all particular purposes made known to Respondent. Finally, Respondent had no obligation to inform Claimant that the Machines would be inappropriate for packing salt.

### **PART TWO: EVEN IF THE MACHINES DID NOT CONFORM TO THE CONTRACT, THE BREACH ALLEGED BY CLAIMANT WAS NOT FUNDAMENTAL.**

Under the strict and objective interpretation of fundamental breach of the CISG, Respondent's alleged breach of the contract was not fundamental. Claimant suffered no substantial detriment as a result of the processing speed of the Machines. Respondent could not reasonably have foreseen the detriment suffered by Claimant as a result of the nonconformities. Moreover, any failure to cure is irrelevant in determining fundamental breach, particularly as Claimant did not give Respondent a reasonable opportunity to cure.

### **PART THREE: EVEN IF RESPONDENT FUNDAMENTALLY BREACHED THE CONTRACT, CLAIMANT DID NOT VALIDLY AVOID THE CONTRACT.**

Claimant's letter of 19 October did not constitute sufficient notice of its intent to avoid the contract. Avoidance was precluded by Claimant's untimeliness, inability to make restitution, and Respondent's right to cure.

### **PART FOUR: RESPONDENT'S REQUEST THAT CLAIMANT POST SECURITY FOR COSTS SHOULD BE GRANTED.**

Respondent is entitled to security for costs under the SIAC Rules. The available evidence of Claimant's insolvency and the surrounding circumstances are sufficient reason to award security for costs. The contractual intent of the parties further justifies such an order. Claimant did not at any point during this arbitration act in bad faith, and the amount of security requested is reasonable.

### **PART FIVE: RESPONDENT'S REQUEST THAT THE TRIBUNAL MAKE AN ORDER OF CONFIDENTIALITY SHOULD BE GRANTED.**

Claimant is obligated to keep the existence of this arbitration confidential from Equatoriana Investors, as Claimant's case does not fall within the exception to confidentiality in §34.6(d) SIAC Rules. The Tribunal has the authority to order Claimant to comply. If Claimant fails to comply, such violation may have serious consequences for Claimant, but these consequences will not affect the authority of the Tribunal or undermine the arbitration as a whole.

## ARGUMENT

### PART ONE: THE MACHINES CONFORMED TO THE CONTRACT.

1. Claimant attempts to characterize this case as one of an ignorant, innocent buyer taken advantage of by an experienced seller. In fact, all of Claimant's problems resulted from its own misuse of the Machines. The Machines complied with all of the requirements of Art. 35 CISG: they were of the quantity, quality and description required by the contract<sup>1</sup> (I); they were fit for the ordinary purposes for which goods of the same description are normally used (II); and they were fit for all particular purposes made known to the seller at the time of the conclusion of the contract (III). Furthermore, Respondent was under no obligation to inform Claimant that the Machines were unable to pack salt (IV). Therefore, Respondent did not breach its contract with Claimant.

#### I. THE MACHINES WERE OF THE QUANTITY, QUALITY AND DESCRIPTION REQUIRED BY THE CONTRACT.

2. The Machines met all of the requirements of Art. 35(1) CISG, that the goods be of the "quantity, quality and description required by the contract." Contrary to Claimant's assertion, the contract did not require machines able to pack salt (A), nor did it include any processing speed requirements (B).

##### A. THE CONTRACT DID NOT REQUIRE MACHINES ABLE TO PACK SALT.

3. Claimant neglected to include the ability to pack salt as a term of the contract and is now asking this Tribunal to read it in *ex post*. The plain language of the contract did not require Machines able to pack salt (a); nor did Claimant's subjective intent in this regard become a term of the contract (b). An objective interpretation of the contract does not require machines able to pack salt (c). In fact, the contract incorporated the industry usage of using special stainless steel machines to pack salt (d).

##### a. The plain language of the contract did not require machines able to pack salt.

4. Claimant submits that the contractual requirement that the Machines be able to pack "a wide range of products" *per se* includes salt [*Cl. Mem., para. 87*]. However, only those products specifically mentioned in the contract were *per se* included: ground coffee, flour, beans and rice [*Cl. Ex. 1*]. Any interpretation of the phrases "wide range of products" and "dry bulk commodities" that includes products other than the four specifically mentioned requires an examination of which products could have been included by implication or reasonable inference.

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<sup>1</sup> Respondent does not dispute that Claimant and Respondent concluded a contract consisting of an offer sent by Respondent on 3 July 2002 [*Cl. Ex. 2*] and an acceptance sent by Claimant on 12 July 2002 [*Cl. Ex. 3*]. The offer incorporated the terms of Claimant's inquiry of 24 June 2002 [*Cl. Ex. 1*]. Nor does Respondent dispute that the CISG applied to the contract.

5. Claimant seems to be confusing “wide range of products” with “all products.” However, the two are not equivalent. A wide range could not reasonably be interpreted to include products that are highly delicate, such as saffron, nor those that are corrosive, such as potassium chloride, ethyl chloride or sodium chloride (*i.e.* salt). Respondent submits that the phrase “wide range of products” is naturally confined to the class of products for which the Model 14 Machines were obviously appropriate, according to reasonable industry standards. On this reading, products which would give rise to reasonable doubt as to whether they could be safely or effectively packed were not included within the catch-all phrase and instead required express agreement.

6. Moreover, if the Tribunal finds that the phrase “wide range of products” is ambiguous, it should be interpreted according to Respondent’s understanding. Under Art. 8 CISG and the UNIDROIT Principles—a conceptual framework within which the CISG operates [*Bonell, UNIDROIT Principles, I(b), III(a)-(b); Farnsworth, 5*—ambiguous terms are to be interpreted against the party who supplied them [*Art. 4.6 UNIDROIT Principles; see also Reitz in Flechtner, 250*]. Since Claimant supplied the phrase “a wide range,” it had the responsibility of making sure Respondent’s understanding was consistent with its own. If Claimant’s intention was that the Machines be able to pack *all* dry bulk commodities, it should have so specified.

**b. Claimant’s subjective intent that the Machines be able to pack salt did not become a term of the contract.**

7. Under Art. 8(1) CISG, interpretation according to one party’s intent is appropriate when “the other party knew or could not have been unaware what that intent was” [*see also Art. 4.2(1) UNIDROIT Principles; Bernstein/Lookofsky, 28; Enderlein/Maskow, 62-63; Eörsi in Galston/Smit, 2-18*]. Claimant has presented no evidence that, at the time the contract was formed, Respondent knew or could have known that Claimant intended to purchase machines appropriate for packing salt.

8. Claimant submits the 23 July conversation as evidence of Respondent’s awareness of Claimant’s intent. Respondent agrees that the 23 July conversation shows Claimant’s intent [*Art. 8(3) CISG (“all relevant circumstances,” including subsequent conduct of the parties, may be used to interpret the contract); see also Art. 4.3 UNIDROIT Principles*]. However, it does not show that Respondent was aware or could not have been unaware of that intent. The fleeting mention of salt in the 23 July conversation was neither substantial nor specific enough to inform Respondent that Claimant intended to use the Machines to pack salt. At the time, the parties were discussing shipment of the Machines. As far as Respondent was concerned, the technical specifications of the Machines were no longer an issue. In

fact, when salt was specifically mentioned, it was in the context not of the parties' contract, but of Claimant's contract with a third party. Since the parties were discussing Claimant's contract with A2Z, Respondent had no reason to think Claimant's statements were a clarification or modification<sup>2</sup> of the parties' contract.

**c. A reasonable person would not have interpreted the contract to require machines able to pack salt.**

9. If Art. 8(1) CISG is not applicable, Art. 8(2) CISG governs the interpretation of the contract: "statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances" [*see also Arts. 4.1(2), 4.2(2) UNIDROIT Principles; Bernstein/Lookofsky, 28; Enderlein/Maskow, 65-66*]. A reasonable person of Respondent's kind would not have interpreted the contract to require machines able to pack salt. The contract itself did not mention salt, nor did Claimant ever specifically mention salt until the 23 July conversation. Furthermore, widely known industry usages indicate that special machines are required to pack salt [*see paras. 12-16 below*].
10. The mention of salt during the 23 July conversation was in the context of the type of small talk that typically occurs between representatives of different companies [*Cl. Ex. 6 ("They have everything in mind from large beans to salt to fine powder and we are going to have to do it all")*], which is meant to be exactly that—small talk. Such "small talk," read from the perspective of a reasonable person of Respondent's kind, was not meant to unsettle the entire contract and shift the burden of clarifying or changing its terms from Claimant to Respondent. At this point in the parties' dealings, the contract was finalized and clear. The Machines were set for delivery and only shipping arrangements were being discussed. A reasonable person in Respondent's position might not even have heard the comment, or if it had, would have no reason to deduce from it that Claimant would be using the Model 14 Machines to pack salt. For all Respondent knew, Claimant had other auger-feeders made of stainless steel. In fact, the proposition that Claimant would actually put salt into the Model 14 Machines was so incredible that it was not unreasonable for Respondent to have not considered it. While a highly assiduous person might have realized Claimant's small talk signaled its intent to put salt in the Machines, it was not unreasonable that Respondent missed it, only unfortunate.
11. At worst, a failure to respond to Claimant's passing mention of salt was carelessness. There is no evidence that Respondent acted unreasonably or in bad faith, so it should not be held responsible

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<sup>2</sup> Claimant does not allege nor is there any evidence that the contract was modified by the 23 July conversation.

for the fact that Claimant negligently purchased unsuitable Machines. If the Tribunal were to find on the basis of the 23 July conversation that the Machines should have been able to pack salt, it would hold Respondent financially responsible for all of Claimant's losses resulting from its misuse of the Machines. Respondent should not be made to insure Claimant's negligence; that would be an extreme punishment for Respondent's innocent lack of attention.

**d. The contract incorporated the industry usage of packing salt with stainless steel machines.**

i. *Usages standard to the packing industry apply to the contract.*

12. Under Art. 9(2) CISG, parties "are considered, unless otherwise agreed, to have impliedly made applicable to their contract . . . a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned" [see also *Arts. 1.8(2), 4.3 UNIDROIT Principles*]. Claimant has not presented evidence of an agreement between the parties concerning trade usages; thus, "it is the law itself which confers a binding force on the usage," creating the fiction of an implied agreement [Bonell in Bianca/Bonell, 108; Bianca in Bianca/Bonell, 272; Schlechtriem, *Uniform Sales Law*, 76; Enderlein/Maskow, 68]. Therefore, usages standard to the packing industry became terms of the contract without any need for explicit mention of them.

ii. *Use of special machines to pack salt is an industry usage.*

13. To be incorporated into contracts, Art. 9(2) CISG requires usages to meet certain objective criteria [Bonell in Bianca/Bonell, 108-109]. In the absence of applicable domestic law,<sup>3</sup> the applicability of a particular usage is determined by whether it was "widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned;" if so, "it may be held that the parties 'ought to have known' of the usage" [*Sec. Comm. to Art. [9], para. 4; see also Bonell in Bianca/Bonell, 111; Schlechtriem, Uniform Sales Law, 76*]. Respondent submits that the use of special machines to pack salt is a usage that is widely known to, and regularly observed by, members of the packing industry.

14. The fact that Respondent offers an entire separate line of machines made for packing salt is evidence of this trade usage. These stainless steel machines are significantly more expensive. In the absence of knowledge that more expensive machines are necessary to pack salt and other corrosive

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<sup>3</sup> Usages are typically determined as a matter of domestic law [Schlechtriem, 77, 80; OGH, 21 March 2000 (*Austr.*); OGH, 15 October 1998 (*Austr.*)].

products, no one would spend the extra money to purchase them. Thus, knowledge of the usage that special machines are required to pack salt must be widespread in the industry.

15. Moreover, this is the first time Respondent has been involved in a legal action [*Clarification 15*]. Respondent has been in business for over 30 years. In order to have gone so long without being subject to legal action, it must have provided products that were, on the whole, satisfactory to its customers. Indeed, these were the last Model 14 Machines Respondent had in stock, meaning that the rest of this line was sold [*Clarification 33*]. Despite the fact that the Model 14 line did not sell as well as Respondent had hoped [*Clarification 32*], it remains that no previous legal action resulted from the sale of the Model 14 Machines. If other members of the packing industry thought it normal to use the Machines to pack salt, they presumably would have done so, with similar results as Claimant.

iii. *Claimant ought to have known of such a usage.*

16. Although laymen might not be aware that special machines are required to pack salt, this fact is widely known to industry members like Claimant [*Cl. Ex. 7*]. Even if Claimant was unaware of this usage, Art. 9(2) applies because Claimant ought to have been aware: “a newcomer to an international market ... must familiarize himself with such usages, because they also apply to him” [*Schlechtriem, Uniform Sales Law, 79; see also Enderlein/Maskow, 69-70*]. The use of special machines to pack salt is just such a usage; thus, it was Claimant’s responsibility to inform itself of it.

**B. THE CONTRACT DID NOT REQUIRE ANY PARTICULAR PROCESSING SPEED.**

17. The fact that the Machines packed certain types of products at below industry average speed did not constitute a breach of the contract. While the contract required machines able to pack a “wide range of products,” it did not on its face specify a particular processing speed (a). Claimant’s intent that the Machines pack goods at industry average speed did not become a term of the contract because Respondent was not and could not have been aware of this intent (b); nor would a reasonable person in the parties’ position have been aware of Claimant’s intent (c).

**a. The contract requirements did not explicitly include processing speed.**

18. Claimant emphasized three particular requirements in the contract with Respondent: that the Machines be able to pack a “wide range of products,” that they be delivered promptly, and that they be of an acceptable price [*Cl. Ex. 1*]. Nowhere in its offer did Claimant indicate any technical specifications, so the only explicit requirements of the contract were the three stated above.

**b. Claimant's intent that the Machines perform at the industry average speed did not become a term of the contract.**

19. Respondent was not and could not have been aware that Claimant intended the contract to require Machines able to perform at industry average speed. At no point during or subsequent to the negotiation of this contract did Claimant ever mention speed. In fact, its first mention of this “problem” was in its Notice of Arbitration [*para. 8 above*]. Claimant placed specific importance on other factors, such as immediate availability and price, but never discussed speed.
20. Furthermore, Claimant asserts that it was unfamiliar with the packing industry. If so, it could not have formed any particular expectations with regard to the Machines' speed. If Claimant did not know that special machines were needed to pack salt, a widely known industry usage [*see paras. 13-15 above*], it is hard to imagine how it could have known that the industry standard packing speed was 180 bags per minute. In fact, it had no expectations with regard to processing speed and thus no speed specification became a term of the contract.

**c. A reasonable person would not have been aware of Claimant's intent that the Machines perform at a particular speed.**

21. Claimant alleges that its request for six machines implied a requirement that these machines work at industry average speed [*Cl. Mem., para. 109*], but this is not the case. The contract here was results-based; it required the packing of a “wide range of products.” While processing speed is one component of the Machines' total output, it is not the only one. For example, total output also takes into account a machine's breakdown rate and maintenance schedule. So while Claimant might have needed six functional machines to service its contract with A2Z, it did not necessarily need six machines operating at a certain number of bags per minute.
22. Contrary to Claimant's assertion, the fact that Respondent is a “premier manufacturer” of packing machines is not a warranty of any kind [*Cl. Mem., para. 111*]. Respondent's reputation is based on others' opinions of it, not on its own claims; therefore, a reasonable person would not understand this to be an implicit warranty by Respondent as to processing speed.

**II. THE MACHINES WERE FIT FOR THEIR ORDINARY PURPOSES.**

23. Under Art. 35(2)(a) CISG, in the absence of specific contractual requirements under Art. 35(1), goods must be “fit for the purpose for which goods of the same description would ordinarily be used” [*see Schwenzger in Schlechtriem, 278; Bernstein/Lookofsky, 59; Schlechtriem in Galston/Smit, 6-20*].

Contrary to Claimant's assertions, packing salt is not an ordinary purpose of the Machines (A). The Machines were fit for their ordinary purposes with respect to their processing speed (B).

**A. THE ORDINARY PURPOSES OF THE MACHINES DID NOT INCLUDE PACKING SALT.**

24. Art. 35(2)(a) CISG requires that goods be “fit for the purpose for which goods of the same description would ordinarily be used.” Auger-feeders are not ordinarily used to pack salt, as “the vast majority of firms that pack dry bulk products into retail sized packages do not pack salt” [*Clarification 27*]. In a situation like the one at hand, where “the goods are not fit for purposes for which they are occasionally, but not ordinarily, used, the seller is liable only if the restrictive conditions of Article 35(2)(b) [*see paras. 28-31 below*] are satisfied” [*Schlechtriem, Uniform Sales Law, 279; see also Enderlein/Maskow (“If the goods in question are only from time to time used for other purposes . . . the buyer has no rights if he has not indicated a specific use”)*]. Auger-feeders are occasionally used to pack salt; when they are, they must have a product path made entirely of stainless steel [*Expert’s Report*]. Since Claimant did not notify Respondent that it would pack salt with the Machines, Respondent provided machines that could do what ordinary auger-feeders do—pack a wide variety of non-corrosive goods. In fact, the existence of special, more expensive machines for packing salt is further evidence that packing salt is not an ordinary purpose of the Machines.

**B. THE MACHINES WERE FIT FOR THEIR ORDINARY PURPOSES WITH RESPECT TO SPEED.**

25. Art. 35(2)(a) CISG does not require that the Machines operate at industry average speed. It explicitly uses an instrumental approach, emphasizing the purpose for which the goods are to be used instead of ephemeral quality determinations, because “interpretation of the contract calls for finding the full meaning of the contract description in the light of the expectations that have developed for such sales” [*Honnold, 225; see also Sec. Comm. to Art. [35], para. 5; Schlechtriem, Uniform Sales Law, 278*]. In evaluating whether the Machines were in conformity with the contract under this Article, we must determine whether they were suited for the ordinary purpose of auger-feeders, *i.e.* packing a wide range of products, and not whether they met certain technical specifications. These Machines were appropriate for their purposes, and were therefore in conformity with the contract.
26. The CISG does not contain an express provision “imposing on the seller a duty to deliver goods of average quality” [*Bianca in Bianca/Bonell, 280; see also Schlechtriem, Uniform Sales Law, 279; Enderlein/Maskow, 142 (“The question of whether insignificant differences in quality have to be considered remains*

*open*”)]. This absence reflects inconsistency across legal systems in defining quality,<sup>4</sup> and the result is the current formulation that emphasizes the appropriateness of the goods for their ordinary use. The consensus is that “[g]oods are unfit for their ordinary use when lack of proper characteristics or defects impede their material use or yield abnormally deficient results or take unusual costs” [*Bianca in Bianca/Bonell*, 274; see also *Enderlein/Maskow*, 144 (“The seller must on the whole deliver goods of average fitness . . . [which] does not necessarily mean that the goods have to be of average quality”); *Arbitral Award of 15 October 2002 (Neth.)* (determining a “reasonable quality standard” was most appropriate for judging conformity)]. The Machines met these requirements. The below-average speed for packing one out of three types of goods was not significant enough to prevent Claimant from getting the results it expected.

27. A determination of conformity under Art. 35(2)(a) CISG also must take into account the price of goods and other surrounding circumstances [*Bianca in Bianca/Bonell*, 281 (“the quality can . . . not [be] conspicuously below the standard reasonably expected according to the price and other circumstances”); see also *SBGH, 22 December 2000 (Switz.)* (seller could reasonably expect buyer to know a 12-year-old machine would not necessarily meet the same technical requirements as a new machine of the same kind); *Enderlein/Maskow*, 144]. Respondent clearly informed Claimant that the Machines were a discontinued model, available at a discount and on short notice. For coarse and medium products, the Machines worked at or nearly at industry standard speed; for fine products, the Machines were only 26% slower than the industry average. Such variation from the average is accounted for in the purchase price and is not conspicuously below what Claimant could have reasonably expected.

### **III. THE MACHINES WERE FIT FOR THE PARTICULAR PURPOSE OF PACKING SALT.**

28. Under Art. 35(2)(b) CISG, goods must be fit for all particular purposes made known to the seller “at the time of the conclusion of the contract.” Claimant does not allege that the ability to pack at industry standard speed was a particular purpose of the contract. It submits only that the packing of salt was a particular purpose [*Cl. Mem.*, para. 116]. The Machines were fit for the only particular purpose under this agreement, the ability to pack a “wide range of products.” Packing salt was not a particular purpose under the contract because Respondent was not informed of this particular purpose at the time of the contract’s conclusion (A), and because Respondent did not create any expectations with respect to salt (B).

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<sup>4</sup> While some systems require that goods be of “fair average quality,” others require only merchantability, which demands that goods be appropriate for resale, but “does not mean of good, or fair, or average quality” [*Bianca in Bianca/Bonell*, 281].

**A. CLAIMANT DID NOT IDENTIFY PACKING SALT AS A PARTICULAR PURPOSE AT THE TIME OF THE CONTRACT'S CONCLUSION.**

29. Under Art. 35(2)(b) CISG, goods must be “fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract.” Packing salt was not a particular purpose because it was not made known either explicitly or impliedly at the time of the contract’s conclusion [see *Sec. Comm. to Art. [35], para. 8; Schlechtriem, Uniform Sales Law, 282; Enderlein/Maskow, 145*]. Claimant has the burden of proving that Respondent knew at the time of the conclusion of the contract that the Claimant wanted the Machines to be able to pack salt [*Slechtriem, Uniform Sales Law, 289; Arbitral Award of 15 October 2002 (Neth.)*]. However, the first and only time Claimant mentioned salt was during the 23 July conversation, long after the conclusion of the contract. Therefore, the ability to pack salt was not required of the Machines.

30. Claimant’s attempt to dispense with the requirement that particular purposes be made known at the time of the conclusion of the contract must fail. Claimant states that “later disclosure of the purpose should be respected as required under general principles of the CISG . . . as well as the good faith principle” [*Cl. Mem., para. 118*]. Respondent does not contest that there are situations, such as gap filling, in which interpretation of the CISG according to general principles and the good faith principle is appropriate [see *Art. 7(2) CISG; Farnsworth, Principles, 5; Bernstein/Lookofsky, 23-24; Eörsi in Galston/Smit, 2-5, 2-10-12; Enderlein/Maskow, 57-59; Bonell in Bianca/Bonell, 72-80*]. However, the view that the general principles of the CISG could be used to contradict what it explicitly states is simply incorrect. When the text of the CISG is clear, as it is here, it must be followed.

**B. RESPONDENT DID NOT CREATE AN EXPECTATION THAT THE MACHINES WOULD BE ABLE TO PACK SALT.**

31. There is no evidence that Respondent did anything to indicate the Machines would be able to pack salt. In fact, the crux of Claimant’s case is that Respondent was silent with respect to this issue. Respondent would have no reason to sell Claimant a machine it knew would be inappropriate for the latter’s purposes; in fact, it would have been in Respondent’s interest to sell Claimant the more expensive stainless steel machines. Any expectations that Claimant had with regard to the capabilities of the Machines were the result of its own carelessness, not Respondent’s actions.

**IV. RESPONDENT WAS UNDER NO OBLIGATION TO INFORM CLAIMANT THAT THE MACHINES WERE UNABLE TO PACK SALT.**

32. Claimant alleges that Respondent was under a freestanding “duty to warn” it against putting salt in the Machines [*Cl. Mem., para. 122*]. No such duty exists. In fact, another arbitral tribunal specifically

denied its existence [OLG, 11 September 1998 (Ger.) (*seller had no duty to advise or warn of the inappropriateness of a standard product even if it had knowledge of what the buyer intended to do with that product*)]. All that the CISG requires is that, if the buyer indicates its reliance on the judgment and/or expertise of the seller, the seller should “advise the buyer” [Enderlein/Maskow, 146]. Here, Respondent had no reason to believe that Claimant was relying on it (A). Furthermore, the use of special machines to pack salt is the subject of an industry usage, and Respondent had no duty to inform Claimant of such a usage (B). Finally, it was Claimant, not Respondent, that was negligent in negotiating and executing the contract (C).

**A. RESPONDENT HAD REASON TO BELIEVE THAT CLAIMANT WAS AN EXPERIENCED MEMBER OF THE PACKING INDUSTRY.**

33. Respondent was not only unaware that Claimant intended to rely on Respondent’s expertise and judgment, but in fact had reason to believe Claimant was an experienced member of the packing industry [Clarification 10]. Claimant’s actions gave no indication that it was new to the industry. In fact, its inquiry letter indicated extensive knowledge of the workings of packing machinery.
34. In its inquiry letter, Claimant did not indicate the quantities of products it wished to pack, nor the rate at which it needed packing to be completed. It was more specific than that, giving the exact number of machines needed [Cl. Ex. 1], thus demonstrating its familiarity with the speed at which packing machines work. Indeed, Claimant later indicated that the Machines performed slower than it had expected [St. of Defense, para. 8]; had it been a newcomer to the industry, it could not have developed such an expectation. Furthermore, Claimant also clearly knew that the size of packages into which the products were to be packed and the fact that both coarse and fine products were to be used were significant [Cl. Ex. 1]; it thus demonstrated at least a reasonable familiarity with the way packing machines work and the variety of machines available.
35. Finally, Claimant could not have been unaware that Respondent believed it to be familiar with the industry. In its offer letter, Respondent states: “As you are also undoubtedly aware, multi-head weighers are considerably more expensive than are auger-feeders” [Cl. Ex. 2]. This was a clear indication to Claimant that Respondent was operating under the assumption that the former was familiar with the packing industry. Claimant did nothing to alter this assumption. Since Respondent had no reason to believe Claimant was relying upon it, it had no obligation even to advise Claimant, let alone warn it against the Machines’ specific inappropriate uses.

**B. RESPONDENT HAD NO OBLIGATION TO INFORM CLAIMANT OF INDUSTRY USAGES.**

36. Even if Claimant had indicated that it was relying on Respondent's expertise, Respondent was entitled to assume that Claimant knew that specialized machinery is required to pack salt. As discussed [*see paras 12-16 above*], the fact that specialized machines are required to pack salt is the subject of an industry usage. Under Art. 9 CISG, usages are considered to be an implicit part of the contract unless the parties have agreed otherwise and newcomers to an industry are obliged to inform themselves of relevant usages.

**C. CLAIMANT WAS NEGLIGENT IN ITS NEGOTIATION AND EXECUTION OF THE CONTRACT.**

37. Even if the Tribunal finds that Respondent ought to have specifically warned Claimant that the Machines were unable to pack salt, such an oversight pales in comparison to the negligent manner in which Claimant entered into the contract. Had Claimant made even the most basic preparations prior to purchasing the Machines, it would have known that the Machines were unable to pack salt. Not only is the existence of special machines to pack corrosive materials, such as salt, well known in the industry, but also the fact that stainless steel machines were available for packing salt was clear from Respondent's literature and from its website [*Cl. Ex. 7*].

38. Furthermore, the instruction manual accompanying the Machines stated that they were not appropriate for use with "highly corrosive" products [*Clarification 25*]. Even if Claimant, due to its negligence, was not aware that salt is corrosive, it was Claimant's duty under Art. 38 CISG to examine the Machines to ensure that they were suitable for its purposes. In addition, Respondent gave explicit warning that the Machines were not appropriate for use with all products in its literature and in the Machines' instruction manual. Thus, even if Claimant had previously thought that the Machines could be used with any food product, it ought to have become aware that the Machines had limitations. Respondent should not be held responsible for Claimant's carelessness in not making even a cursory attempt to inform itself about the product it was purchasing.

**PART TWO: THE BREACH ALLEGED BY CLAIMANT WAS NOT FUNDAMENTAL.**

39. Under Art. 25 CISG, a breach is fundamental if it substantially deprives the injured party of what it was entitled to expect, *i.e.* if it causes the injured party a "substantial detriment." Respondent concedes that, if the contract required machines able to pack salt, then the detriment suffered by Claimant for any breach of that requirement was substantial, but not fundamental. Contrary to Claimant's assertions, fundamental breach should be interpreted narrowly and determined objectively (I). Claimant did not suffer substantial detriment as a result of the processing speed of

the Machines (II). The fact that Respondent did not cure is not relevant to a determination of whether the breach was fundamental (III). Respondent further submits that the Machines' inability to pack salt was not a fundamental breach because, even if Claimant did suffer substantial detriment, the extent of the detriment was not foreseeable (IV).

### **I. FUNDAMENTAL BREACH SHOULD BE INTERPRETED NARROWLY AND DETERMINED OBJECTIVELY.**

40. The purpose of the principle of fundamental breach in the CISG is “to allow avoidance” [*Will in Bianca/Bonell*, 211; *Enderlein/Maskow*, 112], and avoidance is an “extraordinary remedy” that “should not be available for trivial departures that may readily be redressed by damages” [*Honnold*, 327]. The drafters chose to include in the CISG “a stricter test” for fundamental breach than the one in previous international conventions [*Will in Bianca/Bonell*, 215]. In case of doubt, “it must be considered that conditions of such breach are not fulfilled” [15 September 2000 (*Switz*)].
41. Claimant's conception of substantial detriment focuses on violations of its own subjective expectations. However, under the CISG, substantial detriment is tied to what the injured party was entitled to expect as objectively determinable [*Will in Bianca/Bonell*, 206] from the contract interpreted under Art. 8 CISG [*Babiak*, 120; *Caemmerer/Schlechtriem*, Art. 25, para. 9]. The “line between substantial and insubstantial” detriment is defined not by “a party's inner feelings but instead tied to the terms of the existing contract” [*Will in Bianca/Bonell*, 215; see also *Enderlein/Maskow*, 113 (“expectations of the injured party have to be discernable from the contract”)].

### **II. CLAIMANT DID NOT SUFFER SUBSTANTIAL DETRIMENT AS A RESULT OF THE PROCESSING SPEED OF THE MACHINES.**

42. Claimant has the burden of proving that Respondent's alleged breach caused it substantial detriment [*Hellner in Volken/Sarčević*, 349]. For detriment to be substantial, it must either involve the breach of an important contractual term or have consequences so severe as to harm an important contractual interest [*Honnold*, 212; *Schlechtriem in Schlechtriem*, 176; *Will in Bianca/Bonell* 215; see also 15 September 2000 (*Switz*)]. Here, even if a particular processing speed was required, it was not an important term and had no severe consequences for Claimant.
43. In order for an obligation to be considered sufficiently important that a breach of it is fundamental, “[i]t is ... sufficient ... for the contract itself to stipulate that a particular obligation or method of performance is an essential term” [*Schlechtriem/Läser/Huber in Schlechtriem*, 175; see also *Eörsi*, 348; *Enderlein/Maskow*, 112, 114]. While an important term need not be explicitly stated in the

contract, Claimant never did or said anything to indicate that it regarded processing speed as important. Claimant's only argument as to why processing speed should be considered an "essential" term of the contract is that it had to fulfill its obligations to A2Z and that it emphasized the importance of prompt delivery, which it called "equivalent to an essential requirement of machine speed" [*Cl. Mem., para. 131*]. However, the fact that Claimant was under pressure to increase its capacity in order to fulfill its new contract proves only that Claimant had to start work soon, not that it had to complete the work at any particular pace. Had speed been of the essence, a reasonable person would expect Claimant to say so, or at least to inquire about the Machines' processing speed.

44. To show that the consequences of the Machines' processing speed amounted to substantial detriment, Claimant must demonstrate that the below-average speed of the Machines substantially harmed its ability to service the A2Z contract. There is no evidence that the processing speed of the Machines was so low as to "considerably impede ... the fitness for use of the goods" [*Enderlein/Maskow, 114*] or prevent Claimant from making "any reasonable use of the goods" [*OLG, 18 August 1994 (Ger.)*]. Furthermore, Claimant did not mention the processing speed of the Machines until its Notice of Arbitration [*see para. 19 above*], which suggests that it did not in fact suffer substantial detriment as a result of the Machines' processing speed and/or that it is attempting to buttress its claims regarding salt corrosion with allegations of additional nonconformities.

### **III. ANY FAILURE BY RESPONDENT TO CURE ITS ALLEGED BREACH OF THE CONTRACT IS IRRELEVANT.**

#### **A. WHETHER THE SELLER OFFERS TO CURE SHOULD NOT AFFECT A DETERMINATION OF SUBSTANTIAL DETRIMENT.**

45. Claimant submits that Respondent's "failure to offer to remedy the nonconformity is indicative of a fundamental breach" [*Cl. Mem., para. 137*]. In essence, Claimant argues that two separate actions by Respondent—breach of the contract and failure to cure—can be tacked together to constitute a fundamental breach. However, this argument is misguided; it is both unjust and logically untenable to tack a refusal to cure onto a simple breach in order to make it into a fundamental breach.
46. There is no evidence that the CISG drafters intended to allow a failure to cure to be tacked onto a simple breach to create a fundamental breach. Art. 25 contains a complete and clear test for fundamental breach that mentions neither cure nor avoidance, which come into effect only after a

fundamental breach has occurred and are dealt with in separate articles.<sup>5</sup> If “tacking” were tenable, “it would render meaningless the buyer’s right to require substitute goods under Article 46(2)” [*Will in Bianca/Bonell*, 357]. Such a restriction of buyers’ rights was not contemplated by the drafters, or else they presumably would not have dedicated Art. 46 to the buyer’s right to require substitute goods [*Will in Bianca/Bonell*, 357; *see also Sec. Comm. to Art. 25*]. Finally, tacking “contribute[s] to the further weakening of the notion of fundamental breach” because the element to be taken into consideration is too vague to be useful: “Is it a rightful offer received which suddenly converts an otherwise fundamental breach into a non-fundamental one? Is it reliable news of an offer which was dispatched? Is it a mere expectancy?” [*Will in Bianca/Bonell*, 357]. Such lack of precision would only unduly burden buyers attempting to determine whether a fundamental breach has occurred.

**B. CLAIMANT DID NOT GIVE RESPONDENT AN OPPORTUNITY TO CURE.**

47. Even if the Tribunal accepts Claimant’s argument that a refusal to cure can convert a simple breach into a fundamental one, it does not apply in the present case. The absence of an offer to cure is relevant to a determination of fundamental breach only where the lack of a cure involves undue prejudice to or burden on the injured party [*Enderlein/Maskow*, 186]. Here, only one day passed between Claimant’s notification to Respondent of the damage to the Machines and receipt of its letter attempting to avoid the contract [*Cl. Ex. 6*], so there was no chance for Respondent to have caused Claimant any additional prejudice or burden. Claimant must give Respondent a reasonable opportunity to cure an alleged breach before claiming that Respondent’s failure to cure caused Claimant additional detriment [*HG*, 5 November 2002 (*Switz.*)].

**IV. EVEN IF CLAIMANT DID SUFFER A SUBSTANTIAL DETRIMENT, IT WAS NOT REASONABLY FORESEEABLE.**

48. Art. 25 CISG provides that a breach of contract resulting in substantial detriment is not fundamental if the party in breach did not foresee, and a reasonable person of the same kind and in the same circumstances would not have foreseen, that substantial detriment would result from the breach. The purpose of this requirement is to limit liability for unexpectedly severe consequences of breaches of contract [*Schlechtriem/Leser/Huber in Schlechtriem*, 178; *Enderlein/Maskow*, 115]. For the purposes of foreseeability, “of the same kind” refers to a corporate person “of similar scope in the same trade or economic sector [*Schlechtriem in Schlechtriem*, 180], and “in the same circumstances”

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<sup>5</sup> Arts. 48, 49, 64, 71-73 CISG.

refers to the totality of “conditions on world and regional markets, legislation, politics, and climate, ... prior contracts and dealings and ... other factors” [*Will in Bianca/Bonell*, 219].

49. Foreseeability should be determined by taking into account knowledge the Respondent acquired before beginning preparation for performance (A). Claimant has not satisfied its burden of proof to show Respondent foresaw, or should have foreseen, that substantial detriment would result to Claimant as a result of the Machines’ processing speed and their inability to pack salt (B). Even if the burden of proof is placed on Respondent, it did not foresee and reasonably should not have foreseen any substantial detriment to Claimant (C).

**A. FORESEEABILITY SHOULD BE DETERMINED TAKING INTO ACCOUNT THE TIME UNTIL PREPARATIONS FOR PERFORMANCE BEGAN.**

50. It is disputed whether foreseeability should be measured using knowledge the breaching party had at the time of the conclusion of the contract [*Vékás*, 162] or at the time of the breach [*Eisenberg*, 599]. The drafters of Art. 25 CISG left the time for measuring foreseeability vague in order to allow individual tribunals to decide [*Honnold*, 208; *Sec. Comm. to Art. 23, para. 5*]. Respondent submits that a prudent approach consistent with the spirit of the CISG is to start from foreseeability at the point of the formation of the contract and to “allow the taking into account of subsequent knowledge ... up to the time when preparations in view of performance actually did start or should have started” [*Will in Bianca/Bonell*, 221; *see also Enderlein/Maskow*, 75, 116]. It would be improper to take into account knowledge a party in breach acquired subsequent to the beginning of preparations for performance: “by subsequently sending information ... the promisee cannot pave the way to avoiding the contract should a breach occur which would not have been fundamental in the absence of such information” [*Schlechtriem/Leser/Huber in Schlechtriem*, 181].

**B. THE BURDEN IS ON CLAIMANT TO PROVE THAT RESPONDENT DID FORESEE OR SHOULD HAVE FORESEEN THAT SUBSTANTIAL DETRIMENT WOULD RESULT TO CLAIMANT.**

51. Respondent submits that it is more consistent with the notion of fundamental breach to place the burden of proof for foreseeability on the party declaring avoidance. Before the fundamentality of a breach can be assessed, the expectations of the parties as embodied in the contract must be determined: “Only if the person relying on circumstances which show the importance of the obligation breached has proved their existence, can it be asked which party has the burden of proving exempting circumstances” [*Schlechtriem/Leser/Huber in Schlechtriem*, 177]. If the essential importance of an obligation is clear from the contract, then substantial detriment resulting from a breach is foreseeable; however, “if the parties have discussed the special importance of a particular

obligation ... but not characterized [it] clearly in the contract, *and that can be proved by the party affected by the breach*, then the result is the same” [*Schlechtriem/Leser/Huber in Schlechtriem*, 178 (*emphasis added*); *see also Honnold*, 213]. Here, the parties’ obligations under the contract are substantially in doubt. Claimant has the burden of proving the existence and nature of those obligations.

**C. SUBSTANTIAL DETRIMENT TO CLAIMANT WAS NOT FORESEEABLE.**

52. Even if it bears the burden of proof, Respondent can demonstrate that substantial detriment was not foreseeable. In order successfully to invoke unforeseeability, a party in breach must show both that it did not anticipate the substantial detriment caused and that no reasonable person in its place would have done so [*Art. 25 CISG; Will in Bianca/Bonell*, 216]. Respondent did not foresee that substantial detriment would result to Claimant (a), nor would a reasonable person in Respondent’s position have foreseen such substantial detriment (b).

**a. Respondent did not foresee that substantial detriment would result to Claimant.**

53. First, Respondent had no way of knowing that processing speed was important to Claimant, and thus it did not foresee any detriment resulting from the processing speed of the Machines. Second, even if the terms of the original contract were sufficiently broad as to include salt, Respondent did not foresee that substantial detriment would result to Claimant from Respondent’s alleged breach of the contract. If Respondent had known the Machines would be destroyed, it would have had no incentive to proceed with the sale. Furthermore, the 23 July conversation does not demonstrate Respondent’s actual foreknowledge of substantial detriment because that conversation did not give Respondent notice that Claimant would use the Machines to pack salt [*see para. 10 above*].

**b. A reasonable person in Respondent’s position would not have foreseen that substantial detriment would result to Claimant.**

54. A reasonable person in Respondent’s position would not have foreseen that substantial detriment to Claimant would result from the processing speed of the Machines, nor from the inability of the Machines to pack salt. Unforeseeability can only be considered within the context of the breaching party’s knowledge of relevant circumstances. That knowledge “may have been deficient [because] the aggrieved party ... omitted to communicate his expectations” [*Will in Bianca/Bonell*, 217]. Claimant never placed any particular importance on—or even mentioned—the processing speed of the Machines [*see para. 18-22 above*]. Therefore, Respondent cannot have foreseen that the Machines’ speed might cause substantial detriment to Claimant.

55. Even if the Tribunal finds that the contract required machines able to pack salt, a reasonable person in Respondent's position would not have foreseen substantial detriment. A reasonable party, knowing that the Machines were unable to pack salt and that Claimant intended to use them to pack a limited amount of salt, in combination with other products, would or course foresee some damage to the Machines. However, the Machines were not merely damaged; the substantial detriment resulted because they were corroded past the point of repair [*Clarification 29*]. This went beyond the level of detriment foreseeable by Respondent.
56. First, a reasonable person would not have foreseen the scope of the damage. In its inquiry letter, Claimant listed four products as indicative of what it intended to pack: ground coffee, flour, beans and rice [*Cl. Ex. 1*]. A reasonable observer would not have inferred from this list that salt would constitute a major part of Claimant's packing operations; at best salt was fifth most significant in Claimant's list of representative products. Indeed, when Claimant procured replacement machines from Oceanic Machinery, GmbH, it bought only two and not four stainless steel auger-feeders. Given this context, a reasonable person may have expected some damage, but would not have foreseen damage to four, or two-thirds, of the Machines.
57. Second, a reasonable person would not have foreseen the severity of the damage—that all four Machines would be completely destroyed by salt corrosion. Corrosion is not an instantaneous process; it occurs gradually [*Clarification 28*]. Any prudent person would have noticed before 21 September that the Machines were becoming corroded and would have stopped production before they were completely destroyed. Indeed, Claimant had plenty of opportunity to notice earlier in September that the Machines were becoming corroded, since it cleaned the Machines daily and whenever it changed products [*Clarification 31*]. At a minimum, a reasonably prudent person would have asked the seller or some expert as to the possible causes of the corrosion.
58. If Claimant had ceased putting salt into the Machines some time before 21 September, or had restricted the packing of salt to fewer machines (as it is doing now with the auger-feeders it purchased from Oceanic Machinery), the corrosion would not have been as extensive and/or the Machines may have been repairable by replacing the corroded parts [*Clarification 29*]. Indeed, the real cause of the detriment Claimant suffered is the combination of two faults: first, Claimant persisted with using four Machines to pack salt; second, it did so right to the point at which all four were unusable. A reasonably competent operator would have either managed to restrict the damage to fewer Machines or arranged to cure the damage before it rendered the four Machines useless.

59. In other words, the nonconformity could have been cured before substantial detriment occurred. However, Claimant acted recklessly, failing to address the problem until the corrosion advanced beyond repair. Such recklessness constitutes a cause of the substantial detriment independent of any nonconformity, and was therefore not reasonably foreseeable.

**PART THREE: THE 19 OCTOBER LETTER WAS NOT A VALID DECLARATION OF AVOIDANCE.**

**I. THE 19 OCTOBER LETTER DID NOT CONSTITUTE SUFFICIENT NOTICE TO RESPONDENT OF CLAIMANT'S INTENT TO AVOID THE CONTRACT.**

60. Under Art. 26 CISG, “[a]voidance must always be brought about by a declaration” [*Schlechtriem/Leser/Huber in Schlechtriem, 176*]. While there is no requirement that a declaration of avoidance follow any particular form [*Schwenzer/Huber in Schlechtriem, 425; OGH, 5 July 2001 (Austr.)*], it “must satisfy a high standard of clarity and precision ... as is the case generally for unilateral declarations” [*Schlechtriem/Leser/Huber in Schlechtriem, 176*]. The clarity of a declaration of avoidance is to be determined objectively according to the understanding of a reasonable person [*ICC Case No. 8128*].

61. Claimant’s declaration was not clear. In fact, Claimant’s submission that its declaration was “far more consistent with the termination of the contract than with its continuation” [*Cl. Mem., para 147*] itself constitutes an admission that the 19 October letter was not clear. Respondent submits that this ambiguity is fatal. A declaration of avoidance must be more than merely consistent with termination of a contract; it must clearly communicate the sender’s desire to avoid.

62. Specifically, Claimant’s 19 October letter can fairly be read as an invitation to cure by provision of substitute goods. “If the buyer returns the goods with a notice of defects and declares that ‘the goods are at the seller’s disposal’ it is not wholly clear what his wishes are: avoidance of the contract or delivery of substitute goods. In such a case, avoidance of the contract should be assumed only if delivery of conforming substitute goods is impossible or it is clear that the buyer is not interested in delivery of such goods” [*Huber/Schwenzer in Schlechtriem, 425; 5 November 2002 (Switz.)*]. Here, all Claimant stated was, in effect, “The machines broke down. We do not want them any more and will have to buy other machines.” Claimant did not make clear that it was uninterested in any offer to cure. Thus, the 19 October letter was sufficient to suggest to Respondent that Claimant might avoid the contract in the future, but not sufficient to constitute an avoidance by itself.

## II. CLAIMANT WAS PRECLUDED FROM DECLARING AVOIDANCE.

63. Even if the 19 October letter did give sufficient notice of Claimant's intent to avoid the contract, Claimant was precluded from declaring avoidance because its notice of avoidance was not timely (A), it was unable to make restitution of the goods substantially in the condition in which it received them (B), and the 19 October letter did not attempt to accommodate Respondent's right to cure any breach it may have committed (C).

### A. THE UNTIMELINESS OF THE 19 OCTOBER LETTER PRECLUDED CLAIMANT FROM DECLARING AVOIDANCE.

64. Avoidance must be made within a "reasonable time ... after [the injured party] knew or ought to have known of the breach" [*Art. 49(2)(b) CISG*]. If the buyer does not avoid in a timely manner, "[h]e will lose his right to reject the goods and to declare the contract avoided" [*Will in Bianca/Bonell, 364; see also Enderlein/Maskow, 193; 10 November 1999 (Den.)*]. Furthermore, the burden is on the buyer to prove that notice was given in a reasonable time [*27 April 1995 (Switz.)*]. What length of time is reasonable is determined by a variety of circumstances [*Honnold, 331; Will in Bianca/Bonell, 364*], but it "more or less means *immediately*" [*Enderlein/Maskow, 193 (emphasis in original)*] and is generally capped at around one month [*see e.g. BV BA G-2 v. AS C.B. (Bel.) ("one month"); 12 April 2002 (Fin.) ("about one month"); OLG, 20 April 1994 (Ger.) (two months unreasonable); OLG, 1 February 1995 (Ger.) (five week delay reasonable only because buyer had been making concerted efforts to repair the goods)*].

65. It is difficult to pinpoint a time at which Claimant actually knew of the alleged nonconformity of the goods, but pinpoint accuracy is not necessary. Buyers are obliged by Art. 38 CISG to "examine the goods, or cause them to be examined, within as short a period as is practicable in the circumstances." For the purposes of timeliness, knowledge of nonconformity is deemed to exist "at the time when an examination of the goods under Art. 38 should have been performed" [*Huber/Schwenzer in Schlechtriem, 429*]. If a nonconformity can be discovered by examination, "'ought to have known' must be interpreted in the light of the time allotted for examination and will therefore come close to 'as short a period as is practicable in the circumstances' (Article 38)" [*Will in Bianca/Bonell, 365*].

66. Claimant took delivery of the goods on 21 August 2002 [*N. of Arb., para. 8*], and should have examined the goods—including their instruction manual—directly thereafter. Even a basic examination would have informed Claimant of the Machines' processing speed. Since Claimant's

letter declaring avoidance is dated 19 October, nearly two months after it ought to have known of the Machines' processing speed, Claimant is precluded from avoiding the contract on those grounds.

67. Similarly, Claimant is precluded from avoiding the contract based on the Machines' inability to pack salt. As discussed [*see para. 57 above*], the corrosion was a gradual process, so Claimant should have known of it before late September, when the Machines became so corroded as to be unusable. Thus, more than a month passed between the time Claimant ought to have known of the nonconformity and the time it notified Respondent of its intent to avoid.

**B. CLAIMANT'S INABILITY TO MAKE RESTITUTION PRECLUDED IT FROM DECLARING AVOIDANCE.**

68. The CISG prohibits a buyer from avoiding a contract when it cannot return the goods to the seller "substantially in the condition" in which it received them [*Art. 82(1) CISG; see also Schlechtriem in Schlechtriem, 190; Enderlein/Maskow, 190*]. Scholars differ on what constitutes "substantially in the condition," but here there is no doubt that the Machines do not meet that criterion, as they are now useless for packing food products [*N. of Arb., para. 8*] and cannot be repaired [*Clarification 39*].

69. While it is true that Art. 82(2) CISG contains exceptions to Art. 82(1), Claimant cannot avail itself of any of them. The only relevant exception is that, "if the impossibility ... of making restitution of the goods substantially in the condition in which the buyer received them is not due to his act or omission," then the buyer is not precluded from avoiding. Here, Claimant's own act caused the Machines to be seriously damaged. Regardless of whether the contract required machines able to pack salt, it was by Claimant's act that salt was introduced into the Machines and thus by Claimant's act that it was rendered unable to make restitution of the Machines. Claimant has not refuted this. Furthermore, if Claimant had exercised caution and stopped packing salt in the four Machines even as they became more and more corroded, it might have been able to make restitution of the Machines substantially in the condition in which it received them.

**C. RESPONDENT'S RIGHT TO CURE PRECLUDED CLAIMANT FROM DECLARING AVOIDANCE.**

70. Art. 48(1) CISG gives the seller the right, even after the date of delivery, to cure a breach, so long as that cure is without unreasonable delay or inconvenience to the buyer [*AG, 23 June 1995 (Ger.)*]. "[T]he right to cure, as long as it exists, bars the buyer from exercising his remedies" [*Will in Bianca/Bonell, 355*]. Thus, even if the 19 October letter was a valid declaration of avoidance, avoidance was precluded because the seller's right to cure is not entirely subservient to the buyer's

right to avoid (a) and because Claimant hastily avoided the contract without accommodating Respondent's right to cure (b).

**a. Respondent's right to cure is not entirely abrogated by Claimant's avoidance.**

71. Under Art. 48 CISG, the seller's right to cure is "subject to" the buyer's right to avoid. The exact import of the phrase "subject to" is disputed, but there is a general consensus that the right to cure is not entirely abrogated by the Claimant's right to avoid [*Honnold*, 312; *Enderlein/Maskow*, 185]. The history of Art. 48 shows the drafters' intent to protect the right to cure. The draft version allowed the seller to cure only "unless the buyer has avoided the contract" [*Will in Bianca/Bonell*, 348]. The "unless" clause was replaced with the current wording in order to reflect the "widespread agreement that ... the buyer's right to avoid ... should not nullify the seller's right to cure" [*Honnold*, 296].

72. While it is generally agreed that the buyer has an immediate right to declare avoidance if the fundamental breach is a failure to deliver the goods or to deliver them on time [*Huber/Schwenzler in Schlechtriem*, 407], in the case of breach due to nonconformity of the goods, the relationship between cure and avoidance "remains open to interpretation" [*Will in Bianca/Bonell*, 358, 362]. Respondent does not suggest that as long as a cure is possibly forthcoming, the buyer may not avoid; rather, it submits that the Tribunal should adopt an intermediate position like the one proposed by Will: "the buyer ... should ask himself 'Will the seller cure?' Only if, in the totality of his experience, the buyer concludes that the seller will not cure may he proceed with avoidance" [*Will in Bianca/Bonell*, 351].

**b. Claimant hastily avoided the contract without regard to Respondent's right to cure.**

73. Claimant never seriously contemplated whether Respondent might cure, as only one day passed between Claimant's notification to Respondent of the alleged nonconformity of the Machines and its attempt to avoid the contract [*Cl. Ex. 6*]. Where the buyer "hastily declares the contract avoided before the seller has an opportunity to cure the defect ... [t]he seller's right to cure should ... be protected" [*Honnold*, 296; see also *LG*, 24 September 1998 (Ger.) (*the buyer lost its right to avoid because it refused to consider the possibility that the seller would cure*)]. Here, Respondent's overly hasty attempt to avoid the contract abrogated Respondent's right to cure, invalidating the avoidance.

**PART FOUR: RESPONDENT'S REQUEST THAT CLAIMANT POST SECURITY FOR COSTS SHOULD BE GRANTED.**

74. The Tribunal's authority to grant security for costs derives from the SIAC Rules, which the parties contracted to adopt as the governing rules of arbitration [*N. of Arb.*, para. 13]. Where the arbitral

rules are silent, the tribunal may fill in gaps in those rules using the *lex arbitri* [*Born, 411-13, Rubins, 314-15*]; here, the UNCITRAL Model Law. Claimant erroneously contends that the CISG applies to the arbitration when both sets of rules are silent [*Cl. Mem., para. 20*]. The CISG is the substantive law of the contract [*Art. 1 CISG*]; it does not apply to procedural issues arising out of the arbitration agreement. In any event, § 27(3) SIAC Rules expressly permits the Tribunal to order either party to provide security for legal or other costs.

75. Respondent's request for security for costs should be granted, as Respondent has shown there is a genuine risk of non-collection. Claimant sets out a three-part test for Respondent to meet "[a]ccording to international practice" [*Cl. Mem., para. 22*], but no such universal test exists. Arbitral tribunals and national courts use widely differing criteria in deciding requests for security for costs [*see, e.g. Colbran, 233; Delany, 130; Rubins, 369-376*], although the most common approach has been to use factor-based discretion [*Parkinson & Co. v. Triplan Ltd. (USA); Bank Mellat v. Helliniki Techniki SA (UK), 303; Delany, 2; Len, generally*]. Ultimately, the Tribunal should balance the potential harm to Claimant against the injustice to Respondent if no security is ordered [*Altaras, 86*].

76. The balance tilts in Respondent's favor. Respondent is procedurally entitled to an award for costs under the SIAC Rules (I). The evidence justifies a genuine concern that Claimant may not have sufficient funds to pay Respondent's costs (II), and Respondent did not contractually or otherwise agree to bear the risks of Claimant's financial insolvency (III). Finally, Respondent has not engaged in evasive or bad faith behavior during these proceedings (IV).

#### **I. RESPONDENT IS PROCEDURALLY ENTITLED TO AN AWARD OF COSTS UNDER THE SIAC RULES.**

77. Section 30(3) SIAC Rules authorizes the Tribunal to order either party to pay the legal or other costs of the other party. Claimant argues that if the Tribunal grants Respondent security for its legal costs, this would go against the "costs follow the event" principle, which is intended to discourage frivolous claims [*Cl. Mem., paras. 40-41*]. Claimant's argument makes little sense. Respondent has not counterclaimed, so only Claimant could be making a frivolous claim. If Respondent's request for security is denied, it would hardly result in "no consequences for Respondent" [*Cl. Mem., para. 41*]. If Respondent wins and Claimant cannot pay any costs awarded, Respondent would lose the entire amount of its legal costs. Security for costs is thus the most appropriate way to preserve the advantages of the costs following the event rule and to protect Respondent against a frivolous claim.

## II. CLAIMANT'S FINANCIAL SITUATION RAISES CONCERNS ABOUT ITS ABILITY TO COVER RESPONDENT'S LEGAL COSTS.

### A. CLAIMANT'S FINANCIAL CONDITION JUSTIFIES AN AWARD OF SECURITY FOR COSTS.

78. Because the payment of a substantial sum of money is at the root of security for costs orders, the opposing party's financial health is a major factor to consider when contemplating a security request [*Oilex A.G. v. Mitsui & Co. (USA)* (ordering security because "plaintiff has no assets or is out of business"); see also *Atlanta Shipping Corp. v. Chemical Bank (USA)*; *K/S A/S Havbulk I v. Korea Shipbuilding and Eng'g Corp. (UK)*; *Frontier Int'l Shipping Corp. v. Tavros (Can.)*]. Orders for security are the standard method of protecting a party against the other's potential inability to pay costs [*Continental Shelf Case (ICJ)*]; see also *Bernstein, 98*; *Rubins, 310*].

79. Claimants who take advantage of the international arbitral system should comply with tribunals' decisions on costs, win or lose. The system is undermined if Claimant can benefit from it but can escape liability if its claim does not succeed [*Kron, 2*]. When claimants are defeated in arbitration and default with impunity on costs payments, "international businesspeople are deprived of the assurance of even that institution's effectiveness. The risks of doing business across borders rise, the cost of capital for the initiation of international ventures rises, and global expansion is checked to some degree" [*Rubins, 359*; cf. *ICC Case No. 6697 (ordering security for costs because arbitrators bear a "responsibility to safeguard the development of international trade, even at the cost of some procedural niceties")*].

### B. THERE IS A SUBSTANTIAL RISK THAT CLAIMANT WILL NOT BE ABLE TO MEET AN AWARD OF COSTS.

80. Respondent has presented reputable financial press articles reporting that Claimant has a cash flow shortfall and has been delinquent in paying its trade creditors [*Security for costs letter*]. These articles are appropriate and sufficient evidence to support the belief that there is a substantial risk that Claimant will not be able to meet an order of costs against it. Strict application of rules of evidence is at odds with the intended informality of arbitration [*ICC Case No. 1434, Born, 470*; *David, 290*]. All that is required is "that the material ... [be] sufficiently persuasive to permit a rational belief to be formed that, if ordered to do so, the corporation would be unable to pay the costs of that party upon disposal of the proceedings" [*Warren Mitchell v. Austl. Maritime Officers' Union (Austl.)*].

81. The credibility of the newspapers cited by Respondent is unchallenged by Claimant [*Clarification 43*]. While Claimant argues that the newspaper reports are not a "reliable form of evidence," it offers as evidence data from a nameless "reputable publication" that its own annual sales are between \$8,000,000 and \$10,000,000 [*Cl. Mem., para. 29*]. If the Tribunal is to accept this evidence as reliable, it must accept Respondent's financial press reports as well.

82. Furthermore, Claimant's demand that Respondent provide accounting data detailing Claimant's finances is, by its own admission, impossible to satisfy, as Claimant has steadfastly refused to turn over such data [*Security for costs letter*]. The Tribunal is free to draw negative inferences from such conduct [*Born, 489; Rubino-Sammartano, (duty to cooperate in good faith in the taking of evidence); cf. Reinsurance Austl. Corp. (Austl.) (where Claimant refused to offer evidence of its financial viability, the court inferred that the evidence would have hurt Claimant's position); Forsythe Int'l, SA v. Gobbs Oil Co. (USA); Bigge Crane & Rigging Co. v. Docutel Corp. (USA)*]. Claimant's proposal, made for the first time in its Memorandum, that it turn over such statements to the Tribunal [*Cl. Mem. para. 32*], raises serious due process concerns. An *ex parte* examination of the evidence, without the opportunity for Respondent to challenge its veracity and authenticity, would result in a unilateral finding of fact which would greatly prejudice Respondent. In any event, the offer comes too late in the proceedings; the appropriate time was during the preliminary correspondence, when Claimant clearly indicated its unwillingness to provide such statements.

83. Respondent has discharged its evidentiary burden of making a *prima facie* case that Claimant presents a risk of non-payment. The onus is now on Claimant to satisfy the Tribunal that, taking into account all relevant factors, the discretion to make an order should not be exercised [*Idoport v. National Austl. Bank (Austl.)*]. Claimant has not demonstrated that it should be exempt from the general rules to which the parties agreed.

### **III. RESPONDENT DID NOT AGREE TO BEAR THE RISK OF CLAIMANT'S INSOLVENCY.**

84. Respondent did not assume the risk of non-collection of an award of costs. The parties' contract protected Respondent against the risk of non-collection (A). Even if Respondent contracted to bear such a risk, there have been material changes in Claimant's financial situation that Respondent could not have foreseen at the time the contract was concluded (B).

#### **A. THE CONTRACT PROTECTED RESPONDENT AGAINST THE RISK OF NON-COLLECTION OF COSTS.**

85. Since arbitrators derive their power to adjudicate from the agreement of the parties, they should strive to match procedure and substance with the *ex ante* expectations of participants [*Rubins, 314; Style, 3* ("*we should consider not the preferences of the parties in the heat of battle, but their more abstracted utility calculations before*")]. The Tribunal should thus try to identify the kind of arbitral process that the parties, either expressly or by implication, were contemplating and should consider whether it would be consistent with that process to make an order for security [*Coppée Lavalin v. Ken-Ren (UK)*].

86. Claimant correctly points out that the parties contracted with each other in the face of all the risks inherent in that relationship [*Cl. Mem., para. 26*]. Thus, the probability that a contract would lead to conflict and that one party would not meet a costs award was incorporated into the contract price [*Rubins, 358*]. However, parties often adopt governing rules to protect them against just such contingencies [*Rubins, 364*]. By selecting the SIAC Rules, which, unlike most arbitral regimes, expressly provide for security for costs, the parties built into the contract protection against the risk of non-payment. If the contractual mechanisms it bargained for are withheld from Respondent, and it is successful in the arbitration, it would obtain only a Pyrrhic victory [*Van den Berg, 143*].

**B. EVEN IF RESPONDENT CONTRACTED TO BEAR THE RISK OF CLAIMANT’S INSOLVENCY, CLAIMANT’S FINANCIAL SITUATION HAS MATERIALLY CHANGED SINCE THE CONCLUSION OF THE CONTRACT.**

87. The principle of contractual intent does not hold a party responsible for material changes in circumstances that could not reasonably have been foreseen at the time the agreement was signed [*Rubins, 357; Krell v. Henry (UK)*]. Since Claimant’s inability to pay costs was not foreseeable, Respondent could not have contemplated *ex ante* the increased chance of non-payment.

88. According to newspaper reports, “Equipack’s cash-flow problems seem to have begun in late 2002,” after the conclusion of the contract [*Clarification 43*]. While Respondent might foresee that Claimant would experience some financial difficulties, Claimant’s financial situation fundamentally changed once it ran into difficulties servicing its contract with A2Z, purchased replacement machines and commenced this costly and possibly prolonged arbitration. These changes were not foreseeable at the time of the conclusion of the contract.

89. Claimant argues, but presents no evidence, that its financial situation “could improve again with time” [*Cl. Mem., para. 25*]. However, Respondent has no duty to wait and see whether this will occur. After all, Claimant’s upcoming merger could fail to materialize, or worse, further drain Claimant’s resources. Claimant erroneously contends that Respondent must demonstrate that Claimant’s financial situation will not improve [*Cl. Mem., para. 24*]. Since no one can prove whether a hypothetical future event will or will not occur, this would put an impossible burden on Respondent. As there is no reason to believe Claimant’s situation will improve before the end of the proceedings, and in fact may worsen if it loses this arbitration and must pay Respondent’s costs, a showing of urgency is not required [*Interim award of 12 December 1996 (Neth.)*].

#### **IV. RESPONDENT HAS NOT ENGAGED IN STRATEGIC OR BAD FAITH CONDUCT DURING THIS ARBITRATION.**

90. Claimant's allegations that Respondent has acted inappropriately during these proceedings have no basis in fact. Respondent's behavior during this arbitration has been consistently aboveboard. Its slightly delayed payments of the required administrative fees are not definitive evidence of bad faith or strategic behavior; they may merely reflect the organizational realities of running a large company. There are many administrative, financial and legal considerations involved in preparing a defense, and the Tribunal should keep in mind that the Respondent was brought into this arbitration and therefore had little time to consider its options and prepare its documentation.
91. The amount of security requested by Respondent is also reasonable. The allocation of costs is an element of procedure [*Gillis Wetter/Priem*, 249] and is governed by the rules of the arbitral institution chosen by the parties [*Weintraub*, 69; *Triumph Tankers Ltd. v. Kerr McGee Refining Corp. (SMA)*; *Final Award No. 6962 (ICC)*; *Final Award No. 6248 (ICC)*]. Despite the significance of a claim for costs [*see Schwartz*, 8-23; *Gurry*, 233], international tribunals have no uniform approach for awarding them [*Gotanda*, 2]. Since the SIAC Rules are also silent on ways to estimate the reasonableness of legal costs, arbitrators have wide discretion to fix the amount in light of all the circumstances of the case [*Allstate Life Ins. v. Austl. & NZ Banking Group (Austl.) (using "broad brush" to fix the amount)*].
92. The fact that the parties are from different legal systems is common in international arbitrations, and thus is not, as Claimant argues, a reason not to award security for legal costs [*Cl. Mem.*, para. 37]. Arbitrators rarely preside over nationals of their own countries, and yet regularly award costs [*Southern Pacific Properties Ltd. (ICSID) (awarded prevailing party \$5 million in costs)*; *La Pine Tech. Corp. v. Kyocera Corp. (ICC) (awarding \$14.5 million in costs)*; *Compagnie des Bauxites de Guinee v. Hammermills, Inc. (confirming award, including \$1.3 million in costs)*; *Final Award No. 4975 (ICC) (awarding £500,000 in costs)*; *August Trading Ltd. v. The Fund for Democracy & Dev. (SMA) (awarding \$12,000 in damages and \$205,000 in costs)*]. In light of the amounts of costs awarded in these cases, Respondent's request for \$20,000 in legal costs is not only reasonable, but is probably far below its final legal costs.
93. In fact, it is Claimant that has behaved in a suspect manner. It has evaded requests to present its accounting data and thus avoid a security for costs order. Furthermore, information about its merger was revealed only after Respondent's request for security, even though this information materially impacts the arbitration. Considering the concerns that arise whenever a party changes ownership or identity during an arbitration, this information should have been disclosed at the

outset [*see XY Int'l, Inc. v. Société Z (ICC)*]. This is particularly true in arbitral proceedings, where outside parties cannot be impleaded if they have signed no arbitration agreement with the defendant [*Rubins, 361; Altaras, 86-87; Abraham v. Thompson; Coppée Lavalin v. Ken-Ren (UK)*].

**PART FIVE: RESPONDENT’S REQUEST THAT THE TRIBUNAL MAKE AN ORDER OF CONFIDENTIALITY SHOULD BE GRANTED.**

94. The Tribunal should grant Respondent’s request for an order of confidentiality. Claimant is obligated under § 34.6 SIAC Rules to keep the arbitration confidential from Equatoriana Investors and none of the exceptions set out in the Rule apply (I). The Tribunal has the authority to order Claimant to refrain from disclosing the existence or nature of this arbitration (II). Serious consequences may result if the Tribunal issues a confidentiality order and Claimant violates it (III).

**I. CLAIMANT IS OBLIGATED TO KEEP THE ARBITRATION CONFIDENTIAL FROM EQUATORIANA INVESTORS.**

95. Claimant and Respondent entered into a confidentiality agreement by contracting to adopt the SIAC Rules [*Cl. Ex. 2*]. As Claimant falls under none of the exceptions listed in § 34.6(a)-(e) SIAC Rules, it may not disclose the existence and nature of the arbitration to Equatoriana Investors (A). Claimant’s non-disclosure respects the will of the parties (B). The case for non-disclosure is strengthened by the harmful consequences of disclosure for Respondent (C).

**A. CLAIMANT DOES NOT FALL UNDER THE EXCEPTION IN § 34.6(d) SIAC RULES.**

96. Respondent does not dispute Claimant’s premise that the parties agreed to limited confidentiality [*Cl. Mem., paras. 50-52; N. of Arb., para. 15*], or that it is bound to abide by the exceptions in § 34.6 SIAC Rules. However, Respondent submits that Claimant does not fall under any of the exceptions, including the one in § 34.6(d). That exception allows a party to disclose the arbitration if it must do so “to be in compliance with the provisions of the laws of any State which is binding on the party making the disclosure.” However, § 34.6(d) applies only to statutory provisions (a). Even if § 34.6(d) applies to judge-made law, this arbitration does not materially affect Claimant’s financial and business situation (b). Finally, Claimant can avoid being subject to Equatoriana law by not entering into due diligence proceedings with Equatoriana Investors (c).

**a. Section 34.6(d) SIAC Rules applies only to statutorily imposed obligations.**

97. Claimant “is a corporation organized under the laws of Equatoriana,” [*N. of Arb., para. 1*]. “Equatoriana courts have held that a party being purchased must divulge all matters that materially affect its financial or its business situation” [*Confidentiality letter*]. Since Equatoriana is a common law

country [*Clarification 3*] and the relevant decisions “includ[e] several of the Supreme Court of Equatoriana” [*Clarification 38*], Claimant contends that the court decisions constitute law binding on it. However, the plain language of § 34.6(d) SIAC Rules appears to limit its application to statutorily mandated disclosures. First, § 34.6(d) uses the terms “provisions” as well as “laws” in the plural, suggesting a reference to statutory law [*unlike § 30.1 LCLA Rules, which refers to a general “legal duty”*]. Second, §§ 34.6(a)-(c) refer specifically to “courts” while § 34.6(e) refers to “administrative bodies”; if § 34.6(d) encompassed judge-made duties, it would have referred to “courts” as well.

98. This reading of § 34.6(d) SIAC Rules comports with the goals of international commercial arbitration. It provides for the harmonization of standards between civil and common law rules, making the exception equally applicable to any country. It also fosters predictability in international trade. Parties agreeing to use the SIAC Rules will only be required to research the more well-defined statutory provisions of state parties rather than capricious common law rules.

**b. The arbitration does not materially affect Claimant’s financial and business situation.**

99. The courts of Equatoriana require the disclosure only of those matters that materially affect a firm’s financial or business situation. Claimant asserts that as a result of the breach of contract, it has suffered a loss of \$537,650 plus interest and costs, approximately 5% of Claimant’s annual income [*Clarification 44*]. However, there is no evidence that the loss Claimant suffered amounts to \$537,650, as the Tribunal has not yet issued its findings. Furthermore, the amount of damages recoverable and the loss suffered are not necessarily equal. Finally, a loss of 5% does not rise to the level of “material” for a company of Claimant’s size [*In re Castle Industries (USA) (4% change was not material); Monessen Southwestern Ry. Co. v. Morgan (USA) (25% increase in a damages award was “material”*)].

100. Furthermore, Claimant confuses the confidentiality of the arbitral proceedings with the confidentiality of the underlying business transaction [*Cl. Mem., para. 57*]. Claimant’s loss is not “unexplained”—the purchase price of the Machines is already reflected in Claimant’s financial records. Claimant can reveal to Equatoriana Investors that it purchased Machines that were unsuitable and that replacement machines had to be purchased as a result. Finally, there is no counterclaim in this arbitration; hence no award, other than possibly costs and attorneys’ fees, could be rendered against Claimant. Thus, the arbitration cannot result in any “material” negative impact on Claimant’s financial or business situation; any possible losses have already occurred.

**c. Claimant is not legally compelled to enter into the merger with Equatoriana Investors.**

101. Even if this Tribunal finds that § 34.6(d) SIAC Rules encompasses judge-made law, Claimant still does not fall within the exception because it was not obliged to enter into a merger. Claimant intentionally put itself in a situation in which it would have to violate a duty: either it entered into merger negotiations knowing it was obliged to keep this arbitration confidential or it agreed to the SIAC Rules after merger negotiations were underway. Because Claimant voluntarily chose to take on incompatible duties, ordering Claimant to keep this arbitration confidential should not be regarded as forcing it to act in violation of national law.

**B. AN ORDER OF CONFIDENTIALITY RESPECTS THE WILL OF THE PARTIES.**

102. Claimant argues that confidentiality, while an “oft-cited advantage” of arbitration, is less important to the parties than speed, cost effectiveness, quality, and flexibility [*Cl. Mem.*, paras. 58-59]. In fact, confidentiality is one of the most important advantages of arbitration and the primary reason many parties choose to arbitrate [*Bagner*, 243; *Brown*, 970, 972; *Denoix de Saint Marc*, 211; *Smit*, 575; *Aita v. Ojeh (Fr.)*; *Esso/BHP v. Plowman (Austl.)*]. In choosing the SIAC Rules, which, unlike many other arbitral rules, include an explicit provision for confidentiality, the parties made clear that confidentiality was of the utmost importance to them. Reading the exceptions in § 34.6 too broadly undermines the value of the SIAC Rules’ confidentiality requirement.

103. Claimant’s non-disclosure also serves the other goals of arbitration. Claimant argues that disputes over interim measures such as confidentiality orders would create all manner of unnecessary negotiation and litigation, slow the arbitration, harm its cost effectiveness, decrease its quality, and stifle its flexibility [*Cl. Mem.*, para. 59]. There is no doubt that resolution of such disagreements can delay the final award, but that is no reason to condemn all interim measures. The threat of unnecessary litigation would be no less if the Tribunal refused to order confidentiality, as Respondent could seek damages or an injunction against Claimant’s disclosure, increasing the cost and delaying resolution of the arbitration. Moreover, increased litigation is not the result of the Tribunal’s order, but of Claimant’s intention to violate it; to avoid it, all it needs to do is comply.

**C. DISCLOSURE WILL RESULT IN HARM TO RESPONDENT.**

104. As a general rule, a respondent is said to have a greater interest in preserving confidentiality than a claimant, since the respondent’s reputation is at stake [*Smit*, 578; see also *Trakman*, 5; *Rothman*, 69]. While Claimant argues that no harm will result to Respondent [*Cl. Mem.*, para. 62], perhaps because Equatoriana Investors is under a duty to Claimant to keep information it receives during due

diligence confidential, Respondent has no guarantee that Equatoriana Investors will respect its obligation. Information gathered during investigatory dealings is frequently leaked [*see, e.g., Appelbaum v. Milwaukee Metropolitan Sewerage Dist. (USA)*]. Moreover, Equatoriana Investors is “one of the largest financial firms in Equatoriana” [*Clarification 41*], so it is possible that one of its investors or subsidiaries is doing or will do business with Respondent [*see Redfern/Hunter, 27 (“a public company may need to disclose to its shareholders ... that an arbitration is taking place”)*]. Disclosing the existence of this arbitration, internally or externally, could create distrust and a general chilling of Respondent’s future business prospects.

105. Respondent also has no means by which to hold Equatoriana Investors accountable for a breach of confidentiality. Equatoriana Investors owes its duty of confidentiality to Claimant, not Respondent [*see Trakman, 14 (“The ... confidentiality agreement ... ordinarily covers only the parties to the arbitration.”)*]. This Tribunal cannot resolve any dispute between Equatoriana Investors and Respondent because it can not adjudicate issues involving a non-party [*Rubino-Sammartano, 184; Eljer Mfg. Inc. v. Kowin Dev. Corp. (USA)*]. Respondent thus has neither standing nor a forum to enforce confidentiality against Equatoriana Investors. In order to prevent probable irreparable economic harm to Respondent, the Tribunal should order Claimant to keep this arbitration confidential.

## **II. THE TRIBUNAL IS AUTHORIZED TO ORDER CLAIMANT TO REFRAIN FROM DIVULGING THE DETAILS OF THE ARBITRATION.**

106. The Tribunal is authorized to make an order of confidentiality. Confidentiality arises under the agreement to arbitrate, so all decisions regarding confidentiality are within the domain of the Tribunal (A). Even if the Tribunal does not find it has the inherent power to order confidentiality, it may do so pursuant to its power to order interim measures under Art. 17 UNCITRAL Model Law and § 25(j) SIAC Rules (B). Ordering confidentiality does not require adjudicating the rights of Equatoriana Investors, a non-party to this arbitration (C) and will be fully enforceable in court (D).

### **A. BECAUSE CONFIDENTIALITY ARISES UNDER THE ARBITRATION AGREEMENT, IT IS WITHIN THE INHERENT POWER OF THE TRIBUNAL TO ORDER CONFIDENTIALITY.**

107. “Since the issue of ... confidentiality ... arises under the agreement to arbitrate, it is ... to be decided by the arbitrator and not by the court” [*Smit, 569, 579-80*]. “Parties may request that the appointed arbitrator rule on ... issue[s] of confidentiality” [*Trakman, 3*] and such rulings should not be prejudged or reviewed on their merits by courts [*Smit, 579*]. Here, it is clear that confidentiality arises under the agreement to arbitrate. Moreover, the existence of § 34 SIAC Rules presupposes

the arbitrator's power to rule on issues of confidentiality. This rule would not have been enacted if the arbitrator were not empowered by the Rules to make an order for confidentiality.

**B. THE TRIBUNAL CAN MAKE AN ORDER FOR CONFIDENTIALITY AS AN INTERIM MEASURE.**

108. Section 25(j) SIAC Rules empowers the Tribunal “to make orders ... for an interim injunction or any other interim measure” [*Schaefer, at 3.2 (stating that the SIAC Rules “give the arbitrator explicit assurance of his power” to order interim measures)*]. As both the SIAC Rules and the SIAA are silent with regard to what constitutes an interim measure, the Tribunal should look to the UNCITRAL Model Law for assistance. Art. 17 UNCITRAL Model Law allows the Tribunal to “order any party to take such interim measures of protection as the arbitral tribunal may consider necessary in respect of the subject matter of the dispute.” Guided by §25(j) SIAC Rules and Art. 17 UNCITRAL Model Law, this Tribunal has the authority to order confidentiality because such an order is an interim measure (a) and is “necessary in respect of the subject matter of the dispute” (b).

**a. An order of confidentiality is an interim measure.**

109. Art. 17 UNCITRAL Model Law “does not set limits as to the contents of the interim measures ordered by the tribunal” [*Berger, 338; Holtzmann/Neubaus, 531*]. The Model Law does not specifically enumerate measures, nor does it provide an exclusive list of possible interim orders. In fact, language in an earlier draft of Art. 17 limiting interim measures to those “for the conservation of the good forming the subject matter of the dispute” was rejected and replaced with the more general “interim measures of protection” [*Holtzmann/Neubaus, 530; Broches, 91*].

110. Moreover, the drafters of Art. 17, as well as commentators, have found that a “tribunal may order a party to refrain from any publicity relating to the subject matter of the dispute which may have significance for the protection of trade secrets and proprietary information” [*Berger, 340; see also Holtzmann/Neubaus, 531; Broches, 90*]. Looking both to the drafters' intent not to place limitations on the forms of interim measures available and to their recognition of the need for interim measures to protect sensitive information, Art. 17 UNCITRAL Model Law should be read to include orders of confidentiality.

**b. Confidentiality with respect to Equatoriana Investors is “necessary in respect of the subject matter of the dispute.”**

111. Claimant argues that an interim measure can only be necessary in respect of the subject matter of the dispute if its purpose is to maintain the status quo and prevent the parties' assets from deteriorating pending completion of the arbitration [*Cl. Mem., para. 64*]. Adopting Claimant's proposed test, the Tribunal should grant an order of confidentiality. If Claimant were to break

confidentiality or if no order were granted, Respondent's reputation in the field could suffer as a result of Claimant's unproven allegations. The resulting harm to Respondent's business prospects could lead to a dissipation of its assets, which are central to Claimant's potential recovery.

**C. AN ORDER OF CONFIDENTIALITY DOES NOT REQUIRE ADJUDICATING THE RIGHTS OF EQUATORIANA INVESTORS.**

112. Respondent agrees with Claimant that the Tribunal does not have the power to adjudicate the rights of non-parties [*Partial Award in ICC Case No. 5265 (1987)*; *Born*, 673-690; *Rubino-Sammartano*, 184]. The *Hawaiian Kingdom* decision relied upon by Claimant [*Cl. Mem.*, para. 69] is distinguished from the present case by the fact that there, the propriety of the third party's actions was in dispute. Ordering confidentiality in this arbitration does not call upon the Tribunal to adjudicate the rights of Equatoriana Investors. At issue are Claimant's duties with respect to Respondent under an international sales contract, not the domestic rights or duties of Equatoriana Investors, which will remain intact. "An arbitration proceeding [is] not the proper forum for deciding whether an arbitrator may afford relief against a non-signatory who is not covered by an arbitration agreement" [*Fiat SpA v. Ministry of Finance and Planning (USA)*].

**D. AN ORDER OF CONFIDENTIALITY BY THE TRIBUNAL WILL BE FULLY ENFORCEABLE.**

113. This Tribunal is equipped with adequate procedural mechanisms to enforce the order [*see para. 116 below*]. If court enforcement is necessary, Respondent can rely on the courts of Danubia. Even if it is argued that the Tribunal is not authorized to order confidentiality because such a measure cannot be enforced under the UNCITRAL Model Law,<sup>6</sup> such a limitation may not necessarily apply in this case. While Danubia has adopted the UNCITRAL Model Law without amendment, this is not evidence that Danubia lacks domestic law on the matter, as such provisions could be found in judge-made or national procedural laws [*e.g., Arts. 1049, 1051 Dutch Code of Civil Procedure*].

114. Furthermore, the UNCITRAL Working Group has prepared draft revisions and additions to Art. 17 UNCITRAL Model Law, which would require courts in countries that have adopted the Model Law to enforce interim measures ordered by arbitral tribunals [*Rep. of the Working Group on Arb.*, paras. 64-87]. Danubia may adopt the new Article or amend its own laws. Finally, Respondent may persuade the courts of another country to assist with enforcement. In the absence of more explicit information regarding the availability of such provisions on enforcement, or even whether Danubia

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<sup>6</sup> Art. 17 UNCITRAL Model Law "does not deal with enforcement of such measures" and contemplates that "any State adopting the Model Law would be free to provide court assistance in this regard" [*Explan. Notes to UNCITRAL Model Law*, para. 26]. States must provide such assistance "under the procedural law of the arbitration" [*Werbicki*, 66] and Danubia seems not to have provided such assistance, adopting the Model Law without amendment [*N. of Arb.*, para. 14].

is a common law or civil law country, the Tribunal should use its discretion to make the necessary procedural orders. If court enforcement turns out not to be available, the only party harmed will be Respondent; Respondent willingly accepts this risk.

### **III. SERIOUS CONSEQUENCES MAY FOLLOW IF THE TRIBUNAL ISSUES A CONFIDENTIALITY ORDER AND CLAIMANT VIOLATES IT.**

115. Claimant misidentifies the question posed by the Tribunal in Procedural Order No. 2, confusing what consequences may follow the violation of an order with what action the Tribunal should take in case of such a violation [*Cl. Mem., para. 76*]. The issue is not so narrow, encompassing instead not only the Tribunal's actions but also the larger consequences of such a violation. Claimant alleges that it will be forced to violate a confidentiality order, an allegation which is unfounded [*see paras. 97-101 above*]. If Claimant does in fact violate the Tribunal's order, the consequences will be severe enough to hold Claimant accountable, thereby giving the Tribunal's order some teeth [*Brown, 1017*].
116. The Tribunal can impose a number of sanctions on Claimant in response to a violation of its confidentiality order: it may draw adverse inferences against Claimant, refuse to hear Claimant's claims, and stay or dismiss the proceedings [*Smit, 581* ("*When ... confidentiality is breached while ... arbitration is in progress, the arbitral tribunal ... is competent to adjudicate alleged breaches*")]; *Wagoner, 69*; *see also Allstate Life Ins. Co. v Austl. & NZ Banking Group Ltd. (Austl.)*; *Reinsurance Austl. Corp. (Austl.) (proceedings will be stayed in case of non-compliance)*; *cf. LCLA Rules (on which the SIAC rules were modeled, expressly providing for dismissal of proceedings)*. Claimant argues that sanctions are unnecessary because parties usually comply voluntarily [*Cl. Mem., para. 78*], yet it has stated that it will violate the Tribunal's order of confidentiality. Claimant also argues that a tribunal-ordered sanction could render a final award unenforceable because it would violate equality principles [*Cl. Mem., para. 82*]. But equality of the parties is qualified by their adherence to the law and rules they have agreed upon, and the Tribunal is not powerless in the face of any kind of party abuse.
117. Claimant's violation of a confidentiality order could also lead to suits by Respondent in court seeking damages or an injunction against future disclosures [*Brown, 1016*; *Smit, 582*; *Trakeman, 5*; *see also Aita v. Ojeb (Fr.)*]. Most seriously, Claimant's violation may lead Respondent to petition a court for avoidance of the entire arbitration agreement. In cases of egregious breaches of confidentiality, courts may allow avoidance of the arbitration clause [*Bulbank decision (Sweden) (1998)*; *Smit, 582*]. Because of the substantial economic harm to Respondent, this breach of confidentiality could rise to the required level of egregiousness.

118. Finally, the Tribunal’s confidentiality order and any sanctions it might impose on Claimant for violation of the order will not affect recognition and enforcement of the final award. As all pertinent States are signatories of the NY Convention [*N. of Arb., para. 14*], non-recognition can only be sought on the grounds set out in Art. V NY Convention. No relevant subsections of this Article warrant non-recognition.<sup>7</sup> Thus, while the consequences of a violation could be considerable for Claimant, they would not affect the enforceability of a final award. Therefore, the threat of Claimant’s non-compliance should not deter this Tribunal from making a confidentiality order.

### REQUEST FOR RELIEF

In light of the above submissions, Counsel respectfully requests that the Tribunal:

- find that Respondent delivered goods that were in conformity with the contract;
- find that even if the goods were not in conformity with the contract, the breach did not constitute a fundamental breach;
- find that Claimant did not validly avoid the contract;
- grant Respondent’s request for an order for security for costs;
- grant Respondent’s request for an order of confidentiality against Claimant; and
- order Claimant to pay all costs of the arbitration, including legal costs.

(signed)

Julie Calderon

Stela Chincisan

Suzanne deVries

Joshua Karton

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6 February 2004

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<sup>7</sup> In particular, Art. V(1)(b) as raised by Claimant, is an insufficient ground for non-recognition [*see para. 116 above*]. Moreover, any claims for non-recognition under Art. V(2)(b), the “contrary to the public policy of that country” exception, are likely to fail as well in light of the fact that courts rarely refuse recognition on this ground [*Born, 824 (“Most national court decisions in developed jurisdictions have refused to invoke the public policy exception to deny recognition to an ...arbitral award”)*] and as it potentially will not be counter to Equatoriana’s public policy to recognize the award for the reasons set out in paras. 99-100.