

Twelfth Annual Willem C. Vis International Commercial Arbitration Moot
2004 – 2005



Faculty of Law
McGill University

Jean-Pierre Blanchette, David Grossman, Adrian Rae Leipsic, Alison Lester

MEMORANDUM FOR THE RESPONDENT

On behalf of:

Equatoriana Commodity Exporters, S.A.
325 Commodities Avenue
Port City, Equatoriana
(0) 487-2314 (telephone)
(0) 487-2320 (facsimile)
("the Respondent")

Versus:

Mediterraneo Confectionary Associates, Inc.
121 Sweet Street
Capitol City, Mediterraneo
(0) 555-1235 (telephone)
(0) 555-1237 (facsimile)
("the Claimant")

TABLE OF CONTENTS

Table of Contents i

Table of Abbreviations iii

Index of Legal Texts v

Index of Authorities vi

Index of Cases and Awards x

Statement of Facts..... 1

Submissions 3

Argument..... 4

A. The Respondent is not liable to the Claimant in damages for breach of Cocoa Contract 1045..... 4

 I. The Respondent was excused from delivering the 300 tons of cocoa by reason of the embargo..... 4

 (a) The Respondent’s failure to perform was due to the embargo 4

 (i) The Respondent had an obligation to deliver Equatoriana cocoa 4

 (1) The Respondent’s intent was to sell Equatoriana cocoa and the Claimant knew of that intent 5

 (2) The understanding of a reasonable person would be that the parties were contracting in regard to Equatoriana cocoa 7

 (ii) The embargo made the delivery of Equatoriana cocoa impossible 8

 (b) The embargo was beyond the Respondent’s control..... 8

 (c) The Respondent could not reasonably be expected to have taken the embargo into account at the time of the conclusion of the contract 9

 (d) The Respondent could not reasonably be expected to have avoided or overcome the embargo or its consequences..... 9

 II. Even if Article 79 is found not to be applicable, the Claimant cannot claim damages under the CISG..... 11

 (a) The Respondent is not liable for the Claimant’s substitute transaction damages under Article 74 11

 (i) Article 75 does not leave room for substitute transaction costs to be compensated under Article 74 12

 (ii) The Claimant’s interpretation of Article 74 does not cohere with Article 48..... 13

 (iii) The Claimant’s interpretation of Article 74 is inconsistent with the duty to cooperate 14

- (b) The Respondent is not liable for the Claimant’s substitute transaction costs under Articles 75 or 76..... 14
 - (i) The Claimant did not properly avoid the contract before entering into its substitute transaction 15
 - (ii) The Claimant cannot avail itself of any remedy premised on valid avoidance 15
 - (1) The Respondent did not fundamentally breach the contract..... 16
 - (2) The Claimant could not avoid the contract pursuant to Article 49(1)(b) 17
- III. Subsidiarily, if the Claimant is considered to have validly avoided the contract, the Respondent’s liability is limited to damages based on the market price of cocoa on 15 November 2002 18
- B. The Tribunal has jurisdiction to hear the Respondent’s claim for the full amount of USD 385,805..... 18**
 - I. The Respondent’s claim should be characterized as a procedural set-off defence 19
 - (a) The Respondent’s decision to title and present its claim as a “counterclaim” cannot bar its correct characterization as a set-off defence 20
 - (b) The Respondent’s claim meets the established hallmarks of procedural set-off 21
 - (i) A set-off defence can be substantive in nature 21
 - (ii) A set-off defence can be procedural in nature 22
 - (iii) The Respondent’s claim is a valid procedural set-off defence 24
 - II. The Tribunal has jurisdiction to hear the respondent’s procedural set-off defence 24
 - (a) The Swiss Rules, and 21(5) therein, are applicable to the arbitration proceedings 25
 - (i) The nature of arbitration rules informs which version of the rules should apply 25
 - (ii) Under general principles of arbitration procedure, the Swiss Rules should apply 26
 - (iii) The intention of the parties confirms that the Swiss Rules should apply 27
 - (b) Article 21(5) should apply to the procedural set-off defence invoked by the Respondent 28
 - (i) The scope of Article 21(5) is ambiguous 28
 - (ii) The history of Article 21(5) suggests that it is applicable to the Respondent’s set-off. 30
 - (iii) Applying Article 21(5) to the Respondent’s set-off promotes the aims of international arbitration 30
 - (1) The moderate interpretation should prevail over the conservative interpretation.. 31
 - (2) The progressive interpretation should prevail over the moderate interpretation ... 32
 - (iv) Applying 21(5) to the Respondent’s set-off is consistent with accepted legal principles 34
- C. Relief Requested 35**

TABLE OF ABBREVIATIONS

| | |
|---------------|---|
| § | Section |
| AAA | American Arbitration Association |
| Art. | Article |
| CCIG | Chamber of Commerce and Industry of Geneva |
| CHF | Swiss francs |
| CISG | United Nations Convention on Contracts for the International Sale of Goods 1980 |
| ECE | Equatoriana Commodity Exporters, S.A. |
| ed. | Edition |
| Ed. | Editor |
| <i>e.g.</i> | For example (<i>exempli gratia</i>) |
| <i>et al.</i> | And other persons (<i>et alia</i>) |
| <i>ff.</i> | On the following pages (<i>foliis</i>) |
| Geneva Rules | Chamber of Commerce and Industry of Geneva Arbitration Rules |
| ICC | International Chamber of Commerce |
| ICC Rules | International Court of Arbitration Rules of Arbitration |
| <i>i.e.</i> | That is to say (<i>id est</i>) |
| MCA | Mediterraneo Confectionary Associates, Inc. |
| Model Law | UNCITRAL Model Law on International Commercial Arbitration 1985 |
| No. | Number |
| NYBOT | New York Board of Trade |

| | |
|--------------|---|
| p. | Page |
| pp. | Pages |
| para. | Paragraph |
| paras. | Paragraphs |
| Swiss Rules | Swiss Rules of International Arbitration |
| UNCITRAL | United Nations Commission on International Trade Law |
| UNIDROIT | UNIDROIT International Institute for the Unification of Private Law |
| USD | United States dollars |
| v. | Against (versus) |
| WIPO | World Intellectual Property Organization |
| Zurich Rules | International Arbitration Rules of Zurich Chamber of Commerce |

INDEX OF LEGAL TEXTS

| | |
|--------------------------------------|--|
| CISG | United Nations Convention on the International Sale of Goods < http://www.jus.uio.no/lm/un.contracts.international.sale.of.goods.convention.1980/ > |
| Geneva Rules | Chamber of Commerce and Industry of Geneva: Arbitration Rules < http://www.ccig.ch/images/pdf/reglement_arbitrage_ang.pdf > |
| Model Law | UNCITRAL Model Law on International Commercial Arbitration 21 June 1985, U.N. Doc. A/40/17, annex 1 |
| Ontario <i>Courts of Justice Act</i> | R.S.O. 1990, c. C.43 < http://www.canlii.org/on/laws/sta/c-43/20041104/whole.html > |
| Swiss Rules | Swiss Chambers' Arbitration: Swiss Rules of International Arbitration < http://www.swissarbitration.ch/SRIA_english.pdf > |
| UNIDROIT Principles | UNIDROIT International Institute for the Unification of Private Law: Principles of International Commercial Contracts < http://www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf > |
| Zurich Rules | International Arbitration Rules of Zurich Chamber of Commerce < http://www.jurisint.org/pub/03/en/F_6988.htm > |

INDEX OF AUTHORITIES

- Aeberli, Peter D. "Abatements, set-offs and counterclaims in arbitration proceedings"
<<http://www.aeberli.co.uk/articles/set-off.pdf>>
- Baker, S.A.
Davis, M.D. "Arbitral Proceedings under the UNCITRAL Rules – The Experience of the Iran-US Claims Tribunal" in (1989) 23 G. Wash. J. Int'l. L. & Ec. 267
Cited as: Baker & Davis
- Berger, Klaus Peter International Economic Arbitration
(Deventer: Kluwer Law and Taxation Publishers, 1993)
Cited as: Berger 1993
- Berger, Klaus Peter "Set-Off in International Economic Arbitration" in (1999) 15 Arb. Int'l. 53
Cited as: Berger 1999
- Blessing, Mark "Introduction to Arbitration – Swiss and International Perspectives" in *International Arbitration in Switzerland*
Stephen V. Berti, Ed.
(The Hague: Kluwer Law International, 2000)
Cited as: Blessing
- Bond, Stephen "How to Draft an Arbitration Clause" in (1989) 6:2 Journal of International Arbitration 65
Cited as: Bond
- Craig, Laurence W.
Park, William W.
Paulsson, Jan International Chamber of Commerce Arbitration
3rd ed. (Dobbs Ferry, NY: Oceana Publications Inc, 2000)
Cited as: Craig, Park & Paulsson
- Derains, Yves
Schwartz, Eric A. A Guide to the New ICC Rules of Arbitration
(The Hague: Kluwer Law International, 1998)
Cited as: Derains & Schwartz
- Derham, S.R. The Law of Set-Off
3rd ed. (Oxford: Oxford University Press, 2003).
Cited as: Derham
- Enderlein, Fritz
Maskow, Dietrich International Sales Law
(New York: Oceana Publications, 1992)
Cited as: Enderlein & Maskow

- Fouchard, Philippe
Gaillard, Emmanuel
Goldman, Berthold
- Fouchard Gaillard Goldman On International Commercial Arbitration
Emmanuel Gaillard & John Savage, Eds.
(The Hague: Kluwer Law International, 1999)
Cited as: Fouchard
- Garner, Bryan A., Ed.
- Black's Law Dictionary*
7th ed. (St. Paul, Minn: West Group, 1999)
Cited as: *Black's*
- Goode, Roy
- Legal Problems of Credit and Security
3rd ed. (London: Sweet & Maxwell, 2003).
Cited as: Goode
- Hermann, Gerold
- "Does the World Need Additional Uniform Legislation on Arbitration" in (1999) 15 Arb. Int'l. 211
Cited as: Hermann
- Honnold, John O.
- Uniform Law for International Sales
3rd ed. (The Hague: Kluwer Law International, 1999)
Cited as: Honnold
- Huber, Ulrich
- Article 49 in Commentary on the U.N. Convention on the International Sale of Goods
Peter Schlechtriem, Ed.; Geoffrey Thomas, trans.
2nd ed. (Oxford: Oxford University Press, 1998)
Cited as: Huber
- International Cocoa Organization
- "How do the futures and physicals market work?"
<<http://www.icco.org/questions/futures.htm>>
Cited as: International Cocoa Organization
- Jauffret-Spinosi, C.
- UNIDROIT Draft Chapter on Set-Off (May 2001)
<<http://www.unidroit.org/english/publications/proceedings/2001/study/50/50-71-e.pdf>>
Cited as: Jauffret-Spinosi
- Junge, Werner
- Article 8 in Commentary on the U.N. Convention on the International Sale of Goods
Peter Schlechtriem, Ed.; Geoffrey Thomas, trans.
2nd ed. (Oxford: Oxford University Press, 1998)
Cited as: Junge

- Koch, Robert
“The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)” in *Review of the Convention on Contracts for the International Sale of Goods (CISG)* (The Hague: Kluwer Law International, 1998)
Cited as: Koch
- Leboulanger, Philippe
“Multi-Contract Arbitration” in (1996) 13:4 *Journal of International Arbitration* 43
Cited as: Leboulanger
- Leser, Hans G.
Articles 26 and 81 in *Commentary on the U.N. Convention on the International Sale of Goods*
Peter Schlechtriem, Ed.; Geoffrey Thomas, trans.
2nd ed. (Oxford: Oxford University Press, 1998)
Cited as: Leser
- Lord Mackay of Clashern, Ed.
Halsbury’s Laws of England
4th ed. Reissue (London: Butterworths, 1999)
Cited as: Halsbury
- Magnus, Ulrich
“Force Majeure and the CISG” in *The International Sale of Goods Revisited*
Petar Šarčević and Paul Volken, Eds.
(The Hague: Kluwer Law International, 2001)
Cited as: Magnus
- New South Wales
Law Reform Commission
Set-Off (Discussion Paper No. 40)
(Sydney: New South Wales Law Reform Commission, 1998)
Cited as: NSW Law Reform Commission
- New York Clearing
Corporation
“New York Clearing Corporation”
<<http://209.208.183.6/notices/nycc/aboutnycc.htm>>
Cited as: New York Clearing Corporation
- O’Conor
“Enforcement of Arbitration Awards: Arbitration for the Time Being: *China Agribusiness v. Balli Trading*” in (1997) 1 *International Law Review* 42
Cited as: O’Conor
- Palmer, Kelly R.
The Law of Set-Off in Canada
(Aurora, Canada Law Book Inc, 1993)
Cited as: Palmer

- Redfern, Alan
Hunter, Martin
Law and Practice of International Commercial Arbitration
(London: Sweet & Maxwell, 1991)
Cited as: Redfern & Hunter
- Rubino-Sammartano,
Mauro
International Arbitration: Law and Practice
(The Hague: Kluwer Law International, 2001)
Cited as: Rubino
- Schlechtriem, Peter
Article 25 in Commentary on the U.N. Convention on the
International Sale of Goods
Peter Schlechtriem, Ed.; Geoffrey Thomas, trans.
2nd ed. (Oxford: Oxford University Press, 1998)
Cited as: Schlechtriem
- Stoll, Hans
Articles 74-76 and 79 in Commentary on the U.N.
Convention on the International Sale of Goods
Peter Schlechtriem, Ed.; Geoffrey Thomas, trans.
2nd ed. (Oxford: Oxford University Press, 1998)
Cited as: Stoll
- Sutton, Jeffrey S.
“Measuring Damages Under the United Nations Convention
on the International Sale of Goods” in (1989) 50 Ohio St.
L.J. 737
Cited as: Sutton
- UNCITRAL Case Digest
“The UNCITRAL Digest of case law on the United Nations
Convention on the International Sale of Goods”
A/CN.9/SER.C/DIGEST/CISG/8 (8 June 2004)
<<http://www.cisg.law.pace.edu/cisg/text/anno-art-08.html#ucd>>
Cited as: *Digest on Article8*
- UNCITRAL Case Digest
“The UNCITRAL Digest of case law on the United Nations
Convention on the International Sale of Goods”
A/CN.9/SER.C/DIGEST/CISG/75 (8 June 2004)
<<http://www.cisg.law.pace.edu/cisg/text/anno-art-75.html#ucd>>
Cited as: *Digest on Article75*
- Wood, Phillip R.
English and International Set-Off
(London: Sweet & Maxwell, 1989)
Cited as: Wood
- Zimmermann, Reinhard
Comparative Foundations of a European Law of Set-off and
Prescription
(Cambridge: Cambridge University Press, 2002)
Cited as: Zimmermann

INDEX OF CASES AND AWARDS

Arbitral Awards

ICC Arbitration Case No. 8574 of September 1996

<<http://cisgw3.law.pace.edu/cases/968574i1.html>>

Cited as: ICC#8574 (1996)

ICC Arbitration Case No. 8786 of January 1997

<<http://cisgw3.law.pace.edu/cisg/cases/978786i1.html>>

Cited as: ICC#8786 (1997)

Internationales Schiedsgericht der Bundeskammer der gewerblichen Wirtschaft [Arbitral Tribunal - Vienna]; Michael Bonell (sole arbitrator); Award SCH-4366 (15 June 1994)

<<http://cisgw3.law.pace.edu/cases/940615a3.html>>

Cited as: Award SCH-4366 (1994)

Tribunal of International Commercial Arbitration [Arbitral Tribunal - Russian Federation]; Award 54/1999 (24 January 2000)

<<http://www.cisg.law.pace.edu/cases/000124r1.html>>

Cited as: Award 54/1999 (2000)

Austria

Oberster Gerichtshof [Supreme Court], 6 Ob 311/99z (9 March 2000)

<<http://cisgw3.law.pace.edu/cases/000309a3.html>>

Cited as: OGH 6 Ob 311/99z (Austria 2000)

Germany

OLG Hamburg [Provincial Court of Appeals], 1 U 167/95 (28 February 1997)

<<http://cisgw3.law.pace.edu/cases/970228g1.html>>

Cited as: OLG 1 U 167/95 (Germany 1997)

OLG Hamburg [Provincial Court of Appeals], 1 U 31/99 (26 November 1999)

<<http://cisgw3.law.pace.edu/cases/991126g1.html>>

Cited as: OLG 1 U 31/99 (Germany 1999)

OLG Hamm [Provincial Court of Appeals], 19 U 97/91 (22 September 1992)

<<http://cisgw3.law.pace.edu/cases/920922g1.html>>

Cited as: OLG 19 U 97/91 (Germany 1992)

OLG Köln [Provincial Court of Appeals], 27 U 58/96 (8 January 1997)

<<http://cisgw3.law.pace.edu/cases/970108g1.html>>

Cited as: OLG 27 U 58/96 (Germany 1997)

OLG Düsseldorf [Provincial Court of Appeals], 6 U 87/96 (24 April 1997)
<<http://www.cisg.law.pace.edu/cases/970424g1.html>>
Cited as: OLG 6 U 87/96 (Germany 1997)

OLG Bamberg [Provincial Court of Appeals], 3 U 83/98 (13 January 1999)
<<http://cisgw3.law.pace.edu/cases/990113g1.html>>
Cited as: OLG 3 U 83/98 (Germany 1999)

OLG Düsseldorf [Provincial Court of Appeals], 6 U 210/03 (22 July 2004)
<<http://cisgw3.law.pace.edu/cases/040722g1.html>>
Cited as: OLG 6 U 210/03 (Germany 2004)

Italy

CA Milano [Court of Appeals], *Italdecor s.a.s. v. Yiu's Industries (H.K.) Limited* (20 March 1998)
<<http://www.cisg.law.pace.edu/cisg/wais/db/cases2/980320i3.html>>
Cited as: Italdecor s.a.s. v. Yiu's Industries (H.K.) Limited (Italy 1998)

STATEMENT OF FACTS

- 19 November 2001 Cocoa Contract 1045 is concluded between Mediterraneo Confectionary Associates, Inc. (“the Claimant”) and Equatoriana Commodity Exporters, S.A. (“the Respondent”), following the Respondent’s offer by telephone. The contract is confirmed by fax on the same day.
- 22 February 2002 The Equatoriana Government Cocoa Marketing Organization bans the export of cocoa through March.
- 24 February 2002 The Respondent informs the Claimant of the export ban.
- 28 February 2002 The time period within which the Respondent was obligated to fix a date for its delivery of cocoa elapses.
- 5 March 2002 The Claimant informs the Respondent that it still expects the Respondent to deliver 400 tons of cocoa pursuant to Cocoa Contract 1045 and that the source of that cocoa is irrelevant to it.
- 20 March 2002 The Equatoriana Government Cocoa Marketing Organization extends its ban on the export of cocoa indefinitely.
- 10 April 2002 The Claimant informs the Respondent that it still expects the Respondent to deliver 400 tons of cocoa by the end of May 2002.
- 7 May 2002 The Respondent informs the Claimant that, since the Equatoriana Government Cocoa Marketing Organization released a small amount of cocoa for export, the Respondent will be able to ship the Claimant 100 tons of cocoa later in the month.
- 28 May 2002 The Respondent delivers 100 tons of cocoa to the Claimant.
- 31 May 2002 The delivery period envisioned by Cocoa Contract 1045 elapses.
- June-July 2002 Several telephone conversations between the parties occur, in which the Claimant inquires as to the date of delivery for the 300 tons of cocoa outstanding pursuant to Cocoa Contract 1045.
- 15 August 2002 The Claimant writes to the Respondent informing it that the Claimant would soon need delivery of the 300 tons of cocoa that were never delivered. The Claimant informs the Respondent that the Claimant would otherwise be compelled to purchase elsewhere, and would hold the Respondent responsible for its costs.

29 September 2002 The Respondent telephones the Claimant and informs it that there is no indication as yet as to when the export ban would be rescinded.

24 October 2002 The Claimant purchases 300 tons of cocoa from Oceania Produce Ltd. at the current market price, in substitution for the 300 tons of cocoa it was to receive from the Respondent pursuant to Cocoa Contract 1045.

25 October 2002 The Claimant notifies the Respondent of its substitute transaction. The Claimant writes that the Respondent will be receiving a formal claim for the amount it paid for the cocoa acquired in its purchase of the previous day in excess of the price stipulated in Cocoa Contract 1045.

11 November 2002 Counsel for the Claimant writes to the Respondent, claiming the excess amount the Claimant paid for 300 tons of cocoa in its substitute transaction.

12 November 2002 The Equatoriana export ban on cocoa is rescinded.

13 November 2002 The Respondent responds to the Claimant, informing it that the Respondent would have been prepared to deliver the 300 tons of cocoa. It also points out that the contract had never been terminated by the Claimant and, thus, had been breached by the Claimant's cover purchase.

15 November 2002 Counsel for the Claimant formally avoids Cocoa Contract 1045.

20 November 2003 The Claimant and the Respondent conclude Sugar Contract 2212.

4 December 2003 Oceania Shipping Lines receives the sugar stipulated in Sugar Contract 2212 from the Respondent.

15 December 2003 The Claimant receives delivery of the sugar stipulated in Sugar Contract 2212.

19 December 2003 The Claimant informs the Respondent that the sugar it received has become contaminated, and the Claimant will not be paying the purchase price.

2 July 2004 The Claimant submits its request for arbitration against the Respondent.

10 August 2004 The Respondent submits its Answer and Counter-claim.

31 August 2004 The Claimant submits its Answer to the Counter-claim.

SUBMISSIONS

The Respondent submits the following in regard to Cocoa Contract 1045:

- That Contract 1045 was for the sale of cocoa from Equatoriana;
- That, by reason of the government embargo, the Respondent was excused under Article 79 of the CISG from delivering the remaining cocoa called for by the contract;
- That the conditions required for avoidance of the contract under Article 49 were never present;
- That the Claimant made no valid declaration of avoidance before entering into its substitute transaction;
- That the Claimant has no claim for damages under Articles 74, 75, or 76 of the CISG.

The Respondent submits the following in regard to Sugar Contract 2212:

- That the Respondent's claim constitutes a validly framed procedural set-off defence;
- That the Swiss Rules, and Article 21(5) therein, are applicable to this arbitration;
- That Article 21(5) of the Swiss Rules authorizes the Tribunal to hear the Respondent's set-off defence for the full amount of USD 385,805.

Signature (Counsel)

ARGUMENT

A. THE RESPONDENT IS NOT LIABLE TO THE CLAIMANT IN DAMAGES FOR BREACH OF COCOA CONTRACT 1045

1. The Respondent is not liable to the Claimant because it was excused under Article 79 of the CISG from delivering the remaining cocoa by reason of the embargo (I). Even if the Respondent is not excused, the Claimant cannot claim damages under the CISG (II). Subsidiarily, and only if the Claimant is considered to have validly avoided the contract, the Respondent's liability is limited to damages based on the market price of cocoa on 15 November 2002 (III).

I. The Respondent was excused from delivering the 300 tons of cocoa by reason of the embargo

2. The Respondent invokes Article 79(1) of the CISG to excuse its failure to perform any of its obligations under Cocoa Contract 1045. Article 79 states, "A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences." The Respondent's failure to deliver the remaining 300 tons of cocoa called for by Contract 1045 was due to the embargo placed on the export of cocoa by the Equatoriana Government Cocoa Marketing Organization (a). That embargo was an impediment beyond the Respondent's control (b). The Respondent could not reasonably be expected to have taken the embargo into account at the time of the conclusion of the contract (c), or to have avoided or overcome it or its consequences (d).

(a) The Respondent's failure to perform was due to the embargo

3. The Respondent had a contractual obligation to deliver cocoa produced in Equatoriana and not cocoa of any other origin (i). The embargo placed on the export of Equatoriana cocoa made the performance of that obligation impossible (ii).

(i) The Respondent had an obligation to deliver Equatoriana cocoa

4. The obligations of the parties are set out in Claimant's Exhibit No. 2, a document entitled "Contract: Cocoa 1045." That document includes the following words: "SOLD BY: Equatoriana Commodity Exporters, S.A. TO: Mediterraneo Confectionary Associates, Inc. Four hundred (400) metric tons net of cocoa beans..." It does not contain any explicit statement with respect to the origin of the cocoa. This has led the Claimant to

argue in its memorandum, “There is no doubt that the particular contract was for the purchase of 400 tons of cocoa but the origin of it was irrelevant” (Claimant’s Memorandum, para.9). In advancing this argument, the Claimant makes no reference to the provisions of Article 8 of the CISG. Yet, it is well established that “[t]he rules of interpretation in Article 8 apply to *all declarations* made by the parties to a contract [...including] declarations of intent leading to the conclusion of a contract” (Junge, Art.8, para.4)(emphasis added). A correct interpretation of the declaration contained in Claimant’s Exhibit No. 2 thus requires that the provisions of Article 8 be taken into account.

5. Article 8(1) of the CISG states, “For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was.” It was the intent of the Respondent to sell cocoa from Equatoriana, not cocoa of any other origin, and the Claimant knew of that intent (1). If the Tribunal should find that the parties were not *ad idem*, Article 8(2) of the CISG becomes applicable (Junge, Art.8, para.2). That article states, “If the preceding paragraph is not applicable, 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.” The understanding of a reasonable person of the same kind as either the Claimant or the Respondent would have been that the parties were contracting in regard to cocoa from Equatoriana and not cocoa of any other origin (2).

(1) *The Respondent’s intent was to sell Equatoriana cocoa and the Claimant knew of that intent*

6. Article 8(3) states, in relevant part, “In determining the intent of a party [...] due consideration is to be given to *all relevant circumstances of the case* including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties” (emphasis added). When consideration is given to the relevant circumstances of this case, including, in particular, the nature of the Respondent’s cocoa trading business and the Respondent’s conduct subsequent to the conclusion of the contract, it is clear that the intent of the Respondent was to sell cocoa produced in Equatoriana.
7. The sale of cocoa represents a significant portion of the Respondent’s total business – approximately 20% (Procedural Order No.2, para.14). Thus, the Respondent has sold a good deal of cocoa over the years. Yet, since it was founded in 1961, the Respondent has *never* sold cocoa that was not produced in Equatoriana (Procedural Order No.2, paras.13-14). Whatever other commodities the Respondent may have bought and sold internationally, its cocoa business has always been limited to the exportation of

Equatoriana cocoa. Given these facts, it is difficult not to conclude that, in entering into Cocoa Contract 1045, the intent of the Respondent had been to sell the Claimant cocoa exported from Equatoriana.

8. That such was the Respondent's intent at the time of contract formation is confirmed by examination of the Respondent's conduct subsequent to the conclusion of the contract. The Equatoriana Government Cocoa Marketing Organization first ordered the ban on the exportation of cocoa on 22 February 2002, a Friday. Once the Respondent became aware of that order, it did not wait even until Monday to contact the Claimant. The Respondent's representative, Mr. Smart, telephoned the Claimant's representative, Mr. Sweet, on 24 February 2002, a Sunday, and informed him of the embargo. Mr. Smart then confirmed their conversation in a letter (Claimant's Exhibit No.3) which he faxed and posted to the Claimant on that same day. Had the Respondent's intent been to deliver cocoa of any origin, the news of a ban on the exportation of Equatoriana cocoa would not have warranted the actions taken by the Respondent. The Respondent acted as it did because it perceived the embargo as potentially jeopardizing its ability to fulfill its contractual obligations to the Claimant – obligations it had always understood as involving the exportation of cocoa from Equatoriana.
9. Regarding the knowledge of the Claimant, the following is undisputed: the Claimant knew that it had done business with the Respondent on a number of occasions and over a number of years (Statement of Claim, para.3). It knew that every shipment of cocoa it had ever received from the Respondent had been from Equatoriana (Procedural Order No.2, para.19). It knew that the Respondent's name, as it appeared on its contracts of sale and on its letterhead, was "Equatoriana Commodity Exporters, S.A." In short, the Claimant had every reason to believe that the Respondent's intent, in entering into Cocoa Contract 1045, was to sell it cocoa exported from Equatoriana and not cocoa from any other country.
10. That the Claimant actually did know of the Respondent's intent is made clear by its reaction to the Respondent's communications of 24 February 2002, referred to above. That is, the Claimant's assertion that "[t]he contract did not provide specifically for Equatoriana cocoa" (Claimant's Exhibit No.4) was not made immediately upon its being informed of the embargo, as one would expect if the Claimant had believed that to be true at the time. Rather, that assertion was first made more than a week later, in a letter dated 5 March 2002 (Claimant's Exhibit No.4), after the Claimant had had considerable time to ponder the situation and scrutinize the paperwork. Indeed, in that same letter, the Claimant all but explicitly acknowledged its awareness of the Respondent's true intent when it stated, "[W]e are very concerned as to whether you will be *able* to fulfill your agreement to ship to us the 400 metric tons of cocoa that was

agreed” (Claimant’s Exhibit No.4, emphasis added). Clearly, for the Claimant to be concerned about the Respondent’s ability to fulfill its agreement in light of the export ban, the Claimant would have to have *known* that the Respondent’s intent had been to sell its cocoa exported from Equatoriana.

(2) *The understanding of a reasonable person would be that the parties were contracting in regard to Equatoriana cocoa*

11. Article 8(3), in relevant part, states, “In determining [...] the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.” The understanding of the reasonable person should be “that of a specialist who is aware of the practice in his trade sector, of the various types of sales contracts involved and of the technical language relating thereto” (Junge, Art.8, para.7). When consideration is given to the relevant circumstances of this case, including, in particular, the structure and institutions of the international cocoa market, it is clear that the understanding of a reasonable person, as a specialist aware of the practice in his trade sector, would be that the Claimant and Respondent were contracting in regard to cocoa from Equatoriana and not cocoa of any other origin.
12. The international cocoa market actually consists of two markets, known as the physical market and the terminal markets (International Cocoa Organization). On the physical market, parties contract with specific counter-parties for specific goods. Cocoa Contract 1045 between the Claimant and the Respondent is an example of a transaction on the physical market. The terminal markets consist of trade taking place through organized commodity exchanges, such as the Coffee, Sugar & Cocoa Exchange administered by the New York Board of Trade (“NYBOT”), or Euronext LIFFE in London. Contracts to buy and sell cocoa on the terminal markets are highly standardized and, significantly, are not between specific buyers and sellers or for specific lots of cocoa. Rather, purchases and sales of particular grades of cocoa are matched and settled by a clearinghouse which, through arrangements with its clearing members, guarantees the transactions (New York Clearing Corporation).
13. As stated above, Cocoa Contract 1045 was a physical market contract between a specific buyer and specific seller. It called for a price of USD 0.5628 per pound, the same price as cocoa of the same grade trading on NYBOT at that time (Statement of Claim, para. 3). Thus, the Claimant could have purchased the cocoa it needed on NYBOT for exactly the same price and benefited from NYBOT’s institutional settlement guarantee mechanism – *if* the Claimant had been indifferent to the cocoa’s origin. Indeed, it is difficult to

see why, for the same price, the Claimant would forego the valuable benefit of failsafe contract settlement, backed by a large, well-funded clearinghouse like NYBOT's, in order to obtain its cocoa from a relatively small, relatively risky source, unless the Claimant desired to buy cocoa of a particular origin. It is submitted that, whatever the Claimant's subjective intentions may have been, the understanding of a reasonable person familiar with the structure and institutions of the international cocoa market would be that, in choosing to buy cocoa from the Respondent, the Claimant was contracting to buy cocoa from Equatoriana.

14. Of course, all that has been said applies equally to the Respondent. That is, as a supplier of cocoa, the Respondent would be understood by a reasonable person to be aware that, when a purchaser pays terminal market prices to a particular supplier of cocoa, it is because that purchaser is contracting to buy cocoa of a particular origin, and it is cocoa of that origin that must be delivered. Thus, in sum, it is submitted that the understanding of a reasonable person would be that, in entering into Cocoa Contract 1045, both the Claimant and the Respondent were contracting not in regard to cocoa of any origin but in regard to cocoa from Equatoriana.

(ii) The embargo made the delivery of Equatoriana cocoa impossible

15. For the embargo to be considered an exonerating impediment under Article 79 of the CISG, it must be shown that it was an "event [that] render[ed] proper performance impossible from an objective point of view" (Magnus, p.14). It is fairly straightforward that, if the Respondent's obligation under Cocoa Contract 1045 was to deliver cocoa exported from Equatoriana, the government ban on the exportation of such cocoa made it objectively impossible for the Respondent to perform that obligation. Indeed, embargoes in general and export bans in particular are well established as valid impediments for the purposes of Article 79: "[O]bjective circumstances that prevent performance [...] may be natural, social, or political events, or physical or legal difficulties, such as a *ban on exports* or imports" (Stoll, Art.79, para.17)(emphasis added); "Military blockade and *government prohibition* provide excuse on the grounds of 'impossibility'" (Honnold, para.432.1, emphasis added). Thus, it would seem that there is little doubt that the embargo declared by the Equatoriana Government Cocoa Marketing Organization constituted an impediment that made performance of the Respondent's obligation to deliver Equatoriana cocoa objectively impossible.

(b) The embargo was beyond the Respondent's control

16. As the Claimant, at paragraph 9 of its memorandum, appears to have conceded that the impediment in this case was beyond the Respondent's control, the issue will not be belabored here. All that will be added is

that, for the purposes of Article 79, government embargo has been widely and undisputedly recognized as an impediment that does indeed fall beyond a party's control: "Turning to exogenous occurrences beyond the obligor's control, there are a number of exonerating circumstances that have been undisputedly accepted and are well known [...including] state intervention such as an *embargo*, boycott, *import/export restrictions*, closing of trade routes" (Magnus, p.17)(emphasis added). Thus, it seems clear that the export ban declared by the Equatoriana Government Cocoa Marketing Organization constituted an impediment that was beyond the control of the Respondent.

(c) The Respondent could not reasonably be expected to have taken the embargo into account at the time of the conclusion of the contract

17. In its memorandum, the Claimant argues, "[W]e presume that a possible storm could have been reasonably predicted by [the Respondent]" (Claimant's Memorandum, para.9). However, it was not the *storm* that was the impediment to the Respondent's performance of its contractual obligations but the resulting government *embargo*. Thus, the relevant question is whether the Respondent could have reasonably been expected to have taken the possibility of a storm-induced embargo into account at the time of the conclusion of the contract. In addressing that question, it must be kept in mind that "[n]ot every form of foreseeability means that an impediment cannot relieve the promisor under Article 79: after all, there is hardly any state or event which is unforeseeable in abstract terms. It is, rather, a question of whether under the actual circumstances at the time of the conclusion of the contract the promisor ought to have reasonably foreseen the impediment as to some degree *likely to occur*" (Stoll, Art.79, para.23)(emphasis added).
18. At the time of the conclusion of Cocoa Contract 1045 in November 2001, the last storm to have caused damage to Equatoriana's cocoa trees had been in 1980 – 21 years earlier – and even that storm had caused only damage that was "not extensive" (Procedural Order No.2, para.8). Cocoa Contract 1045 called for delivery of the cocoa before the end of May 2002, *i.e.*, less than seven months after the conclusion of the contract. Given that there had not been a significant damage-causing storm in Equatoriana in over 21 years, let alone a storm so serious as to prompt a government embargo, and that the contract's total time horizon was a period covering less than seven months, it is submitted that the Respondent could not possibly have been reasonably expected to foresee the storm-induced government embargo as being to some degree "likely to occur."

(d) The Respondent could not reasonably be expected to have avoided or overcome the embargo or its consequences

19. In its memorandum, the Claimant asserted, “The exemption [under Article 79] can’t be stated regarding the facts that Respondent had ability, possibility and opportunity to deliver the remaining 300 metric tons of cocoa. [...] Claimant could fundamentally expect a delivery from an easily accessible market” (Claimant’s Memorandum, para.9). By this, the Respondent understands the Claimant to be suggesting that the Respondent ought to have avoided the consequences of the embargo by purchasing non-Ecuadoriana cocoa on the open market and delivering it to the Claimant. However, it is well established that a party will not be disqualified from exemption under Article 79 unless it could have avoided the impediment or its consequences in a “reasonable manner,” for example, by performing a “commercially reasonable” substitute delivery (Stoll, para.24)(emphasis added).
20. The Respondent readily concedes that, had the price of cocoa on the open market at the time of the announcement of the embargo been the same or similar to the price agreed between the parties at the time of contract formation, purchasing and delivering cocoa from that market would indeed have been reasonable. However, at the time the embargo was announced in February 2002, the spot price of cocoa on the open market was USD 0.6767 per pound (Respondent’s Exhibit No.3), more than 20% higher than the price of USD 0.5628 agreed to in Contract 1045 (Claimant’s Exhibit No.2). Moreover, the market price never dropped below USD 0.6767 until after the Claimant entered into its substitute transaction in October 2002. Thus, the *least expensive* substitute delivery possible would have caused the Respondent a net loss of USD 100,441.58 (*i.e.*, $(USD\ 0.6767 - USD\ 0.5628) \times 2,204.6\ \text{pounds per ton} \times 400\ \text{tons}$), if it had bought and delivered all 400 tons of cocoa immediately upon learning of the embargo in February 2002. Even if it had waited until after it had delivered the 100 tons of Ecuadoriana cocoa in May 2002, the required open market transaction would have caused the Respondent a loss of at least USD 109,392.25 (*i.e.*, $(USD\ 0.7282 - USD\ 0.5628) \times 2,204.6\ \text{pounds per ton} \times 300\ \text{tons}$; USD 0.7282 was the lowest price for cocoa between the time of the Respondent’s delivery of 100 tons in May 2002 and the Claimant’s substitute transaction in October 2002: see Respondent’s Exhibit No.3).
21. In short, the only way the Respondent could have avoided the consequences of the embargo would have been for it to enter into substitute transactions that would have caused it net losses over USD 100,000. It surely cannot be maintained that such financially punishing measures would constitute avoidance of the embargo’s consequences in a commercially reasonable manner. Indeed, it must be kept in mind that the Claimant freely *chose* to limit its cocoa supply to Ecuadoriana even though, as discussed in section A.I.(a)(i)(2), above, the Claimant could just as easily – and for the same price – have purchased on the terminal markets and had its delivery guaranteed. Put differently, the Claimant chose to take on country-

specific risk in exchange for receiving the particular cocoa it desired. Now that such risk has materialized, the Claimant cannot be permitted to shift the costs of that risk to the Respondent by demanding that the latter provide it with cocoa from the very same terminal markets that the Claimant chose not to buy from in the first place. To allow such a demand would be to require *both* that the Respondent supply Equatoriana cocoa in the absence of impediments beyond its control, as any local exporter would be expected to do, *and*, in the event that such an exonerating impediment should arise, that the Respondent guarantee its performance by supplying cocoa of any other origin, just as a clearinghouse would be expected to do. As the Claimant agreed to pay the Respondent no more than standard market prices for its cocoa, the Claimant is not in a position to reasonably expect that the Respondent would insure its performance in this highly unusual way. It is thus submitted that, in the circumstances of this case, the Respondent could not reasonably have been expected to avoid the consequences of the embargo by purchasing at substantially higher prices substitute cocoa on the open market.

II. Even if Article 79 is found not to be applicable, the Claimant cannot claim damages under the CISG

22. In the event this Tribunal finds that the Respondent wrongly invoked Article 79 to excuse its non-performance, the Respondent admits that it is liable for damages compensable under Article 74. The Claimant, however, has neither suffered nor claimed any damages other than those related to its substitute transaction. As argued below, the Respondent contends that the Claimant's substitute transaction damages are not compensable under Article 74 (a), or under Articles 75 or 76 (b).

(a) The Respondent is not liable for the Claimant's substitute transaction damages under Article 74

23. Article 74 is the general provision for damages in the CISG (Stoll, Art.74, para.2). It applies equally to normal contractual breaches and fundamental breaches (Stoll, Art.74, para.7). Further, as the Claimant observes, it envisions full compensation for the non-breaching party (see *Award SCH-4366* (1994); Sutton, pp.742-743; *OLG 27 U 58/96* (Germany 1997); *OLG 1 U 31/99* (Germany 1999)). Contrary to the Claimant's contention, however, the fact that Article 74 envisions full compensation for the non-breaching party does not resolve the issue. In order to establish that the Claimant is entitled to have its substitute transaction costs compensated through Article 74, the Claimant must show that the meaning it ascribes to Article 74 coheres with the rest of the CISG. One cannot simply "ignore" the articles of the CISG that conflict with the Claimant's interpretation, as the Claimant has asked this Tribunal to do (Claimant's

Memorandum, para.65). The CISG is clear that substitute transaction costs are not to be compensated outside of cases of avoidance. This coherent principle can be established notwithstanding the goal of fully compensating a non-breaching party in Article 74. In advancing this argument, the Respondent relies specifically on Article 75 (i), Article 48 (ii), and the duty to cooperate (iii).

(i) Article 75 does not leave room for substitute transaction costs to be compensated under Article 74

24. Article 75 describes how parties may claim substitute transaction costs. In order for it to apply, three preconditions must be satisfied: the non-breaching party must have entered a substitute transaction after having validly avoided the contract, it must have done so in a reasonable manner, and it must have done so within a reasonable time after avoidance (Art.75). If a claimant were allowed to claim substitute transaction costs under Article 74, Article 75 would be rendered meaningless. Article 75 is a supplement to Article 74 (Stoll, Art.74, para.1); put differently, it exists only to add something to Article 74. In fact, by its own wording, it still leaves open to a claimant “any further damages recoverable under article 74.” The only purpose of Article 75 is to elaborate how a claimant can rightfully claim damages sustained through a substitute transaction (Stoll, Art.75, para.2). But if a claimant could gain compensation for its substitute transaction costs under Article 74, there could be no reason for Article 75. The only possible meaning the Claimant could ascribe to Article 75, under its interpretation of Article 74, is that Article 75 applies only to cases of avoidance and Article 74 applies only to cases of non-avoidance. Yet there is no foundation for such a claim. Article 74 makes no distinction between cases of avoidance and cases where there has been no avoidance, and it has been held to apply equally to both situations (Stoll, Art.74, para.1).
25. Allowing substitute transaction costs to be compensable under Article 74 in cases of non-avoidance would have the perverse effect of *discouraging* non-breaching parties from avoiding contracts before entering substitute transactions. Article 75 imposes two harsh conditions on a claimant: it requires the substitute transaction to have occurred in a reasonable manner and in a reasonable time after avoidance (see also Enderlein & Maskow, p.303). If one of these two conditions is not fulfilled, full compensation for substitute transaction costs will be denied (see *OLG 19 U 97/91* (Germany 1992)). By the Claimant’s reasoning, any claimant could simply circumvent the difficulties associated with these two conditions by not avoiding the contract. Article 74 imposes no conditions of reasonable manner or reasonable time. Any non-breaching party that put its mind to it would not avoid the contract before entering a substitute transaction, lest its claims for substitute transaction damages be more severely scrutinized.

26. There are excellent policy reasons for encouraging non-breaching parties to avoid a contract before entering a substitute transaction. Until avoidance, contractual obligations persist (see *OLG 3 U 83/98* (Germany 1999); *OGH 6 Ob 311/99z* (Austria 2000)). Avoidance reshapes the contractual relationship, such that the parties concern themselves with ending the effects of the contract (Leser, Art.81, para.9) rather than attempting to fulfill their obligations at all costs. Encouraging non-breaching parties to enter substitute transactions without having avoided the relevant contract would unfairly disadvantage defaulting parties. Avoidance is meant to clearly indicate to *both* parties that they can move ahead with their commercial dealings without being further burdened by a failed contract (see *OLG 3 U 83/98* (Germany 1999)).
27. One must also recall that avoidance is available only with respect to particularly egregious contractual breaches (*i.e.*, fundamental breaches or non-delivery pursuant to Article 49). And while the Claimant spent considerable effort in its memorandum explaining why it feels the Respondent committed a fundamental breach – an argument that is refuted at paras.35-39, below – the fact remains that a claim under Article 74 does not require a fundamental breach to be compensated (Stoll, Art.74, para.7). By allowing a party to enter a substitute transaction at *any point* after *any* breach, the Claimant's interpretation of Article 74 conflicts with the core notion behind the substitute transaction regime in the CISG, *i.e.*, that it is because a contract was breached in a way sufficiently serious to render performance useless that the non-breaching party should be allowed to move on beyond the contract. Thus, avoidance and substitute transactions should be understood as a last resort, discouraged by the CISG in all but the most serious cases.

(ii) The Claimant's interpretation of Article 74 does not cohere with Article 48

28. Article 48 recognizes a defaulting party's right to cure any contractual breach, including late delivery (Honnold, §§295, 299). The right to cure is an important right in commercial contracts because it allows parties to resolve disputes themselves, without recourse to more costly methods of dispute resolution. As important as it is, however, a breaching party's right to cure remains subject to the non-breaching party's right to avoidance (Art.48(1)). When a breaching party's performance of the contract is no longer worthwhile for the party not in breach, avoidance will be available as a recourse, subject to the requirements of Article 49. The relationship between the right to cure and avoidance is perfectly illustrated by Article 75. Generally, a defaulting party will have the right to cure its breach (Art.48) – even its fundamental breach (Honnold, §296) – until avoidance (Art.49), at which point the non-breaching party will be free to enter a substitute transaction and have its costs compensated (Art.75). Only once the non-

breaching party has put an end to the contractual relationship will full compensation for a substitute transaction be possible.

29. The Claimant's interpretation of Article 74 is inconsistent with the right to cure. A claimant using Article 74 to claim its substitute transaction costs will not necessarily have avoided the contract. Thus, according to the Claimant's argument, a claimant should have the right to enter a substitute transaction and have it fully compensated *even while the defaulting party's right to cure still subsists*. At the level of commercial policy, this result is highly undesirable: it makes little sense to encourage a defaulting party to work hard to cure its breach while a claimant retains the right to enter a substitute transaction without warning. This rule would leave the defaulting party completely in the dark and subject to any arbitrary decision of the non-breaching party as to when it wishes to enter a substitute transaction.

(iii) The Claimant's interpretation of Article 74 is inconsistent with the duty to cooperate

30. The Claimant spent considerable time in its memorandum elaborating upon the duty to cooperate that exists between two parties that have concluded a contract together (Claimant's Memorandum, paras.36-43). Yet, it is the Claimant's own interpretation of Article 74 that is most offensive to the duty to cooperate. In interpreting the CISG such that avoidance is not required before entering into a substitute transaction, the Claimant eschews the principle that the parties are supposed to "remain loyal to the contract" (*OLG 3 U 83/98 (Germany 1999)*), working together to ensure contractual performance up until the date of avoidance. By allowing a non-breaching party to unilaterally enter a substitute transaction, without fundamental breach or even a specific warning as to when this transaction would occur, the Claimant is offering an interpretation of the CISG that leaves a defaulting party completely at the mercy of a non-breaching party. The non-breaching party is left with no obligation to keep the defaulting party abreast of its situation, and the defaulting party may be left completely in the dark with respect to the status and immediacy of the non-breaching party's needs.

(b) The Respondent is not liable for the Claimant's substitute transaction costs under Articles 75 or 76

31. In its memorandum, the Claimant based its claim solely on Article 74. However, the Respondent would like to take this opportunity to assert that, even if the Claimant had based its claim on Article 75 or Article 76, such claims would not be well-founded. The Claimant did not properly avoid the contract before entering into the substitute transaction, and therefore Article 75 is inapplicable (i). Further, neither article applies

because both are premised on the existence of conditions necessary for valid avoidance, and the conditions for valid avoidance were never present (ii).

(i) The Claimant did not properly avoid the contract before entering into its substitute transaction

32. Article 75 requires a claimant to have avoided the relevant contract *before* entering into a substitute transaction (Art.75; Huber, Art.45, para.43; Enderlein & Maskow, p.303). Article 26 requires that notice be given to the other party before a declaration of avoidance can be considered effective. Contrary to the Claimant's position that the CISG recognizes "implied avoidance" (Claimant's Memorandum, para. 58), Article 26 is based specifically on the principle that *ipso facto* avoidance, *i.e.*, avoidance implied by the conduct of the parties, is *not* recognized in the CISG (Leser, Art.26, para.2; ICC#8574 (1996)). Any declaration of avoidance must be clear, unambiguous, irrevocable, and must leave no doubt that contractual obligations have ended (Leser, Art.26, para.6). The Claimant made no such declaration of avoidance to the Respondent before entering into the substitute transaction.
33. On 24 October 2002, the cocoa contract was still in effect. At that point, the most recent contact between the parties – a phone call of 29 September 2002 – confirmed that the Respondent was still expected to act on its contractual obligations. The Claimant had never wavered from this position at any point in the relationship between the parties up to that point. At no time was the Respondent given a tangible ultimatum with a clear deadline. The Claimant's substitute transaction of 24 October 2002 was entered into while the Respondent clearly believed it was still under the obligation to perform and still had the opportunity to perform without the Claimant having suffered any damages. Such a situation is completely inconsistent with the doctrine of avoidance, not to mention the words and principles of Article 26, which attempt to introduce clarity into breached contractual relationships (Leser, Art.26, para.2). Not having avoided the contract before entering into a substitute transaction, the Claimant cannot avail itself of Article 75 (see *OLG 3 U 83/98* (Germany 1999); *OLG 6 U 210/03* (Germany 2004); *Digest on Art.75*, para.7; *Award 54/1999* (2000)).

(ii) The Claimant cannot avail itself of any remedy premised on valid avoidance

34. Both Articles 75 and 76 are premised on the existence of a valid avoidance (*Award 54/1999* (2000)). The Claimant cannot rely on either of these articles because the conditions for valid avoidance never existed in the present case: there was neither fundamental breach (1), nor the expiry of an additional delay provided pursuant to Article 47 (2).

(1) ***The Respondent did not fundamentally breach the contract***

35. The Claimant rightly treats the Respondent's breach as one of late delivery, not non-delivery (Claimant's Memorandum, paras.14ff; see also Schlechtriem, Art.25, paras.17-18). The Respondent was always willing to perform its obligations once the embargo ended, as evidenced by its timely delivery of 100 tons of cocoa once the government allowed limited exports. The only question in the present case was *when* the cocoa would be delivered, not *if*.
36. Late delivery may amount to a fundamental breach of the contract in a limited number of circumstances. The Claimant correctly noted in its memorandum that "a delay in delivery can rise to a level of a fundamental breach when a timely delivery is in the special interests of the buyer" (para.15). Such special interests, it continued, need to be established at the time of the conclusion of the contract (para.15; *OLG 1 U 167/95* (Germany 1997)). A review of the case law cited by the Claimant itself confirms that late delivery will only exceptionally yield fundamental breach. Thus, in *Italdecor s.a.s. v. Yiu's Industries (H.K.) Limited* (Italy 1998), the parties unambiguously envisioned delivery before the holidays. In *ICC#8786* (1997), neither party denied the existence of a fundamental breach because the contract involved seasonal goods. Most revealingly, in *OLG 6 U 87/96* (Germany 1997), the court found that there was no fundamental breach because late delivery normally will not constitute fundamental breach: "A fundamental breach in this sense, however, can generally not be seen in the mere non-compliance with a date of delivery. In so far, it is required that the precise compliance with the delivery deadline is of particular interest to the buyer, namely that the buyer prefers not to receive delivery at all than receiving delayed delivery and that this is apparent for the seller at the conclusion of contract."
37. In the present case, the criteria for late delivery constituting fundamental breach are not met. Far from constituting "special" circumstances, the specific date of delivery was of so little interest to the Claimant that it let the Respondent choose the date, admittedly within certain parameters. There is no evidence of any emphasis being placed on date of delivery at the time of negotiation. And cocoa is not a seasonal good.
38. Looking at the conduct of the parties through 2002 (which is relevant to the interpretation of a contract: see Art.8(3); Junge, Art.8, para.2; *Digest on Art.8*; *BG 3PZ 97/18* (Switzerland 1997); Honnold, §109), it is obvious that neither party felt timely delivery was particularly important. When the time period for delivery expired, the Claimant never indicated that timely delivery was important to it at present or at a specified date and time in the future. To the contrary, the Claimant indicated that immediate performance would *not* be necessary (Claimant's Exhibit No.4). In later correspondence, the Claimant adequately informed the

Respondent that, at some undisclosed point by the end of the calendar year, it would need the goods; but it never did more than this. The fact that the Claimant never indicated a specific date by which it would need the cocoa is quite revealing: after all, if even on 29 September 2002 the Claimant could not indicate that it would definitely need cocoa within the next month, how could it maintain that *both* parties knew performance before 24 October 2002 was crucial *at the time the contract was concluded*?

39. In fact, even the very day the Claimant entered into the substitute transaction, it was not forced to do so by commercial reality. Its supplies could have lasted almost a month more (Procedural Order No.2, para.24). The Claimant even admits that, if it had suspected the embargo would end so soon, it “could have” considered “other solutions” (Claimant’s Memorandum, para.42). This admission also adequately refutes the Claimant’s contention that it had to enter this substitute transaction in order to mitigate its damages (Claimant’s Memorandum, paras.66-70). In all, it can hardly be said that, following the holding in *OLG 6 U 87/96* (Germany 1997), the Claimant would have preferred not to receive delivery at all than to receive it from the Respondent on 25 October 2002.

(2) The Claimant could not avoid the contract pursuant to Article 49(1)(b)

40. In cases where the goods have not yet been delivered, a claimant can avoid the contract without suffering fundamental breach through a simple procedure elaborated at Article 47. If, for instance, timeliness of performance becomes important to a buyer after the contract is concluded, it may “fix an additional period of reasonable length for performance by the seller” (Art.47(1)), after which the buyer may validly avoid the contract (Art.49(1)(b)), even absent fundamental breach (Honnold, §295). The Claimant never took advantage of this recourse available to it.
41. Most basically, Article 47 requires that an additional period of time be set. Honnold explicitly declares that this period must be “fixed;” he writes that a notice threatening avoidance if goods do not arrive “promptly” is insufficient to satisfy Article 47 (§289). Yet the Claimant never informed the Respondent of a date by which it would have the right to declare the contract avoided. In the absence of such a specific time period, the Respondent’s right to cure continues until cure becomes unreasonable (Art.48; see Koch, p.225). On 24 October 2002, the Respondent had every reason to believe it could still perform its contractual obligations.
42. Subsidiarily, the Tribunal might consider that the Claimant did fix an additional period, but that it had not yet elapsed on 24 October 2002. Through 2002, the Claimant made vague declarations of timelines: “later this year” in its letter of 5 March 2002, and “soon” in its letter of 15 August 2002 and its telephone conversation of 29 September 2002. These vague declarations gave the impression that, while substitute transactions

were being considered by the Claimant, a more definite warning would come before the Claimant acted. Thus, there is room for the Tribunal to consider that the Claimant *started* the additional period under Article 47, but that it never made it clear that that period had *ended*. In other words, had the Claimant said on 17 October 2002 that it was going to enter a substitute transaction the following week, it would have been difficult for the Respondent to argue that the additional period that had been granted was not of “reasonable length.” But the Claimant cannot retroactively pretend that such a clear deadline had been set and then elapsed.

III. Subsidiarily, if the Claimant is considered to have validly avoided the contract, the Respondent’s liability is limited to damages based on the market price of cocoa on 15 November 2002

43. If the Tribunal should find that the conditions for valid avoidance were, in fact, present on 15 November 2002, the Respondent concedes that the Claimant validly declared its avoidance of the contract on that date. The Respondent maintains that, up until that date, the Claimant had not clearly and unequivocally declared avoidance in accordance with the requirements of Article 26. This is apparent from the interaction between the parties before 15 November 2002. For instance, in its letter of 13 November 2002, the Respondent claimed that *the Claimant* breached Cocoa Contract 1045 through its recent actions (Claimant’s Exhibit No.10); this allegation could only make sense in the context of a contract the Respondent believed was still in effect. The Claimant’s letter two days later recognized the Respondent’s confusion, and only then clarified that the Claimant intended to avoid the contract, wind up the relationship, and prepare for the arbitration of these issues (Claimant’s Exhibit No.11). A clear and unambiguous declaration of avoidance did not take place before that letter (see Leser, Art.26, para.6). Under these circumstances, Article 76 is the relevant CISG provision for settling the dispute. Not having entered into a substitute transaction after avoidance, Article 75 is inapplicable (compare *OLG 19 U 97/91* (Germany 1992)). Article 76 would allow the Claimant to be compensated for the difference between the contract price and the current market price on 15 November 2002, *i.e.*, USD 172,026.

B. THE TRIBUNAL HAS JURISDICTION TO HEAR THE RESPONDENT’S CLAIM FOR THE FULL AMOUNT OF USD 385,805

44. Sugar Contract 2212 called for the Respondent to deliver sugar to the Claimant. When the sugar arrived in Mediterraneo, it was wet and unfit for human consumption. Consequently, the Claimant refused to pay the purchase price. The Respondent submits that any loss resulting from the contaminated sugar should be

borne by the Claimant, and that the Claimant is still bound to pay to the Respondent the agreed purchase price of USD 385,805.

45. If, and only if, the Tribunal finds the Respondent liable for damages arising under Cocoa Contract 1045, the Respondent requests that these damages be set off against the damages owed by the Claimant under the sugar contract.
46. This memorandum does not propose to address the substantive merits of the dispute arising out of the sugar contract. Rather, it confines itself to the jurisdictional controversy associated with the Respondent's request to set off an outstanding debt against any amount recovered by the Claimant under the cocoa contract. Fundamental to this controversy is the fact that the aforementioned sugar contract contained an arbitration clause referring all disputes to an arbitration tribunal in Port Hope, Oceania. The Respondent here argues that the Tribunal has jurisdiction over the claim arising out of the sugar contract, notwithstanding that it is subject to a different arbitration clause.
47. The Respondent's argument can be summarized as follows. First, the claim advanced by the Respondent constitutes a validly framed procedural set-off defence (I). Second, Article 21(5) of the Swiss Rules, applicable to the current arbitration, grants the Tribunal jurisdiction to hear all procedural set-off defences, including the one advanced by the Respondent (II). Therefore, the Respondent requests that the Tribunal assume jurisdiction over the sugar contract dispute and hear the Respondent's claim for the full amount of USD 385,805.

I. The Respondent's claim should be characterized as a procedural set-off defence

48. The Respondent's claim is of a specific legal nature: it is invoked for the purposes of shielding the Respondent from any damages owed to the Claimant under the cocoa contract. If successful, the claim will have the consequence of "netting" or "setting-off" the damages owed under each contract. While every legal system imposes criterion for what constitutes a valid "set-off defence", the Claimant alleges that any such inquiry should be preempted from the outset. Specifically, the Claimant contends that because the Respondent has titled and presented its claim as a "counterclaim" and not as a set-off defence, the claim should be denied any benefits that might otherwise be accorded to a true set-off. Not only is this particular objection unsound (a), but a more complete legal analysis reveals that the Respondent's claim meets all the internationally accepted hallmarks of "procedural" set-off defences (b).

(a) **The Respondent's decision to title and present its claim as a "counterclaim" cannot bar its correct characterization as a set-off defence**

49. The Claimant contends that the Respondent's claim cannot be characterized as a set-off defence, but must instead be recognized as a counterclaim. Specifically, the Claimant emphasizes that that Respondent "itself labels its discussion of the dispute in regard to the sugar contract 2212 as a counter-claim" (Answer 2, para.5). However, this argument is seriously flawed because it overlooks the current English usage and meaning of the terms "counterclaim" and "set-off."
50. Notwithstanding the close connection between set-off and counterclaim, the Respondent acknowledges the importance of distinguishing between the two institutions. Most crucially, a true set-off operates as a defence to the main claim, and is asserted by a respondent to deny liability (Goode, p.238). A counterclaim is not linked to the main claim in the same way; it forms a separate and independent cross-action (Berger 1999, para.III; Palmer, p.16). This distinction gives rise to numerous legal consequences. For instance, if the main claim is dismissed, a set-off defence necessary fails (Baker & Davis, p.286). As an independent action, a counterclaim can be sustained by an adjudicator even if the main claim is dismissed (Baker & Davis, pp. 285-286). Furthermore, as this particular dispute illustrates, counterclaim and set-off often receive different jurisdictional treatment in the context of international arbitration (Derham, p. 5).
51. In spite of these distinctions, set-off and counterclaim are often only a "hair's-breadth away" from each other, especially when sums of money are at stake (Wood, para.37). Thus, commentators have remarked that the co-existence of two opposing monetary claims between the same parties might allow a respondent to invoke either a set-off defence or a counterclaim at his or her preference (Berger 1999, para.III). Given the close proximity between the two concepts, it is not surprising that imprecise terminology has often been the source of many problems. Parties intending to plead a set-off defence frequently complicate matters by presenting it as a counterclaim. In response to these complications, common law jurisdictions have formulated a rule allowing any party to plead a true set-off defence as a counterclaim, but nevertheless prohibiting a true counterclaim from being pleaded as a set-off defence (Palmer, p.16; Halsbury, para.409).
52. It is for precisely this reason that lexicographers have recognized the overlap between set-off and counterclaim as legal terms of art. *Black's Law Dictionary*, the most authoritative legal dictionary in the English speaking world, makes this overlap explicit in its entry on "counterclaim", reproduced here:

counterclaim, *n.* A claim for relief asserted against an opposing party after an original claim has been made; esp., a defendant's claim in opposition to *or as a setoff against* the plaintiff's claim (emphasis added) (Black's, p.353).

53. In the English language, the word "counterclaim" can in fact denote a set-off. Accordingly, the Respondent's decision to title and present its set-off defence as a counterclaim is perfectly consistent with the meaning of "set-off" in the contemporary English legal vernacular. Especially in the context of international arbitration, where language barriers and translation issues are already the source of much confusion, the Respondent submits that it should be safely entitled to rely on a dictionary in formulating its claim. In any case, by invoking Article 21(5) of the Swiss Rules, which is particular to set-off defences, the Respondent clearly manifests its intention to invoke those, and only those, remedies unique to set-off, and *not* the more general remedies associated with counterclaim. The Claimant's contention that the Respondent has alleged a counterclaim, and not a true set-off, should therefore be dismissed.

(b) The Respondent's claim meets the established hallmarks of procedural set-off

54. Even if the Tribunal accepts that the Respondent has not alleged a counterclaim, the Respondent's defence is still open to the objection that it does not meet the internationally accepted criteria applicable to set-off defences, and thus cannot be characterized as such. While the Respondent's set-off does not, in fact, meet the international requirements imposed on *substantive* set-off defences, it nevertheless constitutes a validly framed *procedural* set-off defence.
55. A set-off defence generally falls into one of two categories: substantive (alternatively referred to as "equitable" or "transactional" set-off in English, or "*compensation légale*" in French), or procedural (alternatively known as "independent or "statutory" set-off in English, or "*compensation giudicare*" in French). Different legal requirements and consequences attach to each, and so it is necessary to classify the Respondent's claim appropriately.

(i) A set-off defence can be substantive in nature

56. Both common law and civil law jurisdictions acknowledge that set-off can function as a substantive, contractual defence (Berger 1999, para.II(c); Zimmermann, pp.28-29). This type of set-off has a number of distinguishing features, the most important of which is that it serves to eliminate the principal claim advanced by a claimant, exonerating the respondent from liability. In this sense, it functions in the same way as any other substantive contractual defence to an action. Given this rather weighty legal

consequence, it is not surprising that a substantive set-off defence must satisfy specific conditions imposed by the governing substantive law.

57. Although the CISG is itself silent with respect to the issue of set-off, assessing substantive set-off defences in an international context is facilitated by a general consensus across jurisdictions as to the requirements of a valid claim. Recent efforts directed toward the unification of international contract law (specifically, those undertaken by UNIDROIT) have adopted extensive principles outlining the requirements for a substantive set-off defence, the most fundamental for this arbitration being the following: a respondent can invoke a substantive set-off defence based on a right which is uncertain as to its existence or amount if, and only if, that right arises from the same contract as the one giving rise to the principal action of the claimant (UNIDROIT, Chapter 8). It is worth mentioning that the Respondent's action does not, in fact, meet this requirement. Since the Respondent's action is both contested by the Claimant, and arises out of a different contractual arrangement than the one giving rise to the cocoa dispute, it cannot succeed as a substantive set-off defence.

(ii) A set-off defence can be procedural in nature

58. The institution of set-off is not, however, exhausted by substantive set-off. In many legal systems, a party may raise a procedural set-off claim, *i.e.*, a claim that is not a substantive contractual defence to the main claim. A party asserting a successful procedural claim for set-off is not exonerated from liability under the main claim, but by virtue of the cross-action, is excused from fulfilling its financial obligations (Goode, p.238; *In re K.L. Tractors Ltd*, p. 507). This conception enables the adjudicator to “net” mutual outstanding debts, thus reducing the transaction costs that result from the transfer of funds between parties, avoiding circuity of action, and minimizing the risk that a party becomes insolvent (Goode, p.241; Aeberli p.5).
59. Unlike substantive set-off, procedural set-off has not been the target of international harmonization efforts. In fact, the drafters of the UNIDROIT Principles explicitly *excluded* procedural set-off from the scope of the chapter on set-off. In a telling statement by the UNIDROIT Working Group, Professor C. Jauffret-Spinosi remarks that “it would be difficult to consider set-off as a procedural device” within the UNIDROIT Principles. To adopt a procedural conception of set-off “would require integrating the notion of set-off in the procedural rules of the various nations.” Thus, although international harmonization has worked toward a unified approach to set-off within the contractual arena, such consensus does not purport to usurp the institution of procedural set-off from the scope of procedural law, either in the context of domestic legal systems or international commercial arbitration. As Professor Jauffret-Spinosi adds, “[t]he rules of civil

procedure are best left to each individual court system" (emphasis added) (p.5). The possibility of advancing a procedural set-off defence has not, then, been extinguished by the UNDRIT Principles or other harmonization efforts.

60. Notwithstanding the lack of international consensus regarding procedural set-off, both civil and common law jurisdictions generally agree that certain conditions must be met in order for such a defence to be validly construed. Most crucially, the set-off need not be based on the same contract giving rise to the claimant's principal action. In fact, it need not be related in any way to the claimant's action, so long as the debts are mutual (Zimmermann, p.24; Goode, p.248). However, recognizing the possibility that procedural set-off might unnecessarily delay the adjudicative proceedings, both legal traditions impose a strict requirement that the sum to be set-off must be capable of being ascertained or liquidated with precision at the time of the pleading (for the Common Law, see *Stooke v. Taylor*, discussed in New South Wales Commission, p.22, and Derham, p.17; and *Axel Johnson Petroleum v. MG Mineral Group*, discussed in Aeberli, p.5; for the Civil Law, see the discussion of *compensation judiciaire* in Zimmermann, p.52). Note, however, that this "liquidity requirement" pertains only to the quantum of damages being sought, and not to the existence of the respondent's claim: a statutory set-off or *compensation judiciaire* will not be denied simply because the entitlement is disputed by the claimant on grounds that require determination by litigation or arbitration (Derham, p.16).
61. Some commentators would add an additional requirement for valid procedural set-off. According to Berger, a true set-off can only be advanced for an amount less than, or equal to, the principal claim advanced by a claimant (Berger 1999, para.III). While this position reflects the traditional common law maxim that a set-off can "only be used as shield, and not a sword" (Aeberli, p.12), it does not correspond with the position adopted by many contemporary legal systems. In fact, common law jurisdictions themselves have departed from the traditional position and adopted a more progressive conception of procedural set-off which would allow a respondent to recover for the full amount of a set-off claim, even if that amount exceeds the amount of the principal claim. Subsection 111(3) of the Ontario *Courts of Justice Act* provides that where, "on a defence of set off, a larger sum is found to be due from the plaintiff to the defendant than is found to be due from the defendant to the plaintiff, the defendant is entitled to judgment for the balance". *Halsbury's Laws of England* confirms this position when it provides that where a defendant's set-off exceeds the plaintiff's claim, the plaintiff's claim is extinguished, and the defendant may recover the balance (Halsbury, par.495). The Respondent does not here submit that the liberal approach adopted in Ontario and England is appropriate in the context of international arbitration; that argument is advanced below, at paragraph 90.

The Respondent wishes to emphasize, however, for the purposes of characterization, a procedural set-off defence need not be limited to the amount of a Claimant's principal action.

(iii) The Respondent's claim is a valid procedural set-off defence

62. The Respondent's claim meets all the requirements of procedural set-off imposed by both common law and civil law traditions. First, the claim clearly satisfies the requirement of mutuality. Second, the set-off satisfies the requirement of liquidity: the sum to be set-off against the Claimant's entitlement is capable of being ascertained with precision. Recall that the sugar contract called for the Claimant to pay USD 385,805 upon receipt of the sugar. That sugar was completely contaminated upon arrival. The only issue to be decided by the Tribunal is which party should be responsible for bearing the loss. Thus, the Respondent is either entitled to USD 385,805, or it is not – but the amount being claimed is not in dispute. Finally, the fact that the Respondent's claim exceeds the principal claim should not bar its characterization as a set-off defence.

II. The Tribunal has jurisdiction to hear the respondent's procedural set-off defence

63. The Claimant contends that the Tribunal lacks jurisdiction to hear the set-off defence advanced by the Respondent. As the Claimant correctly remarks in its Answer to Counter-Claim, the sugar contract, which here forms the basis of the set-off defence, contained an arbitration clause referring arbitration to Port Hope, Oceania in accordance with the Rules of Arbitration of the Oceania Commodity Association. The Claimant then suggests that because the Respondent's claim is subject to a different arbitration clause than the principal claim, the Tribunal lacks jurisdiction to consider it.
64. It is worth mentioning that the modern approach to set-off in international commercial arbitration is liberal: as a general principle, the jurisdiction of an arbitral tribunal extends even to those set-off claims that are subject to different arbitration clauses (Herman, para.(II)(d)(ii)). Thus, in 1999, Klaus Peter Berger wrote: "there is growing tendency to assume that, as rule, an international arbitral tribunal has jurisdiction to hear a set-off defence based on a cross-claim that is subject to a different arbitration agreement or jurisdiction clause" (Berger 1999, para.V(b)(ii)). However, in order to ensure that this liberal approach does not threaten the stability of arbitrations, commentators and arbitrators have restricted the application of this rule to instances where the set-off operates as a true *substantive* defence to the principal claim (Berger 1999, para.V(b)(ii); Aeberli, p.15).
65. As discussed above at paragraph 57, the Respondent's set-off does not (nor indeed strives to) meet the requirements for substantive set-off. The Respondent therefore admits that its set-off defence cannot

benefit from the generally accepted rule of jurisdiction. Likewise, the Respondent concedes that the only basis for jurisdiction is Article 21(5) of the Swiss Rules. The Respondent here argues, first, that Article 21(5) of the Swiss Rules does, in fact, apply to this arbitration (a) and, second, that Article 21(5) of the Swiss Rules, in contemplating both substantive and procedural set-off, authorizes the Tribunal to hear the Respondent's set-off defence (b).

(a) The Swiss Rules, and 21(5) therein, are applicable to the arbitration proceedings

66. The arbitration clause contained in Cocoa Contract 1045 referred disputes to arbitration under the rules of the Chamber of Commerce and Industry of Geneva ("CCIG"). At that time, all CCIG arbitrations were conducted according the Geneva Rules. Since then, the CCIG has adopted the new Swiss Rules. Nothing in the arbitration clause, or in the Geneva Rules themselves, stipulated which rules would apply in the event of a rule change. The Claimant contends that the parties envisioned the Geneva Rules to apply notwithstanding any subsequent rules changes, and consequently that Article 21(5) of the Swiss Rules cannot apply to the current arbitration (Answer 2, para.4).
67. The Respondent submits that the Swiss Rules are, in fact, applicable to the current arbitration. This result accords not only with the contemporary practices of arbitral institutions (ii), but also with the original intentions expressed by the parties (iii). First, however, it is essential to consider the nature of private arbitration rules and the basis for their authority (i).

(i) The nature of arbitration rules informs which version of the rules should apply

68. Although institutional arbitration rules are adopted as a consequence of an institution's administrative decisions, commentators and courts have nevertheless identified the binding character of procedural rules as contractual in nature.(Fouchard, §359) This is to say that private arbitration rules derive their authority to the extent that parties have agreed to them. However, complete deference to the parties' choice of procedural rules must nevertheless be compromised in regard for an arbitral institution's ability to provide simple and effective proceedings (Rubino, p.58). Hence, Fouchard *et al.* concede that where a principle of institutional arbitration procedure is "widely known and regularly observed" or has otherwise attained the status of a procedural usage, it can apply to the arbitral proceedings even in the absence of an express provision or agreement to that effect (Fouchard, §362). In deciding which version of the rules should apply to this arbitration, the Tribunal must consider, first, if, as a matter of arbitration procedural usage, any future revision to the Geneva Rules should be applicable to the arbitration, and second, whether the parties

themselves agreed to be bound by future rule changes. Both of these lines of analysis confirm that the new Swiss Rules should apply.

(ii) Under general principles of arbitration procedure, the Swiss Rules should apply

69. For the past fifteen years, arbitral institutions have regularly had to address controversies associated with institutional rule changes. As early as 1987, in a statement of communication from the Secretary General of the Court of Arbitration, the ICC inaugurated a presumption in favour of the applicability of the *most recent version* of institutional rules where the arbitration agreement or the rules themselves were otherwise silent on the matter (Craig, Park & Paulsson, p.143). Specifically, the new amended ICC rules would govern all arbitrations commenced on or after their entry into force. The old rules would be applied if, and only if, an arbitration clause agreed to by the parties before that date made unambiguous reference to the arbitration rules “then in force”, that is, to the rules existing at the precise time when the arbitration agreement came into existence.
70. Accordingly, when the ICC promulgated the heavily reformulated version of its institutional rules in 1998, the drafters considered it appropriate to indoctrinate this general principle into the written text (Derains & Schwartz, p.76). Article 6(1) of the ICC Rules now provides that “where the parties have agreed to submit to arbitration under the Rules, they shall be deemed to have submitted *ipso facto* to the Rules in effect on the date of commencement of the arbitration proceedings unless they have agreed to submit to the Rules in effect on the date of their arbitration agreement”. The Respondent emphasizes that this approach is in no way unique to ICC Arbitration, but has been adopted in other institutional settings, and is today reflected in Article 1 of the AAA International Arbitration Rules, Article 2 of the WIPO Arbitration Rules and, indeed, the model arbitration clause contained in the new Swiss Rules. English courts have paid similar deference to this principle, and in a series of decisions have established a presumption that where a clause requires arbitration according to the rules of a particular institution, that clause should be interpreted as referring to the rules in place when the arbitration is begun (O’Conor, p.42).
71. The arbitration clause in the cocoa contract designated the Geneva Rules as those applicable to the arbitration, but made no reference to the rules “then in force”. Nor did the Geneva Rules contain an express provision incorporating future rule changes by reference. As a matter of arbitration usage, the arbitration clause should therefore be constructed as referring to the rules now in force, which are the Swiss Rules. This conclusion also accords with the expressed intentions of the parties.

(iii) The intention of the parties confirms that the Swiss Rules should apply

72. Discerning the parties' intention requires a careful interpretation of the agreement to arbitrate. The principle of interpretation in good faith, widely accepted in international arbitration, demands that the parties' true intention should be privileged over their declared intention (Fouchard, §477). As a corollary of this principle, a tribunal cannot defer to what the parties now assert to be their true intention, but must instead examine, first, the circumstances which the parties could have reasonably envisioned at the time of contract formation and, second, the attitudes of the parties after contract formation.
73. When the parties concluded the cocoa contract on 19 November 2001, it was reasonably foreseeable that the CCIG would be adopting new rules at a future date. Well before 2000, foreign users of Swiss arbitration had expressed frustration that each of the five chambers of commerce operated under different rules (Blessing, p.275). In response, the Swiss Arbitration Association tabled a proposal to develop uniform rules for the various Swiss chambers of commerce. Hence, one year prior the conclusion of the cocoa contract, and in a leading text on international arbitration in Switzerland, President of the Swiss Arbitration Association Marc Blessing explicitly endorsed the establishment of new Swiss Rules applicable to all international arbitration in Switzerland (Blessing, p.275). Knowledge of this unification project was by no means confined to insiders or exclusive circles, but was "well publicized in interested circles and known by lawyers who engage in international commercial arbitration" (Procedural Order 2, para.5). When the cocoa contract was concluded in 2001, the Claimant knew, or at least ought to have known, that a rule change was imminent.
74. Although the Claimant ought to have anticipated the possibility of a rule change, it failed to take any measures reasonably necessary to preserve the applicability of the Geneva Rules. Lawyers who draft contracts and arbitration clauses have long been aware of the complications associated with institutional rule change. In a 1989 article aptly titled "How to Draft an Arbitration Clause", Secretary General Stephen R. Bond of the ICC cautions lawyers to make reference to the rules "'then in force', *i.e.*, at the time of the signature of the contract containing the arbitration clause" if they wish to be bound by a previous version of rules (Bond, para.III(b)). Failure to adopt this standard drafting technique would, according to Craig, Park, and Paulsson, lead arbitrators to conclude that the parties implicitly accepted that the institutional rules might evolve (p.89). That the Claimant now alleges that it never contracted to be bound by new rules is inconsistent with both the information which was reasonably available at the time of contract formation and with its choice to adopt a standard arbitration clause where a rule change was reasonably conceivable.

75. Most fundamentally, however, the behavior of the Claimant after contract formation is inconsistent with its present submission that it never envisioned itself being bound to Article 21(5) of the Swiss Rules. Even though the Claimant was, or ought to have been, aware of the rule change long before this dispute arose, a letter sent by the administering institution to the Claimant on 6 July 2004 provided explicit notice of the new rules. Shortly thereafter, the Claimant paid the necessary registration costs, as provided in a letter to the institution on 12 July 2004. In that correspondence, the Claimant made no mention of the new Swiss Rules. Four days later, in a letter sent to both the Claimant and the Respondent, the institution once again provided explicit notice of the rule change. And yet, on 21 July 2004, when the Claimant responded with a letter making reference to specific provisions in the new Swiss Rules (indicative that the Swiss Rules had, in fact, been read *in their entirety*), it provided absolutely no indication that it found these rules to be objectionable, in whole or in part. It was not until 31 August 2004, fifty-six days after the Claimant first received official notice of the rule change, but (rather conveniently) just shortly after the Respondent had voiced its intention to rely on Article 21(5), that the Claimant voiced an objection to the rule change in its Answer to Counter-Claim. Before its Answer to Counter-Claim, the Claimant was acting like a party who had fully contemplated the implications of the rule change and had consented to its application. Now, the Claimant is behaving like a party who wishes to exploit to its own advantage an administrative decision which it had previously foreseen and to which it had acquiesced.
76. General principles and usage of arbitration entail that the Swiss Rules should apply to the arbitration. The circumstances surrounding the present dispute confirm that the parties' intention accords with that result. Therefore, the Tribunal should apply the Swiss Rules, and Article 21(5) therein, to the present dispute.

(b) Article 21(5) should apply to the procedural set-off defence invoked by the Respondent

77. Having established that Article 21(5) does in fact apply to the current arbitration, the question of jurisdiction now turns on whether the specific procedural set-off defence invoked by the Respondent can be brought under the scope of the provision.

(i) The scope of Article 21(5) is ambiguous

78. Article 21(5) of the Swiss Rules provides that the Tribunal shall have jurisdiction to hear a set-off defence even where that defence is subject to a different arbitration clause. However, the Swiss Rules themselves provide no indication of what constitutes a validly construed set-off defence for the purposes of Article 21(5). On a strict reading of the text, a reader could impart three different (yet equally plausible)

interpretations to the term “set-off”, ranging from a very conservative construction of the term to a highly progressive one. In order to properly assess the question of jurisdiction raised by the Respondent’s set-off, these varying interpretations must be examined.

79. First, it could be alleged that “set-off” in Article 21(5) refers only to *substantive* set-off, that is, only to those set-offs which function as true substantive defences to a claimant’s principal action. Note that this interpretation represents the most conservative of three: according to generally accepted principles of international arbitration, a tribunal will *always* have jurisdiction to hear a substantive set-off defence even in the absence of an authorizing provision (see para.64, above). In rendering Article 21(5) a mere codification of an already accepted principle, this “conservative” interpretation seems to conflict with the drafter’s choice to include a specific provision addressing the jurisdiction of set-off defences within the Swiss Rules.
80. A less conservative interpretation of Article 21(5) would include within the scope of “set-off” all those defences typically recognized as procedural. Under such a reading, Article 21(5) would apply to instances where a respondent advanced a set-off defence based on a liquidated obligation arising out of an unrelated contract. Liberal as this interpretation might be, it would still limit the amount of the set-off defence to the amount of the principal claim. Therefore, under this “moderate” interpretation, the Tribunal would have jurisdiction to hear the respondent’s set-off defence, but recovery would be strictly limited to the amount of the principal claim.
81. Under the most “progressive” interpretation, Article 21(5) would include procedural set-off defences within the scope of “set-off”, and allow recovery for an amount greater than the amount of the principal claim. Under such a construction, similar to the approach adopted in Canada and England, the Tribunal would have jurisdiction to hear the Respondent’s set-off defence for the full amount of USD 383,805.
82. Article 21(5) is therefore subject to a conservative, moderate, or progressive interpretation. Since the Swiss Rules themselves do not help to resolve the ambiguity, the Tribunal must rely on general principles of arbitration and interpretation to elicit the intended scope of Article 21(5). Alternatively, the Tribunal may wish to conceptualize this problem as one to be approached in terms of discretion: since the will of the parties, the rules of procedure, and the applicable procedural law are all silent with regards to the permissible scope of set-off, Article 19(2) of the Model Law empowers the Tribunal to select the rules of procedure it deems appropriate. In any case, a thorough analysis of the three possible interpretations confirms that the third, progressive interpretation best accords with the exigencies of commercial reality, the expectations of sophisticated commercial traders, and, indeed, the aims of commercial arbitration

generally. First, however, it is useful to consider the history of Article 21(5), which itself endorses the progressive interpretation.

(ii) *The history of Article 21(5) suggests that it is applicable to the Respondent's set-off*

83. The Claimant may allege that Article 21(5) should receive a conservative interpretation because it does not purport to derogate from the generally accepted principle that a tribunal can have jurisdiction only over a substantive set-off defence. However, a careful review of the history of Article 21(5) confirms that its scope of application has always extended to the more expansive procedural set-off.
84. It is essential to recognize that Article 21(5) is almost identical to the much older Article 27 of the Zurich Rules, which, like Article 21(5), grants a tribunal jurisdiction to hear a set-off defence subject to a different arbitration clause. But the type of set-off contemplated by Article 27 is undisputedly procedural. Article 2 of the Schedule for Arbitration Costs of the Zurich Rules provides that for the purposes of calculating the value in dispute, the value should be "increased by the amount of set-off defences of *non-connected claims to be evaluated by the Arbitral Tribunal*" (emphasis added). In other words, Article 2 of the schedule confirms that the Zurich Rules' conception of set-off extends to claims that are first, non-connected with the contract under dispute, and, second, not yet certain as to their existence. Yet it is precisely those types of claims, identical in structure to Respondent's set-off defence in this case, which cannot meet the definition of substantive set-off proposed by international sources. The most reasonable conclusion to draw, therefore, is that the Zurich Rules contemplate an expansive procedural conception of a set-off defence congruent with the specific set-off defence invoked by the Respondent. Since Article 21(5) of the Swiss Rules is almost identical to Article 27 of the Zurich Rules, it would appear that the drafters of Article 21(5) intended procedural set-off defences to fall within its ambit, thus militating against a conservative interpretation of Article 21(5).

(iii) *Applying Article 21(5) to the Respondent's set-off promotes the aims of international arbitration*

85. Even if the Tribunal were to overlook the history of Article 21(5), general principles of efficiency, fairness, and commercial practice all entail that the Tribunal should choose the progressive interpretation of Article 21(5) and therefore assume jurisdiction over the Respondent's claim for the full amount under the sugar contract. This result is confirmed by an analysis of all three possible interpretations of Article 21(5).

(1) *The moderate interpretation of Article 21(5) should prevail over the conservative interpretation*

86. A conservative interpretation of Article 21(5), followed to its logical conclusion, would betray the spirit and values of a dispute settlement system tailored to meet the demands of international trade. Most crucially, a conservative interpretation of Article 21(5) would impart an unnecessary element of circuitry of action into the dispute settlement process. Unable to exercise its rights in this forum, the Respondent would have to initiate arbitration in Oceania and incur additional (but unnecessary) expenses relating to legal counsel, travel costs, registration fees, arbitrator's remuneration, and perhaps the enforcement of a separate Oceania award. Furthermore, the financial health of the Respondent, already ailing as a result of the storm and subsequent embargo in Equatoriana, would be significantly weakened if it were denied recovery under the sugar contract while the Claimant was awarded full recovery under the cocoa contract. Indeed, it is difficult to fathom why sophisticated commercial parties would limit the application of Article 21(5) in a manner that would only increase the insolvency risk of a high-stakes lawsuit, and also force parties to invest unnecessary time and money into the settlement of a contemporaneous dispute in a parallel arbitration proceeding. The Respondent therefore submits that a conservative interpretation of Article 21(5) is inappropriate, not only because such a reading would be inconsistent with the provision's history, but also because it would result in significant financial and procedural inefficiency.
87. Adopting the moderate interpretation of Article 21(5) would avoid these deleterious consequences without giving rise to any additional negative consequences. First, were the Tribunal to assume jurisdiction over procedural set-off defences, the Claimant and the Respondent would be spared significant costs in resolving the second dispute under the sugar contract: the parties would be able to resolve both disputes simultaneously under the expedited procedure (since, pursuant to Article 42(2)(a) of the Swiss Rules, the total amount in dispute would still not exceed 1,000,000 CHF) and yet incur no additional expenses except for a 3.75% to 15% increase in the arbitrator's fees (per Appendix B Article 2). Second, if Article 21(5) extends to procedural set-off, the Claimant and the Respondent could settle both disputes in the shortest time possible. Both parties could avoid the cumbersome process of filing notice for arbitration in Oceania and then waiting for an award to be rendered. Finally, the moderate interpretation of Article 21(5) would minimize the insolvency risks associated with parallel proceedings. Allowing procedural set-off provides a safety net for a respondent found liable under the principal claim, and guarantees that outstanding liquid debts owed by the claimant will first be netted from the principal claim, thus protecting the respondent from insolvency. Notice that all of these consequences are consistent with the expectations of sophisticated

commercial parties who wish to tailor an efficient and cost-effective dispute resolution process to meet their commercial needs.

88. The Claimant may object to the moderate interpretation of Article 21(5) on the grounds that it unduly privileges procedural economy at the expense of the parties' autonomous choice to select a forum best fitted to resolve disputes under the sugar contract. Such an objection should be overlooked for two reasons. First, if the Claimant was so concerned about preserving the sanctity of its choice of forum under the sugar contract, it should have vehemently objected to the application of Article 21(5) when it first became aware that the Swiss Rules would apply to the cocoa dispute. More fundamentally, however, the Claimant would be hard pressed to identify any significant prejudice which would be suffered as a result of the Tribunal assuming jurisdiction over the sugar dispute. In its Answer to the Counter-claim, the Claimant asserts that all sugar disputes had been referred to arbitration in Oceania precisely because the sugar itself was of Oceanian origin, and that the administering institution in Oceania was specialized in commodities arbitrations (Answer 2, para.2) Had the current sugar dispute between the Claimant and the Respondent pertained to the nature, quality, or quantity of the sugar, then the Oceania Commodity Association might well be better suited to hear the sugar dispute. But the sugar dispute does not implicate the technicalities or industry standards which a commodities arbitration tribunal might admittedly be better suited to adjudicate. Rather, the dispute turns on the evidential question of when, exactly, the sugar became completely contaminated: if the deterioration had occurred prior to loading, then the Respondent bears the risk, but if the deterioration had occurred after the loading, then the Claimant bears the risk and is liable for the full amount under the contract (Procedural Order 2, para.32). Again, this present dispute hinges on a simple finding of fact which any reasonably credible arbitration institution could execute with competence.
89. Accordingly, the moderate interpretation of Article 21(5) would entail a number of benefits without resulting in any objectionable consequences. Thus, at the very least, the moderate interpretation of Article 21(5) should be privileged over the conservative interpretation, and the Tribunal should assume jurisdiction over the Respondent's procedural set-off defence.

(2) *The progressive interpretation of Article 21(5) should prevail over the moderate interpretation*

90. As mentioned above at paragraph 80, the moderate interpretation of Article 21(5) would limit the Respondent's recovery under the sugar contract to a strict set-off against any recovery the Claimant might recover in regard to the cocoa contract. That is, the Respondent would still have to return to Oceania to

recover the balance owing under the sugar contract. The Respondent emphasizes that the moderate interpretation, in limiting recovery to a strict set-off, cannot be reconciled with the aims of commercial arbitration, and therefore the progressive interpretation of Article 21(5), which would authorize the Tribunal to grant recovery for the full amount of the sugar contract, should be adopted. Two reasons are here advanced: first, a progressive interpretation would minimize inefficiency in the dispute settlement process and second, a progressive interpretation would guard against the risk of inconsistent arbitration awards.

91. First, suppose the Respondent was granted recovery under the sugar contract only for the amount awarded to the Claimant under the cocoa contract. In order to recover the remainder, the Respondent would be required to initiate proceedings in Oceania, and once again incur significant expenses relating to travel costs, registration fees, arbitrator's remuneration, and legal counsel just to recover the residual amount from a dispute already subject to an arbitral award. Some would allege that this inconvenience is a necessary implication of the often cited but rarely contemplated rule that a set-off defence can be used only as a shield and not a sword (see para.61, above). Esteemed as this principle may be, one would nevertheless be hard pressed to articulate any persuasive explanation for this archaic rule which, in prohibiting recovery above and beyond the amount of the principal claim, defies all commercial common sense. It is for precisely this reason that English and Canadian courts have adopted a progressive interpretation of set-off which would allow the Respondent to recover the entire amount owing under the sugar contract (see para.61, above). Indeed, the good sense of a progressive interpretation is confirmed by contemplating the absurd consequences which would result if the tribunal in Oceania considered itself bound by this Tribunal's treatment of the sugar dispute. Citing the principle of *stare decisis*, the tribunal would not need to conduct further hearings or ascertain additional evidence relating to the sugar dispute, but would simply act as a "rubber stamp" and issue an award to the Respondent in exchange for the required registration fee and arbitrator remuneration (Redfern & Hunter, p.396). It is submitted that this sort of procedural red tape, while perhaps a common phenomena of domestic legal systems, is entirely repugnant to a dispute settlement system designed to foster the interests of international traders.
92. However, the most compelling argument in favour of a progressive interpretation follows not from the supposition that the Oceania Tribunal will consider itself bound by this Tribunal's decision, but rather from the more alarming possibility that it will choose instead to re-arbitrate the merits of the sugar dispute. The moderate interpretation of Article 21(5) leaves open the possibility that the tribunal in Oceania could render an award totally inconsistent with the findings of this Tribunal. Indeed, commentators urge that the threat of inconsistent awards should be avoided at all costs because it gives rise to serious problems at the

enforcement stage and also threatens the prestige of international commercial arbitration generally (Leboulanger, para.III(a)(2)). The Tribunal could eliminate the risk of inconsistent awards altogether by adopting the progressive interpretation of Article 21(5) and hear the Respondent's claim for the full amount under the sugar contract.

(iv) Applying Article 21(5) to the Respondent's set-off is consistent with accepted legal principles

93. One fundamental objection may still be voiced in opposition to the progressive interpretation of Article 21(5) of the Swiss Rules. The Claimant may argue that, in hearing the Respondent's claim for the full amount under the sugar contract, the tribunal would be eviscerating any meaningful legal distinction between set-off and counterclaim, a result incompatible with the fact that the Swiss Rules explicitly distinguish counterclaim and set-off in terms of their legal effect. In other words, the progressive interpretation of Article 21(5) would be so broad as to encompass not only set-off defences but also counterclaims, which is incompatible not just with the text of the Swiss Rules, but with the generally accepted legal principle that a tribunal cannot have jurisdiction over counterclaims subject to different arbitration clauses.
94. On the contrary, the progressive interpretation of Article 21(5) preserves a clear distinction between counterclaims and set-off. Under this interpretation, although the amount claimed by way of a counterclaim or procedural set-off defence can exceed the amount of the principal claim, a procedural set-off defence must first satisfy an additional requirement which, in turn, sharply distinguishes it from an ordinary counterclaim. Specifically, a true procedural set-off defence for the purposes of Article 21(5) must be based on a claim which, like the Respondent's claim under the sugar contract, satisfies a strict liquidity requirement. In other words, a true procedural set-off must be easily ascertained as to its amount. If that amount is uncertain, or could only be ascertained with great difficulty, then it cannot form the basis of a true set-off defence under Article 21(5), but must instead be pleaded as a counterclaim.
95. For these reasons, the Respondent requests that the Tribunal adopt the progressive interpretation of Article 21(5) and hear the Respondent's set-off defence for the full amount under the sugar contract. In the alternative, the Respondent requests that the Tribunal adopt the moderate interpretation of Article 21(5) and hear its set-off defence for the amount awarded to the Claimant under the cocoa contract.

C. RELIEF REQUESTED

96. The Respondent requests that the Tribunal find that it was excused under Article 79 of the CISG from delivering the remaining 300 tons of cocoa called for by Contract 1045.
97. In the alternative, the Respondent requests that the Tribunal find that the Claimant has no claim for damages under Articles 74, 75, or 76 of the CISG.
98. In the alternative, the Respondent requests that the Tribunal find that the amount of the Claimant's damages is limited to the difference between the contract price and the market price of cocoa on 15 November 2002, *i.e.*, USD 172,026.
99. The Respondent requests that the Tribunal assume jurisdiction over the Respondent's claim for the full contract price of Sugar Contract 2212.
100. In the alternative, the Respondent requests that the Tribunal assume jurisdiction over the Respondent's claim for an amount equal to the Claimant's recovery under Cocoa Contract 1045.