Twelfth Annual Willem C. Vis International Commercial Arbitration Moot

MEMORANDUM FOR RESPONDENT

HAMLINE UNIVERSITY SCHOOL OF LAW

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INDEX OF ABBREVIATIONS

(LG) Landgerichgt	Regional Court, Germany
(OGH) Oberster Gerichtshof	Supreme Court of Austria
(OLG) Oberlandesgericht	Court of Appeal, Germany
§	Section
Art.	Article
Bundesgerichts	Decisions of the Swiss Federal Tribunal
cf.	Compare
CIETAC	International Economic and Trade Arbitration Commission
CISG	United Nations Convention on Contracts for the International Sale of Goods
CLOUT	Case law on UNCITRAL texts http://www.uncitral.org/en-index.htm
e.g.	For example
et. seq.	And following
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
Id.	Same as previous citation
Inc.	Incorporated
Lloyd's Rep.	Lloyd's List Law Reports
Ltd.	Limited
n.	Note
No.	Number
Nos.	Numbers
OCA	Oceania Commodity Association
p.	Page
para.	Paragraph
PECL	Principles of European Contract Law
pp.	Pages
S.A.	Sociedad Anomina

supra	above
U.S.	United States
UNCITRAL	United Nations Commission on International Trade
UNIDROIT	International Institute for the Unification of Private Law
US CTR	United States Claims Tribunal
USD	United States Dollars
Y.B.	Yearbook (of Commercial Arbitration)

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CISG	United Nations Convention on Contracts for the International Sale of Goods (1980)
Geneva Protocol, 1923	Protocol on Arbitration Clauses, 24 Sept. 1923
NY Convention	New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958)
(New) Swiss Rules	Swiss Rules of International Arbitration, Jan. 2004
PECL	Guide to Article 79 – Comparison with Principles of European Contract Law (PECL) <http://www.cisg.law.pace.edu/cisg/text/peclcomp79.html> (Cited as: *PECL*)
Secretariat Commentary	Guide to CISG Article 79 – Secretariat Commentary <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-79.html> (Cited as: *Secretariat Commentary*)
UNCITRAL Model Law	United Nations Commission on International Trade Law (UNCITRAL) Model Law on International Commercial Arbitration (1985)
UNIDROIT	Guide to This Article – Use of UNIDROIT Principles to help interpret CISG Article 79 <http://www.cisg.law.pace.edu/cisg/priniples/uni79.html> (Cited as: *UNIDROIT*)

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STATEMENT OF FACTS

2001

19 November Respondent telephones Claimant and offers to sell 400 metric tons of cocoa beans for USD 496,299.55 with a delivery date sometime between March and May 2002 as determined by Respondent between January to February 2002. Claimant accepts Respondent's offer. Respondent sends a written confirmation of the transaction along with a signed contract via facsimile and mail.

23 November Claimant signs the contract.

2002

14 February A tropical storm hits the cocoa producing areas in Equatoriana causing the Equatoriana Government Marketing Organization to withhold cocoa from export for the month of March.

24 February Respondent sends Claimant a letter informing him of the storm and its effects.

5 March Claimant sends Respondent a letter informing him that the contract did not require only Equatoriana cocoa. Claimant informed Respondent that cocoa could come from anywhere. Claimant informs Respondent that a failure to deliver will result in Claimant seeking a cover contract and holding Respondent responsible for any additional costs incurred.

10 April Claimant informs Respondent of its expectation that the entire 400 tons of cocoa is to be delivered by the end of May.

7 May Respondent sends Claimant a facsimile informing him that 100 tons of cocoa would be shipped later that month.

18 May Claimant receives and pays for 100 tons of cocoa sent by Respondent.

15 August Claimant sends Respondent a letter informing him that if the remaining 300 tons of cocoa are not delivered soon, Claimant will have to seek a cover contract and will hold Respondent responsible for the additional costs it will incur.

24 October Claimant contracts with Oceana Produce for 300 tons of cocoa for USD 601,560.

13 November Respondent sends Claimant a letter informing him that delivery of the 300 tons of cocoa could have been made within a few weeks. Further, Respondent informs Claimant that the contract was never terminated and

	therefore Claimant's contract with Oceana constituted a breach of contract with Respondent. Thus, Respondent informs Claimant that it will not pay the additional costs incurred by the cover contract.
2003	
20 November	Respondent sells 2500 metric tons of sugar to Claimant for a total contract price of USD 385,805.
8 December	Respondent ships the sugar to Claimant.
18 December	Claimant refuses to pay for the sugar.
2004	
6 July	Claimant submits its claim to arbitration.

SUBMISSIONS

In view of the above facts, we respectfully make the following submissions on behalf of our client, Equatoriana Commodity Exporters, S.A. (Respondent):

- The Tribunal should find that, in regards to the cocoa contract 1045:
  - That the contract was for the sale of cocoa from Equatoriana;
  - That Respondent was impeded through no fault of its own from delivering the cocoa during the time contracted;
  - That Claimant did not fix a period for delivery pursuant to Article 47 CISG for Respondent to deliver the 300 tons of cocoa not yet delivered;
  - That Claimant was not authorized under Article 49 CISG to avoid the contract;
- The Tribunal should find that, in regards to the sugar contract 2212:
  - That the Tribunal has jurisdiction to consider the counter-claim;
  - That any damage that may have occurred to the sugar happened after the risk of loss had passed to Claimant;
  - That Claimant is obligated to pay the full contract price of USD 385,805 for the sugar.
- Therefore, Respondent requests the Tribunal to order, in regard to the cocoa contract 1045:
  - That the claim for damages in totality brought by Claimant be dismissed;
  - Alternatively and only if it finds that Claimant has a claim for damages, find that the damages are limited to USD 172,026.
- Therefore, Respondent requests the Tribunal to order, in regard to sugar contract 2212:
  - That Claimant pay the full contract price of USD 385,805 and any interest accrued since 18 December 2003;
- Therefore, Respondent requests the Tribunal to order, in regard to both contracts:
  - That Claimant pay all costs of the arbitration including legal costs.

Counsel Signatures

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PART ONE – THE SUGAR CONTRACT

I. This Tribunal has jurisdiction over Sugar Contract 2212 because the parties agreed to have their dispute resolved according to the New Swiss Rules of International Arbitration, which provides for adjudication of set-off defenses

1. The Claimant does not dispute the Tribunal's authority to adjudicate claims related to Cocoa Contract 1045 ("the cocoa contract"). Additionally, Claimant agreed to the application of the new Swiss Rules of International Arbitration (the Swiss Rules) to resolve its claim under the cocoa contract. Under Article 21(5) of the Swiss Rules, arbitral tribunals have jurisdiction to hear set-off defenses "even when the relationship out of which this defense is said to arise is not within the scope of the arbitration clause or is the object of another arbitration agreement or forum selection clause." In this case, simultaneous adjudication of the cocoa contract claim and the sugar contract claim is permitted under separate theories. First, the parties' agreement controls the question of jurisdiction. Second, the claims are related to each other. Finally, the Swiss Rules allow for adjudication of set off defenses.

A. The sugar contract should be resolved in Vindobona, Danubia

2. "Party autonomy is the guiding principle in determining the procedure to be followed in an international commercial arbitration. It is a principle that has been endorsed not only in national laws, but by international arbitral institutions and organizations" [*Redfern, pp. 96, 278; see also Craig, Park, Paulsson, p. 135; Born, p. 413*]. Parties usually select an arbitral institution based on geographical, personal, technical or legal reasons[*Berger, at 76*]. However, when determining party autonomy, the tribunal must consult the parties' agreement with particular regard for the applicable rules of arbitration [*Id.* at 62].

3. In this instance, although the two contracts specify different arbitral fora, this Tribunal must consider the Swiss Rules which govern the cocoa contract when determining party autonomy. The Swiss Rules specifically provide that this Tribunal has the authority to hear claims subject to alternate arbitration agreements and fora. Here, even though the forum selection clause in the sugar contract specifying Oceania, the Swiss Rules and arbitral economy demand that the sugar contract be resolved simultaneously with the cocoa contract claim in Danubia. Furthermore, the parties can impliedly extend the scope of their arbitration agreements, and arbitrators must determine the scope of the agreement by examining the law applicable to it [*Id.*

at 62, 65]. In this case, Claimant and Respondent each agreed that the Swiss Rules would govern their dispute. Consequently, the parties impliedly agreed per Article 21(5) to extend arbitral jurisdiction to set off defenses which would encompass Respondent's claim under the sugar contract.

B. Jurisdiction is warranted because the claims are connected

4. A close link between a contract and an ancillary contract, from which a counterclaim arises, may sometimes justify resolving the counterclaim with the main claim, if the counterclaim arises "in connection" with the main contract [*Berger, at 67; see also, e.g. the ICSID case SOABI v. La Republique du Senegal in (1991) in ISCID Review at pp. 124, 144; Nova (Jersey) Knit Ltd v. Kammgam Sinnerei GmbH in (1977) 1 Lloyd's Rep. 163; Craig, Park and Paulsson, International Chamber of Commerce Arbitration (1990, 2nd ed.) at p.* 110]. Often, the question arises in arbitral practice whether an arbitration agreement contained in one contract extends to related contracts. [*Berger,* at 66]. There is no general rule that applies in these cases. The answer always depends on the circumstances of the case, especially on the language of the arbitration agreement in the main contract and the applicable law of arbitration agreements [*Id.*].

5. The cocoa contract and the sugar contract are connected by virtue of the fact that they were concluded between the same parties, and because the parties wish to continue their ongoing business relationship [*Claimant's Exhibit No. 8*]. As such, the two grievances should be adjudicated together by this Tribunal.

C. Arbitral economy demands that the claims be adjudicated together

6. Procedural economy is a guiding principle for arbitrations [*Berger,* at 69]. Moreover, "there is a growing tendency to assume that, as a rule, an international arbitral tribunal has jurisdiction to hear a set-off defense based on a cross-claim that is subject to a different arbitration agreement or jurisdiction clause" [*Id.* at 72]. Simultaneous adjudication conserves valuable time and resources and reduces the administrative burden on arbitral institutions. Thus, even if the Tribunal determines that the cocoa and sugar contracts are not related, procedural economy demands that the claims be resolved together.

II. The sugar contract is a set-off defense, which is permitted under the Swiss rules

A. Respondent's claim under the sugar contract is a set-off defense

7. Article 21(5) of the Swiss Rules provides that "[t]he arbitral Tribunal shall have jurisdiction to hear a set-off defense[.]" The plain language of the rule permits tribunals to exercise jurisdiction over set-off defenses. Although Respondent initially characterized its claim arising under the sugar contract as a counterclaim, it is, in fact, a set-off defense [*Id.* at 58].

B. By failing to exclude this Tribunal's jurisdiction over other claims the parties have agreed to extend the scope of the arbitration

8. Parties must clearly indicate that they intend to exclude a tribunal's jurisdiction over counterclaims [*Berger, at 74; ICC Award No. 5971 in (1995) 13 ASA Bulletin at pp. 728, 739; Honsell, Vogt, Schnyder, and Wenger, n. 62, Nos. 24, 28*]. A tribunal will infer such intent only if: (1) the parties to an arbitration agreement agree to resolve their dispute through fasttrack arbitration; or (2) the counterclaim is subject to an arbitration clause that refers to a specialized form of arbitration [*Berger, at 74; Honsell, Vogt, Schnyder, and Wenger, n. 62, Nos. 27].* Finally, parties may either expressly or impliedly extend the scope of an arbitration agreement [*Berger,* at 65].

9. Both Claimant and Respondent agreed to expedited arbitration, pursuant to Article 42(2)(a) of the Swiss Rules [*Letter from Swiss Chambers, 24 September 2004*]. Expedited arbitration, however, is not the same as fasttrack arbitration. Expedited procedure, under 42(2)(a) of the Swiss Rules, is applicable to disputes that do not exceed CHF 1 000 000. The parties did not submit the claim under the cocoa contract to a fasttrack procedure. Instead, the parties were required to submit their dispute to expedited arbitration because of the relatively low monetary amount involved. Additionally, the sugar contract does not require a specialized form of arbitration. Oceania was selected by the parties because of its familiarity and experience with commodities arbitration [*Claimant's Answer to Counterclaim*]. Familiarity and experience does not, however, make a forum a specialized forum. Therefore, because the parties did not exclude other claims for the jurisdication of this Tribunal, and the intent of the parties to do so may not be inferred under one of the recognized exceptions, this Tribunal may exercise jurisdiction over Respondent's claim arising under the sugar contract.

C. In the alternative, if the Tribunal does not find the claims to be related, there are some exceptions which permit Tribunals to hear unrelated set-off defenses, therefore granting this Tribunal jurisdiction over the sugar contract

10. There are several recognized exceptions that permit a tribunal to hear a set-off that is not related to the main claim. First, an unrelated set-off can be heard if the cross-claim is not disputed [*Berger*, at 77]. Hence, an uncontested counterclaim, whether it relates to the actual contract/claim or not, can be properly adjudicated by a Tribunal. Second, a Claimant who does not object to Respondent's set-off counterclaim, which is asserted in Respondent's defense, also permits the set-off to be considered [*Berger*, at 78]. Finally, if the parties grant the arbitrators the competence to consider the unrelated set-off defenses, the Tribunal will have the authority to consider the merits of the set-off; this third exception essentially gives the Tribunal power over the set-off, regardless of the set-off's forum selection clause [*Ibid.*].

11. The Claimant did not initially contest this Tribunal's jurisdiction in this proceeding; in fact, only after requesting arbitration, governed by the Swiss Rules, and receiving Respondent's reply, did the Claimant contest the set-off [*Answer to Counterclaim, pp. 40, 41*]. By requesting arbitration, and accepting the notice from the Swiss Chamber regarding the implementation of the New Rules, which was evidenced by payment to the chamber for their services, the Claimant expressly adopted the Swiss Rules without reservation. [*Letter from Fasttrack transferring administrative Fee*, 12 July 2004]. While Claimant subsequently objected to the set-off defense, they had already agreed to the arbitral rules mandating inclusion of the set-off. Thus, both parties had agreed to the expanded scope of the Tribunal's jurisdiction to hear the set-off defense.

12. Thus, "the general rule developed here is that the Tribunal has no jurisdiction to hear set-off defenses that are subject to jurisdiction or different arbitration clauses unless there are clear indicators for the exceptional case that the Tribunal's jurisdiction is extended by agreement of the parties to the cross-claim that would otherwise fall outside the arbitrator's competence." [*Berger*, at 78]. In this instance, the general rule does not apply; the Tribunal's jurisdiction had been expanded through party agreement, when the parties agreed to the application of the New Swiss Rules of International Arbitration. Hence, any award rendered from the cocoa contract should be limited by sugar contract, because it is a valid set-off defense.

III. The law of the forum also permits adjudication of set-off defenses

13. It is well-established that an arbitration is governed by the law of the forum of the arbitration [*Redfern, at 81; see Mann, "State Contracts and International Arbitration" (1967) 42 B.Y.I.L. 1 at 4-12; Park, "The Lex Loci Arbitri and International Commercial Arbitration" (1983) 32 I.C.L.Q. 21; Mann, "England rejects delocalized contracts and arbitration" (1984) 33 I.C.L.Q 193*]. The Model Law, which has been adopted by Danubia without amendment [*Claim, p. 4*], stipulates "[t]he provisions of this Law . . . apply only if the place of arbitration is in the territory of this State." This usually means that the Model Law applies to all arbitral proceedings that take place in its territory [*Dore, p. 102*]. Under the Model Law, however, parties are free to stipulate alternate procedural law to be used in an arbitration [*Model Law, Art. 19(1); see also Holtzman/Neuhaus, p. 564; Dore, p. 120; Carbonneau, p. 518*]. Thus, "if the parties have granted the arbitrators the competence to decide on set-offs that are not subject to the arbitration agreement, [they indicate] that the competence of the arbitrators shall take priority over any other forum selection clause covering possible cross-claims" [*Berger*, at 78]. By accepting the application of the Swiss Rules to govern their dispute under the cocoa contract, the parties have extended the jurisdiction of this Tribunal to resolve the sugar contract in conjunction with the cocoa contract.

14. Therefore, the Respondent respectfully requests that the Tribunal recognize jurisdiction over Respondent's set-off defense pursuant to either the Swiss Rules, or the mandates of arbitral economy. Moreover, the Respondent respectfully requests the Tribunal to recognize the validity of the Respondent's set-off defense, when determining any damage award that might be warranted.

PART TWO – THE COCA CONTRACT

I. The United Nations Convention on Contracts for the International Sale of Goods (CISG) governs this dispute.

15. Respondent and Claimant do not dispute that they entered into a contract on 11 November 2001. They also do not dispute that they are parties to the CISG, and as such, their contract is governed under Article 1(1)(a) CISG.

II. The contract called for the delivery of Equatoriana cocoa

16. Claimant asserts IN ITS LETTER DATED 5 March 2002, that the contract does not expressly require delivery of Equatoriana cocoa and that the source of the cocoa is irrelevant.

[Claimant's Ex. No. 4] Respondent disputes this assertion. Based on established practices with Claimant, Respondent reasonably expected that the current transaction contemplated Equatoriana cocoa [A]. Furthermore, according to Article 8(3) CISG, consideration of all the relevant circumstances, Claimant's letter of 5 March 2002, can only be seen as a unilateral attempt to alter the contract, and thus it cannot be binding on Respondent. [B]

A. The parties have always contracted for Equatoriana cocoa

17. Article 9(1) CISG provides that "[t]he parties are bound by any usage to which they have agreed and by any practices which they have established between themselves." Usage has not been defined under the CISG, however, many commentators have viewed this term in a broad context. [Enderlien/Maskow, p. 68; Bonell, p. 11] Practices, that can be interpreted as implied agreements between the parties and that frequently modify original agreements, generally take precedence over usage. [*Enderlien/Maskow*, p. 67]

18. In the present case, Claimant and Respondent have had numerous previous dealings, and as a result, they have established practices between themselves. In particular, in previous cocoa transactions, Claimant had always received Equatoriana cocoa from Respondent. [Proc. Ord. 2, para. 19] Claimant understood that the cocoa was Equatoriana cocoa because it arranged for the carriage of the goods. [Proc. Ord. 2, para. 19] Additionally, the cocoa was packed in bags that were labeled as "Equatoriana Cocoa" [Proc. Ord. 2, para. 19]. There is no basis for the claim that the parties contracted for the purchase and delivery of anything other than Equitoriana cocoa. Therefore, based on the established practice between the parties of the sale and delivery of Equatoriana cocoa, a reasonable interpretation of the present contract would be that the parties contemplated the sale and purchase of Equatoriana cocoa in the cocoa contract.

19. It is of no consequence that the cocoa contract is silent as to the origin of the cocoa. [Cl. memo, para. 8] It is true that the facts do not disclose what the "usual terms" are between the parties, however, as demonstrated above, the CISG allows for contracting parties to rely on past practices as binding. Since there is no evidence that previous transactions involved anything other than the sale of Equatoriana cocoa, it follows that the sale and delivery of Equatoriana cocoa was contemplated in the contract. Thus, pursuant to Article 9(1) CISG, the parties are bound by this practice and Respondent was required to deliver Equitoriana cocoa under the cocoa contract.

B. Claimant's letter dated 5 March 2002, was an attempt to unilaterally alter the terms of the contract.

20. Article 8(3) CISG allows the Tribunal to consider surrounding circumstances, including any subsequent conduct of the parties, to determine the actual intent of the parties at the time of contracting. Therefore, in the present case, Claimant's letter dated 5 March 2002 as well as past practices between the parties and market conditions, are all relevant to determining the parties' intent [*See* Secretariat Commentary Article 8, para. 6; *Bundesgerichtshof* (Germany) (11 Dec. 1996)]. Finally, a clarification to the contract, four months after the conclusion of the contract, is not timely and cannot be considered binding upon both parties. [Filanto S.p.A. v. Chilewich International Corp. (U.S.A.) (14 April 1992) (holding that prior practices between the parties required seller to alert the buyer in a timely fashion of its objection to incorporation of an arbitration clause, and an objection five months after incorporation was not timely)]

21. Claimant's letter dated 5 March 2002, which claimed that the contract did not specifically call for Equatoriana cocoa, and that the origin was irrelevant, was a unilateral attempt to alter the contract. First, although the contract is silent regarding the origin of the cocoa, past transactions between the parties always involved Equatoriana cocoa. Second, Equatoriana is a commodities *exporter*; its primary business relies on trading Equatoriana commodities. [Resp. Statement of Case, para. 2; proc. ord. 2, para. 14] Although it has occasionally traded certain commodities from other countries, all of its cocoa dealings have involved Equatoriana cocoa. [Proc. Or. Para. 14] Such circumstances indicate that it is unreasonable for Claimant to have expected Respondent to deliver cocoa from another source.

22. Finally, the purpose of contracting for a fixed price is to ensure that both the buyer and seller are able to rely on a set price in a fluctuating market. It would not make good business sense for Respondent to lock in at an average market price, with the expectation that it would purchase foreign cocoa at potentially higher prices. The only reasonable interpretation under these circumstances is that Respondent contracted to deliver and Claimant contracted to receive Equitoriana cocoa.

III. Claimant was not justified in avoiding the contract

A. Claimant was not entitled to avoidance because Respondent did not fundamentally breach the contract

23. Respondent concedes that the contract terms indicated that Respondent would deliver 400 tons of Equitoriana cocoa to Claimant between March and May 2002, and that Claimant was entitled to expect such delivery. Furthermore, Respondent agrees that the failure to deliver was a breach of contract. Nevertheless, as described in a subsequent section of this memorandum, such failure was excused due to impediment.

24. Respondent's delay, however, was not a fundamental breach of contract. As a consequence, Claimant did not have an automatic right to avoid the contract. A delay in performance is not *automatically* a fundamental breach of contract. [Enderlien, Maskow, at 181] Such a delay is a fundamental breach "if, and only if, the failure to deliver on the contract delivery date causes [buyer] substantial detriment *[results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract]* and the seller foresaw or had reason to foresee such a result." [Secretariat Commentary Article 25, para. 4] A delay in delivery constitutes a fundamental breach only if "time was of the essence" [Chengwei, §4.2.3; Fletchner, p. 72]. A buyer may not avoid the contract based on late delivery if the late delivery was not sufficiently serious or the buyer waived its right to prompt delivery. [Secretariat Commentary Article 47, para. 1]

25. In the instant case, Claimant has not proven there was a fundamental breach of contract. The failure to deliver by the end of May 2002, was not a substantial detriment for Claimant. [1] Additionally, neither a reasonable merchant, nor Respondent had reason to foresee that the failure to deliver by May would have substantially deprived Claimant of its expectations. [2]

1. The failure to deliver by the May deadline was not a substantial detriment

26. Claimant was not *substantially* deprived of its expectations under the cocoa contract. First, Claimant may not argue that time was of the essence due to its willingness allow Respondent to fulfill the contract after the deadline had passed. In August, Claimant simply said that its stocks were "lower than [it] was comfortable with." [Cl. Ex. 7] Furthermore, in a telephone conversation on 29 September 2002, Claimant simply repeated its desire for Respondent to perform. [Proc. Or. 2, para. 22] This indicates that time was never of the essence in the contract.

27. In addition, Claimant waived its right to prompt delivery by virtue of its willingness to accept delivery from Respondent after the deadline had passed. The ICC Court of Arbitration held in a case with facts similar to the instant case, that a contract provision for fifteen-day late delivery penalty precluded the buyer from claiming that the delivery date was fixed, and therefore precluded the buyer from claiming a fundamental breach. [ICC Arbitral Award, Mar. 1995]. Claimant's correspondence with Respondent in August and September do not indicate that Claimant had suffered any detriment, and demonstrated that it was willing to accept late delivery of cocoa. This clearly shows that the May deadline was not a "fixed" deadline. As a result, even if Respondent's breach was fundamental, Claimant waived its right to terminate the contract.

28. Finally, even on 24 October 2002, when the cover purchase was made, Claimant *still* had not suffered a substantial detriment. Claimant explained in its letter dated 25 October 2002, that it faced a *likelihood* of running out of supplies. [Cl. Ex. 8] When the cover purchase was made, Claimant still had supplies. Claimant was still able to continue fulfilling its orders, and performing under its own contracts. The cover purchase was unjustified because at the time the cover purchase was made, Claimant had not yet suffered any detriment.

2. Neither Respondent, nor a reasonable merchant had reason to foresee that the failure to deliver by May would have substantially deprived Claimant of its expectations

29. Under CISG Article 25, the results of the substantial detriment must be foreseeable both by the party in breach, as well as by a reasonable merchant under similar circumstances. [*see* Article 25]. The lack of foreseeability is a defense to fundamental breach. It is a two-prong test that the breaching party has the burden to satisfy. [Chengwei, §8.2.3.2]

30. In the instant case, Respondent has satisfied both prongs. Although the terms of the contract required a final delivery by the end of May, when Respondent failed to deliver, Claimant continued to seek Respondent's compliance. Such behavior indicated to Respondent, as well as a reasonable merchant in the same situation, that Claimant was not harmed by the delay and could afford to wait for Respondent's delivery. Claimant never complained that the delay had caused it hardships or supply problems until 25 October 2002, the date of its cover purchase. Before that point, Mr. Smart vaguely indicated that the stocks "were lower than we are comfortable with", which is not sufficiently definite to put Respondent on notice that

Claimant would make a cover purchase in October. [Cl. Ex. 7] Claimant's behavior shows that Respondent had no reason to suspect a late delivery would have or did substantially deprive Claimant of its expectations.

31. Even when Respondent called Claimant and indicated it could not deliver, Claimant continued to insist Respondent fulfill its duty. None of these communications ever gave Respondent notice that Claimant would make a cover purchase when it did. Furthermore, a reasonable merchant, based on Claimant's behavior of requiring Respondent to perform, would also have concluded that Claimant was not suffering any hardship because of the late delivery.

B. Since Respondent did not fundamentally breach the contract, Claimant should have affixed a *Nachfrist* notice pursuant to Articles 47(1) and 49(1)(b) CISG to avoid the contract

32. The *Nachfrist* notice is an optional recourse for the injured party, and is not required under the CISG. However, the only basis for an injured party to avoid the contract when a breach is *not* fundamental is through the *Nachfrist* procedure. [Fletchner, p. 70]

1. Claimant failed to affix a *Nachfrist* notice, thus it could not avoid the contract

33. If the late or non-delivery is not a fundamental breach, Article 49(b) CISG requires a buyer to affix an additional period of time for the seller to perform, called a *Nachfrist* notice, before the buyer may declare the contract avoided. It is not until the expiration of the *Nachfrist* period that the buyer may claim a fundamental breach based on late or non-delivery. [Article 49(1)(b)] Although the *Nachfrist* notice is optional, the Convention specifically rejects the idea that a buyer may avoid the contract simply because the contract delivery date has passed without the delivery of goods. [Secretariat Commentary Article 47(1), para. 4] Thus, for the aggrieved party to avoid a contract in the case of a non-fundamental failure to deliver, the party must affix a *Nachfrist* notice indicating a specific date or period of time by which other party must comply. [ICC Court of Arbitration, Mar. 1995 (holding that delay in delivery did not constitute a fundamental breach); Amtsgericht Oldenburg in Holstein, 24 April 1990 (Germany) (holding that for a buyer to avoid the contract based on late or non-delivery, the buyer must affix an additional period of time to perform); Oberlandesgericht Frankfurt am Main, 18 Jan. 1994 (Germany)].

34. In this situation, Claimant asserts that the late or non-delivery within the three-month period called for in the contract amounts to a fundamental breach of contract. [Cl. Ex. 8,9,11] This

argument fails because mere delay in delivery, without more, does not constitute a fundamental breach. It is clear therefore that Respondent's failure to make a timely delivery was not a fundamental breach of contract. As such, in order to avoid the contract, Claimant was required to provide Respondent with *Nachfrist* notice including a precise date or period after which the contract would terminate if Respondent failed to act. In this instance, Claimant never affixed an additional time for Respondent to comply. On 15 August 2002, Claimant simply told Respondent that if it did not receive notification "soon," it would have to purchase the remaining 300 tons of cocoa elsewhere. [Cl. Ex. 7] The term, "soon" is not sufficiently definite and thus does not qualify as *Nachfrist* notice. .

35. Therefore, Claimant was not entitled to avoid the contract based on late delivery because it did not affix an additional period of time for compliance pursuant to Article 47(1).

IV. Claimant is not entitled to 289,353 USD in damages or any corresponding interest thereto

36. As a consequence of the storm and subsequently imposed government regulations on the export of cocoa, Respondent would be exempt from paying any damages owed pursuant to Article 79 CISG (A). In the alternative, even if this Tribunal determines that Claimant is entitled to damages, Claimant may not rely on Article 75 CISG, as it did not properly declare the contract avoided before it executed a cover purchase on 24 October 2002 for the remaining 300 tons of cocoa (B). Thus, any damages to which Claimant is entitled must be calculated according to Article 76 CISG based on the market price on 15 November 2002, when Claimant sent notice to Respondent that it considered the contract terminated (C). Also, any damages to which Claimant may be entitled should be reduced because Claimant violated its duty to mitigate loss under Article 77 CISG (D). Furthermore, Respondent is entitled to set off any damages awarded under the cocoa contract against the damages it suffered as a result of Claimant's breach of the sugar contract (E). Finally, any damages awarded to the Claimant are not subject to interest (F)

A. Respondent is exempt from paying damages under Article 79 CISG

37. The storm and the export restrictions subsequently imposed by the government of Equatoriana are sufficient to exempt Respondent from liability as to damages. Respondent has met the requirements of Article 79 CISG. In particular, the facts in the instant case amount to an impediment beyond Respondent's control that rendered Respondent's performance under

the contract impossible (1). Further, the impediments were not foreseeable (2). Finally, Respondent could not have avoided or overcome the impediments without fundamentally altering the purpose of the contract, namely the sale of Equatoriana cocoa to Claimant for the Class C price as it existed during November 2001 (3).

1. **The storm and the government export restrictions constituted impediments beyond Respondent's control that rendered Respondent's performance under the contract impossible**

38. Both the storm and the subsequent embargo constitute impediments within the meaning of Article 79 CISG. An impediment refers to an external force or event that objectively interferes with the performance of a contract by rendering that performance actually impossible. [*PECL, para. 4*]. Natural disasters such as storms and government embargos that affect the commodities market, are well-established as impediments to contract performance [*Secretariat Commentary, para. 5*].

39. In this case, Respondent contracted to deliver to Claimant, 400 tons of Equitoriana cocoa by the end of May 2002. However, a devastating storm occurred on 14 February 2002 that directly affected the cocoa producing area in Equatoriana and substantially destroyed the Equatoriana cocoa crop. [*Claimant's Statement of the Case, para. 5*]. In response to the devastation caused by this storm, and due to the uncertainty among government officials as to the amount of cocoa ruined in the storm's wake, the Equatoriana Government Cocoa Marketing Organization (EGCMO) imposed an immediate export embargo on all Equatoriana cocoa. In other words, no cocoa could leave Equatoriana unless released by the government

2. **Respondent could not be expected to either foresee the occurrence of the impediments at the time the contract was concluded, or to overcome the consequences**

40. This Tribunal should find that the storm and subsequent government export ban constitute impediments that were not reasonably foreseeable at the time the contract was concluded.

41. Whether or not an event or occurrence was reasonably foreseeable is determined on a case-by-case basis [*Secretariat Commentary, para. 6*]. Since the last storm of comparable magnitude in Equitoriana occurred over 20 years ago and since the government had never instituted a blanket restriction on the export of cocoa in the past, Respondent could not

reasonably be expected to take such risks into account at the time of contracting [*Procedural Order No. 2 para. 11*].

42. Three arbitral decisions illustrate the concept of reasonableness. In the *Bulgarska* decision, the tribunal held that a government export ban on coal did not constitute an impediment beyond the seller's control because the ban was in force at the time the contract was made. Also, in the *Russian Federation* decision, the tribunal refused to excuse the seller from paying damages when its supplier failed to deliver the goods because the seller could have foreseen a delivery problem with its supplier when it entered into the contract. [*CLOUT case 140*]. Finally, in *Malaysia Dairy*, a seller was not exempt from damages because the government regulations it claimed were an impediment existed at the time of contract and therefore were foreseeable by seller.

43. In the instant case, the Equatoriana Government Cocoa Marketing Organization (EGCMO) has a monopoly over all the country's cocoa. [*Procedural Order No. 2 para. 11*]. The cocoa is stored in EGCMO warehouses and is only released on an as-needed basis determined by how much cocoa must be delivered under the contract. [*Id.*] However, the long-established practice is that EGCMO will always release the amount of cocoa required by the contract [*Id.*]. Thus, unlike the *Bulgarska* decision where the government export ban was in force at the time of contract, no embargo existed in November 2001 when the contract in this case was concluded. On the contrary, at the time the contract was made, established practice was such that Respondent believed that the EGCMO *would* release 400 tons of cocoa pursuant to its contract with Claimant.

44. The present case is also clearly distinguishable from *Russian Federation.* In that case, a supplier failed to deliver to seller resulting in seller's failure to deliver to buyer [*CLOUT case 140*]. The seller was not excused from damages because the seller could foresee delivery problems with its supplier occurring in the future [*Id.*]. In this case, however, since the EGCMO manages all of the Equatoriana cocoa, the EGCMO is not simply one of many suppliers Respondent could choose from, but *the* "supplier" Respondent *had* to negotiate with in order to export Equatoriana cocoa. While the established practice in Equatoriana could be likened to a "need-based government-rationing program," the fact that the government possessed all the cocoa had never been a problem in the past. Indeed, the government-rationing program was instead an asset to business rather than a hindrance. Since every contract for

Equatoriana cocoa had always been honored by the EGCMO, contracts for Equatoriana cocoa were backed up by a promise from the Equatoriana government that the amount of cocoa required by contract would be honored.

45. Thus, when Respondent contracted to deliver 400 tons of Equatoriana cocoa it could reasonably foresee that the cocoa would be delivered since the promise to deliver was supported by the Equatoriana government. This case, then, is clearly distinguishable from *Russian Federation* because in that case the seller did not have a promise backed up by its government. Instead, the seller in *Russian Federation* had only a private supplier [*Id.*]. It is foreseeable by the seller in any supplier-seller business relationship that circumstances may develop that would cause the supplier to fail to deliver goods to the seller. For example, the seller could experience financial difficulties, labor problems, or government sanctions. But when the supplier is not a business but the government itself, the supplier-seller relationship is fundamentally different. The government-supplier is more than a supplier – it is a guarantor. A seller cannot reasonably foresee a failure to deliver when a promise to deliver is backed up by its government.

46. In *Malaysia Dairy,* a seller was not excused from damages because the government regulations could not be considered an impediment due to the fact that those regulations were in place at the time seller concluded its contract with buyer. In the *present* case, however, the impediment was *not* in place when the contract was concluded. Instead, Respondent promised to deliver in Novembers 2001 what it reasonably thought it could deliver based on the fact that the government had always provided Respondent enough cocoa to cover its contracts. There was simply no reason for Respondent to believe in November 2001 that a terrible storm would occur three months later that would cause the government to impose an embargo. The only result Respondent could reasonably foresee in November 2001 was that its contract with Claimant would be honored by the Equatoriana government as it had always been in the past.

47. Thus, because the government export ban was (1) not in place at the time the contract was concluded, (2) the government had always provided Respondent with cocoa in the past, and (3) the government's failure to provide Respondent with cocoa in *this* case was due to a devastating and unpredictable storm, Respondent could not reasonably have foreseen at the time of contract that the cocoa would be impossible to deliver. Accordingly, Respondent is exempt from damages under Article 79 CISG.

3. Respondent could not avoid or overcome the impediments

48. As stated in the preceding sections above, the contract at issue was clearly for Equatoriana cocoa at November 2001 market price. Thus, since the contract called for a specific type of cocoa at a specific price, Respondent could not have avoided or overcome the impediment by purchasing a different type of cocoa at a different price. In other words, Respondent is exempt from damages under Article 79 CISG because there was no "commercially available substitute" for Equatoriana cocoa at the November 2001 market price.

49. Under Article 79 CISG, the non-performing party must prove that there were no "commercially reasonable substitutes" available to meet their contractual obligations. [*Secretariat Commentary, para. 3*]. As discussed in the preceding sections of this memorandum, the cocoa contract called for Equitoriana cocoa, which was unavailable as a result of the storm and the government regulations. Additionally, since Equatoriana cocoa is rated "Class C" cocoa under the NYBOT rules, Respondent could not have purchased cocoa from another source without paying a higher premium than was contemplated at the time of contract with Claimant [*Respondent's Exhibit No. 1*]. Also, since Equatoriana cocoa is listed as "Origin Group 5 cocoa" under the LIFFE exchange [*Respondent's Statement of the Case para. 7*], Equatoriana cocoa was sold at a discount making it one of the cheapest sources of cocoa on the market [*Respondent's Exhibit No. 2*]. Equatoriana cocoa's listing on both NYBOT and LIFFE, then, makes it one of the cheapest on the market and thus there was not "commercially reasonable substitute" for the greatly discounted Equatoriana cocoa that Respondent could have purchased in order to avoid the impediments stated above. Moreover, since the market price for Class C cocoa continued to rise since November 2001, a purchase of any other type of cocoa for any other price other than that of November 2001 would have fundamentally altered to purpose of the contract.

50. If Respondent purchased cocoa of a different class at the current market price, Respondent would have paid a substantially higher price of cocoa than it intended under the contract. Further, the contract called for Equatoriana cocoa since Claimant had an interest in procuring discount cocoa. Thus, the sale of Equatoriana cocoa benefited both parties and no other type of cocoa would have had that same effect. Thus, since Respondent could not deliver Equatoriana cocoa due to the government export ban, and it could not purchase other cocoa similar to

Equatoriana cocoa in terms of quality and price, Respondent could not overcome the impediments mentioned above and is therefore not liable for damages under Article 79 CISG.

B. Even if this Tribunal determines that Claimant is entitled to damages under the cocoa contract, Claimant may not rely on Article 75 CISG

51. Claimant's demand for damages is based on Article 75 CISG. Article 75 CISG provides in pertinent part, "[i]f the contract has been avoided and if in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement . . . the party claiming damages may recover the difference between the contract price and the price in the substitute transaction . . . ." According to the plain language of this Article, a party is not entitled to the difference between the contract price and the cover price unless it avoided the contract *before* concluding a substitute transaction. [*Chengwei,* Remedies for Non-Performance: Perspectives from CISG, UNIDROIT Principles & PECL, September 2003, Chapter 15; *Enderlin & Maskow,* International Sales Law United Nations Convention on Contracts for the International Sale of Goods Convention on the Limitation Period in the International Sale of Goods, Oceana Publications, 1992, Section II Damages]. Because Claimant failed to properly avoid the contract prior to making a cover purchase of the remaining 300 tons of cocoa, Claimant is not entitled to damages under Article 75 CISG amounting to the difference between the contract price and the cover price.

1. Claimant did not provide Respondent with notice of its declaration of avoidance as required by Article 26 CISG prior to concluding a substitute transaction

52. Article 26 CISG provides that "a declaration of avoidance of the contract is effective only if made by *notice* to the other party." (emphasis added). Thus, a party seeking to terminate a contract must send notice that clearly and unequivocally conveys that the party will no longer be bound by the contract and that it considers the contract terminated [*Landgericht Frankfurt, Germany 16 September 1991*].

53. In the present case, Claimant executed a cover purchase on 24 October 2002, however, it did not sent notice expressly declaring the contract avoided until 15 November 2002. As such the date when the contract was effectively terminated was 15 November 2002.

54. Although no particular form is required for the notice of declaration of avoidance, a party should issue a declaration of avoidance in a way that a "reasonable party in the breaching party's position [would understand] that the contract has been avoided" [*Flechtner, Remedies*

Under the New International Sales Convention: The Perspective From Article 2 of the U.C.C., 8 J.L. & Com. 53, 83 (1988)]. At least one court has held that an announcement that the contract will be terminated sometime in the future if the party fails to act does not operate as a valid notice of avoidance because it does not represent the party's clear intention to avoid the contract [*Landgericht Zweibruecken, Germany 14 October 1992*].

55. In its letter dated 5 March 2002, Claimant asserted that it will "look elsewhere for the cocoa if [Respondent] has not lived up to its agreement" [Claimant's Ex. No. 4]. Further, in a letter dated 10 April 2002, Claimant again expressed its expectation that Respondent would "deliver the entire 400 metric tons by the end of May" [Claimant's Ex. No. 5]. However, at the end of May when the time for performance was due, Claimant did not declare the contract avoided as it indicated it would in its letters. Indeed, Claimant accepted delivery of 100 tons of cocoa and did not contact Respondent again until August 2002.

56. Additionally, Claimant may not invoke its letter dated 15 August 2002, as notice of its declaration of avoidance. In particular, Claimant's letter ambiguously admonishes "if we do not receive notification from you *soon* when you will be shipping the remaining 300 tons, we will have to purchase elsewhere" [Claimant's Ex. No. 7 (emphasis added)]. This statement does not represent either a present intent to avoid the contract or a *Nachfrist* notice indicating a date when the contract would terminate if Respondent failed to perform. Moreover, in a telephone conversation that occurred on 29 September 2002, Respondent explained that it could not provide Claimant with a firm date for delivery to which Claimant responded simply by reiterating its concerns contained in the 15 August 2002 letter [Procedural Order No. 2, para. 22]. In sum, although Claimant indicated in its correspondence that it would eventually avoid the contract and seek substitute goods if it did not receive the remaining 300 tons of cocoa, Claimant failed to expressly declare the contract avoided prior to concluding a substitute transaction. Due to its failure to provide adequate notice of its declaration of avoidance to Respondent as required under Article 26 CISG prior to making a cover purchase, Claimant is not entitled to damages based on Article 75 CISG.

2. Even if this Tribunal determines that Claimant is entitled to damages, the amount of damages demanded by Claimant must be calculated according to Article 76 CISG based on the market price of cocoa on the date the contract was effectively declared avoided

57. If a cover purchase is not made in a reasonable manner or within a reasonable time *after* the contract was avoided, damages should be calculated under Article 76 CISG as though no substitute transaction had occurred. [*Chengwei*; *Secretariat Commentary on Article 71 of the 1978 Draft, draft counterpart of CISG 75*; *Secretariat Commentary on Article 72 of the 1978 Draft, draft counterpart of CISG 76*]. Thus, because Claimant failed to notify Respondent of its declaration of avoidance, any damages to which Claimant is entitled must be calculated according to the market price formula in Article 76 CISG based on the market price of cocoa when the contract was avoided. *Id.*

a. The act of making a cover purchase did not constitute a valid declaration of avoidance

58. The plain language of Article 26 CISG rejects the notion of ipso facto, or automatic rejection. [*Christopher Jacobs,* Notice of Avoidance Under the CISG: A Practical Examination of Substance and Form Considerations, the validity of Implicit Notice and the Question of Revocability, 64 Univ. Pitt. L. Rev. 407, 411 (Winter 2003)]. In fact, the drafters of Article 26 CISG specifically intended to modify the law regarding notification of avoidance under Article 25 of the Uniform Law on the International Sale of Goods, which allowed a buyer to make a substitute purchase without requiring the buyer to provide notice to the seller. [*Id.* at 413]. For this reason, courts have interpreted Article 26 CISG as permitting implicit notice only in very limited cases. [*Id.*] Furthermore, at least one court held that the mere purchase by the buyer of substitute goods does not constitute an implicit notice of declaration of avoidance to the seller [*Oberlandesgericht Bamburg, Germany 13 January 1999*].

59. As such, the fact that Claimant made a substitute purchase of the remaining 300 tons of cocoa on 24 October 2002 does not meet the requirements for notice of declaration of avoidance.

b. Claimant's letter dated 15 November 2002 constituted a valid declaration of avoidance

60. In its letter dated 15 November 2002, Claimant stated clearly and unequivocally that Claimant "considers the [cocoa contract] to be terminated" [Claimant's Ex. No. 11]. Therefore, if this Tribunal determines that Claimant is entitled to damages under the cocoa contract, the amount should be the difference between the contract price and the current price at the time of avoidance per Article 76 CISG. On 15 November 2002, the market price of cocoa had fallen to 82.29 cents per pound. Therefore, if Claimant had made its cover purchase on that date, it would have paid 544,251 USD instead of 661,578 USD, a difference of 172,026 USD. As such, Claimant's damages, if it is indeed entitled to damages, should be limited to the difference between the contract price and the market price for 300 tons of cocoa on 15 November 2002.

C. Claimant violated its duty to mitigate loss under Article 77 CISG

61. Even if this Tribunal finds that Claimant is entitled to damages any damage award should be reduced due to Claimant's failure to mitigate loss per Article 77 CISG. According to Article 77 CISG, a party alleging a breach of contract must take such measures that are reasonable under the circumstances to mitigate losses. In other words, a party must take steps to minimize or prevent the occurrence of loss. [*Enderlin/Maskow*, International Sales Law, art. 77, para 2]. The purpose of the mitigation principle is to protect the breaching party from having to pay damages in excess of those that were ultimately the result of its breach [*Djakhongir Saidov,* Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods (December 2001)]. The duty to mitigate loss arises as soon as the alleged breach becomes foreseeable. [*Enderlin/Maskow*, Art. 77, para 2].

62. Generally a measure is considered reasonable if, under the circumstances of the particular case, it could have been expected to be taken by a person acting in good faith, or it is adequate with respect to the loss [*Saidov*]. Although a party is not obliged to avoid the contract if the other party has committed or is expected to commit a breach of contract, avoidance may be one reasonable measure that would mitigate losses to the injured party. [*Enderlin/Maskow*, Art. 77, para 2]. In the present case, Respondent first notified Claimant on 24 February 2002, of the likelihood that delivery of the 400 tons of cocoa called for in the cocoa contract would be delayed due to the storm and the subsequent government export restrictions. [Claimant's Ex.

No. 3]. Thus, Claimant was on notice that it may not receive the shipment of 400 tons of cocoa long before the time for performance was due. By the end of May when the time for performance under the cocoa contract had expired and Respondent was only able to furnish Claimant with 100 of the 400 tons of cocoa, it was abundantly clear that Respondent had not met the delivery requirements under the contract. At this time, given the steadily rising price of cocoa in the market, Claimant should have exercised its option to give *Nachfrist* notice and to avoid the contract if Respondent failed to perform by the specified date. If Claimant had attached a *Nachfrist* date for the end of June and sought a cover purchase when Respondent was unable to perform, Claimants damages would have been substantially less than 289,353 USD.

63. In June 2002, the current price of cocoa was 75.24 cents per pound. [*Respondent's Ex. No. 3*] Therefore, Claimant would have paid only 497,622 USD as compared to 661,578 USD when the cover purchase was made—a difference of 163,956 USD. As such, Claimant's damages should be reduced to the difference between the contract price for 300 tons of cocoa and the price for 300 tons of cocoa in June, when Claimant should have acted to mitigate its damages.

D. The amount of damages demanded by Claimant should be reduced by the amount of payment due under the sugar contract

64. Claimant is obligated to pay the sum of 385,805 USD and the corresponding interest thereto under the terms of the sugar contract. According to the terms of the contract, Respondent was to deliver 2,500 tons of sugar to the carrier, Oceania Shipping Lines, on 4 December 2003 for shipment FOB (*Incoterms 2000*) Port Hope, Oceania. [*Respondent's Ex. No. 4*]. A timely delivery was made by Respondent to the carrier where it was duly inspected and deemed to be in good condition as indicated by the receipt issued by the carrier. [*Respondent's Ex. No. 6*]. The carrier did not notify Respondent about any incident related to the sugar that occurred when the sugar was being loaded onto the vessel for shipment. When Claimant received the sugar on 18 December 2003, the sugar was wet and had become contaminated. [*Answer to Notice of Arbitration and Counterclaim, para. 14*]

65. According to Article 66 CISG, "loss or damage to the goods after the risk has passed to the buyer does not discharge him from his obligation to pay the price." In the present case, it is clear that the damage to the sugar occurred during the voyage from Oceania to Mediterraneo.

At that time the risk had passed from Respondent to Claimant according to FOB (*Incoterms 2000*) section B5 which provides that "[t]he seller must bear all risks of loss of or damage to the goods from the time they have passed the ship's rail at the named port of shipment." Therefore, Claimant is obligated to pay the sum of 385,805 USD and the interest accrued from 18 December 2003, when the sugar was received.

E. Claimant is not entitled to interest

66. Even if this Tribunal finds that Claimant is entitled to damages, Claimant may not recover interest on any damages owed. The right to interest payments is governed by Article 78 CISG which provides that interest is available only on a "sum that is in arrears"—or a liquidated sum. [*Honnold §422*]. Because the amount of damages is in dispute, it cannot be certain and thus is not a liquidated sum. As such, Claimant may not recover interest as of the date of the substitute transaction.

F. Claimant should bear the legal costs of these proceedings

67. According to Article 38 of the Swiss Rules, this Tribunal may order Claimant to bear the cost of these proceedings and any additional legal costs.