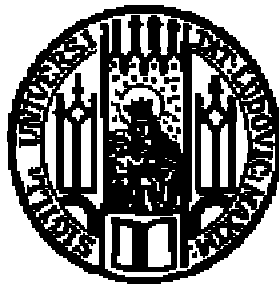


FIRST ANNUAL
WILLEM C. VIS (EAST) INTERNATIONAL COMMERCIAL ARBITRATION MOOT
19 – 21 MARCH 2004

MEMORANDUM FOR THE CLAIMANT



LUDWIG-MAXIMILIANS-UNIVERSITÄT MÜNCHEN

ON BEHALF OF:

Equapack, Inc.
345 Commercial Ave.
Oceanside
Equatoriana

CLAIMANT

AGAINST:

Medi-Machines, S.A.
415 Industrial Place
Capitol City
Mediterraneo

RESPONDENT

Counsel:

Susan Tatum • Alexandra Walgenbach • Miseong Yoon
Benjamin Hamberger • Max Peiffer

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LIST OF ABBREVIATIONS

\$	Dollar
%	per cent
§/§§	Paragraph/paragraphs
A.L.R.	Australian Law Reports
All. E.R.	All England Reports
Am. Rev. Int'l Arb.	American Review of International Arbitration
Arb. Int'l	Arbitration International
Ave.	Avenue
BGB	Bürgerliches Gesetzbuch (German Civil Code)
BGH	Bundesgerichtshof (German Federal Court)
BGHZ	Entscheidungen des Bundesgerichtshofs in Zivilsachen (Decisions of the German Federal Supreme Court in Civil Matters)
C.Cass.	Cour de Cassation (French High Court)
cf.	Compare
Cir.	Circuit
CISG	United Nations Convention on Contracts for the International Sale of Goods of 11 April 1980
civ.	civil/civile
CJ	Chief Justice
Clarif.	Clarification
Co.	Company
Corp.	Corporation
Ed.	Editor/editors
e.g.	<i>exemplum gratia</i> (for example)
EGBGB	Einführungsgesetz zum Bürgerlichen Gesetzbuch (Introductory Law to the German Civil Code)
et al.	<i>et alii/ et alia</i> (and other persons, and other places)
Etc.	<i>et cetera</i> (and so on)

et seq.	<i>et sequentes</i> (and following)
Fed. Trib.	Federal Tribunal
GB	Great Britain
GmbH	Gesellschaft mit beschränkter Haftung (Limited liability company)
ibid.	<i>ibidem</i> (in the same place)
ICC	International Chamber of Commerce
ICC Rules	Rules of Arbitration of the International Chamber of Commerce 1998
idem	the same
i.a.	<i>inter alia</i> (among others)
i.e.	<i>id est</i> (that is)
in liq.	in liquidation
Inc.	Incorporated
Incoterms	International Commercial Terms of the International Chamber of Commerce (ICC) of 2000
infra	Below
IPRax	Praxis des Internationalen Privat- und Verfahrensrechts
J	Justice
J. Int'l Arb.	Journal of International Arbitration
Jura	Juristische Ausbildung
JZ	Juristenzeitung
K.B.	High Court of Justice (King's Bench) (Great Britain)
Kg	Kilogram
KG	Kommanditgesellschaft (limited partnership)
L	Lord
LCIA	London Court of International Arbitration
LG	Landgericht (District Court, Germany)
LJ	Lord Justice
Lloyd's Rep.	Lloyd's List Law Report
Ltd.	Limited

Mealey's Int'l Arb. Rep	Mealey's International Arbitration Report
ML	UNCITRAL Model Law on International Commercial Arbitration, 21 June 1985
NJW	Neue Juristische Wochenschrift
No.	Number
nt.	note
NYC	United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958
OLG	Oberlandesgericht (Higher Regional Court, Germany)
OR	Obligationenrecht (Swiss law of obligations)
p./pp.	page/pages
Q.B.	High Court of Justice (Queen's Bench) (Great Britain)
RIW	Recht der Internationalen Wirtschaft
S.A.	Société par actions (Incorporated company/ stock company)
SARL	Société à responsabilité limitée (Limited liability company)
Sec./Secs.	Section/Sections
SIAC	Singapore International Arbitration Centre
SIAC Rules	Arbitration Rules of the Singapore International Arbitration Centre
S.p.A.	Società per azioni (Incorporated company/stock company)
supra	preceding
UCC	Uniform Commercial Code
UNCITRAL	United Nations Commission on International Trade Law
US/U.S.	United States
U.S.S.C.	United States Supreme Court
v.	<i>versus</i> (against)
Vol.	Volume
WIPO	World Intellectual Property Organization
WLR	Weekly Law Report
W.T.A.M.	World Trade and Arbitration Material

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STATEMENT OF FACTS

- **24 June 2002:** Letter from Equapack, Inc. [hereinafter referred to as CLAIMANT] to Medi-Machines S.A. [hereinafter referred to as RESPONDENT] inquiring into the possibility of purchasing several new packaging machines to be used over a wide range of products to pack dry bulk commodities
- **3 July 2002:** Letter from RESPONDENT to CLAIMANT offering six Model 14 auger-feeder packaging machines at US\$ 65,000.00 a piece as fit for a “wide range of products” and packing “finer goods”
- **12 July 2002:** Acceptance of CLAIMANT
- **23 July 2002:** Telephone call from CLAIMANT to RESPONDENT inquiring into the progress of the transfer of the goods and mentioning that i.a. salt would be packed
- **21 Aug. 2002:** Delivery of the machines
- **18 Oct. 2002:** Telephone call from CLAIMANT to RESPONDENT informing RESPONDENT about the corrosion of the machines. RESPONDENT admitted that the machines were not suitable for packing salt
- **19 Oct. 2002:** Letter from CLAIMANT to RESPONDENT declaring avoidance
- **End 2002:** CLAIMANT was forced to purchase new machines from Oceanic Machinery GmbH at a substantially higher price
- **20 March 2003:** Letter from SIAC to RESPONDENT reminding of advance of costs for the third time after letters of 6 and 13 March 2003
- **20 June 2003:** Expert report stating that the machines’ production rate for finer goods was noticeably below average industry rate
- **1 Sept. 2003:** Letter from RESPONDENT to Prof. (Presiding Arbitrator) requesting CLAIMANT be ordered to provide security for costs because of alleged financial difficulties
- **9 Sept. 2003:** Letter from CLAIMANT to Prof. (Presiding Arbitrator) opposing the application to post security for costs and stating its intention of informing its potential purchaser Equatoriana Investors, Inc. of the arbitration
- **17 Sept. 2003:** Letter from RESPONDENT to Prof. (Presiding Arbitrator) reminding CLAIMANT of the alleged duty of confidentiality in its communications with Equatoriana Investors, Inc.
- **24 Sept. 2003:** Letter from CLAIMANT to Prof. (Presiding Arbitrator) opposing RESPONDENT’s allegations concerning confidentiality

STATEMENT OF PURPOSE

CLAIMANT has prepared this Memorandum in compliance with the Arbitral Tribunal's Procedural Order No. 2, issued on 3 October 2003.

CLAIMANT respectfully submits:

- The Model 14 machines delivered by Medi-Machines, S.A. (hereinafter referred to as RESPONDENT) were not in conformity with the contract.
- RESPONDENT fundamentally breached the contract, and CLAIMANT lawfully declared avoidance of the contract.
- The request to order CLAIMANT to post security for costs is to be rejected.
- RESPONDENT cannot claim any right arising from the intended disclosure by CLAIMANT

CLAIMANT shall demonstrate the legal and factual bases for its claim and shall respond to the asserted and anticipated affirmative defences of RESPONDENT.

ARGUMENTS

I. The Model 14 Machines Delivered By RESPONDENT Were Not in Conformity with the Contract

In response to Procedural Order No. 2 § 7 (a) CLAIMANT wishes to raise three points. First, 1 the contract concluded between CLAIMANT and RESPONDENT is to be interpreted according to Article 8 of the Convention on Contracts for the International Sale of Goods [hereinafter referred to as CISG] [A.]. The Model 14 machines delivered by RESPONDENT to fulfil the contract lacked conformity for two reasons. On the one hand, the contract provided for machines suitable for packing salt [B.]. On the other hand, the production rate of the Model 14 machines was too slow [C.].

A. The Contract Concluded between CLAIMANT and RESPONDENT Is to Be Interpreted According to Article 8 CISG

CLAIMANT and RESPONDENT concluded a contract pursuant to Articles 14 *et seq.* CISG by 2 offer of 3 July 2002 (*CLAIMANT's Exhibit No. 2*) and acceptance of 12 July 2002 (*CLAIMANT's Exhibit No. 3*) for six Model 14 machines for the sales price of US\$ 65,000.00 a piece (*Statement of Claim § 5; Statement of Defense § 4*).

According to Article 1 (1) (a) CISG, the law applicable to the substance of the dispute is the 3 CISG, since both the State of the seller and the State of the buyer are Contracting States to the CISG (*Procedural Order No. 3 Clarif. No. 2*). Pursuant to number 15 of the General Conditions of Sale incorporated into the contract, the parties stipulated – in addition – that the CISG is the law applicable to any dispute arising out of the contract (*CLAIMANT's Exhibit No. 2*). The parties thus did not deviate from or vary any provisions in the application of the CISG as allowed by Article 6 CISG.

Article 8 CISG sets the parameters for determining the substance of the agreement (*Secretariat 4 Commentary Article 8 § 1*). According to Article 8 (2) CISG, “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.” Interpretation under Article 8 (2) CISG applies also to the formational phase of the contract (*ZIEGEL Article 8 § 3*), such as the description of the goods in CLAIMANT's invitation to negotiate of 24 June 2002.

B. The Contract Provided for Machines Suitable for Packing Salt

The Model 14 machines were not of the quality required by the contract 5 (Article 35 (1) CISG) [1.]. Should the Tribunal find that Article 35 (1) CISG is not applicable, then

CLAIMANT submits that the machines were not fit for the particular purpose impliedly made known to the seller (Article 35 (2) (b) CISG) [2]. Further, the machines were not fit for the purposes for which goods of the same description would ordinarily be used (Article 35 (2) (a) CISG) [3].

1. The Model 14 Machines Were Not of the Quality Required By the Contract, (Article 35 (1) CISG)

The Model 14 machines did not have the quality required by the contract (Article 35 (1) CISG). 6 According to this provision, the “seller must deliver goods which are of the quantity, quality and description required by the contract.” The quality “includes all features inherent to the good” (*Magnus in HONSELL Article 35 § 10; see Magnus in STAUDINGER Article 35 § 8*) and may be “expressly or impliedly determined by the contract” (*Schwenzer in SCHLECHTRIEM Article 35 § 7; see Magnus in HONSELL Article 35 § 10; COESTER-WALTIJEN p. 638*).

Salt, due to its broad availability in the marketplace, is a product within the category of “wide 7 range of products” (*CLAIMANT’s Exhibit No. 2*) as agreed upon in the contract [a)]. Salt is not a “special product” (*CLAIMANT’s Exhibit No. 7*) that ought to have been expressly mentioned [b)]. CLAIMANT had no obligation to consult RESPONDENT’s website or other literature [c)]. RESPONDENT cannot rely on any information contained in its operation manual to justify the lack of conformity [d)]. Finally, CLAIMANT did not relinquish its claim to a machine suitable for a wide range of products in favour of a lower price and prompt delivery [e)].

a) Salt Is a Product Contained in the Category of “Wide Range of Products”

In its letter of 24 June 2002, CLAIMANT first stated that the machines it wished to purchase 8 were “expected to be used over a wide range of products” (*CLAIMANT’s Exhibit No. 1*). RESPONDENT confirmed this description on 3 July 2002, by stating that if CLAIMANT “plan[ned] to use the machines over a wide range of products, [CLAIMANT would] wish to purchase auger-feeder machines” (*CLAIMANT’s Exhibit No. 2*). RESPONDENT argues that it could not have foreseen that CLAIMANT planned to use the machines to pack salt even occasionally (*Statement of Defense § 4*).

It can clearly be shown that a reasonable person of the same kind as RESPONDENT would 9 have understood CLAIMANT’s description as including salt. RESPONDENT agreed to sell machines that were useful to package a “wide range of goods” when it sent the offer to CLAIMANT (*CLAIMANT’s Exhibit No. 2*). The examples provided by CLAIMANT in the letter of 24 June 2002 concerning the products it intended to package all refer to dry food products (“ground coffee or flour”, “beans or rice”; *CLAIMANT’s Exhibit No. 1*). Salt falls within this category, as

salt is considered to be both “dry stuff” (*Procedural Order No. 3 Clarif. No. 16*) and “food”. “Food” is defined as “material ... that contains or consists of essential body nutrients, such as carbohydrates, fats, proteins, vitamins, or minerals and is ingested and assimilated by an organism to produce energy, stimulate growth and maintain life” (<http://dictionary.reference.com/search?q=food>). Since salt is a mineral that is assimilated by human organisms to uphold life functions it falls under this definition. Consequently, salt falls within the category of dry food products and therefore is also included in the description “wide range of products”. The description of the goods in the offer is binding for the seller without the need of a specific promise (*ENDERLEIN/MASKOW Article 35 § 5*). Therefore, under the agreement of 12 July 2002, it was agreed that the machines were to be suitable for packing various products, including salt.

b) Salt Is Not a “Special Product” that Ought to Have Been Expressly Mentioned

RESPONDENT argues that “salt is ... a special product” due to its highly corrosive nature and 10 that it “cannot assume that a customer intends to pack it unless ... told so specifically” (*CLAIMANT’s Exhibit No. 7; see also Statement of Defense § 8*).

However, CLAIMANT submits that salt cannot be considered a special product. Corrosive 11 products, salt, salted products, and products that contain salt are not unusual. There are a multitude of dry food products that fall within the category of corrosive products, such as bouillon powder, dry soup, soda, vinegar powder, mustard powder, pretzels, popcorn, peanuts, crackers, potato chips, baking powder, pre-mixed seasonings for salad, grilled meat, tacos etc., that are also part of a “wide range of products”. Consequently, corrosive products are so prevalent in the marketplace today that RESPONDENT, due to its experience and knowledge of the industry, should have known that it was highly probable that CLAIMANT would use the machines to package corrosive products, be it salt or products. However, the Model 14 machines were not suitable for corrosive products (*Procedural Order No. 3 Clarif. No. 26*). Furthermore, so many companies do package salt that there is a market for machines designed for that purpose (*Procedural Order No. 3 Clarif. No. 27*), which means that salt is not an unusual substance in the food packaging industry. Indeed, it is a normal ingredient of various retail products.

c) CLAIMANT Had No Obligation to Consult RESPONDENT’s Website or Other Literature

RESPONDENT argues that its website and literature make “it clear that machines built to pack 11 salt ... use a high-grade stainless steel” (*CLAIMANT’s Exhibit No. 7*). However, RESPONDENT did not furnish CLAIMANT with literature on the Model 14, 16, or 17 machines prior to the conclusion of the contract (*Procedural Order No. 3 Clarif. Nos. 17 and 18*). RESPONDENT never

suggested that there was pertinent information located on its website; in fact, RESPONDENT never informed CLAIMANT that it had an Internet presence, nor inquired whether CLAIMANT had access to the Internet. Therefore, CLAIMANT did not visit the website prior to the dispute (*Procedural Order No. 3 Clarif. No. 20*), and a reasonable person of the same kind as RESPONDENT would have had no reason to think CLAIMANT would do so. Consequently, any information contained on RESPONDENT's website or in its literature is not part of the contract.

d) RESPONDENT Cannot Rely on Information Provided in Its Operation Manual to Deny the Lack of Conformity

RESPONDENT did not provide CLAIMANT with the operation manual before the contract 12 was concluded, as it was sent only together with the machines (*Procedural Order No. 3 Clarif. No. 25*). Therefore, RESPONDENT cannot rely on information provided in its operation manual to deny the lack of conformity.

Moreover, the operation manual was too vague to warn CLAIMANT or any reasonable person 13 against packing salt. It simply states that the "Model 14 is not intended for use with highly corrosive products." There is no mention of salt (*Procedural Order No. 3 Clarif. No. 25*). The Merriam-Webster dictionary does not define salt as corrosive (<http://www.m-w.com/cgi-bin/dictionary?book=Dictionary&va=salt>) and does not list salt as a corrosive product (<http://www.m-w.com/cgi-bin/dictionary?book=Dictionary&va=corroding>). CLAIMANT's primary business was to package many different types of goods for other companies (*Statement of Case § 2*). Only a small part of CLAIMANT's operation in the past had been the packaging of bulk commodities (*CLAIMANT's Exhibit No. 7*). CLAIMANT had no experience with packaging salt (*Statement of Case § 4*). Therefore, a reasonable person of the same kind as CLAIMANT in the same circumstances could not have been expected to know that salt is corrosive. Consequently, any information contained in the operation manual is of no relevance for the contract.

e) CLAIMANT Did Not Relinquish Its Claim to a Machine Suitable for a Wide Range of Products in Favour of Lower Price and Prompt Delivery

In the contract negotiations, RESPONDENT could not assume that the CLAIMANT's only 14 criteria in the purchasing decision were "price and prompt delivery" (*CLAIMANT's Exhibit No. 1*). No reasonable person would purchase a useless machine only because of its low price. In this case, the Model 14 machines were useless for packaging salt and therefore for CLAIMANT's performance of the contract with A2Z, Inc. (*CLAIMANT's Exhibit No. 3*). RESPONDENT claimed it had discounted the price for the Model 14 machines because it had decided to discontinue this model (*CLAIMANT's Exhibit No. 2*). The model had not sold as well as had been

expected when it was first introduced; these machines were the last six RESPONDENT had in its inventory (*Procedural Order No. 3 Clarif. Nos. 32 and 33*). To secure this lower price, RESPONDENT compelled CLAIMANT to purchase all six remaining machines (*CLAIMANT's Exhibit No. 2*). Therefore, the lower price and prompt delivery agreed upon had no negative impact on the quality provided for in the contract.

2. The Machines Were Not Fit for the Particular Purpose Impliedly Made Known to the Seller (Article 35 (2) (b) CISG)

Should the Tribunal nevertheless consider salt a “special product”, CLAIMANT submits that it has impliedly made known to RESPONDENT that it wanted to use the machines for packaging salt. According to Article 35 (2) (b) of the CISG, the goods have to be “fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract”. “Made known” in this Article is less restrictive than “contractually agreed” (*Schwenzler in SCHLECHTRIEM Article 35 § 20*). The particular purpose was the use with a “wide range of products” (*CLAIMANT's Exhibit No. 1*) as opposed to specific products. The standard for “impliedly made known” is the reasonable person standard of Article 8 (2) CISG (*KAROLLUS p. 117*). A reasonable person as defined in Article 8 (2) CISG would have interpreted this as to mean “suitable for any dry bulk commodity on the market including salt” (*see supra §§ 6-14*). 15

RESPONDENT cannot argue that CLAIMANT “did not rely, or that it was unreasonable for [it] to rely, on [RESPONDENT's] skill and judgement” (Article 35 (2) (b) CISG). CLAIMANT relied on RESPONDENT's superior knowledge of its products. CLAIMANT inquired into packing machines, thereby demonstrating that it lacked the knowledge necessary to choose a particular model. In its reply, RESPONDENT suggested that the Model 14 machines were suitable for a wide range of products without specifically asking what was going to be packed. The buyer can rely on the superior knowledge and experience of the seller, “if the seller is a specialist or expert in the manufacture ... of goods for the particular purpose intended by the buyer” (*Schwenzler in SCHLECHTRIEM Article 35 § 23; see Magnus in HONSELL Article 35 § 21; BAMBERGER/ROTH Article 35 § 8*). This is the case, as RESPONDENT is a manufacturer of machinery, including dry foods packaging equipment (*Statement of Defense § 2*) and has been in the industry for over thirty years (*Procedural Order No. 3 Clarif. No. 10*). CLAIMANT had little experience packaging food. Before the delivery of the Model 14 machines, it had relied solely on one second-hand machine to package small quantities of food (*Procedural Order No. 3 Clarif. No. 10*). Furthermore, CLAIMANT had no experience packaging salt (*Statement of Case § 4*). Consequently, CLAIMANT did rely, and it was reasonable for it to rely, on RESPONDENT's skill and judgement. 16

3. The Machines Were Not Fit for the Purposes for Which Goods of the Same Description Would Ordinarily Be Used (Article 35 (2) (a) CISG)

Should the Tribunal find Article 35 (2) (b) CISG does not apply, then at least the conditions for 17 conformity found in Article 35 (2) (a) CISG are not fulfilled. According to Article 35 (2) (a) CISG, unless otherwise agreed by the parties, the goods sold should be “fit for the purposes for which goods of the same description would ordinarily be used.” In this case, where goods are ordered by “general description...the scope of the seller’s obligation [under Article 35 (2) (a) CISG] is not determined by whether the seller could expect the buyer himself to use the goods in one of the ways in which such goods are ordinarily used” (*Secretariat Commentary Article 35 § 5*).

The general description of the goods has to be interpreted in the light of the parties’ telephone 18 conversation of 23 July 2002. “Contrary to Article 35 (2) (b) CISG, Article 35 (2) (a) does not specify that quality requirements are determined at the time of the conclusion of the contract. Thus, factual elements occurring after the conclusion of the contract may be taken into account to determine quality standards” (*Netherlands Arbitration Institute 15 October 2002 § 72*). Therefore, the telephone conversation in which CLAIMANT specifically declared that salt would be packed (*CLAIMANT’s Exhibit No. 5; Statement of Defense § 6*), should be seen as a standard of quality in the contract. Clearly, the ordinary use of the goods under the parties’ agreement was to pack salt.

Even if the Tribunal should discount the telephone conversation of 23 July 2002, the goods 19 lacked conformity within Article 35 (2) (a) CISG. “Goods are detrimental to an ordinary use when they lack specific ordinary characteristics ... which impede their material use (*ENDERLEIN/MASKOW Article 35 § 8, emphasis omitted*). The packing of salt is to be considered as an ordinary use of goods which are able to pack “a wide range of products” (*CLAIMANT’s Exhibit No. 1*). In order to be suitable for packing salt, the machines “would require the entire product path to be in stainless steel or some other corrosion resisting material” (*Procedural Order No. 2, Extracts from report of expert engineer Eur. Ing. Franz van Heath-Robinson*). However, the Model 14 machines lacked this feature. Moreover, the goods must be suitable for all purposes, for which goods of the same kind are normally suitable. If the delivered goods are only suitable for some of the normal purposes, they are non-conforming (*Magnus in STAUDINGER Article 35 § 20*). Therefore, the Model 14 machines were not in conformity with the contract.

C. The Model 14 Machines Lacked Conformity Because Their Production Rate for Finer Goods Was Too Slow

The average industry production rate is 180 1kg bags per minute for fine and coarse products 20 (*Procedural Order No. 2, Extracts from report of expert engineer Eur. Ing. Franz van Heath-Robinson*). However, the machines delivered to CLAIMANT had a production rate of only 130-135 1kg bags

per minute for finer goods (*Procedural Order No. 2, Extracts from report of expert engineer Eur. Ing. Franz van Heath-Robinson*). In any case, the goods lacked conformity since their production rate was too slow. CLAIMANT submits that the goods lacked conformity as the parties' agreement provided for machines that adhered to the average industry production rate (Article 35 (1) CISG) [1.]. Even if no specific production rate was agreed upon, the goods lacked conformity as their production rate was notably below industry average (Article 35 (2) (a) CISG) [2.].

1. The Parties' Agreement Provided for Machines that Adhered to the Average Industry Production Rate (Article 35 (1) CISG)

A reasonable person of the same kind in the same circumstances as CLAIMANT would have 21 understood RESPONDENT's offer of 3 July 2002 (*CLAIMANT's Exhibit No. 2*) as guaranteeing machines that perform at least at industry average. RESPONDENT, "a premier manufacturer of equipment for the food packaging industry" (*CLAIMANT's Exhibit No. 2*), advised CLAIMANT that it "would need auger-feeders for the fine products. Auger-feeders [could] also be used to pack coarser items such as beans or rice, though they [were] slower at doing so than are multi-head weighers" (*ibid.*). RESPONDENT expressly advised CLAIMANT that auger-feeders were slower for packing coarser goods, but recommended auger-feeders for finer goods. Because RESPONDENT referred to the Model 14 machine as a "top product" (*ibid.*), RESPONDENT impliedly declared that the production rate for finer goods was at least industry standard. RESPONDENT cannot allege that it was agreed upon a production rate below industry average as the Model 14 was an older model. The average industry rate has not changed in recent years, and this Model was only three years old (*Procedural Order No. 3 Clarif. No. 34*). A reasonable person would therefore have expected to purchase machines that work at a 100% and not just 72 % of the industry average.

2. The Machines Lacked Conformity as Their Production Rate Was Notably below Industry Average (Article 35 (2) (a) CISG)

Even if the Tribunal finds that the minimum production rate was not impliedly agreed upon in 22 the contract, the Model 14 machines still were not fit for the purposes for which goods of the same description would ordinarily be used, because the machines failed to be of average quality [a)]. Moreover, the machines even failed to be of reasonable quality [b)].

a) The Machines Failed to Be of Average Quality

Within the guidelines of Article 35 (2) (a) CISG, the goods must be of average quality (*Magnus in 23 STAUDINGER Article 35 § 19; Salger in WITZ/SALGER/LORENZ Article 35 § 18; Schwenzler in SCHLECHTRIEM Article 35 § 15; District Court Berlin 15 September 1994*). This standard is laid down in

many domestic systems (*see Sec. 243 § 1 BG; Article 71 § 2 OR; Article 1246 Code Civil; § 2-314 (2) (b) UCC*). The production rate of the Model 14 machines delivered by RESPONDENT for fine products is only 72% of, thus “noticeably below”, the average industry production rate (*Procedural Order No. 2, Extracts from report of expert engineer Eur. Ing. Franz van Heath-Robinson*). Hence, the Model 14 machines are not of average quality and thus not in conformity with Article 35 (2) (a) CISG.

b) The Machines Failed to Be of Reasonable Quality

Even if the Tribunal does not apply the average quality standard, still the goods were not in 24 conformity with the contract under the reasonable quality standard of Article 35 (2) (a) CISG. According to this standard “reasonable expectations are to be taken into account” (*Netherlands Arbitration Institute 15 October 2002 § 117*) in the determination of the quality required by the contract. “The principle of the buyer’s reasonable expectancy with respect to the general and particular purpose of the goods that has found this expression in CISG also appears in many domestic laws” and “can hardly be regarded as controversial” (*Beijing Light Automobile Co. v. Connell*). The reasonable expectation would have been that the machines pack at the industry rate.

II. RESPONDENT Fundamentally Breached the Contract, and CLAIMANT Declared Avoidance of the Contract

In response to Procedural Order No.2 § 7 (b), CLAIMANT respectfully submits that 25 RESPONDENT committed a fundamental breach of the contract [A.] and that CLAIMANT lawfully avoided the contract [B.].

A. RESPONDENT Committed a Fundamental Breach of the Contract (Article 25 CISG)

RESPONDENT fundamentally breached its contractual obligations within the meaning of 26 Article 25 CISG. According to this provision, a “breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result.” In this matter, such fundamental breach resulted first from the machines’ lack of conformity with the contract already discussed above [1.], and second from RESPONDENT’s violation of its duty to inform [2.].

1. The Machines’ Lack of Conformity Resulted in a Fundamental Breach of Contract

The lack of conformity with regard to the inability to package salt and the slowness of the 27 production rate constitute a breach of contract. First, this is a breach within the meaning of

Article 25 CISG [a)], second, the breach was fundamental [b)], and third, the result of the breach was foreseeable [c)].

a) RESPONDENT Breached Its Contractual Obligation (Article 35 CISG)

RESPONDENT failed to fulfil its obligation to deliver goods in conformity with the contract 28 (Article 35 CISG) (*see supra* §§ 1-19).

b) The Breach was Fundamental (Article 25 CISG)

The breach was fundamental because it resulted in a substantial detriment to CLAIMANT as 29 defined in Article 25 CISG. Substantial detriment occurs when “the purpose the aggrieved party pursued with the contract was foiled and, therefore, led to his losing interest in the performance of the contract” (*ENDERLEIN/MASKOW Article 25 § 3.1, emphasis omitted; see KOCH p. 266*). The detriment is to be determined in light of the circumstances of each case, e.g. the monetary value of the contract, the monetary harm caused by the breach, or the extent to which the breach interferes with other activities of the injured party (*Secretariat Commentary Article 25 § 3*). The machines’ inability to pack salt [i]) as well as their slow production rate [ii]) resulted in a fundamental breach.

i) The Machines’ Inability to Pack Salt Resulted in a Fundamental Breach

The machines’ inability to pack salt resulted in a fundamental breach, as CLAIMANT was 30 substantially deprived of what it was entitled to expect under the contract. The machines can neither be used in the way CLAIMANT intended nor in any other reasonable way.

First, CLAIMANT suffered a substantial detriment since it was not able to fulfil its contract 31 with A2Z, Inc. When goods are purchased for a distinct purpose, it is of primary interest for the buyer to receive goods of a certain quality appropriate for the intended use (*BOTZENHARDT p. 199*). CLAIMANT wanted to package dry commodities including salt to fulfil its contract with A2Z, Inc. (*Statement of Case § 4*). Moreover, detriment includes “immaterial detriments such as losing a customer, losing resale possibilities or being brought into disrepute etc.” (*LORENZ at III.A.; see KREBS p. 24*). Therefore, the “serious impact” CLAIMANT’s inability “to properly service its contract with A2Z, Inc. has had ... on [CLAIMANT’s] reputation as a responsible firm” (*letter of 24 September 2002*) aggravates CLAIMANT’s detriment.

Second, CLAIMANT cannot make use of the machines in any other way. It has been held that 32 a buyer’s interest in the contract is substantially deprived if the goods cannot be put to another reasonable use (*OLG Frankfurt 18 January 1994 (Germany), affirming BGH 3 April 1996 (Germany)*). To determine whether this is possible for the buyer, the purpose for which the buyer originally purchased the machines must be considered (*Huber in SCHLECHTRIEM (2000) Article 46 § 35*). In

this case, CLAIMANT wanted to use the machines for packaging a wide range of dry bulk commodities (*CLAIMANT's Exhibit No. 1*). Since the machines, which have been used for packaging salt, showed serious signs of corrosion, they can no longer be used for packing any food (*Statement of Case § 9*). The corroded parts of the machines cannot be replaced or repaired (*Procedural Order No. 3 Clarif. No. 29*). The six machines sold to CLAIMANT were the last that RESPONDENT had in its inventory (*Procedural Order No. 3 Clarif. No. 33*). So, RESPONDENT cannot replace or repair the defective machines. It is unreasonable to reuse goods when their defects can not be remedied (*KOCH, RIW 1995, p. 100*). Therefore, the machines could only be used for packing non-foodstuffs. Since only a small part of CLAIMANT's business is packaging dry bulk commodities into retail packages (*Statement of Case § 1*), CLAIMANT cannot be expected to keep the damaged machines for any potential future packaging contracts. Thus, in the case at hand, CLAIMANT cannot reasonably make use of the machines. Finally, RESPONDENT cannot allege that CLAIMANT could make use in another way of the two machines that were not used to pack salt. It would be unreasonable for CLAIMANT to make use of only two machines, since CLAIMANT needed six functioning machines (*Procedural Order No. 3 Clarif. No. 35*).

Moreover, CLAIMANT cannot make another reasonable use of the machines by reselling them **33** without considerable additional efforts. As long as the buyer of goods is not a wholesaler for the type of product bought, compelling it to resell the products would overburden it (*Huber in SCHLECHTRIEM (2000) Article 46 §§ 36 et seq.*). If the additional strain necessary to resell the goods is unreasonable for the aggrieved party, the detriment caused by the nonconforming goods is fundamental (*BENICKE p. 329*). CLAIMANT is not in the business of selling machines and it does not appear that it has business partners to whom it could sell the machines. Hence, CLAIMANT does not have an obligation to resell the machines. Consequently, it is not possible to expect CLAIMANT to put the goods to another reasonable use by reselling them.

Even if the Tribunal finds that CLAIMANT could put the machines to another reasonable use, **34** this would not affect the substantiality of the harm to CLAIMANT. It has been held that the impossibility to use of the machines for other purposes is not a precondition for a fundamental breach (*SARL Sacovini v. SARL Les Fils de Henri Ramel (France)*; see *SCHLECHTRIEM, IPRax 1997, p. 132*; *WITZ in Recueil Dalloz Sirey – Jurisprudence, 1996, pp. 334 et seq. sub II.C.*). Consequently, the detriment suffered by the CLAIMANT was fundamental.

ii) The Machines' Slow Production Rate Resulted in a Fundamental Breach

Similarly, the fact that RESPONDENT delivered packaging machines that had a slow speed 35 when packaging finer goods resulted in a fundamental breach within the meaning of Article 25 CISG.

First, CLAIMANT was entitled to expect machines of a higher production rate than only 130- 36 135 1kg bags per minute for finer goods (*supra* §§ 20-24). Impliedly agreed conditions for special purpose capability can be considered material terms of the contract (*KAPPUS p. 530*). CLAIMANT is in the business of packaging foodstuffs (*Statement of Case § 1*) and RESPONDENT knew that CLAIMANT would use the machines for its business purpose (*CLAIMANT's Exhibit No. 3*). As a party can be aggrieved by a detriment that is a loss of one of the contractual benefits (*Magnus in STAUDINGER Article 25 § 11*), CLAIMANT suffered a detriment because the delivered machines were not able to work efficiently and profitably.

Second, this detriment was substantial. A party commits a fundamental breach, if the goods 37 sold do not fulfil conditions that “are important determinants of the product’s value” (*Delchi Carrier SpA v. Rotorex Corporation (USA)*). At the same time, substantiality “does not refer to the extent of the damage but to the importance or the interest which the contract ... actually create[s] for the promisee” (*Huber in SCHLECHTRIEM Article 25 § 9*). In the present case, speed is an essential requirement for the efficient and cost-effective use of industrial machines, including auger-feeders. Thus, the detriment caused to CLAIMANT was substantial.

c) The Result of the Breach Was Foreseeable

RESPONDENT cannot argue that it or a reasonable person of the same kind in the same 38 circumstances as RESPONDENT could not have foreseen the substantial detriment that resulted from RESPONDENT’s breach of the contract. The burden to prove unforeseeability lies with the breaching party (*LORENZ at III.B.; KAZIMIERSKA p. 108*), the RESPONDENT. RESPONDENT cannot prove that the result was not foreseeable.

First, it was foreseeable within the meaning of Article 25 CISG that the lack of conformity with 39 regard to the ability to pack salt would lead to a fundamental detriment for CLAIMANT. Even if the Tribunal finds that, at the time of the conclusion of the contract, RESPONDENT could not have known of CLAIMANT’s substantial interest in the machines’ ability to pack salt, the information transmitted in the telephone conversation of 23 July 2002 is to be taken into account in interpreting the contractual agreement. Since Article 25 CISG provides that only the party, that could foresee the substantial detriment, can commit a fundamental breach, the decisive question is whether the party in breach could have avoided committing the breach. Therefore, the relevant

point in time to determine foresight or foreseeability is the moment of the breach of contract and not the moment of its conclusion (*NEUMAYER p. 105; KAZIMIERSKA p. 108; ENDERLEIN/MASKOW Article 25 § 3.4; FREIBURG, p. 54*). Only “information that a party receives too late to affect performances [lies] outside the scope of Article 25” (*HONNOLD p. 209 § 183*). In this case, RESPONDENT was informed that CLAIMANT intended to use the machines for packaging salt on 23 July 2002 (*Statement of Case § 6*). At that time, RESPONDENT was still able to stop the shipping (*Procedural Order No. 3 Clarif. No. 23*). Consequently, RESPONDENT was able to recognise its breach of contractual obligations and therefore would have been able to prevent it.

Second, it was foreseeable that the lack of conformity with regard to the production rate would lead to a fundamental detriment for CLAIMANT. A result is foreseeable, where “the promisor ... knew of the circumstances which made the obligation in question specially important” (*Schlechtriem in IDEM Article 25 § 14*). RESPONDENT, as the manufacturer, knew of the machines’ low production rate for finer goods. RESPONDENT furthermore knew that CLAIMANT wished to use the machines in its business and stressed the importance of the production rate in its own offer (*CLAIMANT’s Exhibit No. 2*). Consequently, the substantial detriment was foreseeable for RESPONDENT.

2. RESPONDENT Fundamentally Breached the Contract by Not Complying with Its Duty to Inform (Article 7 (1) CISG)

Apart from the lack of conformity, RESPONDENT committed a fundamental breach of contract by not complying with its duty to inform. First, RESPONDENT failure to inform CLAIMANT of the machines’ inability to pack salt on or about 23 July 2002 constitutes a breach of contractual obligation [a)], second, the breach of the duty to inform substantially deprived CLAIMANT of what it was entitled to expect under the contract (Article 25 CISG) [b)], and third, the result of the breach was foreseeable for RESPONDENT and for a reasonable person of the same kind in the same circumstances as RESPONDENT (Article 25 CISG) [c)].

a) RESPONDENT’s Failure to Inform CLAIMANT of the Machines’ Inability to Pack Salt on or about 23 July 2002 Constituted a Breach of a Contractual Obligation

RESPONDENT was subject to a duty to inform CLAIMANT of the inability to pack salt. This duty was breached by RESPONDENT. “As soon as the seller recognises that the goods contractually agreed on, are not fit for the special purpose, for which the buyer intends to use them, a duty to warn and to inform arises for the seller. This is deducted from the principle of good faith (Article 7(1) CISG)” (*Magnus in STAUDINGER Article 35 § 35; see Secretariat Commentary Article 35 § 9 and nt. 5; Schwenzger in SCHLECHTRIEM (2000) Article 35 § 23; ENDERLEIN/MASKOW Article 35 § 13;*

KAROLLUS pp. 117 et seq.; Salger in WITZ/ SALGER/LORENZ Article 35 § 10; Magnus in HONSELL Article 35 § 23). On 23 July 2002 CLAIMANT informed RESPONDENT that “A2Z, Inc. wants [CLAIMANT] to get going on packaging [A2Z, Inc.’s] stuff. [A2Z, Inc. has] everything in mind from large beans to salt to fine powder and [CLAIMANT was] going to have to do it all” (*Statement of Defense § 6*). The duty to inform arose at this moment. RESPONDENT cannot allege that CLAIMANT’s language “was [not] sufficient to alert [RESPONDENT] that the Model 14 machines being delivered to [CLAIMANT] would be used to pack salt” (*ibid.*). The purpose of the buyer must merely be made known to the seller in such a way that it is able to take notice of it; whether or not the seller actually takes notice is irrelevant (*Magnus in STAUDINGER Article 35 § 28*). The language used by CLAIMANT in the telephone conversation is clear and unequivocal since it leaves no doubt that CLAIMANT intended to pack salt with the machines. Similarly, RESPONDENT cannot allege that it had no reason to “pay particular attention to those elements of the conversation ... since [CLAIMANT] was not asking [RESPONDENT] to do anything” (*Statement of Defense § 5*). The efficacy of the duty is not dependent upon the form of the inquiry. RESPONDENT, thus, had the duty to reply to this remark since it knew of the inability of the machines to pack salt. However, RESPONDENT breached this duty by “not pay[ing] particular attention” (*Statement of Defense § 5*) to CLAIMANT’s announcement and not warning CLAIMANT of the limitations of the Model 14 machines.

b) RESPONDENT’s Breach of Its Duty to Inform Resulted in a Fundamental Breach

CLAIMANT submits that RESPONDENT’s breach of its duty to inform constituted a 43 fundamental breach since it substantially deprived CLAIMANT of what it was entitled to expect under the contract. RESPONDENT cannot evade the claim of fundamental breach by asserting that its duty to inform was merely ancillary. It is generally accepted that a breach of an ancillary duty can lead to a fundamental breach of contract (*BGH 3 April 1996 at II.2.c.aa; OLG Frankfurt 17 September 1991; KAZIMIERSKA p. 104*).

First, CLAIMANT was entitled to be warned by RESPONDENT pursuant to the contractual 44 relationship. Expectations of the aggrieved party have to be discernible from the contract (*ENDERLEIN/MASKOW Article 25 § 3.3*). CLAIMANT’s right to be informed can be deduced from the contract since CLAIMANT expressly informed RESPONDENT that prompt delivery was an essential element of its purchasing decision (*CLAIMANT’s Exhibits Nos. 1 and 3*). Hence, CLAIMANT was entitled to expect that RESPONDENT would care for its ancillary interests as “a promisor [is] bound not only to what he has promised expressly but also to numerous ‘auxiliary duties’ of protecting the interest of the obligee” (*RHEINSTEIN pp. 597 et seq.*).

Second, CLAIMANT has suffered a fundamental detriment, since it was not notified about the machines' inability to pack salt, despite informing RESPONDENT by telephone that it intended to use the machines for packing salt. By shipping machines, which were not suitable for this purpose, considerable additional costs for CLAIMANT arose. Furthermore, a noticeable delay was caused, since the inappropriate machines were used in the normal course of business for over a month before CLAIMANT had to purchase new machines, which consumed additional time and money. If CLAIMANT had known on 23 July 2002 that the machines were unsuitable for salt, any delay would have been lessened since CLAIMANT could either have purchased appropriate machines from RESPONDENT, so that the delivery of the Model 14 machines could have been stopped on 23 July 2002 (*Procedural Order No. 3 Clarif. No. 23*), or CLAIMANT could have started looking for another company from which to buy the necessary machines.

Third, the detriment to CLAIMANT was fundamental. The breach of an ancillary obligation constitutes "a fundamental breach if it has some repercussions on the performance of the principal obligations in a such way that the interest of the creditor in the performance of the contract is lost" (*FCF S.A. v. Adriafil Commerciale S.r.l. (Switzerland)*; see *BOTZENHARDT p. 184*). In the case at hand, CLAIMANT's good reputation is damaged as it cannot fulfil its contract with A2Z, Inc. (*Statement of Case § 4*). As a result, CLAIMANT's relations to other potential business partners will suffer. Since a detriment is especially substantial when the aggrieved party suffers harm in its relationship with business partners (*BENICKE p. 329*), RESPONDENT's breach of its duty to inform resulted in a substantial detriment.

c) The Result of the Breach Was Foreseeable

RESPONDENT and any reasonable person could have foreseen that compelling CLAIMANT, through trial and error, to discover the machines' inability to pack salt would jeopardize CLAIMANT's ability to fill orders and service contracts in a timely manner and that CLAIMANT's reputation would suffer from its inability to fulfil the contract. As stated above, the decisive moment to evaluate the foreseeability is the moment of the breach (*see supra § 42*). The party in breach does not escape liability merely by proving that it did not, in fact, foresee the result. It must also prove that it had no reason to foresee it (*Secretariat Commentary Article 25 § 4*). Therefore, RESPONDENT cannot prove any lack of foreseeability.

B. CLAIMANT Lawfully Declared Avoidance of the Contract

CLAIMANT lawfully avoided the contract because first, RESPONDENT fundamentally breached the contract [1.], second, CLAIMANT's letter of 19 October 2002 constituted an effective declaration of avoidance [2.]. Further, CLAIMANT submits that Article 82 (1) CISG

does not apply in the present case [3.], and that RESPONDENT cannot rely on Article 49 (2) CISG to deny CLAIMANT's right to declare the avoidance [4.].

1. RESPONDENT Fundamentally Breached the Contract

According to Article 49 (1) (a) CISG, “the buyer may declare the contract avoided, if the failure 49 by the seller to perform ... his obligations under the contract or [the CISG] amounts to a fundamental breach of contract.” As shown above, RESPONDENT committed a fundamental breach of contract (*see supra* §§ 26-47).

2. CLAIMANT's Letter of 19 October 2002 Constituted an Effective Declaration of Avoidance Pursuant to Article 26 CISG

Pursuant to Article 26 CISG, a “declaration of avoidance of the contract is effective only if 50 made by notice to the other party.” A declaration of avoidance under Article 26 CISG requires that first, the buyer specify the lack of conformity, that second, he makes it clear that he will not “accept or keep the goods, and [third] that the seller has the responsibility to take over their disposition” (*HONNOLD p. 214 § 187.2*). All these requirements are fulfilled by CLAIMANT's letter of 19 October 2002.

In this letter, CLAIMANT stated that it “cannot use the machines [as] there is corrosion that is 51 sufficient to cause the product to block and cause outages when [CLAIMANT tried] to package any products.” (*CLAIMANT's Exhibit No. 6*). By stating “they are yours” and “we need to have the space” (*ibid.*), CLAIMANT explicitly informed RESPONDENT that it no longer wished to keep the machines. In the statement that it “would [be] appreciate[d] ... if [RESPONDENT] would arrange something to be done with them” (*ibid.*), CLAIMANT made clear that it wished to return the machines and that RESPONDENT should take action to arrange the removal of the machines.

RESPONDENT cannot rely on CLAIMANT's failure to state “declaration of avoidance” 52 specifically, as the CISG does not require use of the express term (*OLG Frankfurt 17 September 1991 (Germany), p. 5 of 14; ICC Case No. 7645; Magnus in STAUDINGER Article 26 § 7*), the more so as implicit behaviour can suffice as a declaration of avoidance (*Hamburg Arbitration Proceedings 29 December 1995; Leser in SCHLECHTRIEM Article 26 § 10*). The form of communication is also not regulated by the CISG; therefore post, telephone and fax have all been held by the Arbitral Tribunals as allowed (*ICC Case No. 9978; Russia 5 March 1998 160/1997*). So CLAIMANT's letter of 19 October 2002 constituted a declaration of avoidance as required by Articles 49 (1) and 26 CISG.

3. Article 82 (1) CISG Does Not Apply in the Present Case

According to Article 82 (1) CISG, the buyer could “lose the right to declare the contract avoided 53 ... if it is impossible for him to make restitution of the goods substantially in the condition in which he received them.” In the case at hand, the four machines used for salt are corroded and cannot be restituted in the condition in which CLAIMANT received them. Nonetheless, Article 82 (1) CISG does not apply. First, the impossibility of restitution is not due to CLAIMANT’s act or omission (Article 82 (2) (a) CISG) [a], and second, the machines have been “transformed” by CLAIMANT in the course of normal use before the lack of conformity had been discovered [b]).

a) The Impossibility of Restitution Is Not Due to CLAIMANT’s Act or Omission (Article 82 (2) (a) CISG)

According to Article 82 (2) (a) CISG, Article 82 (1) CISG does not apply, “if the impossibility of 54 making restitution of the goods ... substantially in the condition in which the buyer received them is not due to his act or omission.” CLAIMANT has not caused the deterioration of the machines in the sense of Article 82 (2) (a) CISG. This article does not refer to all damage regardless of the source (*KREBS p. 104*), but demands evaluation concerning the question of the allocation of risks (*Leser in SCHLECHTRIEM Article 82 § 20; Weber in HONSELL Article 82 § 19*), as indicated by the wording “due to” (*KREBS p. 104; SCHLECHTRIEM, Int. UN-Kaufrecht p. 101*). Otherwise, the provision would be superfluous, since the mere acceptance of the delivery of the goods affects their condition (*KREBS p. 103*). Thus, in general, the “seller is responsible for all consequences ensuing from a lack of conformity of the goods” (*Leser in SCHLECHTRIEM Article 82 § 19*). Therefore, the corrosion of the machines is not due to CLAIMANT’s act or omission, but rather to RESPONDENT’s failure to deliver machines in conformity with the contract and to inform CLAIMANT that the delivered machines were inappropriate to pack salt. Damages due to the lack of conformity itself as well as due to insufficient information (*see supra § 42*) do not affect buyer’s right to avoid the contract (*Magnus in STAUDINGER Article 82 § 21*).

b) The Machines Were Transformed by CLAIMANT in the Course of Normal Use Before the Lack of Conformity Had Been Discovered (Article 82 (2) (c) CISG)

Further, CLAIMANT retains the right to avoid the contract because the deterioration of the 55 machines constitutes a transformation in the course of “normal use” as required in Article 82 (2) (c) CISG. “Transformation” includes not only the creation of a new product, but also the use of an existing product (*Leser in SCHLECHTRIEM Article 82 § 25*). Using the machines for packaging salt complies with their “normal use”, which is to be interpreted according to Article 8 (2) CISG, i.e. the conduct of a reasonable person in the same circumstances as

CLAIMANT (*KREBS p. 114*). As the contract was for machines suitable to package a wide range of products including salt (*see supra §§ 5-19*), CLAIMANT could not expect the machines to be inappropriate for the packaging of salt. Further, since RESPONDENT did not inform CLAIMANT about the limited usability of the Model 14 machines before 18 October 2002, and since CLAIMANT could not otherwise have known of the machines' limitations (*see supra §§ 10-14*), CLAIMANT had a reasonable expectation to trust that the machines conformed to the contract and therefore acted appropriately in using them for salt (*KREBS p. 114*). The only way for CLAIMANT to recognize the machines' non-conformity was the discovery of the corrosion itself. Once CLAIMANT discovered the corrosion and the uselessness of the machines at the end of September (*Statement of Case § 8; Procedural Order No. 3 Clarif. No. 28*), CLAIMANT stopped using them (*Statement of Case § 8; CLAIMANT's Exhibit No. 6*). Hence, a reasonable person as defined in Article 8 (2) CISG would have had no reason not to act as CLAIMANT did. As a result, the damage to the machines constituted a transformation within their "normal use" as required by Article 82 (2) (c) CISG.

4. RESPONDENT Cannot Rely on Article 49 (2) (b) (i) CISG to Deny CLAIMANT's Right to Declare the Avoidance

CLAIMANT submits that it declared avoidance within a reasonable period of time after it knew 56 of RESPONDENT's breach of contract, as required in Article 49 (2) (b) (i) CISG. First, RESPONDENT would be inconsistent in questioning the timeliness of the notice of the declaration of avoidance pursuant to Article 49 CISG. RESPONDENT has stated that it will not raise any questions under Article 39 CISG as to CLAIMANT's timely notice of the non-conformity of the machines (*Procedural Ord. No. 2 § 2*): In case of delivery of goods not in conformity with the contract, the period of time for the declaration of avoidance is to be calculated more liberally than in Article 39 CISG because the far-reaching consequences of avoidance require careful consideration (*PILTZ p. 250 § 282; Magnus in STAUDINGER Article 49 § 38*). Regarding this fact, it would consequently make no sense to rely on Article 49 CISG, as this would be a disadvantage for RESPONDENT.

Second, in any case, CLAIMANT had declared the avoidance within the time period required by 57 Article 49 CISG when declaring avoidance on 19 October 2002, seven weeks and one day from delivery of the Model 14 machines. As they were in service nine days after delivery, 30 August 2002 (*Statement of Case § 8*), this would have been the earliest time, depending on the goods packaged, that CLAIMANT could have recognized the problem of the slower than the industry average production rate. The period of time referred to in Article 49 (2) (b) (i) CISG begins with

the receipt of the results of the examination of the goods according to Article 38 CISG (*SCHLECHTRIEM Article 49 § 43*).

“Reasonable time” in the sense of Article 49 (2) (b) (i) CISG allows a certain scope of discretion, 58 otherwise the provision would specify a precise time limit. Both the *Bundesgerichtshof* (German Supreme Court) and the *Cour de Cassation* (French Supreme Court) have decided cases in which Article 39 CISG was interpreted based on the individual circumstances of the cases, including nature of the goods and the type of nonconformity. Both of the courts in these cases gave the companies a time frame of approximately seven weeks due to the complex nature of the goods at issue. The *Bundesgerichtshof* defined the time limit as one week for inspection, two weeks for an expert inspection and a month to consult with attorneys and declare avoidance. The first three weeks are variable due to the types of goods involved. Parties with machines and other goods that are more complex and difficult to inspect are given more time (*BGH 3 November 1999 (Germany); Société Karl Schreiber GmbH v. Société Thermo Dynamique Service et autres*).

As the period of time allowed in Article 49 CISG is even longer than in Article 39 CISG 59 (*see supra § 56*), the five and one-half weeks CLAIMANT used to inspect the products, detect the lack of conformity and issue the declaration of avoidance are definitely in line with the liberal guidelines established in Article 49 (2) CISG.

Even if the Tribunal should find the five and one-half weeks too long to discern a lower than 60 industry average packing speed and declare avoidance, then CLAIMANT thirdly submits that it can still declare avoidance due to the corrosion and RESPONDENT’s failure to inform. The time periods for determining the declaration of avoidance are varied according to the specific issues (*KREBS p. 30*). As it was impossible for CLAIMANT to discover the lack of conformity before the corrosion occurred, at the end of September, CLAIMANT declared avoidance three weeks after recognizing this lack of conformity.

In the alternative, if the Tribunal finds that the declaration of avoidance due to both varieties of 61 non-conformity of the machines was too late, then, fourthly, the declaration of avoidance due to RESPONDENT’s failure to inform CLAIMANT of the machines’ unsuitability for its purpose was on time. RESPONDENT first informed CLAIMANT during the telephone call on the 18 October 2002, one day before the declaration of avoidance, that the Model 14 machines were unequivocally not suitable to pack salt. Therefore, CLAIMANT declared the avoidance in this regard immediately. Hence, RESPONDENT cannot challenge CLAIMANT’s fulfilment of the timeliness requirement pursuant to Article 49 (2) (b) (i) CISG.

III. The Request to Order CLAIMANT to Post Security for Costs Is to Be Rejected

RESPONDENT requests the Tribunal to order CLAIMANT to post security for costs in the amount of US\$ 20,000.00. In response to Procedural Order No. 2 § 7 (d), CLAIMANT respectfully submits that RESPONDENT's request be denied.

CLAIMANT does not dispute the Tribunal's "power to order any party to provide security for the legal or other costs of any other party by way of deposit or bank guarantee or in any other manner the Tribunal thinks fit" (Arbitration Rules of the Singapore International Arbitration Centre [hereinafter referred to as SIAC], Rule 27.3). This power is based on Article 17 of the UNCITRAL Model Law on International Commercial Arbitration [hereinafter referred to as ML] pursuant to which the "tribunal may order any party to take such interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject-matter of the dispute." Since an order to post security for costs is an interim measure pursuant to Article 17 ML (*BROCHES p. 93 § 10*), the Tribunal has the power to order security for costs by means of an interim measure. CLAIMANT disputes, however, that such order would be justified in the present circumstances.

CLAIMANT does not have any financial difficulties and RESPONDENT has failed to prove the existence of any [A.]. Even if CLAIMANT was in financial difficulties, there would be no necessity to order CLAIMANT to post security for costs [B.]. Furthermore, an order for security would be unreasonable in the present case [C.]. If CLAIMANT was in financial difficulties and the Tribunal was to issue the requested order, the arbitration agreement would be inoperative, and the claim would have to be brought before a national court [D.].

A. CLAIMANT Does Not Have Any Financial Difficulties and RESPONDENT Has Failed to Prove the Existence of Any

CLAIMANT submits that there is no reason for RESPONDENT to doubt that it could recover any potential award of costs from CLAIMANT, since CLAIMANT does not have any financial problems. CLAIMANT affirmed in its letter of 9 September 2003 that it would not have any difficulty in paying a potential award of costs against it. As long as RESPONDENT does not prove the opposite, this statement has to be taken as a fact since RESPONDENT has to submit *prima facie* evidence of the facts purportedly supporting the request for interim relief (*BERGER p. 123*). *Prima facie* evidence is not defined in the SIAC Rules or the Model Law. However, Article 6 (2) ICC Rules contains the term "prima facie [evidence]". As the current matter is an international arbitration, interpretation of this provision is helpful in evaluating the evidentiary standard required. Pursuant to Article 6 (2) ICC Rules, "prima facie evidence" has to be

“reasonably ... made out,” i.e. “the [Tribunal must be] convinced that [the circumstances relied upon] ‘may arguably exist’” (*CRAIG/PARK/PAULSON* p. 60). RESPONDENT has not provided *prima facie* evidence of CLAIMANT’s alleged financial difficulties for the following three reasons.

First, newspaper articles alone are insufficient as evidence. As seen in *Bank Mellat v. Helliniki Techniki S.A.*, the reliability of the sources upon which the evidence is based has to be verified thoroughly. Even an expert’s report by the “world’s leading provider of business information” (www.dunandbradstreet.com/us/about/index.html, 22 November 2003) can contain faulty information (*GOFF LJ in Bank Mellat v. Helliniki Techniki S.A. (GB)*). With newspaper articles, the risk of inaccurate information has to be considered even higher.

Second, RESPONDENT’s proffer of general newspaper articles does not show, as RESPONDENT alleges, that CLAIMANT is on the verge of bankruptcy. Review of the articles reveals that they refer to purported financial difficulties only in the most general terms. Since the articles submitted by RESPONDENT do not contain specific information about CLAIMANT’s alleged financial difficulties (*Procedural Order No. 3 Clarif. No. 43*), such unspecific references can hardly suffice to prove that CLAIMANT could not pay an adverse arbitration award, should one be ordered.

Third, CLAIMANT has promptly paid its advance on costs of the arbitration. Contrary to RESPONDENT’s allegations, this is to be taken as an indication of CLAIMANT’s financial health. Consequently, RESPONDENT has not presented any reliable evidence about CLAIMANT’s alleged serious financial problems.

B. Any Possible Financial Problems Do Not Provide Reason in and of Themselves for Ordering Security for Costs

Any alleged financial problems of CLAIMANT do not constitute a reason for ordering security for costs. It would be wrong in principle to issue such an order solely on the basis of CLAIMANT’s alleged financial problems [1.], as the risk that one of the contracting parties will face financial difficulties in the future is a general risk assumed by both contracting parties [2.] and considering the financial health of a party runs contrary to general policies of international arbitration [3.].

1. It Would Be Wrong in Principle to Issue Such an Order Solely on the Basis of CLAIMANT’s Alleged Financial Problems

It has been considered “wrong in principle” to make any such security order on the ground that the claimant may be unable to pay the other party’s costs if the award requires him to do so (*KERR LJ in Bank Mellat v. Helliniki Techniki S.A. (GB)*). Similarly, in *J & M O’Brien Enterprises v. Shell*, Chief

Justice BOWEN refused to order security for costs, even though he concluded that the claimant would be unlikely to be able to meet the costs of the respondent of the appeal, if the appeal was unsuccessful: “In view of this conclusion [that there are financial problems], I have a discretion to order security for costs. The question is, whether I should do so” (*J & M O'Brien Enterprises Pty Ltd. v. The Shell Company of Australia Ltd. (Australia)*). The existence of any financial difficulties “is certainly not sufficient in itself, to form the basis of a request for security” (*FOUCHARD/GAILLARD/GOLDMAN*, § 1256). Consequently, a request for security based solely on financial difficulties should be rejected.

2. The Risk That a Party Will Face Financial Difficulties in the Future Is Part of the Bargain Made between the Contracting Parties

CLAIMANT submits that in the contract, CLAIMANT and RESPONDENT impliedly agreed 71 to the risk of the other side’s potential financial problems. The general commercial risk of being engaged in business and trade includes the risk of involvement in arbitral proceedings and, in the case of being successful, “the risk of being [un]able to collect the reimbursement of costs ... in the framework of enforcement proceedings” (*BLESSING at 48.14*). Thus, the possibility that a contract will lead to conflict and that in the end the other side will be unwilling or unable to meet an arbitral costs award should already have been incorporated into the contract price (*RUBINS p. 357*). Since RESPONDENT assumed this risk by entering into a sales contract and suggesting that any dispute should be resolved under arbitration (*CLAIMANT’s Exhibit No. 2*). RESPONDENT cannot now shift this risk to CLAIMANT when a dispute arises by requesting security for costs. Similarly, an arbitral tribunal has even ordered the wealthier party to pay the other party’s advance on costs, since otherwise the arbitral proceedings could not have been continued (*ICC Case No. 9873/JK/DK*).

3. Considering the Financial Health of a Party Runs Contrary to General Policies of International Arbitration

First, considering the financial health of a party as a factor in deciding upon a request to order 72 security for costs runs contrary to the general policy of international arbitration, as the less liquid party could be precluded from the arbitration. Ordering security for costs in cases of financial problems will exclude smaller, newer companies from commercial arbitration, making arbitration the domain of wealthy corporations only (*Pearson v. Naydler (GB)*; *RUBINS p. 373*). It has been taken as a decisive factor in denying an order for security for costs that such an order would have the effect of stifling an action (*Sir Nicolas BROWNE-WILKINSON V.C. in Porzellan KG v. Porzellan (UK) Ltd. (GB)*). Thus, a wealthy party could intentionally breach its contract with a poorer party being

aware that an order for security for costs would preclude its opponent from pursuing its claims. This is the risk in the present case. RESPONDENT first suggested to refer any disposition to arbitration. RESPONDENT then breached the contract and caused egregious damage to CLAIMANT. Third, RESPONDENT now appears to stifle CLAIMANT's legitimate claim by demanding security for costs.

Furthermore, security for costs orders make arbitration proceedings complex, prolonged and 73 expensive. "Especially arbitrations between foreign parties should be conducted with the minimum of complexity, delay and expense – a purpose which would be substantially weakened if the practice were to make orders for security for costs more or less automatically" (*KERR LJ in Bank Mellat v. Hellinki Techniki S.A. (GB), agreeing BINGHAM LJ in K/S A/S Bani and K/S A/S Havbuik 1 v. Korea Shipbuilding and Engineering Corporation*). Therefore, an order for security for costs should not be made if an arbitration is international in nature (*COLBRAN, by nt. 36*), and so in this case, such an order should not be issued.

C. An Order to Post Security for Costs Would Be Unreasonable in the Present Case

Even if CLAIMANT were in financial difficulties in the case at hand, an order for security 74 would be unreasonable, as CLAIMANT's behaviour gives no reason for such an order [1.], while RESPONDENT's behaviour gives reason to reject the request for such an order [2.]. Further, RESPONDENT cannot rely on the alleged inability to enforce its awards in Equatoriana [3.].

1. CLAIMANT's Behaviour and Prospects of Success Demands for the Rejection of RESPONDENT's Request

In deciding upon a request to order security for costs, the Tribunal may take into account 75 whether a CLAIMANT's "claim is bona fide and not a sham" (*Aspendale Pastoral Co. Pty. Ltd. v. W. J. Drever Pty. Ltd. (Australia)*). A claim that is scandalous or oppressive or is based on allegations which are unlikely to found a proper cause of action, will not be considered *bona fide* (*O'REILLY at 6.3.3.*). However, CLAIMANT's submissions being well-founded and CLAIMANT having paid its share of the costs advance promptly, there is nothing to suggest that CLAIMANT's claim is not *bona fide*. First, the possibility of ordering security for costs is "to protect defendants against the risk that [claimants] under the shield of limited liability might use litigation as a weapon of aggression putting defendants to expense they would not be able to recover under order for costs" (*BOWEN CJ in J & M O'Brien Enterprises Pty Ltd. v. The Shell Company of Australia Ltd. (Australia)*). On the contrary CLAIMANT has shown good faith at every step of the proceedings and has not used the arbitral process as a weapon of aggression but only to pursue its justified claim. One example of its good faith is that CLAIMANT made several attempts to settle the dispute (*Statement of Case § 11*),

another example is that CLAIMANT has promptly paid its share of the advance on costs in full (*see letter of 5 March 2003*).

Second, RESPONDENT's request should be refused because CLAIMANT will be successful in this dispute. In the evaluation of such a request it may be taken into account "whether the company has a reasonably good prospect of success" (*BEACH J in Aspendale Pastoral Co. Pty. Ltd. v. W. J. Drever Pty. Ltd. (Australia)*). Where the claimant has "a strong and apparently meritorious case the court is reluctant to make an order which may have the effect of shutting the plaintiff out" (*BOWEN CJ in J & M O'Brien Enterprises Pty Ltd. v. The Shell Company of Australia Ltd (Australia)*). Here, RESPONDENT fundamentally breached the contract (*see supra* §§ 26-47), and CLAIMANT declared avoidance (*see supra* §§ 48-61). Therefore, CLAIMANT is entitled to damages in the amount of US\$ 537,650.00 and the costs of the arbitration from RESPONDENT. Consequently, RESPONDENT's request for security for such costs is unnecessary and should be denied. 76

2. RESPONDENT's Behaviour Gives Reason to Reject RESPONDENT's Request

Although there is no reason to question CLAIMANT's good faith, RESPONDENT's behaviour gives reason why the Tribunal should reject its request for a security order. Any financial problems of CLAIMANT, if they exist, would be the result of RESPONDENT's failure to adhere to the parties' contract [a)] and the request by RESPONDENT is only a dilatory practice [b)]. 77

a) Any Financial Problems of CLAIMANT, If They Exist, Would Be the Result of RESPONDENT's Failure to Adhere to the Parties' Contract

Since any of CLAIMANT's financial problems would be the result of RESPONDENT's behaviour, RESPONDENT's request is to be denied. Where a claimant's financial problems have arisen from the wrongful act complained of in the action, to require security for costs on the ground of financial problems can constitute a denial of justice (*BOWEN LJ in Farrer v. Lacy Hartland & Co. (GB)*; *Lord DENNING MR in Sir Lindsay Parkinson & Co Ltd v. Tripan Ltd (GB)* and *BEACH J in Aspendale Pastoral Co. Pty. Ltd. v. W. J. Drever Pty. Ltd. (Australia)*). In the case at hand, any alleged financial problems of CLAIMANT would have been caused by RESPONDENT's breach of contract. CLAIMANT's present financial position was heavily influenced by its contractual relationship with RESPONDENT. First, CLAIMANT was unable to fulfil its contract with A2Z, Inc. because of RESPONDENT's delivery of defective machines, which had a serious impact on CLAIMANT's reputation as a responsible firm and a significant direct financial consequence (*letter of 24 September 2003*). Second, although CLAIMANT paid the purchase price in full to RESPONDENT for the defective machines, it was forced to purchase new machines for which it had to pay a substantially higher price (*Statement of Case* § 12). This drain on CLAIMANT's 78

cashflow was caused by RESPONDENT's behaviour, which should lead the Tribunal to deny the request for security for costs.

b) The Request by RESPONDENT Is Only a Dilatory Practice

Since there is no evidence to support its allegations, RESPONDENT's request can only be 79 considered as a dilatory practice to be ignored by the Tribunal. Article 18 ML prohibits a party from obstructing the proceedings by dilatory practices (*HOLZMANN/NEUHAUS p. 551*). Where a party requests the Tribunal to order security for costs, there is a risk that the party merely employs such a practice (*CATO p. 475*). The following are indicative of RESPONDENT's attempt to delay the proceedings.

First, RESPONDENT has been delinquent in paying its own share of the advance on the costs 80 of arbitration. Arbitral Tribunals have held that a respondent must show good faith by paying its own portion of any pre-paid administrative fees before a security for costs request will be entertained (*RUBINS p. 375*). RESPONDENT had to be reprimanded three times before it paid (*letters of 6, 13 and 20 March 2003*).

Second, RESPONDENT's request for CLAIMANT's financial information is unjustified. In its 81 letter of 1 September 2003, RESPONDENT asks for financial information about CLAIMANT and states that it would reconsider its request for security for costs if the information was provided. RESPONDENT cannot justify this demand for financial information. On the contrary, RESPONDENT has failed to satisfy its duty of proof for the alleged financial difficulties (*see supra §§ 65-68*). It is not CLAIMANT's duty to furnish the proof for RESPONDENT, and the requested business information is highly confidential. RESPONDENT is attempting to extract information from CLAIMANT to which it would otherwise not be entitled by bringing a motion for security for costs.

Third, RESPONDENT's request is too late. RESPONDENT delayed its application for the 82 security for costs order for four and one-half months. Based on this unwarranted delay in the application alone, the request is to be rejected. The application has to be made promptly, since if there was delay of one party in applying for security, this would be a proper matter to be taken into account when judging RESPONDENT's request (*BOWEN CJ in J & M O'Brien Enterprises Pty Ltd. v. The Shell Company of Australia Ltd., (Australia)*; *BEACH J in Aspendale Pastoral Co. Pty. Ltd. v. W. J. Drever Pty. Ltd., (Australia)*). Therefore, the delay in RESPONDENT's request must lead to its rejection.

IV. RESPONDENT Cannot Claim Any Right Arising from the Intended Disclosure by CLAIMANT

In response to Procedural Order No. 2 § 7 (d), CLAIMANT respectfully submits that the Tribunal lacks jurisdiction to issue a confidentiality order [A.]. In the alternative, CLAIMANT submits that it cannot maintain confidentiality [B.] and that CLAIMANT would not suffer any disadvantageous consequences by breach of any such order [C.]. 86

A. The Tribunal Lacks Jurisdiction to Issue a Confidentiality Order

CLAIMANT respectfully submits that the Tribunal lacks jurisdiction to order CLAIMANT to maintain confidentiality. First of all, national courts have final jurisdiction to decide on the question of confidentiality [1.]. Second, Article 17 ML and SIAC Rule 25 (j) are not applicable because a confidentiality order is not an interim measure [2.] and third, the SIAC Rules do not grant the Tribunal jurisdiction to render a confidentiality order [3.]. 87

1. National Courts Have Final Jurisdiction to Decide on the Question of Confidentiality

The national courts have jurisdiction to consider questions of confidentiality or a breach of a duty to maintain confidentiality and the consequences of such a breach, even where an arbitration tribunal has already decided the issue (*Bulbank Ltd. v. A.I.T. Finance, Inc. (Sweden, Supreme Court) p. 150; SMT p. 568*). Therefore, the question of the existence and scope of a duty to maintain confidentiality may become decisive for the jurisdiction of the Tribunal. 88

2. Article 17 ML and SIAC Rule 25 (j) Are Not Applicable Because a Confidentiality Order Is Not an Interim Measure

RESPONDENT cannot rely on Article 17 ML or SIAC Rule 25 (j), which grant the Arbitral Tribunal broad powers to allow interim measures. These provisions do not apply to the present case because an order to maintain confidentiality is not an interim measure within the meaning of Article 17 ML or SIAC Rule 25 (j). Interim measures must be a provisional step related to the final relief sought, i.e. the interim measure has to be in relation to the principal matter in dispute (*HUßLEIN-STICH p. 101; ADEN Part E Article 25 nt. 1; HOLTZMANN/NEUHAUS p. 530*). In the instant matter, however, the order sought has no connection with the final relief demanded or the questions it raises, which are breach of contract and damages. Further, any such order would not be provisional, since, by its nature, it does not expire at the conclusion of the proceedings. It would still have a legal effect after the issue of the final award. Therefore, as an order to maintain confidentiality cannot be an interim measure, Article 17 ML and SIAC Rule 25 (j) are not relevant. 89

3. The SIAC Rules Do Not Grant the Tribunal Jurisdiction to Render a Confidentiality Order

RESPONDENT cannot argue that by stipulating to the application of the SIAC Rules, the parties impliedly agreed that all duties established in the SIAC Rules should be enforceable by the Tribunal. SIAC Rule 34.6 contains a duty but no enforcement mechanism: The rule does not empower the Tribunal to order any party to maintain confidentiality. To find otherwise would render the express authorizations in SIAC Rules 25, 26, 27.3, 27.4, 30.3 (“...[The Tribunal] shall have the power/authority/jurisdiction...”) superfluous. Consequently, the Tribunal has no power to order CLAIMANT to maintain confidentiality. 90

B. CLAIMANT Cannot Maintain Confidentiality

Should the Tribunal find that it has jurisdiction to issue a confidentiality order, CLAIMANT respectfully submits that the Tribunal cannot issue the order, because CLAIMANT must disclose the details of the current arbitration to Equatoriana Investors for two reasons. First, RESPONDENT cannot compel CLAIMANT to maintain confidentiality under SIAC Rule 34.6 because CLAIMANT meets the exception to this obligation pursuant to SIAC Rule 34.6 (d) [1.]. Second, if confidentiality is to be considered a general principle in arbitration which supersedes the parties’ agreement, this principle contains an inherent exception for the present case [2.]. 91

1. RESPONDENT Cannot Compel CLAIMANT to Maintain Confidentiality under SIAC Rule 34.6

RESPONDENT argues that CLAIMANT would be in violation of SIAC Rule 34.6, if it were to divulge the existence and details of the arbitration (*letter of 17 September 2003*). CLAIMANT respectfully submits that it may reveal all relevant information concerning the arbitration in accordance with SIAC Rule 34.6 (d). This exception provides that the matters relating to the arbitration proceedings may be disclosed “in compliance with the provisions of the laws of any State which is binding on the party making the disclosure.” SIAC Rule 34.6 (d) applies in the present case because, within the legal system of Equatoriana, the court decisions referred to by CLAIMANT in its letter of 24 September 2003 obligate a party being purchased to reveal all matters that materially affect its financial or business situation in due diligence proceedings. These court decisions are “provisions of the laws“ within the meaning of SIAC Rule 34.6 (d) [a.] and are binding on CLAIMANT because the current arbitration proceedings materially affect CLAIMANT’s financial and business situation [b.]. 92

a) The Equatorianian Court Decisions Are to Be Considered as “Provisions of the Laws” within the Meaning of SIAC Rule 34.6 (d)

CLAIMANT submits that even though the Equatorianian court decisions are not based on 93 statutory provisions (*Procedural Order No. 3 Clarif. No. 38*), they are part of the “provisions of the laws” of Equatoriana in terms of SIAC Rule 34.6 (d). The wording of SIAC Rule 34.6 (d) does not require the existence of statutory provisions [i.], the scheme of SIAC Rule 34.6 allows for a broad interpretation of its terms [ii.]. Similarly, SIAC Rule 34.6 is to be interpreted liberally, as it is not a codification of a general principle of confidentiality [iii.]

i) The Wording of SIAC Rule 34.6 (d) Does Not Require the Existence of Statutory Provisions

RESPONDENT may assert that the very wording “provisions of the *laws*” as opposed to 94 “provisions of the *law*” refers to statutory provisions only and excludes case law. This interpretation is, however, not sustainable because it would undermine the uniform application of the SIAC Rules to parties from civil law and from common law countries. In common law countries such as Equatoriana (*Procedural Order No. 3 Clarif. No. 3*), court decisions are functionally comparable to statutory provisions in civil law countries, and are binding in the same way unless overruled by subsequent case law or superseded by statute. The court decisions referred to by CLAIMANT include those of the Equatorianian Supreme Court (*Procedural Order No. 3 Clarif. No. 38*), which have therefore the greatest precedential value in Equatorianian law.

To interpret the exception as applicable only to statutory provisions would thus render parties to 95 arbitration from common law countries at odds with their own legal systems. Rather than encouraging compliance, this would force parties to choose between adhering to their national law or an order of a tribunal. In addition, provisions concerning the exceptions of confidentiality are normally formulated as “disclosure [...] only if required by *law*...” (*BAGNER, p. 248*), and it is recommended that the formulated exceptions should be of broad application to be applied in individual cases (*CLARKE J in Ali Shipping Corp. v. Shipyard Trogir*), so that it is very likely that the drafters of the SIAC Rules did not imply a different meaning by “laws”. Therefore, the relevant court decisions of Equatoriana must be regarded as analogous to statutory provisions.

ii) The Scheme of SIAC Rule 34.6 Allows for a Broad Interpretation of Its Terms

Furthermore, the wording of SIAC Rule 34.6 e, which allows even non-binding but customary 96 disclosure, shows that the exceptions within SIAC Rule 34.6 are meant to be broadly interpreted since any “binding” provisions (SIAC Rule 34.6 d) must be as considerable as “non-binding” “custom”, which is protected by the SIAC Rules.

iii) SIAC Rule 34.6 Is to Be Interpreted Liberally, as It Is Not a Codification of a General Principle of Confidentiality

RESPONDENT cannot argue that SIAC Rule 34.6 codifies a general principle of confidentiality 97 in international arbitration and thus mandates a narrow interpretation of the exceptions to SIAC Rule 34.6, because no such generally accepted principle exists. A party's obligation of confidentiality can only be based on a contract (*BRENNAN J in Esso Australia Resources Ltd v. Plowman (Australia)*).

The undisputed requirement of privacy in arbitration proceedings (*COLMAN J. in Hassneh 98 Insurance Co. Of Israel and others v. Stuart J Mew (GB)*; *MASON CJ in Esso Australia Resources Ltd v. Plowman (Australia)*) is not synonymous with a general principle of confidentiality. Privacy means that "outsiders are not entitled to attend the hearings during the proceedings" (*Bulbank Ltd. v. A.I.T. Finance, Inc., p. 153 (Sweden, Supreme Court)*), while confidentiality is an "obligation [not to] improperly disclose information about the arbitration proceedings" (*Bulbank Ltd. v. A.I.T. Finance, Inc., p. 154 (Sweden, Supreme Court)*). However, privacy is not at issue here.

b) The Current Arbitration Proceedings Materially Affect CLAIMANT's Financial and Business Situation

The question whether specific matters materially affect the financial and business situation of a 99 party and may therefore be disclosed is to be decided on a case-by-case basis (*Procedural Order No. 3 Clarif. No. 38*). Arbitration proceedings can generally affect the value of the company being purchased or endanger its viability (*DENOIX DE SAINT-MARC p. 215*). Due to RESPONDENT's breach of contract, CLAIMANT could not service its contract with A2Z, Inc. (*letters of 17 and 24 September 2003*) and has suffered damages in the amount of US\$ 107,200.00 as well as further expenses in the amount of US\$ 430,450.00 (*Statement of Case § 18*). CLAIMANT has annual sales of between US\$ 8,000,000.00 and US\$ 10,000,000.00 (*Procedural Order No. 3 Clarif No. 44*). In comparison, the value of the claim is very high – five to seven per cent of the annual sales. Without disclosing the profit margin of CLAIMANT, the damages suffered and expenses incurred are likely to absorb most of CLAIMANT's annual profit. Not only does the arbitration itself have direct and indirect effects on CLAIMANT's financial and business situation, but the potential success of failure in the arbitration has a significant effect on CLAIMANT's purchase price.

If CLAIMANT were actually in the financial difficulties alleged by RESPONDENT, they would 100 directly reflect to what extent the present arbitration affects CLAIMANT's financial situation. The outcome of the arbitration, as well as the details of the claim materially affect CLAIMANT's

situation and therefore have to be disclosed to Equatoriana Investors in due diligence as required by Equatoriana law.

2. Even If Confidentiality Is to Be Considered a General Principle in Arbitration, the Present Case Falls within an Inherent Exception to This Principle

In the alternative and should the Tribunal interpret confidentiality to be an inherent principle in international arbitration practice, CLAIMANT submits that customary practice has developed a number of exceptions to a general principle [a.], which are applicable in this case [b.].

a) Customary Practice Has Developed a Number of Exceptions to a General Principle

Should confidentiality be construed to be an inherent principle in international arbitration, the generally acknowledged exceptions to confidentiality established in international arbitration practice (*DENOIX DE SAINT-MARC p. 212*), some of which are listed in 34.6 (a)-(e), cannot be ignored. Even if none of the express exceptions of SIAC Rule 34.6 apply, other exceptions not listed in SIAC Rule 34.6 are not precluded, as SIAC Rule 34.6 (a)-(e) are only illustrative of the purpose of a contractual agreement and not exhaustive. Any decisions purportedly establishing this principle, simultaneously established exceptions to it, as the duty of confidentiality is not absolute (*POTTER LJ in Ali Shipping Corp. v. Shipyard Trogir (GB)*). Complete confidentiality cannot be achieved, when other important duties are opposed to it (*MASON CJ in Esso Australia Resources Ltd and others v. Plowman and others (Australia)*; *REDFERN/HUNTER p. 29 § 1-46*). For example, absolute confidentiality could be in contradiction to the party's obligations to its contractual partners and shareholders (*LIONNET p. 237*). The confidential nature of arbitration is not contained in any national legislation (*BAGNER p. 245*). Because of such a weak legal basis and as arbitration proceedings are based on contract not statute (*Bulbank Ltd. v. A.I.T. Finance, Inc. (Sweden, Supreme Court) p. 152*), parties may disclose information if certain circumstances exist (*Bulbank Ltd. v. A.I.T. Finance, Inc. (Sweden, Supreme Court) p. 152*).

b) The Exceptions Are Applicable to the Present Case

Any competing duties of confidentiality and disclosure for CLAIMANT are to be resolved in favour of disclosure pursuant to the law of Equatoriana as well as to customary practice. A party is entitled to disclose information to a third party if it is so required or if it is reasonably necessary for the protection of the party's legitimate interest (*NEILL by nt. 16, 17*). Whether an interest in disclosure is legitimate or necessary has to be weighed against the other party's interest in confidentiality (*SMIT p. 567*). In particular, it is relevant to what extent the disclosure is or shall be made (*SMIT p. 567*). Generally the disclosure of the existence of the arbitration and the amount in

dispute or of other circumstances without identifying a specified party are not of such detriment for the other party that its interest in confidentiality would prevail (*DENOIX DE SAINT-MARC* p. 216; *Bulbank Ltd. v. A.I.T. Finance, Inc. (Sweden, Court of Appeal)*; see *SMIT*, p. 567). Thus, RESPONDENT's contention that every last detail of the arbitration, even its very existence, may under no circumstances be disclosed to Equatoriana Investors (*letter of 17 September 2003*), is unsustainable. In the case at hand, CLAIMANT is to be granted an exception to the alleged duty of confidentiality since, first, the duty to disclose information in due diligence proceedings is reasonable and generally recognized [i]), second, the exception to the duty to maintain confidentiality established in case law with respect to the disclosure of information to shareholders applies in the present case [ii]) and, third, RESPONDENT has a strong interest in the disclosure of information about the current proceeding to Equatoriana Investors [iii]).

i) The Duty to Disclose Information in Due Diligence Proceedings Is Reasonable and Generally Recognized

In weighing the competing interests, it is to be considered that the duty to disclose information 104 in due diligence proceedings is a reasonable and generally recognized duty of good faith, which binds parties at a pre-contractual stage (*DENOIX DE SAINT MARC* p. 215). CLAIMANT therefore submits that this legal duty is not to be disregarded.

ii) The Exception to the Duty to Maintain Confidentiality Established in Case Law with Respect to the Disclosure of Information to Shareholders Applies in the Present Case

CLAIMANT submits that the exception to the duty to maintain confidentiality established in 105 the relationship between a company and its shareholders applies in the present case. It has been held that disclosure may be necessary for the legitimate purpose of providing up-to-date information to shareholders on the company's affairs (*MASON CJ in Esso Australia Resources Ltd v. Plowman (Australia)*; *REDFERN/HUNTER* p. 27 § 143). The proposed deal with Equatoriana Investors is a share-purchase deal. The holding in *Esso* suggests that Equatoriana Investors, as a future shareholder, has the same rights to information as shareholders because they have the same interest in obtaining the information to which present shareholders are entitled, e.g. evaluation of the current and potential financial position and assets of their investment

iii) RESPONDENT Has a Strong Interest in the Disclosure of Information about the Current Proceedings to Equatoriana Investors

RESPONDENT also has a strong interest in the disclosure as full disclosure of the arbitration 106 and its details are necessary for a successful takeover of CLAIMANT by Equatoriana Investors. Such takeover furthers RESPONDENT's interest, as there is no reason to expect that Equatoriana

Investors will not support CLAIMANT after becoming its shareholder, so that CLAIMANT will be able to pay any adverse award. CLAIMANT itself has no interest in other companies knowing about the present dispute and will therefore obligate (*Procedural Order No. 2 Clarif. No. 39*) Equatoriana Investors not to disclose the acquired information to any other company or to the public.

C. CLAIMANT Would Not Suffer Any Disadvantageous Consequences by Breach of Any Such Order

Even were it ordered to maintain confidentiality, RESPONDENT would be entitled neither to 107 terminate the arbitration agreement to the detriment of CLAIMANT [1.] nor to claim damages [2.] based on a violation by CLAIMANT.

1. RESPONDENT Cannot Terminate the Arbitration Agreement to the Detriment of CLAIMANT

CLAIMANT submits that RESPONDENT cannot Terminate the arbitration agreement to the 108 detriment of CLAIMANT. Swedish Courts have held that a breach of confidentiality entitles the opposing party to avoid the arbitration agreement (*Bulbank Ltd. v. A.I.T. Finance, Inc. (Sweden, Stockholm City Court; Court of Appeal; Supreme Court on this point)*). However, these judgements met with severe criticism by the international arbitration community (*ROSENBERG p. 21; PARTASIDES (2000) by nt. 14*). The mechanism of allowing avoidance of the arbitration agreement because of a breach of confidentiality is not only “manifestly at odds with contemporary international standards,” but would “render the entire arbitral process ineffectual” and “destroy ... the claimant’s right ever to bring its claim to arbitration” (*PARTASIDES (1998) by nt. 9*). It challenges the clear and exhaustive list of grounds for setting aside an arbitral award laid down in Article V of the New York Convention. Furthermore, it bears the risk of an “unscrupulous party engineering a leak and then relying on it to avoid an unfavourable award” (*ibid.*).

Even if the breach of the obligation of confidentiality by CLAIMANT is to be treated in the 109 same manner as the breach of a contractual obligation in general (*SMIT p. 581*), avoidance of the arbitration agreement should not be allowed in the present case. As both avoidance due to a breach of contract and due to a violation of the duty of confidentiality have equally far-reaching consequences, the right to cancel the arbitration agreement can only be granted in a very limited sense (*Bulbank Ltd. v. A.I.T. Finance, Inc. (Sweden, Court of Appeal)*). Even if a court granted a termination of the arbitration agreement, it would do so only as *ultima ratio* in the case of an egregious breach of confidentiality that caused substantial harm to the opposite party (*SMIT p. 581*). The intended disclosure by CLAIMANT, however, would not constitute such a fundamental

breach, since CLAIMANT would only disclose facts that are absolutely necessary for the due diligence proceedings to Equatoriana Investors, but not to any other third party. Any detriment suffered by RESPONDENT would only consist of a slight loss of reputation, neither valuable nor substantial. Furthermore, CLAIMANT does not seek to intentionally harm RESPONDENT, but rather to fulfil one of two opposing duties. Consequently, there are no grounds for such an avoidance.

Furthermore, avoidance of the arbitration agreement is not in the interests of RESPONDENT. 110 It would destroy the basis for the Tribunal's jurisdiction. RESPONDENT, which introduced the arbitration clause into the sales contract, would then be sued by CLAIMANT in the national courts.

2. RESPONDENT Cannot Claim Damages

Further, the only sanction for such a violation is an award of damages (*ROSENBERG p. 21*). 111 Damages, however, can only be awarded if determinable (*SMIT p. 581*). RESPONDENT has offered no evidence of what if any damages it would sustain by disclosure. Moreover, when deciding whether certain sanctions are adequate, due consideration should be granted "to the policies of the place where the disclosure was, or is likely to be made" (*SMIT p. 581*). The law of Equatoriana, where the disclosure shall take place, allows and even obligates companies in the same circumstances as CLAIMANT to disclose all matters relevant to financial situation in due diligence, their disclosure by CLAIMANT would be in accordance with the policies of Equatoriana. Based on the minimal potential damages caused by a disclosure and the necessity of the proper due diligence, RESPONDENT cannot make out a claim for damages.

RELIEF REQUESTED

In the light of the submissions above, CLAIMANT respectfully requests the Tribunal

- to find that the Model 14 machines delivered by RESPONDENT were not in conformity with the contract,
- to find that RESPONDENT fundamentally breached the contract, and CLAIMANT lawfully declared avoidance of the contract,
- to reject RESPONDENT's request to order CLAIMANT to post security for costs and
- to find that RESPONDENT cannot claim any right arising from the intended disclosure by CLAIMANT.