SECOND ANNUAL WILLEM C. VIS (EAST) 2004-2005

HONG KONG INTERNATIONAL COMMERCIAL ARBITRATION MOOT

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MEMORANDUM *for* CLAIMANT

On Behalf Of:

Mediterraneo Confectionary Associates, Inc.
121 Sweet Street
Capitol City
Mediterraneo

The CLAIMANT

Against:

Equatoriana Commodity Exporters, S.A.
325 Commodities Avenue
Port City
Equatoriana

The RESPONDENT

UNIVERSITY *of* HOUSTON *Law Center*

LACY JOHNSON • ELAHE PARSA • JAMES ROGERS • BRETT THORSTAD

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LIST OF ABBREVIATIONS

§ / §§	Section / Sections
¶ / ¶¶	Paragraph / Paragraphs
Am. Jur.	American Jurisprudence
Arb.	Arbitration
Art.	Article
BEL	Belgium
C.J.S.	*Corpus Juris Secundum*
CCIG	Chamber of Commerce and Industry of Geneva
cf.	*conferatur* (compare)
Cir.	Circuit
CISG	United Nations Convention on Contracts for the International Sale of Goods
Co.	Company
Comm.	Commentary
Corp.	Corporation
e.g.	Example
ECJ	European Court of Justice
ed.	Editor
ENG	England
EST	Estonia
et al.	*et alii* (and others)
F.	Federal
FRA	France
GER	Germany
id.	*idem* (same as above)
i.e.	*id est* (that is)

ICC	International Chamber of Commerce
Inc.	Incorporated
Int'l	International
ITA	Italy
J.	Journal
L.	Law
Ltd.	Limited
No.	Number
p.	Page
Q.B.	Queen's Bench
Rev.	Review
Sec.	Secretariat
SWI	Switzerland
U.C.C.	Uniform Commercial Code
UNCITRAL	United Nations Commission on International Commercial Arbitration
UNIDROIT	International Institute for the Unification of Private Law
USA	United States of America
USD	United States Dollars
v.	Versus

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Arbitration Rules	UNCITRAL Arbitration Rules (1976), available at <*http://www.uncitral.org*>
Black's Law Dictionary	Black's Law Dictionary (8th ed. 2004)
CCIG Rules	Rules of Arbitration of the Chamber of Commerce and Industry of Geneva Switzerland
CISG	United Nations Convention on Contracts for the International Sale of Goods (1980), available at <*http://www.unilex.info*>
French Civil Code	French Civil Code (1804)
ICSD	International Central Securities Depository Rules
New York Convention	United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 10 June 1958)
U.C.C.	Uniform Commercial Code (2004)
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STATEMENT OF FACTS

ORIGINAL CLAIM (COCOA)

19 November 2001 — Equatoriana Commodity Exporters, S.A. (hereinafter RESPONDENT) telephones Mediterraneo Confectionary Associates, Inc. (hereinafter CLAIMANT) with an offer to sell cocoa. An agreement is reached whereupon RESPONDENT will sell 400 metric tons of cocoa to CLAIMANT for a total contract price is USD 496,299.55 (market price). Date of delivery is to be between March and May 2002, and is to be fixed by RESPONDENT sometime between January and February 2002.

14 February 2002 — Severe storm hits the cocoa producing area of Equatoriana resulting in extensive damage to the cocoa crops.

22 February 2002 — Equatoriana Government Cocoa Marketing Organization (EGCMO) orders a ban on all cocoa exports.

24 February 2002 — RESPONDENT informs CLAIMANT of the storm and of the fact that the EGCMO has suspended export of cocoa through at least March 2002.

5 March 2002 — CLAIMANT reaffirms the obligation of RESPONDENT, while informing RESPONDENT that it will be under pressure to receive the cocoa later in the year.

20 March 2002 — EGCMO extends the current ban of cocoa exports.

10 April 2002 — CLAIMANT informs RESPONDENT that it expects delivery of the cocoa by the end of May 2002.

7 May 2002 — RESPONDENT informs CLAIMANT that 100 tons of cocoa will be delivered later in the month.

28 May 2002 — RESPONDENT ships 100 tons of cocoa for which CLAIMANT pays USD 124,075.

June – July 2002	CLAIMANT makes numerous inquiries as to the remaining cocoa.
15 August 2002	CLAIMANT informs RESPONDENT that it will soon require the remaining 300 tons of cocoa and may have to purchase the cocoa elsewhere. CLAIMANT reiterates that RESPONDENT will be liable for any extra expenses that may be incurred as a result.
24 October 2002	CLAIMANT purchases 300 tons of cocoa from Oceania Produce Ltd. at the current market price of USD 661,578.
25 October 2002	CLAIMANT informs RESPONDENT that it has purchased the remaining cocoa elsewhere and will be seeking recovery of the extra expenses incurred.
11 November 2002	CLAIMANT informs RESPONDENT by letter that it demands payment of USD 289,353 representing the amount paid in excess of the contract price.
12 November 2002	EGMCO removes the export ban on cocoa.
13 November 2002	RESPONDENT informs CLAIMANT that it would have been prepared to deliver the remaining 300 tons of cocoa. RESPONDENT asserts that CLAIMANT has breached the contract by electing cover.
15 November 2002	CLAIMANT provides RESPONDENT written notice formally avoiding the contract.

COUNTERCLAIM (SUGAR)

20 November 2003	RESPONDENT sells 2,500 metric tons of sugar to CLAIMANT for a total contract price of USD 385,805.
4 December 2003	RESPONDENT delivers sugar the carrier.

8 December 2003	Sugar is loaded onto the vessel ("passes the ship's rails").
19 December 2003	CLAIMANT informs RESPONDENT that the sugar arrived soaked and contaminated as is unfit for human consumption.

NOTICE OF ARBITRATION

5 July 2004	CLAIMANT files Notice of Arbitration with the Chamber of Commerce and Industry of Geneva (CCIG).
6 July 2004	CCIG acknowledges receipt of the Notice of Arbitration and informs CLAIMANT that as of 1 January 2004 the CCIG has adopted the new Swiss Rules of International Arbitration.
10 August 2004	RESPONDENT acknowledges receipt of the Notice of Arbitration and files a response along with the counterclaim pursuant to Swiss Rules Article 21(5).

STATEMENT OF PURPOSE

In light of the aforementioned facts and in compliance with the Arbitral Tribunal's Procedural Order No. 1, Counsel for the CLAIMANT has prepared this Memorandum and sets forth the following submissions:

- RESPONDENT fundamentally breached the cocoa contract;
- RESPONDENT was not excused from performing its obligation;
- CLAIMANT avoided the cocoa contract and is entitled to recover damages;
- damages should be USD 289,253.00 pursuant to CISG Articles 74, 75, and 76;
- the Tribunal lacks jurisdiction to here RESPONDENT's counterclaim;
- and, if the Tribunal hears the counterclaim, it should be limited to the set-off amount.

ARGUMENTS

PART ONE: RESPONDENT FUNDAMENTALLY BREACHED THE CONTRACT BY FAILING TO SUBSTANTIALLY PERFORM ITS OBLIGATIONS; THEREFORE, CLAIMANT WAS ENTITLED TO AVOID THE CONTRACT AND RECOVER DAMAGES

1. According to Article 25 of the CISG, RESPONDENT fundamentally breached the cocoa agreement by substantially depriving CLAIMANT of what it was "entitled to expect under the contract" [*CISG, art. 25*]. The CISG makes it absolutely clear that a seller must deliver the contracted goods either within the period of time fixed by the contract or within a reasonable time after the conclusion of the contract [*CISG, arts. 33*]. By delivering only one-quarter of the contracted amount of cocoa [*Claimant's Exhibit No. 6*], CLAIMANT was unfairly deprived of three-quarters of its expectation. Although RESPONDENT may suggest that it should be excused from performance, RESPONDENT fails to show that it satisfies the necessary requirements for excuse. As a result CLAIMANT chose to employ its express right of avoidance and as such, the CISG provides that it may now recover damages [*CISG, arts. 74-76*].

2. A substantial breach of performance from a contemplated agreement should not go uncompensated. CLAIMANT should not be asked to bear the expense of RESPONDENT's failure to perform. Such a result would constitute a windfall to the RESPONDENT and would fly in the face of contract policy—that being the enforcement of contractual expectations. The CISG strives to "promote the development of international trade" and "friendly relations among States" by providing a set of uniform rules that will be upheld by our enforcement bodies [*CISG, Preamble*]. CLAIMANT suggests that this Tribunal recognize the calamity of RESPONDENT's breach and, in promoting the "observance of good faith in international trade," honor the remedies contemplated by the CISG [*CISG, art. 7(1)*].

I. RESPONDENT Fundamentally Breached its Contractual Obligations

3. The CISG defines fundamental breach as

> a breach of contract by one of the parties is fundamental if it results in such detrimental 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 [*CISG, art. 25*].

As per the cocoa contract concluded in November of 2001, RESPONDENT was obligated to deliver 400 metric tons of cocoa to CLAIMANT during the months of March, April or May of 2002 [*Claimant's Exhibit No. 2*]. RESPONDENT's only delivery of cocoa to CLAIMANT was 100 metric tons shipped in May of 2002 [*Claimant's Exhibit No. 6*]. Despite repeated requests by CLAIMANT, RESPONDENT failed to deliver the remaining 300 metric tons by 24 October 2002—nearly five and one-half months after RESPONDENT was required to deliver all 400 tons of cocoa [*Claimant's Exhibit No. 8*]. RESPONDENT—or a reasonable person in its position—knew, or ought to have known, that CLAIMANT requires large quantities of cocoa for producing its confectionaries [*Claimant's Request for Arbitration, ¶¶ 1, 3*]. Accordingly, RESPONDENT should have foreseen that failure to deliver would potentially disrupt CLAIMANT's operations, and CLAIMANT would have to purchase cocoa elsewhere.

4. By failing to deliver the remaining 300 metric tons of cocoa within the contracted time frame, RESPONDENT fundamentally breached the contract [*Foliopack v. Daniplast (ITA); Lorenz, § II*]. Article 33 expressly provides that a seller must deliver the goods: (1) on a date fixed by the contract; (2) within a period of time fixed by the contract; or (3) within a reasonable time after the conclusion of the contract [*CISG, art. 33*]. Not only did RESPONDENT fail to deliver the cocoa within the time period fixed by the contract, it would not have been able to deliver the goods an entire year after the conclusion of the contract [*Claimant's Exhibit No. 10*]. RESPONDENT would need to purport a very colorful argument to suggest that one year is a reasonable time for delivery. Therefore, once it had become clear that RESPONDENT was not going to deliver the cocoa, CLAIMANT was forced to buy replacement cocoa and avoid the contract [*Claimant's Exhibit No. 8*].

II. RESPONDENT was not Excused from Performing its Obligation

a. Article 79 of the CISG

5. RESPONDENT claims that it should be excused from delivering the 300 metric tons of cocoa under Article 79(1) of the CISG [*Respondent's Answer, ¶ 18*]. Article 79(1) provides:

> A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences [*CISG, art. 79*].

Thus, in order to claim excuse under Article 79(1), RESPONDENT must prove: (1) the impediment was beyond its control; (2) it could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract; and, (3) it could not have avoided or overcome its consequences [*Id.; CISG Sec. Comm., art. 79 ¶ 3*]. RESPONDENT can not meet this burden.

6. While CLAIMANT concedes that the storm and subsequent government ban on export of cocoa were beyond the control of RESPONDENT—thus fulfilling the first requirement of CISG Article 79 (1), CLAIMANT suggests that RESPONDENT cannot meet the second requirement of Article 79(1) because RESPONDENT could have reasonably been expected to have taken the storm into account at the conclusion of the contract. Storms regularly occur in Equatoriana, and in 1980 a severe storm damaged Equatoriana's cocoa trees [*Procedural Order No. 2, ¶ 8*]. It is reasonable to expect RESPONDENT—a business entity that has operated since 1961—to have taken the possibility of a similar severe storm into account when it entered into the sales contract [*CISG Sec. Comm., art. 79 ¶ 5*]. Furthermore, because the Equatoriana Government Cocoa Marketing Organization (EGCMO) controls all distributions of cocoa in Equatoriana, it is reasonable for RESPONDENT to have taken into account the possibility that EGCMO could ban exports. [*Procedural Order No. 2, ¶ 11*] CLAIMANT suggests that RESPONDENT cannot meet the second requirement of Article 79(1) and thus cannot claim excuse from performance.

7. RESPONDENT also cannot meet the third requirement of Article 79(1) because RESPONDENT could have foreseen the storm and export ban, it could and should have overcome the consequences of the storm and export ban. The contract between RESPONDENT and CLAIMANT was for cocoa; nowhere does the contract state that RESPONDENT must deliver Equatorianan cocoa [*Claimant's Exhibit No. 2*]. Although the storm and export ban resulted in no Equatorianan cocoa being available, the storm did not affect any other cocoa-growing countries [*Procedural Order No. 2, ¶ 9*]. RESPONDENT could and should have bought cocoa from another source and delivered it to CLAIMANT in order to fulfill its contractual obligations. It chose not to do so.

8. RESPONDENT's claim that it did not buy cocoa from another source because it would have cost more is without merit. [*Respondent's Answer, ¶¶ 4-8*]. It is a well-settled principle that additional costs of performance are not enough to invoke the protection of CISG Article 79(1) [*Schiedsgericht der Handelskammer (GER); Case No. 1 U 143/95 and 410 O 21/95 (GER); Case No. 11/1996 (BUL); Unknown Parties (FRA); Vital Berry v. Rechtbank (BEL); Nuovo Fucinati v. Fondmetal Int'l (ITA)*]. Indeed, additional costs such as a price change are a commercial risk that the seller accepts when entering into a sales contract [*Id.*]. Article 79(1) does not encompass the notion of economic hardship, which is defined excuse from performance because the cost of performance has increased [*Nuovo Fucinati S.p.A. v. Fondmetal Int'l (ITA); ICC 8873; Carlsen, §§ I–IV*]. CISG Article 79 reflects the traditional view of contracts: *pacta sunt servanda*, agreements must be kept though the heavens fall [*Jenkins, 2019; Perillo, 112; Rimke, § I*]. Article 79 of the CISG only provides an excuse where performance has become impossible [*Flambouras, 277*]. To be permitted to excuse performance on the basis of economic hardship, RESPONDENT should have included a hardship clause in the contract itself [*Unknown Parties (FRA); Perillo, 115, 129; Rimke, § IV 9; Van Houette, § No Assumption of Risk*]. It failed to do so.

b. Hardship provision of the UNIDROIT Principles

9. When provisions of the CISG and provisions of the UNIDROIT Principles conflict, the CISG will take precedence [*Carlsen, §2A*]. RESPONDENT may suggest that the Tribunal use the UNIDROIT Principles hardship provision to "gap-fill" the CISG. Article 7(2) of the CISG allows

the Tribunal to settle questions about the CISG which are not expressly settled in it, are to be settled in accordance with the general principles on which the CISG is based [*CISG, art. 7(2)*]. There are some scholars and tribunals that believe the UNIDROIT Principles embody the principles upon which the CISG is based [*Case No. 229/1996 (RUS); ICC 8817; ICC 9117*]. However, the use of the UNIDROIT Principles hardship provision to "gap-fill" CISG Article 79 would be inappropriate for several reasons [ICC *887; ICC 9029*].

10. First, there is no gap in Article 79 that needs to be filled; simply because the CISG does not mention the concept of hardship does not mean that the matter is not expressly settled in the CISG [*Ziegel, § 4*]. This Tribunal is authorized to look at the legislative history (*traveaux preparatoire*) of the CISG in making this determination [*Povrzenic, § 3A*]. The legislative history of the CISG reveals that the Working Group not only considered adding a hardship provision, but specifically rejected adding a hardship provision [*Carlsen, 1998; Flambouras II, § 3; Rimke, § B2; Ziegel, § 1C*]. The Working Group rejected the hardship provision because of the problems associated with the Convention Relating to a Uniform Law on the International Sale of Goods (ULIS)—the predecessor of the CISG—which allowed contracting parties to escape their contractual obligations too easily [*Flambouras II, § 3; Rimke, § B2*]. The Working Group's rejection of a hardship provision is a dispositive settlement of the hardship matter: the CISG does not allow performance to be excused for mere economic hardship [*Flambouras, 278*]. Thus, with all due respect, the Tribunal would exceed its authority if it were to use the UNIDROIT's hardship provisions to excuse RESPONDENT's performance in this case.

11. Second, the UNIDROIT's hardship provision is not a general principle on which the CISG is based [*Slater, 250*]. While some provisions of UNIDROIT were included because drafters thought they were the best rules and hoped that they would become internationally accepted [*Id.*], several scholars and tribunals recognize that the UNIDROIT hardship provision is not an internationally accepted principle of contract law [*Id.; ICC 8873; ICC 9029*]. Although some may argue that hardship is becoming more accepted, it can not be thought of, at this point, as a general principle upon which the CISG is based [*Id.*].

12. Furthermore, even if this tribunal decides to apply the UNIDROIT hardship provision, RESPONDENT cannot meet the requirements of UNIDROIT Article 6.2.2, which reads:

> There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished, and
> (a) the events occur or become known to the disadvantaged party after the conclusion of the contract;
> (b) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;
> (c) the events are beyond the control of the disadvantaged party; and
> (d) the risk of the events was not assumed by the disadvantaged party [*UNIDROIT 1994, art. 6.2.2*].

As noted above [*supra, ¶ 4*], RESPONDENT could have reasonably taken into account both the storm and the EGCMO ban on exporting cocoa at the time of the conclusion of the contract. RESPONDENT can not meet the requirements of UNIDROIT Article 6.2.2 and thus cannot claim hardship.

13. Assuming, *arguendo*, that this Tribunal finds that RESPONDENT meets the requirements of UNIDROIT Article 6.2.2, RESPONDENT'S remedy was re-negotiation of the contract, an action not taken by RESPONDENT [*UNIDROIT 1994, art. 6.2.3; Perillo, 125, 129*]. UNIDROIT does not entitle a contracting party who is experiencing economic hardship to simply not perform, as has occurred in this case [*UNIDROIT 1994, art. 6.2.3 Official Comment*]. All RESPONDENT did was inform CLAIMANT that it would not deliver the cocoa within the contractual time frame due to the storm and export ban [*Claimant's Exhibit No. 3 & No. 6*].

14. Moreover, even if RESPONDENT had requested re-negotiation of the contract, it would not have been entitled to withhold performance simply because of the request [*UNIDROIT 1994, art. 6.2.3 Official Comment*]. Because UNIDROIT Article 6.2.3(2) is of an exceptional nature and is easily abused, Article 6.2.3(2) and its Official Comments make it clear that simply because the disadvantaged party has requested re-negotiation, the disadvantaged party is not entitled to withhold performance [*Id.*].

III. CLAIMANT was Entitled to Avoid the Contract

15. Article 49(1) (a) of the CISG states:

> (1) the buyer may declare the contract avoided:
> (a) if the failure by the seller to perform any of his obligations under the contract or this Convention amounts to a fundamental breach of contract [*CISG, art. 49(1) (a)*].

As established above, RESPONDENT fundamentally breached its contract with CLAIMANT by failing to deliver the remaining 300 metric tons of cocoa [*supra ¶¶ 1-12*]. Thus, CLAIMANT was legally entitled to avoid the contract [*CISG, art. 49(1)(a); ICC 7531; ICC 9978*].

16. Nevertheless, RESPONDENT argues that CLAIMANT was not entitled to avoid the cocoa contract because it had not fixed an additional period for performance under CISG Article 47 [*Respondent's Answer, ¶¶ 10-11*]. Article 47 reads:

> (a) The buyer <u>may</u> fix an additional period of time of reasonable length for performance by the seller of his obligations.
> (b) Unless the buyer has received notice from the seller that he will not perform within the period so fixed, the buyer may not, during that period, resort to any remedy for breach of contract. However, the buyer is not deprived thereby of any right he may have to claim damages for delay in performance [*CISG, art. 47* (emphasis added)].

17. CLAIMANT notes that the language of Article 47 indicates that fixing an additional period for performance is an option the buyer has when the seller has fundamentally breached the contract, but is not a mandatory undertaking [*CISG Sec. Comm., art. 49 ¶ 5 & art. 47 ¶ 6*]. CLAIMANT was entitled to avoid because RESPONDENT fundamentally breached the contract, not because RESPONDENT failed to perform within a fixed additional period of time. Alternatively, CLAIMANT was not required to fix an additional time period for performance because RESPONDENT made clear that it was unable to deliver the cocoa during the contractual period [*Claimant's Exhibits No. 4, 5 & 6; Schiedsgericht Hamburger Freundschaftliche Arbitrage; Case No. 1 U 143/95 and 410 O 21/95 (GER)*].

IV. CLAIMANT Validly Avoided the Contract

a. Implicit notice of avoidance on 15 August 2002

18. An aggrieved party's declaration of avoidance is not effective unless it is made by notice to the other party [*CISG, art. 26*]. Relying on CLAIMANT's letter dated 15 November 2002, in which CLAIMANT stated that "in an abundance of caution, I wish now to state clearly that [CLAIMANT] considers the referenced contract to be terminated," RESPONDENT asserts that CLAIMANT effectively declared its intention to avoid the contract on 15 November 2005 [*Claimant's Ex. No. 11*]. However, applicable case authority holds that "the CISG does not provide any obligation concerning the form of avoidance" [*FCF v. Adriafil Commercial (SWI) ¶ A(a); see also ICC Basel 8128* (stating that when a party's requests for performance are unmet, a contract may be avoided "even in the absence of an express subsequent declaration" of avoidance, provided that a reasonable person would have understood the contract to be avoided)].

19. In *FCF S.A. v. Adriafil Commercial S.r.l.*, the buyer and seller entered into a contract for cotton [*FCF v. Adriafil Commercial (SWI), ¶ A(a)*]. Delivery was to be made between May and June 1994 [*Id.*]. In June 1994, seller informed buyer that performance would not be rendered [*Id., ¶ A(c)*]. Buyer responded, via letter, requesting that seller perform the contract as soon as possible [*Id.*]. Having received no response from seller, buyer purchased substitute cotton from other suppliers at a higher price and requested compensation from seller in a letter dated 27 June 1994 [*Id.*]. The Supreme Court of Switzerland held that "the CISG does not provide any obligation concerning the form of the avoidance of sale contracts. . . . Therefore, it is accepted that a conclusive conduct constituted by a rejection of the goods that that do not conform to the contract and a refusal to pay may, depending on the circumstances, be held as an implicit declaration of avoidance of the contract" [*Id., ¶ C(3)*].

20. Similarly, in *ICC Arbitration Case Number 8128*, the buyer and seller entered into a contract under which seller was to provide buyer with chemical fertilizer [*ICC 8128*]. Buyer then entered into a forwarding contract with another party [*Id.*]. When seller failed to perform part of his contractual obligations, buyer sent a letter informing him that its client was threatening

contractual penalties and additional costs under its forwarding contract. [*Id.*] Further, buyer insisted that it must receive a definitive response from seller regarding seller's ability to perform [*Id.*]. Buyer also indicated that seller's failure to respond would result in buyer purchasing chemical fertilizer from another supplier [*Id.*]. The arbitral panel stated that "[i]t does not matter that the Buyer did not expressly declare the contract partly avoided" and that the "guide for interpretation is the manner in which a reasonable person would have understood [the] declaration . . . or conduct in the same circumstances" [*Id.*]. Accordingly, the panel held that buyer's letter constituted effective notice of avoidance because a reasonable person would have known that failure to meet a "condition put forth by the buyer" would avoid the contract [*Id.*].

21. CLAIMANT made a final attempt at inducing RESPONDENT to perform its contractual obligations in a letter dated 15 August 2002 [*Claimant's Ex. No. 7*]. In that letter, CLAIMANT cautioned that in the event RESPONDENT failed to notify CLAIMANT of when the outstanding 300 tons of cocoa would be shipped, CLAIMANT would be forced to purchase cocoa elsewhere [*Id.*]. CLAIMANT awaited a response from RESPONDENT for over two months [*Claimant's Ex. No. 8*]. By October 2002, CLAIMANT was running dangerously low on its supply of cocoa and would have had to cease production of certain products if it did not receive additional cocoa [*Procedural Order No. 2*]. Faced with the likelihood of running out of cocoa and shutting down its production, CLAIMANT purchased substitute cocoa in October 2002 [*Claimant's Ex. No. 8*]. CLAIMANT'S letter dated 15 August 2002 constituted "conclusive conduct" by CLAIMANT that RESPONDENT'S failure to deliver would result in termination of the contract. Furthermore, a reasonable person in RESPONDENT's position would have understood that under the circumstances, its failure to respond to CLAIMANT'S letter and perform for over two months amounted to an avoidance of the contract. Accordingly, this Tribunal should find that the contract between CLAIMANT and RESPONDENT was avoided on 15 August 2002.

b. Express notice of avoidance on 25 October 2002

22. Alternatively, CLAIMANT submits to the Tribunal that it validly avoided the contract in a letter dated 25 October 2002 [*Claimant's Exhibit No. 8*]. In this letter, CLAIMANT informed RESPONDENT that it had been forced to buy 300 metric tons of replacement cocoa in order to avoid running out of supplies [*Id.*]. CLAIMANT also informed RESPONDENT that RESPONDENT's president would be receiving a demand letter from CLAIMANT's legal counsel requesting that RESPONDENT pay CLAIMANT the price of the replacement cocoa [*Id.*]. This language is sufficient to alert a sophisticated business entity such as RESPONDENT that CLAIMANT considered the contract to be avoided.

23. A German arbitral panel reached the same conclusion in the Hamburg Arbitration Proceeding of 29 December 1998 [*Hamburg Arbitration Proceeding (GER), ¶ V(6)(a)*]. That action arose from seller's partial breach in delivery of 300 tons of cheese [*Id., Facts*]. Upon lapse of the time for delivery, buyer initiated arbitration proceedings against seller by serving papers on the seller and declaring the contract avoided due to non-performance [*Id.*]. Although the buyer affirmatively declared the contract avoided, the German arbitral panel noted that "a fitting declaration . . . without requirements as to form, that is directed to the termination of the business relationship is sufficient" notice [*Id., V(6)(a)*]. The panel then concluded that buyer's faxed statement that he would not do any business with the seller in the future and his serving of legal papers amounted to sufficient notice of avoidance under article 26 [*Id.*]. Accordingly, this Tribunal should find that CLAIMANT's letter dated 25 October 2002 constitutes an implicit declaration of avoidance in so much as it is a manifestation of CLAIMANT's termination of its contractual relationship with RESPONDENT.

c. CLAIMANT's letter of 15 November 2002

24. Despite prior communications that gave RESPONDENT notice of avoidance, CLAIMANT formally reiterated its avoidance of the contract in its letter dated 15 November 2002. That letter clearly stated that CLAIMANT considered the contract terminated [*Claimant's Exhibit No. 11*]. This language is clear enough to give notice to RESPONDENT that CLAIMANT was avoiding the

contract. In other cases, where courts and tribunals had to determine what was sufficient notice of avoidance, they found that languages and behaviors that were much more vague than CLAIMANT's language in the 15 November 2002 letter, was sufficient. For instance, on one occasion, canceling a purchase order is sufficient notice of avoidance [*Italdecor v. Yiu's Indus (ITA)*]. On another occasion, notification to seller of buyer's intent to discontinue relationship and have shoes produced by another company was sufficient notice of avoidance [*Case No. 5 U 164/90 (GER)*]. Another tribunal held that buyer's fax refusing to pursue its business relationship with seller was sufficient notice of avoidance [*Schiedsgericht Hamburger Freundschaftliche Arbitrage*]. CLAIMANT's statement that it considered the contract to be terminated in the 15 November 2002 letter meets the threshold established by courts and tribunals for an effective notice of avoidance.

PART TWO: CLAIMANT IS ENTITLED TO RECOVER DAMAGES UNDER THE TERMS OF THE CISG

I. CLAIMANT is Entitled to USD 289,353.00 in Damages Pursuant to Article 75

25. Article 75 of the CISG provides a means of calculating damages when an aggrieved party has avoided the contract and has purchased substitute goods [*CISG Sec. Comm., art. 75*]. Because CLAIMANT avoided its contract and purchased substitute cocoa, Article 75 is applicable in determining CLAIMANT's damages. Article 75 states,

> If the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods, the party claiming damages may recover the difference between the contract price and the price in the substitute transaction as well as any further damages recoverable under article 74 [*CISG, art. 75*].

a. CLAIMANT purchased substitute cocoa in a reasonable manner

26. A substitute transaction is conducted in a reasonable manner if it is likely to have caused a cover purchase at the lowest price reasonably possible [*CISG Sec. Comm, art. 75*]. Use of current

market price is relevant in determining whether a substitute transaction was conducted in a reasonable manner [*Honnold, 508*].

27. CLAIMANT purchased substitute cocoa on 24 October 2002 at a rate of USD 100.03 cents per pound [*Claimant's Ex. No. 8, ¶ 3*]. According to the International Cocoa Organization's table of Monthly Average Cocoa Prices, the price of cocoa on 24 October 2002 was USD 100.03 cents per pound [*Respondent's Ex. No. 3*]. Since CLAIMANT purchased the substitute cocoa at current market price for October, this Tribunal should find that CLAIMANT's repurchase was conducted in a reasonable manner.

b. CLAIMANT purchased substitute cocoa within a reasonable time after avoidance

28. An aggrieved party's declaration of avoidance is not effective unless it is made by notice to the other party [*CISG, art. 26*]. Relying on CLAIMANT's letter dated 15 November 2002, RESPONDENT asserts that CLAIMANT effectively declared its intention to avoid the contract on 15 November 2002 [*Claimant's Ex. No. 11, ¶ 4*].

29. However, applicable case authority holds that "the CISG does not provide any obligation concerning the form of avoidance" and that a contract is avoided "even in the absence of an express subsequent declaration" of avoidance, provided that a reasonable person would have understood the contract to be avoided [*FCF v. Adriafil Commercial (SWI) ¶ A(a); ICC 8128*]. Thus, a party may effectively avoid its contract via implicit notice of avoidance [*FCF v. Adriafil Commercial (SWI) ¶ C(3)*]. Accordingly, this Tribunal should find that CLAIMANT'S 15 August 2002 letter constituted an implicit notice of avoidance in so much as it constituted a "conclusive conduct" informing RESPONDENT that its failure to deliver would result in termination of the contract.

30. In that letter, CLAIMANT cautioned that in the event RESPONDENT does not notify CLAIMANT of when the outstanding 300 tons of cocoa would be shipped, CLAIMANT would be forced to purchase cocoa elsewhere [*Id.*]. CLAIMANT awaited a response from RESPONDENT for over two months [*Claimant's Ex. No. 8, ¶ 2*]. By October 2002, CLAIMANT was running dangerously low on its supply of cocoa and would have had to cease production of certain products if it did not

receive additional cocoa [*Procedural Order No. 2, ¶ 24*]. Faced with the likelihood of running out of cocoa and shutting down its production CLAIMANT purchased substitute in October 2002 [*Claimant's Ex. No. 8, ¶ 2*]. A reasonable person in RESPONDENT's position would have understood that under the circumstances, its failure to respond and perform for over two months would result in CLAIMANT avoiding the contract. Accordingly, this Tribunal should find that the contract between CLAIMANT and RESPONDENT was avoided on 15 August 2002, that CLAIMANT purchased substitute cocoa within a reasonable time after avoidance of the contract, and that CLAIMANT is entitled to USD 289,353.00 in damages.

II. If CLAIMANT is not Entitled to Damages Under Article 75, it Should be Entitled to USD 289,353.00 in Damages Under Article 76

31. In cases where a contract is avoided, the aggrieved party may resort to Articles 75 and 76 of the CISG for damages [*Honnold, 504*]. There is a dichotomy between the applications of Articles 75 and 76 in relation to one another. Some courts have found that when an aggrieved party performed a substitute transaction, it is automatically subjected to Article 75 [*E.g. Novia Handelsgesellschaft v. AS Maseko (EST)*]. However, many scholars state "that there is no reason to suppose that an aggrieved party who makes an unsuccessful attempt to comply with Article 75 completely looses the right to recover damages" [*Honnold, 512; see also Schlechtriem, 97* (stating that where goods covered by the transaction have a market price, the aggrieved party may seek Article 76 damages "abstractly" or independently from any cover transaction)].

32. Furthermore, the Secretariat Commentary states that Article 76 is applicable where the substitute transaction was not made in a reasonable manner and within a reasonable time after avoidance, as required by article 75 [*CISG Sec. Comm., art. 76 ¶ 2*]. Because the market price for the quality and quantity of cocoa covered by this transaction is easily ascertained, this Tribunal should assess CLAIMANT's damages pursuant to Article 76.

33. Under Article 76, an aggrieved party's damages may be assessed based on the current price of the contracted goods at either the time of avoidance or at the time when buyer took possession of the goods [*Honnold, 509*]. Specifically, Article 76 states,

> (1) If the contract is avoided and there is a current price for the goods, the party claiming damages may, if he has not made a purchase or resale under article 75, recover the difference between the price fixed by the contract and the current price at the time of avoidance as well as any further damages recoverable under article 74. If, however, the party claiming damages has avoided the contract after taking over the goods, the current price at the time of such taking over shall be applied instead of the current price at the time of avoidance.
> (2) For the purposes of the preceding paragraph, the current price is the price prevailing at the place where delivery of the goods should have been made or, if there is no current price at that place, the price at such other place as serves as a reasonable substitute, making due allowance for differences in the cost of transporting the goods [*CISG, art. 76* (emphasis added)].

Therefore, when assessing the damages under Article 76, the Tribunal should determine the current price of cocoa at the time of avoidance and place of delivery.

a. Time of avoidance

34. Under Article 76 paragraph one, damages may be assessed as of the time the aggrieved party avoided the contract or took possession of the contracted goods [*Schlechtriem, 97; Honnold, 510*]. Because CLAIMANT never took possession of the RESPONDENT's outstanding 300 tons of cocoa, CLAIMANT is entitled to damages as of the time it avoided its contract with RESPONDENT—namely, 25 October 2002. RESPONDENT contends, however, that CLAIMANT avoided its contract on 15 November 2002. RESPONDENT'S reliance on this letter is misplaced. Case authority clearly indicates that a "declaration . . . that is directed to the termination of the business relationship is sufficient" notice of avoidance [*Hamburg Arbitration Proceeding (GER), ¶ V(6)(a)*]. Accordingly, this Tribunal should find that CLAIMANT's letter dated 25 October 2002, initiating a legal demand of compensation for its substitute transaction, constitutes an implicit declaration of avoidance.

b. Place of delivery

35. The current price of goods is assessed based on the official or unofficial market price for goods of the same kind under comparable circumstances in the place where delivery should have been made [*CISG Sec. Comm., art. 76 ¶ 6; Novia Handelsgesellschaft v. AS Maseko (EST); Case No. 3 U 246/97 (GER), 360*]. As is indicated by the International Cocoa Organization's table of Monthly Average Cocoa Prices, the international market price of cocoa throughout October 2002 was 100.03 US cents per pound [*Respondent's Ex. No. 3; Procedural Order No. 2*]. Accordingly, this Tribunal should assess CLAIMANT's damages pursuant to the market price of cocoa (100.03 US cents per pound) in Equatoriana during the month of October 2002. Specifically, this Tribunal should find that CLAIMANT is entitled to USD 289, 353.00.

III. If this Tribunal finds Neither Article 75 nor Article 76 Acceptable, it Should Award CLAIMANT USD 289,353.00 in Damages Pursuant to Article 74

36. Whenever and to the extent that Articles 75 and 76 are not applicable for calculating damages, a tribunal may assess damages pursuant to Article 74 [*CISG Sec. Comm., art. 74, ¶ 2; Novia Handelsgesellschaft v. AS Maseko (EST)* ("There is a reference in CISG commentaries allowing a claim to be filed directly on the basis of article 74 . . . .")]. Article 74 provides

> Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in light of the facts and matters of which he knew or ought to have known, as a possible consequence of the breach of contract [*CISG, art. 74*].

Article 74 is intended to place the aggrieved party in as good a position as if the breaching party had performed [*Honnald, 503*].

37. On 19 November 2001, CLAIMANT entered into a contract for 400 metric tons of cocoa with RESPONDENT at a rate of USD 1,240.75 per metric ton (USD .5268 per pound) [*Claimant's Ex. No.*

2, ¶ 4]. The total contract price was USD 496,299.55 [*Id.*]. At the time the contract was concluded, RESPONDENT could have, or ought to have, foreseen that in case of non delivery, CLAIMANT would have to purchase the requisite cocoa from another source. Although CLAIMANT was not under an immediate pressure to obtain the 400 tons of cocoa at the time of contracting, based on the companies' years of trading experience, RESPONDENT knew, or ought to have known, that CLAIMANT requires large quantities of cocoa for producing its confectionaries [*Claimant's Request for Arbitration, ¶¶ 1, 3*]. Accordingly, RESPONDENT knew, or ought to have known, that failure to deliver would potentially disrupt CLAIMANT's operations, and CLAIMANT would have to purchase cocoa elsewhere.

38. CLAIMANT expected to obtain 400 tons of cocoa for USD 496,299.55. Had RESPONDENT made timely delivery of the cocoa, RESPONDENT would have met CLAIMANT's contractual expectations. However, due to RESPONDENT's breach of contract, CLAIMANT obtained the sum of 400 tons of cocoa at a price of USD 661,578.00—USD 289,353.00 more than what it expected to pay under the contract. Accordingly, this Tribunal should award CLAIMANT damages in the amount of its loss, namely in the amount of USD 289,353.00.

PART THREE: THIS TRIBUNAL LACKS JURISDICTION TO HEAR RESPONDENT'S COUNTERCLAIM

39. Although arbitral efficiency may sometimes warrant hearing claims together with counterclaims and set-off defences,[1] CLAIMANT contends that this arbitration is not an appropriate instance. This Tribunal is not the correct venue to adjudicate RESPONDENT's counterclaim as it disregards the parties' original intent, specialized needs and mutual agreement to arbitrate under both the cocoa and sugar contract. Moreover, consistent with the general principle of *Kompetenz-Kompetenz*, this Tribunal has the ability to decide the scope of its

[1] As a preliminary matter, the terms counterclaim and set-off should be distinguished. However, for clarity of the current argument, CLAIMANT will refer to RESPONDENT's claim as its "counterclaim" throughout Part Three, but distinguish the two in Part Four [*see infra, Part Four*].

jurisdiction and hold that RESPONDENT cannot bring a counterclaim concerning the sugar contract in this arbitration.

40. The parties entered into the cocoa contract in mutual agreement that "[a]ny dispute arising with respect to or in connection with" the cocoa contract would be decided "in accordance with the Rules of Arbitration of the Chamber of Commerce and Industry of Geneva Switzerland" [*Claimant's Ex. No. 2*]. Mutual agreement is the very genesis of the creature known as international arbitration; the agreement to arbitrate is the foundation of a tribunal's jurisdiction and "the consent of the parties remains the essential basis of a voluntary system of international commercial arbitration" [*Redfern / Hunter, 135; Coe, 55; Rubino-Sammartano, 55*].

41. It is undisputed that when the parties entered into the sugar contract, they agreed that "[a]ny dispute arising with respect to or in connection with [the sugar contract] be finally decided by three arbitrators in Port Hope, Oceania in accordance with the Rules of Arbitration of the Oceania Commodity Association" [*Respondent's Ex. No. 4*]. Therefore, the parties intended these two contracts to remain separate; indeed there is no common thread among them except the fact that they involve the same parties.

42. There is no area of arbitration where the connection of the disputes is more important than in asserting counterclaims [*Rubino-Sammartano, 596; Bus. Trans. Ger., § 6.05; van Hof, 131*]. As many learned scholars have stated and many awards have held, to be asserted in arbitration, a counterclaim must arise out of the same contract as the underlying transaction [*van Hof, 131, ICSD art. II; Am. Bell Int'l v. Iran, 83; Westinghouse v. Iran, 12; Rubino-Sammartano, 596*]. Both of these contracts are separate entities, with separate arbitration clauses and separate arbitral needs. As such, this arbitration is not the correct venue to adjudicate RESPONDENT's counterclaim: holding otherwise disregards the parties' original intent and the original agreements to arbitrate.

I. Neither the Cocoa Contract nor Swiss Rules Article 21(5) Provides Jurisdiction for this Tribunal to Hear RESPONDENT's Counterclaim

43. RESPONDENT attempts to raise its counterclaim under Swiss Rules Article 21(5), which provides that "the arbitral tribunal shall have jurisdiction to hear a set-off defence even when the relationship out of which this defence is said to arise is not within the scope of the arbitration clause or is the object of another arbitration agreement…." RESPONDENT suggests that these rules allow the Tribunal jurisdiction to hear the matter despite any logical connection. However, RESPONDENT's reliance on Article 21(5) is misplaced. The RESPONDENT expressly refers to its counterdemand as a "counterclaim" rather than a "set-off defence" [*Respondents Answer, § IV*]. However, these terms are not interchangeable [*infra, Part Four*] and thus RESPONDENT's "counterclaim" may not be heard under the jurisdiction of Article 21(5).

44. In the cocoa contract, the parties agreed to arbitration according to the CCIG Rules, not the Swiss Rules [*Claimant's Exhibit No. 2*]. Specifically, while the CCIG Rules do provide for contractual counterclaims, they do not provide for counterclaims based upon separate contracts with independent arbitration clauses and facts [*CCIG, Rule 16*]. To consolidate these claims would be manifestly against the parties' original understanding and intent, thus exceeding this Tribunal's jurisdiction.

45. While CLAIMANT does not object to the application of the Swiss Rules to this proceeding in general, it does object to Article 21(5) [*Claimant's Answer, ¶ 4*]. The vast majority of other international rules of arbitration require a firm connection between disputes before allowing this type of consolidation [*Rubino-Sammartano, 595-60*]. These rules require either a relationship governed by the arbitration agreement, a claim arising out of the same contract or transaction, or at the very least a set of connected circumstances [*Id.*]; none of these conditions are present in this instance [*Rubino-Sammartano, 596 (*listing UNCITRAL, ICC & LCIA, AAA, Stockholm, ECA Rules as examples)]. In this instance, these matters are governed by separate and completely independent arbitration agreements, they designate separate specialized

institutions to hear underlying disputes, they arise out of completely independent contracts and transactions and there are no connecting circumstances save for the parties involved.

46. Lastly, some countries even incorporate the generally understood notion that counterclaims in the area of commodities contracts must arise out of the *same* commodities contract, otherwise the counterclaims cannot be heard [*Johnson / Hazen, §206[4][f] (*citing *17 C.F.R. §§ 180.1-180.5)*]. In this instance, the connection is so tenuous that application of Swiss Rules Article 21(5) is all the more unreasonable and this Tribunal should decline jurisdiction.

II. The Specialized Arbitration Clause In The Sugar Contract Preempts Any Jurisdiction to Hear RESPONDENT's Counterclaim

47. RESPONDENT's attempt to raise a counterclaim based upon the sugar contract is further preempted by the sugar contract itself. In the sugar contract, the parties agreed upon the specialized arbitration institution of the Oceania Commodity Association: a venue both physically, technically and intellectually closer to the sugar contract dispute. In fact, many commodity exchanges require mandatory arbitration clauses to be written in commodities contracts [*Procedural Order No. 2, ¶ 6; Johnson / Hazen, §206[4][f]* (citing *17 C.F.R. §§ 180.1-180.5*)]. These arbitration clauses require the parties to submit their disputes to a specific body adept at handling such claims as a condition of using the exchange [*Id.*]. Such is the case here [*Procedural Order No. 2, ¶ 6*].

48. Scholars point out that this increases the efficiency of the dispute settlement procedure, ensures expert handling of the matter and further minimizes the cost to the parties as all members are fluent in the language of commodities contract disputes [*17 C.F.R. 108(3)(b); Park, 700*]. Such specialization is essential to the proper resolution of the sugar contract dispute and thereby preempts jurisdiction in this arbitration as a counterclaim. Indeed, when "it is sufficiently clear that the parties wanted the claim subsequently raised by way of a set-off to be dealt with by the ordinary courts or by another arbitral court, the set-off should be rejected by the arbitrators. To permit the introduction of claims by way of a set-off would thus violate the

agreements between the parties" [*Bus. Trans. Ger., §6*]. Here, the parties chose a specific institution to handle their dispute—the Oceania Commodity Association. That venue is better suited to the needs of the Sugar Contract; it is closer to the relevant facts and necessary evidence and will offer a more efficient resolution for the parties [*Respondent's Exhibit No. 4*].

49. CLAIMANT asserts that these important facts preempt jurisdiction to hear the matters relating to the sugar contract as a counterclaim in this proceeding. To hear such a counterclaim is not only against carefully chosen arbitration forum in the sugar contract, but is also against some rules of commodity trading currently in use throughout the international economic community. Again, the prudent choice is to allow arbitration according to the Oceania Commodity Association, in Oceania, according to the parties' original intent, understanding and needs.

III. If this Tribunal was to Hear RESPONDENT's Counterclaim, the Award may Run the Risk of not Being Enforced

50. Besides being manifestly against the parties' original understanding and intent, if this Tribunal were to allow RESPONDENT to submit its unrelated counterclaim it would run the risk of non-enforcement under the New York Convention [*New York Convention, V(1)(c); Coe, 56*]. A tribunal's mandate is circumscribed by the arbitral agreement [*Coe, 55*]; basic tenets of International Commercial Arbitration require adjudication within these bounds [*Id.*]. When an award is "in excess of the submission" of the parties agreement, that award can be attacked [*Id., 56*]. Specifically, the New York Convention, to which both parties' home countries are members, allows an enforcing state to decline recognition of an arbitral award when "[t]he award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration" [*New York Convention, V(1)(c)*]. Thus, if this Tribunal were to apply Swiss Rules Article 21(5) and hear this counterclaim, it would run the risk of non-enforcement of that portion of the award, therefore making all the cost and effort of arbitrating the matter

senseless. The prudent course of action would be to honor the parties' original understanding to arbitrate and deny application of Swiss Rules Article 21(5), thus saving unnecessary costs and burden and granting the parties' their rightfully contracted for expectations.

PART FOUR: IF THIS TRIBUNAL HAS JURISDICTION TO CONSIDER THE COUNTERCLAIM, THE RECOVERY SHOULD BE LIMITED TO SET OFF THE AMOUNT RECOVERED BY CLAIMANT

51. In the event that the Tribunal finds that it has jurisdiction to consider RESPONDENT's counterclaim, the amount of recovery should be a "set-off"—limited to that recovered by CLAIMANT in the cocoa dispute. The intent of the drafters of the Swiss Rules was not to equate the terms counterclaim and set-off. Moreover, legal jurisprudence in both common law and civil law jurisdictions distinguish demands of counterclaim from those of set-off. Furthermore, the weight of authority limits a set-off defence to the amount of recovery had by the original claim.

I. The Intent of the Drafters was to Make the Set-off Defence Distinct from that of Counterclaim

52. Swiss Rules Article 21(5) plainly states that "[t]he arbitral tribunal shall have jurisdiction to hear a *set-off defence*…" but excludes from this statement an equal provision for counterclaims [*Swiss Rules, art. 21(5)* (emphasis added)]. Strict interpretation of the entire Swiss Rules would dictate that the drafters intentionally excluded counterclaims from Article 21(5). For example, Swiss Rules Article 3(9) states in part, "Any *counterclaim* or *set-off defence* shall in principle be raised with the Respondent's Answer to the Notice of Arbitration" [*Id., art. 3(9)* (emphasis added)]. If the intent of the drafters was to allow a respondent the full rights of a counterclaim in Article 21(5), they would have explicitly provided this as in Article 3(9). Further, if the intent of the drafters was to equate the terms "counterclaim" with "set-off defence", then they would not have separately identified the two terms throughout the remainder of the Swiss Rules.

53. The UNCITRAL Arbitration Rules and the Zurich Rules provide support for the notion that a set-off defence is to be read as something inherently different than a counterclaim. The new Swiss Rules were modeled after the UNICTRAL Arbitration Rules [*Swiss Rules, Introduction*], which state in Article 19 that "the respondent may make a *counter-claim* arising out of the same contract or rely on a claim arising out of the same contract for the purpose of a *set-off* [*Arbitration Rules, art. 19(3)* (emphasis added)]. Likewise, the Zurich Rules emphasize this distinction by providing tribunal jurisdiction over a counterclaim independent of jurisdiction over a set-off defence [*Zurich Rules, arts. 26 & 27*]. When a set of arbitration rules bears separate provisions for a counterclaim and a set-off defence, the intent of the drafters must have been that these two terms would effectuate differing results.

II. Legal Jurisprudence Distinguishes Set-off from that of Counterclaim and Holds that Set-off May not be Used to Obtain a Positive Recovery

a. Set-off is distinct from counterclaim

54. Set-off, or compensation as termed in civil law jurisdictions, may generally be defined as "[a] defendant's counterdemand against the plaintiff, arising out of a transaction independent of the plaintiff's claim" [*Black's Law Dictionary, 1404*]. As opposed to a set-off, a counterclaim is a separate claim, which "must still be decided upon by the arbitrators when the original claim is withdrawn or settled" [*Pellonpää, 348*]. Put another way, a counterclaim must relate to the original claim, whereas the set-off merely indicates the existence of a debt that extinguishes all or part of the claimant's claim. [*Id., 373*]. However, the most important distinction between the two is that unlike a counterclaim, a set-off may not exceed the amount of the original claim [*Id., 348; Berger, 60* ("Contrary to a counterclaim, the respondent can recover nothing for himself.")].

55. The distinction between set-off and counterclaim is explicitly recognized in both common law and civil law jurisdictions.

> French law distinguishes between "demande reconventionelle" and "moyens de defense au fond", English law between "counterclaim" and "set-off as a defence", German law between "Widerklage" and

> "Prozessaufrechnung", and Italian law between "domanda riconvenzionale" and "eccezione di compensazione" [*Danvaern Prod. v. Schuhfabriken (ECJ), ¶ 17*].

56. In the United States, the Oregon Supreme Court stated the distinction simply, "'[S]et off' and 'counterclaim' are not synonymous terms" [*Rogue River Mgmt. Co. v. Shaw (USA), 442*]. The French Civil Code defines set-off (compensation) as the extinguishment of two debts [*French Civil Code, art. 1289*] and the civil procedure law declares that "[n]o counterclaim is required if the defendant wants to set off liquidated debt against the plaintiff's claim" [*Pellonpää, 373* (citing P. Herzog, Civil Procedure in France, Martinus Nijhof, 1967, p. 277)].

b. Set-off may not exceed the amount of the original claim

57. "Set-off…is not a device to attack but a mere defence of the respondent against the claimant's claim" [*Berger, 60*]. When defence of set-off was first enacted by English statute in 1729 [*Rogue River Mgmt. Co. v. Shaw (USA), 442; Green v. Farmer (ENG), 158*] it provided that "no affirmative judgment could be recovered by defendant against the plaintiff" [*Rogue River Mgmt. Co. v. Shaw (USA), 442; see also Berger* (providing a detailed history of set-off in Roman, Civil, and Common law jurisdictions)]. In Germany, the law defines set-off as the "mutual redemption of reciprocal debts" and explains that "[t]he effect of the set-off is to extinguish the two claims to the extent they are congruent, i.e., up to the amount of the lesser claim" [*Bus. Trans. Ger., 2(a)(ii)*]. In Switzerland, Article 124 of the Swiss Code of Obligations provides that a set-off allows for the discharge of an outstanding debt [*Burger, 4; see also Craig / Park / Paulsson, 101*], while Russia's International Commercial Arbitration Court provides that counterclaims may be raised during the proceedings provided that they "operate in direct setoff of claims previously asserted" [*O'Donnell, 806*].

58. In the United States, "a defendant who has pleaded set-off is not entitled to recover the excess of his claim over the plaintiff's demand" [*CJS, § 110*; *Am. Jur. 2d., § 6* ("Although setoff may be used to offset a plaintiff's claim, it may not, however, be used to recover affirmatively.")]. U.S. courts have consistently upheld this limitation [*See e.g. Schenck, 134;*

Matasar, 1475 ("A set-off is a counter claim that is used defensively: i.e., a defendant may not receive any independent relief under the claim and may use it only to reduce any judgment ultimately obtained by the plaintiff."); *Mack, 449* ("Set-off is an independent demand of the defendant, made to counterbalance that of the complainant *in whole or in part.*") (emphasis added)]. The reasoning for this limitation was spelled out by the Fourth Circuit in *In re Johnson*. "[S]et-off…does not go to the foundation or justice of a plaintiff's claim…and as such constitutes a defence only in the practical sense that *it operates to reduce the [plaintiff's] remedy*" [*In re Johnson, 1078* (emphasis added)].

c. Model law prescribes the limiting nature of set-off

59. Where a dispute arises regarding the meaning or usage of a term, the UNIDROIT Principles ("Principles") are intended to be used as a means of interpreting and supplementing existing international instruments [*UNIDROIT 1994, Preamble; Craig / Park / Paulsson, 632*]. As such, the Principles may further serve to interpret the precise meaning of "set-off" as is written in the Swiss Rules. The UNIDROIT Principles were revised in 2004 and include a new chapter that specifically defines set-off [*Bonell, 14*]. The revised Principles define set-off as the situation where "two parties owe each other money or other performances of the same kind" and subsequently provide that "if the two obligations differ in their amount, set-off will discharge the obligations *up to the amount of the lesser obligation*" [*Id.* (emphasis added)]. Under this definition, RESPONDENT's set-off defence would be limited to the amount of the lesser obligation—that being CLAIMANT's claim.

60. The Uniform Commercial Code (U.C.C.) offers a similar limiting clause which implies that set-off damages should be limited to the amount of the original claim. U.C.C. § 2-717 provides:

> The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract [*Id.*].

The language conveys the notion that the set-off may be in all or in part of the damages resulting from the breach.

61. Precedent arbitral decisions have not clarified the scope of a set-off as is written in the Swiss Rules. Although prior arbitral decisions have encountered set-off, these decisions have not been faced with a set-off in excess of the original claim [*E.g. ICC 3540*]. Therefore, this Tribunal should look to precedents and decisions from other courts.

III. Fairness Considerations Demand that Set-off Defences be Treated Differently than Counterclaims

62. As previously highlighted, unlike set-offs, counterclaims must relate to or arise out of the underlying transaction [*supra, ¶ 55*]. In the present case, RESPONDENT's set-off defence does not arise out of the original cocoa claim. For this reason, fairness would demand that the scope of the set-off defence be more limited than that of the counterclaim [*Seibert, 449* ("The counterclaim…is broader and more comprehensive than…set-off.")]. This argument was eloquently stated by Chief Justice Cockburn in Stooke v. Taylor [*Stooke v. Taylor (ENG), 576*].

> But the most striking difference is that the counter-claim operates, not merely as a defence, as does the set-off, but in all respects as an independent action by the defendant against the plaintiff. To the extent to which the damages accruing to the defendant on the counter-claim may be in excess of those accruing to the plaintiff on his claim, the defendant becomes entitled to judgment, with this additional advantage that, having been obliged to meet the plaintiff on the forum chosen by the latter, he is not bound, as to costs, by the conditions on which the plaintiff depends for obtaining them [*Id.*].

63. If set-off defences could produce awards greater than that of the original claim, respondents could avoid unfavorable forums by raising completely unrelated claims in favorable forums. For example, CLAIMANT and RESPONDENT agreed to arbitrate disputes relating to the sugar contract with the Oceania Commodity Association [*Respondent's Answer, ¶ 17*] presumably because they found this forum to be most appropriate. However, RESPONDENT may feel that this forum is unfavorable to their claim and wish to settle the claim in a more favorable forum, such as the Chamber of Commerce and Industry of Geneva. Therefore, a liberal application of

set-off, allowing awards greater than that of the original claim, may result in "forum shopping"—where a party chooses to raise its claims in the forum most favorable to it.

REQUEST FOR RELIEF

In light of the above arguments and submissions, Counsel for CLAIMANT respectfully requests that the Tribunal find that:

- RESPONDENT fundamentally breached the cocoa contract;
- RESPONDENT was not excused from performing its obligation;
- CLAIMANT avoided the cocoa contract and is entitled to recover damages;
- damages should be USD 289,253.00 pursuant to either CISG Articles 74, 75, or 76;
- the Tribunal lacks jurisdiction to here RESPONDENT's counterclaim;
- and, if the Tribunal hears the counterclaim, it should be limited to the set-off amount.

Signed,

Lacy Johnson	Elahe Parsa	James Rogers	Brett Thorstad

Counsel for CLAIMANT.