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PROBLEMS RELATING TO THE PLACE OF PERFORMANCE FOR PAYMENT OF DAMAGES AND THE ADMISSIBILITY OF SET-OFF CLAIMS UNDER ARTICLE 74 CISG

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PROBLEMS RELATING TO THE PLACE OF PERFORMANCE FOR PAYMENT OF DAMAGES AND THE ADMISSIBILITY OF SET-OFF CLAIMS UNDER ARTICLE 74 CISG

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ABSTRACT

Article 74 United Nations Convention on Contracts for the International Sale of Goods (CISG), which lays down a general framework for the recovery of damages under the CISG, has been associated with certain challenges due to the fact that it does not derive its basis from any of the existing legal systems of the world. In particular, certain elements fundamental to the recovery of damages are not expressly addressed by the said provision. These include the use of a counter claim to cancel out claims for the recovery of damages and place of performance for the payment of damages. This paper will investigate the admissibility of the abovementioned aspects under the CISG. In doing so, it will consider the opinions of scholarly writers, courts and arbitral tribunals and will evaluate the impact of their arguments on the entire Convention. In addition, it will recommend important guidelines for consideration in deriving solutions for matters not settled by Article 74 CISG.

I. INTRODUCTION

The United Nations Convention on Contracts for the International Sale of Goods (CISG) contains uniform rules relating to the conduct of international business transactions. The goal of the Convention is to promote uniformity and enhance good faith in international trade.¹ In this regard, it furnishes courts and arbitral tribunals with sufficient guidance to interpret its provisions by providing them with a mechanism embodied in Article 7 CISG. This provision is arguably identified as the most influential provision in ensuring the success of the abovementioned Convention.² However, its effort in pursuing the goal of uniformity is jeopardized by certain interpretational challenges resulting from some of the Convention’s provisions. Such challenges are particularly visible in provisions which do not derive their basis from any existing legal system.

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Article 74 CISG, which establishes the rule governing the recovery of damages when there is a breach of contract, is a clear example of a provision which does not derive its basis from a specific legal system such as the common law and the civil law.\(^3\) In this regard, Article 74 CISG is controversial.\(^4\) Debate centers on certain material aspects relating to the recovery of damages under the Convention such as the burden of proof, the recovery of certain categories of losses and expenditures, the place of performance for the payment of damages and the use of a counter claim to cancel out claims for the recovery of damages.\(^5\)

In order to investigate their status under the CISG, this paper focuses on two of the aspects mentioned above which are the place of performance for the payment of damages and the use of a counter claim to cancel out claims for the payment of damages. In doing so, the paper will consider whether they are subjected to rules in the Convention. The opinions of contributors such as scholarly writers, courts and arbitral tribunals will be evaluated and the impact of their judgment on the entire Convention will be discussed. Finally the paper will recommend certain guidelines to be followed when considering an interpretation of Article 74 CISG in respect of unsettled matters.

\(^4\) Keily (n 2) 15.
II. Article 74 CISG and Problems Relating to the Place of Performance for Payment of Damages and the Defence of Set-Off

Article 74 CISG sets out the general framework for the calculation of damages under the CISG. It states that;

Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the other party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known as a possible consequence of the breach of contract.6

The wording of this provision appears to be very explicit as it highlights two basic principles in contract law relating to the recovery of damages. These are the principle of full compensation7 and the rule of limitation through foreseeableability.8 A critical observation of this provision has associated it with certain fundamental challenges. Such challenges arise as a result of its ambiguous character that does not make provision for place of performance for the payment of damages or the use of a counter claim to cancel out claims for the recovery of damages. These issues are not expressly settled in the provision and as such their admissibility under the CISG has been the subject of compromise by courts, arbitral tribunals and scholarly writers, some of which have greatly undermined the objectivity of the CISG.

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6 United Nations Convention on Contracts for the International Sale of Goods (n1), Art. 74 CISG.
2.1 Place of Performance for Payment of Damages

The CISG contains no express rules on the place of performance for the payment of damages and Article 74 CISG is rather silent on the issue. Furthermore, none of the important documents relating to the adoption of this provision, including its legislative history or the travaux preparatoires, provide any guidance on this aspect. The CISG Advisory Council opinion is also silent on the issue.

In the absence of an express rule in the CISG or guidelines from other sources, some have advocated that the solution is to invoke the gap filling mechanism of Article 7 CISG in order to resolve the ambiguity revolving around a place of performance for the payment of damages under Article 74 CISG. In doing so, they have utilised an underlying principle from the Convention by making certain analysis of the default rule in Article 57(1) (a) CISG. The rule mandates that the buyer is to pay the purchase price at the seller’s place of business if he is not bound to pay at any particular place. Scholarly writers, therefore, have applied this analogy to the context of Article 74 CISG in order to determine a place of performance for the payment of damages. In this regard, they have arrived at the seller’s place of business as the place of performance for payment of damages. The attribution to this place is justified on the grounds that if all payments under the Convention are tendered at the place where the creditor has his principal place of business, then this place would be decisive as to the place for the payment of all other claims governed by the CISG including payment of interest, liquidated damages and reimbursement of liquidated expenses.

The rule in Article 57(1) (a) CISG has been instrumental for the determination of jurisdictional questions relating to the place of performance for the payment of damages. Many courts have applied

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10 United Nations Convention on Contracts for the International Sale of Goods (n 1), Art. 57 CISG.
11 Magnus (n 9).
12 Ibid.
this rule for gap filling purposes under Article 74 CISG with regard to the place of performance for the payment of damages. The Court of Appeal in France, for instance, held that the CISG has established the place for the payment of the purchase price under Article 57(1) CISG to be the seller’s place of business. Based on this assertion, the court concluded that the usual interpretation of this provision should be taken to determine the place for the payment of damages, which is the place of the business or the domicile of the creditor.\textsuperscript{13} The appellate court of Germany also invoked Article 57(1) (a) CISG and in delivering its judgment, it argued that, by requiring the purchase price to be payable at the seller’s place of business, the Article was also indicative of a general principle under the Convention that all other claims of money including damages for the breach of contract are to be payable at the business place of the creditor.\textsuperscript{14}

\textbf{2.2 The Defence of a Set-Off Claim arising under the Convention}

The CISG does not address issues of set-off claims and whether they can be used to cancel out claims for the payment of damages under the Convention. As far as set-off claims are concerned, their admissibility for the purpose of cancelling out claims for damages under Article 74 CISG is unclear. Scholarly writers are divided over this issue considering the varied interpretations obtained across different jurisdictions, though the majority argues that such claims should be admissible under the CISG. For example, Magnus submits that, although a counter claim is not expressly settled in the Convention, it should be granted in situations where the buyer wants to offset the seller’s claim for non-payment of the purchase price because the goods did not conform to the contract and had caused damage.\textsuperscript{15} He further points out that the Convention indirectly deals with set-off claims in Article 84(2)


\textsuperscript{14} Germany 2 July 1993 Appellate Court Düsseldorf (\textit{Veneer cutting machine case}) [translation available] [Cite as: <http://cisgw3.law.pace.edu/cases/930702g1.html>] accessed 16 October 2012.

\textsuperscript{15} Magnus (n9).
CISG which deals with restitution of all benefits derived from the goods by the buyer in the event the contract has been avoided.\textsuperscript{16} This implies that the seller can offset all benefits derived from the goods against the buyer’s claim for a refund of the purchase price.

However, certain courts have deviated from the above reasoning and have considered set-off claims as an inadmissible aspect under the CISG. They have argued that Article 4 of the CISG, which limits the CISG only to the rights and obligations of the buyer and the seller arising under the contract, should not be given an expanded interpretation to include set-off claims as the legislative history of the Convention does not support such an approach.\textsuperscript{17} These courts have further argued that the issue of a set-off claim constitutes a gap which is not settled in the CISG and that this gap can only be filled with the domestic law applicable by virtue of the rules of private international law.\textsuperscript{18} The Appellate Court of München followed this approach and considered a set-off as not being part of the parties’ rights and obligations flowing from the contract as required by Article 4 CISG. As a consequence, the court ruled that it fell out of the bounds of the Convention.\textsuperscript{19} The court had to invoke German rules of private international law to determine the admissibility of the set-off claim, eventually leading to the application of Italian Law. The set-off claim was therefore dismissed because set-offs claims are generally inadmissible under Italian law.\textsuperscript{20}

Although some courts have adhered to the aforementioned reasoning, their judgment is inconsistent with the uniform law concept advanced by the CISG. Considering therefore that set-off claims are treated differently across jurisdictions, it is important for these courts to adopt a creative approach by searching for underlying principles within the CISG before having recourse to domestic laws.

\textsuperscript{16} Ibid.
\textsuperscript{17} Bruno Zeller, \textit{CISG and the Unification of International Trade Law} (Routledge-Cavendish 2007) 72
\textsuperscript{18} Ibid.
\textsuperscript{19} CLOUTcaseNo.7U 3771/97 [Appellate Court München] (\textit{Automobiles case}) \textcolor{blue}{http://cisgw3.law.pace.edu/cases/980128g1.html} accessed 16 October 2012.
\textsuperscript{20} Ibid.
In support of this proposition, Felemegas has pointed out an underlying principle in the Convention, more precisely the principle of full compensation. Felemegas has hailed it to justify the admissibility of counter claims under the CISG, as the principle prevents a party from being disadvantaged or privileged as a result of a breach of contract. This position is therefore compatible with the notion that the aggrieved party can off-set his losses against any benefit or advantages derived from the breached contract. In this respect, it can be invoked by the breaching party as a counter claim against the claim of the aggrieved party and prevent him from receiving double advantages.

In spite of the abovementioned arguments or justifications put forward by Felemegas, another issue of contention is whether the set-off claim should emanate from the disputed contract governed by the CISG. This issue is of critical importance as set-off claims have been attributed with various forms. As Kröll puts it, they may arise from the same contract as the main claim, from another contract not governed by the CISG but by domestic law, or from a different contract governed by the CISG. In the opinion of scholarly writers such as Magnus, set-off claims should be admissible only when it arises from the same contract as the main claim in order to avoid the cumbersome process imposed by the conflict of law rules to determine the applicable law. The justification of this argument is that it will be easy to identify the applicable law of the set-off claim as it will be identical to the law applicable to the entire transaction governed by the CISG. This argument sounds convincing as any determination under domestic law may in practice depart from the uniform law concept propagated by the CISG

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21 Schlechtriem (n 8), 595.
23 Ibid.
25 Ibid.
26 Ibid.
27 Ibid.
III. CONCLUSION

This article showed that there is an evide lack of precision in Article 74 CISG with respect to the place of performance for the payment of damages and the use of set-off claims to cancel out claims for the recovery of damages. Serious academic and judicial consideration has been required in order to provide a solution to these issues and determine their admissibility under the CISG. A critical observation of some of these contributions, however, questions their objectivity in relation to the notion of uniformity envisaged by the CISG. In this regard, it can therefore be argued that although the efforts of these contributors cannot be underestimated, they are likely to distort a proper functioning of the CISG. This is because some of the arguments put forward, have departed from the uniform law concept. As a result of their resort to domestic law principles, results that are inconsistent with the notion of uniformity are produced, which greatly undermine the objectivity of the CISG. It is therefore important to direct the minds of these contributors to the fact that uniformity constitutes the ultimate goal of the CISG, an aim which is further stressed in its preamble as a Convention which seeks to overcome the challenges of international trade and promote its development. Therefore, contributors such as scholarly writers, courts and arbitral tribunals, are encouraged to adopt a reasonable approach towards matters not expressly settled by the CISG in order to ensure that the goal uniformity is preserved.

However, as Bridge argues, even with the adoption of the aforesaid approach, there are still varieties of ways in which a national legal system can distort the functioning of a legal text such as the CISG as far as the interpretation of its provisions are concerned. He further asserts that, unless there is harmonisation of the civil procedures of the different jurisdictions in the world, there can hardly be any

true harmonisation and unification of the laws relating to conduct of international sales.\textsuperscript{31} In spite of this argument, legal practitioners are advised to overcome the challenges posed by national legal systems over uniform law concepts by looking towards standards of international practice to interpret their provisions.\textsuperscript{32} They are required to do so by avoiding the trend of resorting to domestic laws principles in order to interpret provisions with ambiguities such as Article 74 CISG. By adhering to these recommendations, the underlying goal of a Convention such as the CISG will not only be achieved but certainly will be guaranteed in international business transactions.


\textsuperscript{32} Mazzacano (n30), 89.