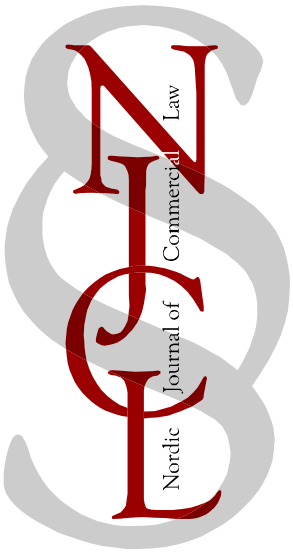

EFFECTS OF AVOIDANCE:
Perspectives from the CISG, UNIDROIT Principles and PECL and case law

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Where the contract has been avoided, both parties are released from any future performance of their obligations and restitution of that which has already been delivered may be required.[1]

1. General

Under the United Nations Convention on Contracts for the International Sale of Goods (1980; "CISG" or "Convention"), the effects of avoidance are described in Arts. 81 to 84, four articles of unequal importance dealing with the consequences which result from a declaration of avoidance accomplished by a party in accordance with the conditions set forth in CISG Arts. 49, 51, 64, 72 and 73.[2] Among the four, Art. 81 states the basic consequences of avoidance,[3] while Arts. 82 to 84 give "detailed rules for implementing certain aspects" of Art. 81.[4]

From the outset, it is to be made clear that the Convention does not apply to "consensual avoidance" – *i.e.*, termination of the contract that occurs where the parties have, by mutual consent, agreed to cancel the contract and to release each other from contractual obligations – but rather is properly limited to cases where one party "unilaterally" avoids the contract because of a breach by the other party.[5] Avoidance is the process through which an aggrieved party, by notice to the other side, terminates the contractual obligations of the parties. If the contract is not avoided, the Convention contemplates that the basic exchange of goods and price will be completed despite a breach, with damages or other remedies to compensate for defects in the exchange.[6] That is to say, failure to effectively avoid the contract means that the parties remain bound to perform their contractual obligations. Courts have found a failure of effective avoidance where a party failed to follow proper procedures for avoidance (*i.e.*, lack of timely and specific notice of avoidance to the other party) or where a party lacked substantive grounds for avoiding (e.g., lack of fundamental breach).[7]

In any event, as a rule, only avoidance of contract makes it clear that the contract will not be performed. When the contract is avoided, the parties lose the right to perform and regain their freedom of disposition. Up until then it is their duty to remain loyal to the contract.[8] On the

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1 *See* Secretariat Commentary on Art. 72 of the 1978 Draft *[draft counterpart of CISG article 76]*: Comment 2; available at: <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-76.html>.

2 *See Denis Tallon* in *Commentary on the International Sales Law: The 1980 Vienna Sale Convention*, *Cesare Massimo Bianca & Michael Joachim Bonell* eds., Milan (1987), p. 601; available at: <http://www.cisg.law.pace.edu/cisg/biblio/tallon-bb81.html>.

3 *See John O. Honnold*, *Uniform Law for International Sales under the 1980 United Nations Convention*, 3rd ed., Kluwer Law International, The Hague (1999), p. 502; available at: <http://www.cisg.law.pace.edu/cisg/biblio/ho81.html>.

4 *See* Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*: Comment 1; available at: <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-81.html>.

5 *See UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods* (8 June 2004), A/CN.9/SER.C/DIGEST/CISG/81: Digest 2; available at: <http://www.uncitral.org/english/clout/digest_cisg_e.htm>.

6 *See Harry M. Flechtner* in "Remedies Under the New International Sales Convention: The Perspective from Article 2 of the U.C.C.": 8 *Journal of Law and Commerce* (1988); p. 56; available at: <http://www.cisg.law.pace.edu/cisg/biblio/flecht.html>.

7 UNCITRAL Digest 3 on CISG Art. 81; *supra.* n. 5.

8 *See* Judgment by Oberlandesgericht [Appellate Court] Bamberg, Germany 13 January 1999; No. 3 U 83/98. English translation by *Ruth M. Janal*; available at: <http://www.cisg.law.pace.edu/cases/990113g1.html>.

other hand, however, in cases of "consensual avoidance," it has been asserted, the rights and obligations of the parties are governed by the parties' termination agreement.[9] In this regard, a relevant ruling is found in [Austria 29 June 1999 *Oberster Gerichtshof* [Supreme Court]]:[10]

> "The CISG does not regulate [...] the consequences deriving from a consensual avoidance of contract. It is up to the parties to reach adequate arrangements or agree upon adequate provisions for the avoidance (citations omitted). Should, however, as here, no adequate arrangements have been made, the resulting gaps are to be filled under the CISG and not through recourse to national law (citation omitted). In so far as the parties do not autonomously regulate the legal consequences of the consensual avoidance of the contract in their agreement for avoidance – particularly the bearing of risk, the place of performance and the bearing of the costs – the remaining gap must be filled by interpretation according to Art. 7(2) CISG ..."

In addition, it is to be made clear that Art. 81 *et seq* CISG are effective only between the parties. They do not affect the consequences with regard to third parties, namely those which may follow from contracts entered into by the buyer prior to the avoidance (resale, rental, etc.). This issue is governed by the applicable law.[11]

2. The CISG approach: retrospective or prospective?

Arguably, the various legal systems exhibit great differences in concepts and terminology when dealing with the effects of termination or avoidance. The differences in the practical results obtained are not so great but are still significant. The most apparent difference is between systems such as the French which treats *résolution* as essentially retrospective and those such as the Common Law which sees termination as essentially prospective.[12]

As regards the question whether termination has retrospective or prospective effects on the contract, however, it is hard to say that the Convention adopted any single approach.[13] To discuss this matter, it is to be firstly made clear:[14]

> "According to the retroactive approach, the contract is void *ab initio* (*ex tunc*), which means that the parties are placed in the situation they would be in had the contract never been concluded. By contrast, under the prospective approach, the contract remains in existence with the restitutionary obligations being the reverse of the original obligations of performance."

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9 UNCITRAL Digest 2 on CISG Art. 81; *supra.* n. 5.
10 *See* Judgment by Oberster Gerichtshof [Supreme Court], Austria 29 June 1999; No. 1 Ob 74/99k. English translation by *Dr. Peter Feuerstein*, translation edited by *Todd J. Fox*; available at: <http://www.cisg.law.pace.edu/cases/990629a3.html>.
11 *See Denis Tallon, supra.* n. 2; p. 602.
12 *See* Comment and Notes to PECL Art. 9:309: Notes; available at: <http://www.cisg.law.pace.edu/cisg/text/peclcomp81.html>.
13 *See Mirghasem Jafarzadeh* in "Buyer's Right to Withhold Performance and Termination of Contract: A Comparative Study Under English Law, Vienna Convention on Contracts for the International Sale of Goods 1980, Iranian and *Shi'ah* Law" (December 2001); available at: <http://www.cisg.law.pace.edu/cisg/biblio/jafarzadeh1.html>.
14 *See Florian Mohs* in "Commentary on the manner in which Articles 7.3.5 and 7.3.6 of the UNIDROIT Principles compare with Articles 81 and 82 of the CISG", (January 2004); available at: <http://www.cisg.law.pace.edu/cisg/principles/uni81,82.html>.

It is clear that, Art. 81, governing the general consequences that follow if one of the parties avoids the contract or some part thereof,[15] sets forth the two consequences:

> *(1) Avoidance of the contract releases both parties from their obligations under it, subject to any damages which may be due. Avoidance does not affect any provision of the contract for the settlement of disputes or any other provision of the contract governing the rights and obligations of the parties consequent upon the avoidance of the contract.*
> *(2) A party who has performed the contract either wholly or in part may claim restitution from the other party of whatever the first party has supplied or paid under the contract. If both parties are bound to make restitution, they must do so concurrently.*

Release for the future: The *primary effect* of avoidance is to relieve both parties of their obligations to perform; i.e., the seller need not deliver the goods, and the buyer need not pay.[16] That is to say, once a contract has been (validly) declared avoided by one of the parties, both parties, *as a rule* (first sentence, Art. 81(1)), are released from all their obligations *for the future*. If the contract is partially avoided, the parties are released from their obligations only as to that part of the contract which has been avoided.[17]

Exceptions to the release: On the other hand, although avoidance of the contract releases both parties from their performance obligations, it does not eliminate all rights and obligations which arose out of the contract.[18] In this regard, two respects are to be particularly outlined:

- The first sentence of Art. 81(1) specifies that the release takes place "*subject to any damages which may be due*." As opposed to the situation in which a contract is avoided because it has become impossible to perform (Art. 79), avoidance, in the instant case, does not prevent the injured party from claiming damages on account of the non-performance by the other party of one of his obligations.[19] Thus, though the party in breach need not deliver or pay, that party remains liable for any loss suffered by the other party as a consequence of the breach.[20] In this regard, it is expressly held in [Germany 21 March 1996 Hamburg Arbitration award]: "Where, [...], the contract is terminated and damages for failure to perform are claimed under Art. 74 CISG et seq., one uniform right to damages comes into existence, which [...] prevails over the consequences of the termination of a contract provided for in Arts. 81-84 CISG."[21]

- The second sentence of Art. 81(1) states another restriction: the avoidance does not affect two categories of clauses: (a) clauses relating to the "*settlement of dispute*," including mainly arbitration and renegotiation clauses – designed to resolve conflicts resulting

15 UNCITRAL Digest 1 on CISG Art. 81; *supra.* n. 5.
16 *See Joseph Lookofsky* in "The 1980 United Nations Convention on Contracts for the International Sale of Goods": *J. Herbots editor / R. Blanpain general editor*, Suppl. 29 *International Encyclopaedia of Laws - Contracts*, Kluwer Law International (December 2000), p. 167; available at: <http://www.cisg.law.pace.edu/cisg/biblio/loo81.html>.
17 *See Denis Tallon, supra.* n. 2; p. 602.
18 *See Joseph Lookofsky, supra.* n. 16; p. 167.
19 *See Denis Tallon, supra.* n. 2; p. 602.
20 *See Joseph Lookofsky, supra.* n. 16; p. 167.
21 *See* Judgment by Schiedsgericht der Handelskammer [Arbitral Tribunal] Hamburg, Germany 21 March 1996; No. Partial award of 21 March 1996: *Yearbook comm. Arb'n XXII*, Albert Jan van den Berg ed. (Kluwer 1997); available at: <INK"http://cisgw3.law.pace.edu/cases/960321g1.html"http://www.cisg.law.pace.edu/cases/960321g1.html>.

> from unforeseeable changes in circumstances – and forum selection clauses; and (b) those which spell out the consequences of the non-performance of the contract: penalties, liquidated damages, clauses restricting or excluding liability.[22] However, the question of whether such clauses remain binding will also depend on their validity, and this is normally a question for the applicable domestic law.[23] That is to say, as a matter of fact, only where these clauses are valid according to the applicable law (which may not always be the case, especially concerning penalties), could they be deemed effective notwithstanding the avoidance of the contract.[24]

Art. 81 provides *a non-exhaustive list* of contractual and Convention obligations which continue even after avoidance. The duty of the buyer to take steps to preserve goods which he intends to reject constitutes another example of the kind of obligation not extinguished by avoidance.[25] In any event, avoidance of the contract does not terminate either the right to claim damages or clauses which may prove useful in resolving a conflict between the parties. Such express provisions are important because in many legal systems avoidance of the contract eliminated all rights and obligations which arose out of the existence of the contract. Under such a view once a contract has been avoided, there can be no claim for damages for its breach and contract clauses relating to the settlement of disputes (usually arbitration clauses) terminate with the rest of the contract. No such effects are produced by the avoidance of the contract under the Convention.[26]

Restitution of the past: Restitution is another effect of avoidance. According to Art. 81(2), a party who has performed the contract either wholly or in part may claim restitution from the other party of whatever the first party has supplied or paid under the contract. If both parties are bound to make restitution, they must do so concurrently.[27] That is to say, the declaration of avoidance has the consequence that both parties are vested with claims *for restitution* in respect of any performances in part previously rendered (relationship for restitution; Art. 81(2) CISG).[28] Art. 81(2) is concerned *only with the past*. It does not pose a problem in abstract terms of retroactivity. Its wording, however, implies the retrospective disappearance of the contract. By undermining the legal basis (some systems would refer to the notion of cause) of the contract, *i.e.*, that on which the parties have performed their obligations, the avoidance renders any act accomplished prior to it void. This situation entails the application of the rules of unjust enrichment or quasi-contracts.[29]

Thus, the following effects of avoidance have been expressly contemplated in CISG Art. 81:[30]

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22 *See Denis Tallon, supra.* n. 2; p. 603.

23 *See Joseph Lookofsky, supra.* n. 16; p. 168.

24 *See Denis Tallon, supra.* n. 2; p. 603.

25 *See Joseph Lookofsky, supra.* n. 16; p. 168.

26 *See Victor Knapp* in *Commentary on the International Sales Law: The 1980 Vienna Sale Convention, Cesare Massimo Bianca & Michael Joachim Bonell* eds., Milan (1987), p. 468; available at: <http://www.cisg.law.pace.edu/cisg/biblio/knapp-bb64.html>.

27 In principle, the party in breach will bear the reasonable expenses which both parties incur in relation to the making of restitution for goods or sums received prior to avoidance; as regards the non-breaching party's expenses, the breaching party is liable in damages for such losses as a consequence of the breach. (*See Joseph Lookofsky, supra.* n. 16; p. 168.)

28 *See* Judgment by Handelsgericht [Commercial Court] St. Gallen, Switzerland 3 December 2002; No. HG.1999.82-HGK. Translation by *Stefan Kuhm*; available at: <http://www.cisg.law.pace.edu/cases/021203s1.html>.

29 *See Denis Tallon, supra.* n. 2; p. 604.

30 *See Peter Schlechtriem* in "Uniform Sales Law - The UN-Convention on Contracts for the International Sale of Goods", Manz, Vienna (1986); p. 107; available at: <http://www.cisg.law.pace.edu/cisg/biblio/schlechtriem.html>.

> "An effective avoidance of the contract releases both parties from their obligations (Article 81(1) sentence one) and obligates the parties to make restitution of whatever has been supplied or paid under the contract (Article 81(2) sentence one). An avoidance only 'redirects' the main obligations of the contract; it does not void the contract *ab initio*. Under Article 81, damage claims for breach, dispute-settlement mechanisms (arbitration clauses), liquidated damages and penalty clauses, etc., are not affected by an avoidance (Article 81[(1)] sentence two)."

From Art. 81, it should be concluded that under the Convention, the contract is not nullified upon the exercise of the remedy of avoidance. Some obligations of the parties are terminated and some remain in existence. The specific obligations characteristic of the sales contract end or performance already made in fulfilling these obligations has to be returned in goods or in price so that a situation is achieved as from before the conclusion of the contract. However, the contract remains in force as long as there are still claims of the parties under it, including claims for returning the goods or payment of the price. On these grounds, the contract cannot be considered as terminated either *ex nunc* or *ex tunc*, although legal doctrine does not adopt unified opinion on that question.[31] Indeed, even as regards domestic systems, it has been noted that as the differences are sometimes *more apparent than real* it may be helpful to consider the effect of "termination" in the various systems in a number of factual situations.[32] That is to say, this question of principle should be left open because one can disregard the theoretical questions, but *should address the practical consequences*.[33]

In sum, Art. 81 clearly shows that the avoidance of the contract *does not nullify* the latter and clarifies which are the obligations that are terminated or returned, respectively, and which remain in existence. It does not meet the character of the provision that there is a dispute on whether the avoidance has the effect of *ex nunc* or *ex tunc*.[34] Therefore, the discussion, whether the avoidance operates retrospectively or prospectively is said to be of little help as avoidance always releases the parties from future characteristic obligations and, at the same time, imposes on the parties reciprocal duties of restoration having retrospective effect.[35] To conclude this section, the leading ruling found in [Austria 29 June 1999 *Oberster Gerichtshof* [Supreme Court]] provides a very valuable guidance regards the Convention's effects of avoidance, which states:[36]

> "According to the CISG, the contract is not entirely annulled by the avoidance, but rather it is 'changed' into *a winding-up relationship* (emphasis added) (citations omitted). The parties are released from their primary contractual obligations due to the avoidance according to Art 81(1) CISG. Exceptions from this are obligations for damages, as well as other provisions which regulate the consequences of the avoidance for the parties, as set out in the second sentence of Art. 81(1) CISG. This encompasses all provisions connected with the undoing of

31 *See Anna Kazimierska* in "The Remedy of Avoidance under the Vienna Convention on the International Sale of Goods": *Pace Review of the Convention on Contracts for the International Sale of Goods*, Kluwer (1999-2000); p. 148; available at: <http://www.cisg.law.pace.edu/cisg/biblio/kazimierska.html>.
32 Notes to PECL Art. 9:309; *supra.* n. 12.
33 *See Florian Mohs*; *supra.* n. 14.
34 *See Fritz Enderlein & Dietrich Maskow, International Sales Law: United Nations Convention on Contracts for the International Sale of Goods*, Oceana Publication (1992); p. 341; available at: <http://www.cisg.law.pace.edu/cisg/biblio/enderlein.html>.
35 *See Anna Kazimierska, supra.* n. 31; pp. 148-149.
36 *See* Judgment by Oberster Gerichtshof [Supreme Court], Austria 29 June 1999; *supra.* n. 10.

> the contract, such as the obligation to 'return' (*Rückgewahr* / 'restitution') all items received in connection with the contract (citation omitted), including the obligation to send back delivered goods (citation omitted). Along with restitution, the results of the (partial) performance of the contract must be dislodged, but not through the establishment of a hypothetical goal such as 'as if the contract had been duly performed' or 'as if the contract had never been concluded.' Rather, as in Roman law, the claim for the return of the rendered performance (*Rückforderung*) is permitted and thereby tied to the item of performance itself (*Leistungssache*) and *to its fate* (emphasis added). Articles 81-84 CISG contain *at their core a risk distribution mechanism* (emphasis added), which within the framework of the reversal of the contract (restitution), overrides the general provisions on the bearing of risk contained in Art. 66 *et seq.* CISG (citation omitted)."

3. Counterpart rules under the UNIDROIT Principles/PECL

The general effects of avoidance under the Convention are virtually the same as of termination under the UNIDROIT Principles of International Commercial Contracts (1994; "UNIDROIT Principles"). In this respect, *Mohs* provides the following comparison:[37]

- Firstly, both parties are released from their obligations under the contract, Art. 81(1) first sentence CISG/Art. 7.3.5(1) UNIDROIT Principles.

- Secondly, possible damages claims are not precluded, Art. 81(1) first sentence, second part CISG/Art. 7.3.5(2) UNIDROIT Principles.

- Thirdly, dispute settlement clauses are not affected, Art. 81(1) second sentence CISG/Art. 7.3.5(3) UNIDROIT Principles.

- Fourthly, even other clauses which operate after avoidance or termination, respectively, are not affected, Art. 81(1) second sentence, second part CISG/Art. 7.3.5(3) second part UNIDROIT Principles.

- Finally, under both sets of rules either party may claim restitution of what has been performed, Art. 81(2) first sentence CISG/Art. 7.3.6(1) first part of the sentence UNIDROIT Principles. If both parties have received anything under the contract, restitution will take place concurrently, Art. 81(2) second sentence CISG/Art. 7.3.6(1) second part of the sentence UNIDROIT Principles.

Mazzotta gives a comparison of CISG Art. 81 and its counterparts in the Principles of European Contract Law (1998; "PECL"), where it is stated:[38]

> "The principal provisions are to be found in PECL Article 9:305, entitled *Effects of Termination in General*, which basically provides, much like CISG Article 81, that termination

37 *See Florian Mohs*; *supra.* n. 14.

38 *See Francesco G. Mazzotta* in "Commentary on CISG Article 81 and its PECL counterparts" (2003); available at: <http://www.cisg.law.pace.edu/cisg/text/peclcomp81.html#er>.

releases both parties to the contract from their obligation to effectuate and receive future performance [PECL Art. 9:305(1)], but that does not affect any provision of the contract for the settlement of disputes or any other provision which is to operate even after termination [PECL Art. 9:305(2)]."

A difference found is that, both Art. 7.3.5(1) UNIDROIT Principles and PECL Art. 9:305(1) stipulate that, as a rule, termination releases both parties from their obligation "*to effect and to receive future performance*," thus stating "the general rule that termination has effects for the future."[39] From this, it is evident that termination under the UNIDROIT Principles or PECL has *prospective effect*. This becomes apparent when comparing the remedies of termination and avoidance (the latter, referring to rescission due to misrepresentation, etc.) *within* the UNIDROIT Principles. According to Art. 3.17(1) UNIDROIT Principles (similarly PECL Art. 4:115), "[a]voidance takes effect retroactively" which means that the contract should be regarded as never having been concluded. By contrast, in the case of termination of contract, the UNIDROIT Principles do not provide for *retroactive effect*, but rather refer to "*future* performance." This difference shows that termination (the equivalent of "avoidance" under the Convention) of the contract under the UNIDROIT Principles (or the PECL) only has *prospective effect*.[40] In this regard, it is recalled that it does not meet the character of CISG Art. 81 that there is a dispute on whether the avoidance has the effect of *ex nunc* or *ex tunc*.[41] Practically speaking, the question of principle can be left open and the practical consequences are answered by the Convention itself.[42] In essence, therefore, all three instruments provide that avoidance of a contract does not have retroactive effect, since they all expressly exclude that a terminated contract should be treated as never having been made.[43]

The idea behind the *prospective* approach adopted under both Art. 7.3.5(1) UNIDROIT Principles and PECL Art. 9:305(1), is that it would be very inconvenient to treat a contract which has been terminated as cancelled in the sense of never having been made. The PECL Comment explains:[44]

- First, if the contract had never been made the aggrieved party might be precluded from claiming damages for loss of its expectations, which would not seem an appropriate outcome. PECL Art. 8:102 states that a party does not lose its right to damages by exercising another remedy.
- Secondly, if the contract were cancelled in the sense of never having been made, this might prevent the application of dispute settlement clauses or other clauses which were clearly intended to apply even if the contract were terminated. Therefore, this article states that termination is not retroactive and specifically states the position on the clauses just mentioned.
- It would also be inconvenient to treat a contract which has been terminated as being retrospectively cancelled in the sense that performances received must be returned or restitution made of their value. This is not appropriate where the contract was to be performed over a period of time when there can be termination for the future without undoing what has been achieved already.

39 *See* Comment on Art. 7.3.5 UNIDROIT Principles: Comment 1; available at: <http://www.cisg.law.pace.edu/cisg/principles/uni81,82.html>.

40 *See Florian Mohs*; *supra.* n. 14.

41 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 341.

42 *See Florian Mohs*; *supra.* n. 14.

43 *See Francesco G. Mazzotta, supra.* n. 38.

44 *See* Comment and Notes to PECL Art. 9:309: Comment B; available at: <http://www.cisg.law.pace.edu/cisg/text/peclcomp81.html>.

As already discussed above, as for the former two reasons, they have been well encompassed under CISG Art. 81(1). On the other hand, as regards the third reason, in a comparison of the rules *on restitution* of both the CISG and the UNIDROIT Principles, *Mohs* points out that both sets of rules correspond with regard to the fact that restitution takes place on avoidance or termination of the contract, respectively, to the fact that partial restitution is possible, on the question of what contractual provisions survive avoidance of the contract, and that, if both parties had already received performance, restitution must be made concurrently. However, they do not correspond *on the legal mechanism to apply in situations where it is impossible for the avoiding party to return* what it had received under the contract: *the CISG generally bars the aggrieved party from avoiding the contract whereas the UNIDROIT Principles grants the other party allowance in money*.[45]

In this area, the PECL follows basically the UNIDROIT Principles and therefore differs from the Convention to a similar extent. In a comparison of the rules *on restitution* of both the CISG and the PECL, *Mazzotta* notes, similarly to *Mohs*, that the CISG clearly requires restitution of whatever was received *as a condition to avoiding* the contract. Such differences arise out of the different understanding regarding the retroactivity concept. While both the Convention and the PECL provide that avoidance of a contract does not have retroactive effect, since both expressly exclude that a terminated contract should be treated as never made, the CISG and the PECL *differ on what survives after avoidance and on the regime to be applied to the performances made under the contract*. These are major differences that must be taken into consideration when comparing the CISG and PECL. The difference between them is clear: *while the CISG tends to eliminate the consequences of an already partially performed contract, the PECL tends to maintain the exchange when it is satisfactory for both parties*.[46]

With such differences kept in mind, one may generally conclude, CISG Art. 81 sets forth the two consequences which result from the avoidance of the contract:[47]

> "As to the future, the parties are released from their obligations. As to the past, they must return what has been supplied or paid under it."

These two main consequences will be discussed in detail below, and where necessary, the counterpart rules of the two sets of Principles will be taken into account.

4. Release for the future but with certain preservations

4.1 Both parties released from future performance

The primary effect of the avoidance of the contract by one party is that both parties are released from their obligations to carry out the contract. The seller need not deliver the goods and the buyer need not take delivery or pay for them.[48] According to CISG Art. 81(1) (sentence one, first

45 *See Florian Mohs*; *supra.* n. 14.
46 *See Francesco G. Mazzotta, supra.* n. 38.
47 *See Denis Tallon, supra.* n. 2; p. 602.
48 Comment 2 of Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*; *supra.* n. 4.

part), "avoidance of the contract releases both parties from their obligations under it." The main consequence is that both parties are free in the sense that they are released from the duties and obligations assumed under the contract.[49]

That is to say, valid avoidance of the contract releases the parties from their executory obligations under the contract.[50] Specifically, what matters in particular are the obligations of the seller to deliver the goods and to transfer property in them as well as to hand over the documents (Art. 30), and those of the buyer to pay the price and to take delivery of the goods (Art. 53). Insofar as they are not fulfilled at the time of the avoidance of the contract (notice to the other party – Art. 26), they will not have to be fulfilled later, i.e., the other party could refuse to accept performance.[51] On the other hand, partial avoidance of the contract under Art. 51 or 73 releases both parties from their obligations as to the part of the contract which has been avoided (and gives rise to restitution under Art. 81(2) as to that part).[52] For example, where the buyer avoids with respect to a portion of the goods not delivered, the seller is released from his obligation to deliver the portion concerned, and the buyer need not pay for that portion.[53] All systems now accept that where a contract for performance in successive parts or installments is terminated after some parts of it have been performed, it may be terminated for the future without the need to undo the completed parts (cf. CISG Art. 73(2)).[54]

As compared to Art. 81(1) CISG which simply states that the parties are released "from their obligations," both UNIDROIT Principles Art. 7.3.5(1) PECL Art. 9:305(1) contain more specific a text releasing both parties from their obligation "to effect and to receive future performance." According to Mohs, the term performance might, at a first glance, suggest a restrictive interpretation in a way that the parties are not released from all of their obligations but from their obligations of performance only. Under this viewpoint, the parties would not be released from ancillary obligations, e.g., the right of sole distribution. However, the structure of the provision shows that the obligations which continue to exist are exhaustively identified by paras. (2) and (3) of Art. 7.3.5 UNIDROIT Principles. Thus, as does the CISG, the UNIDROIT Principles (similarly the PECL), in general, release the parties from all obligations under the contract except with respect to damages, dispute settlement and other clauses which operate (even) after avoidance. Especially with regard to the provision of para. (3), whether or not a clause qualifies under the prerequisites, e.g., the duty not to divulge confidential information or the duty to restrain from entering into competition, survive termination, is a question of contractual interpretation on a case-by-case basis.[55]

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49 *See Jelena Vilus* in "Provisions Common to the Obligations of the Seller and the Buyer": *Petar Sarcevic & Paul Volken* eds., *International Sale of Goods: Dubrovnik Lectures*, Oceana (1986); p. 257; available at: <http://www.cisg.law.pace.edu/cisg/biblio/vilus.html>.
50 UNCITRAL Digest 3 on CISG Art. 81; *supra.* n. 5.
51 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 342.
52 Comment 3 of Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*; *supra.* n. 4.
53 *See Joseph Lookofsky, supra.* n. 16; p. 167.
54 Note 4 to PECL Art. 9:309; *supra.* n. 12.
55 *See Florian Mohs*; *supra.* n. 14.

4.2 Preservation of the right to claim damages

In some legal systems avoidance of the contract eliminates all rights and obligations which arose out of the contract. In such a view once a contract has been avoided, there can be no claim for damages for its breach.[56]

In this respect, Art. 81(1) (sentence one, second part) provides a mechanism to avoid that result by specifying that the avoidance of the contract is "subject to any damages which may be due." Indeed, Arts. 45 and 61 have already made it clear that claims for damages can be asserted apart from other legal consequences of breaches of contract, thus also apart from avoidance.[57] This general rule is put "in more specific terms" for the right to avoid the contract in Art. 81(1) CISG.[58]

This provision in Art. 81(1) "any damages which may be due," refers in particular to claims for damages which have arisen in connection with the obligations from which the party is now released.[59] In this regard, it is held in [ICC March 1999 *International Court of Arbitration*, Case 9978]:[60]

> "This wording does not refer to a new claim for damages arising due to the seller's failure to refund the purchase price received from the buyer [or due to the buyer's failure to return the goods received from the seller]. Rather, this wording provides for the continuation of any claims for damages which may exist due to the seller's violation of his primary obligation under the contract or under Art. 30 et seq. CISG (citation omitted) [or due to the buyer's violation of his primary obligation under the contract or under Art. 53 et seq. CISG]. This continuing claim for damages covers the part of the loss which exceeds the interest claim under Art. 84(1) CISG (citation omitted)."

According to Enderlein & Maskow, however, the term "damages which may be due" is in this context conceived as a bit tight, for the same should apply to obligations to pay penalties under the contract in their different manifestations. According to them, damages, for instance, have to be paid because of delay, even if the contract is later avoided because of that delay and even if damages arise because of avoidance, which in their view come under sentence two of Art. 81(1).[61] But in this respect, one should note:[62]

> "New claims for damages may arise after avoidance only with respect to the violation of those contractual duties which already existed prior to the avoidance of the contract and which are left untouched by the avoidance according to Art. 81(1) CISG (citation omitted)."

In any event, justified under the clear preservation in Art. 81(1) of the right to claim damages, many decisions have recognized that responsibility for damages for breach survives avoidance, and have awarded damages to the avoiding party against the party whose breach triggered the

56 Comment 4 of Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*; *supra.* n. 4.
57 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 342.
58 *See* Judgment of ICC Arbitration Case No. 9978 of March 1999; available at: <http://www.cisg-online.ch/cisg/urteile/708.htm>.
59 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 342.
60 *See* Judgment of ICC Arbitration Case No. 9978 of March 1999; *supra.* n. 58.
61 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 342.
62 *See* Judgment of ICC Arbitration Case No. 9978 of March 1999; *supra.* n. 58.

avoidance.[63] For instance, it is held in [ICC March 1995 *International Court of Arbitration*, Case 7645]:[64]

> "The declaration of avoidance by [buyer] ... had as a consequence that the contract ended and [buyer] automatically became entitled to damages suffered by the breach of contract by [seller], all in accordance with Art. 81(1) and Art. 74 et seq. of the CISG."

It is repeated in [INK"http://cisgw3.law.pace.edu/cases/010427r2.html"Russian Federation 27 April 2001 Arbitation Court [Appellate Court] for the Moscow Region]:[65]

> "Pursuant to Article 81(1) CISG, avoidance of the contract does not release parties from their obligations to pay damages which they may claim under the Convention."

Again, it is stated in [Switzerland 3 December 2002 *Handelsgericht* [Commercial Court] St. Gallen]:[66]

> "A confirmation of this unilateral right to have an agreement altered and avoided does not deprive [seller] of his right to claim damages under Art. 74 et seq. CISG (see Arts. 61(2) and 81 CISG)."

In any event, Art. 81 CISG in principle permits recovery of damages under avoidance of the contract.[67] It explicitly stipulates the principle that an aggrieved party does not forfeit his right to claim damages if he petitions for any other remedies. Therefore, the declaration of avoidance does not exclude any claim for damages.[68] Just as the Court in [Germany 21 March 1996 Hamburg Arbitration award] states:[69]

> "Where [...] the contract is terminated and damages for failure to perform are claimed under Art. 74 CISG et seq., one uniform right to damages comes into existence, which [...] prevails over the consequences of the termination of a contract provided for in Arts. 81-84 CISG."

Like CISG Art. 81(1), UNIDROIT Principles Art. 7.3.5(2) reads: "Termination does not preclude a claim for damages for non-performance." Although no counterpart is specifically introduced in the PECL, the same result may be reached by virtue of the general rule of PECL Art. 8:102, which states partly: "In particular, a party is not deprived of its right to damages by exercising its right to any other remedy." It is clearly stated in the PECL Comment: "A party which pursues a remedy other than damages is not precluded from claiming damages. A party which terminates the

63 UNCITRAL Digest 4 on CISG Art. 81; *supra.* n. 5.
64 *See* Judgment of ICC Arbitration Case No. 7645 of March 1995: *Yearbook Comm. Arb'n XXVI*, Albert Jan van den Berg, ed. (Kluwer 2001) pp. 130-152; available at: <http://www.cisg.law.pace.edu/cases/957645i1.html>.
65 *See* Judgment by Federal Arbitration Court for the Moscow Region [Cassation Instance]; Russian Federation 27 April 2001; No. KG-A40/1946-01. English translation by *Yelena Kalika*; available at: <http://www.cisg.law.pace.edu/cases/010427r2.html>.
66 *See* Judgment by Handelsgericht [Commercial Court] St. Gallen, Switzerland 3 December 2002; *supra.* n. 28.
67 *See* Judgment by Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry; Russian Federation 7 June 1999; No. 238/1998. English translation by *Gilyana Bovaeva*, translation edited by *Mykhaylo Danylko*; available at: <http://www.cisg.law.pace.edu/cases/990607r1.html>.
68 *See*, e.g., Judgment by Bezirksgericht [District Court] der Saane (Zivilgericht), Switzerland 20 February 1997; No. T 171/95. English translation by *Stefan Kuhm*; available at: <http://www.cisg.law.pace.edu/cases/970220s1.html>.
69 *See* Judgment by Schiedsgericht der Handelskammer [Arbitral Tribunal] Hamburg, Germany 21 March 1996; *supra.* n. 21.

contract may, for instance, also claim damages."[70] Thus, under each of the three instruments, the general rule is:[71]

> "The fact that, by virtue of termination, the contract is brought to an end, does not deprive the aggrieved party of its right to claim damages for non-performance."

4.3 Contract provisions remaining in existence

Aiming at preventing the disappearance of clauses which may prove useful in resolving a conflict between the parties,[72] certain contractual clauses are preserved despite avoidance. This is made clear in the following relevant rules:

- CISG Art. 81(1) (sentence two): "*Avoidance does not affect any provision of the contract for the settlement of disputes or any other provision of the contract governing the rights and obligations of the parties consequent upon the avoidance of the contract.*"
- UNIDROIT Principles Art. 7.3.5(3): "*Termination does not affect any provision in the contract for the settlement of disputes or any other term of the contract which is to operate even after termination.*"
- PECL Art. 9:305(2): "*Termination does not affect any provision of the contract for the settlement of disputes or any other provision which is to operate even after termination.*"

Each of these provisions makes it clear, that termination is not retroactive and specifically states the position on the clauses just mentioned.[73] Hereby, a widely recognized rule is repeated.[74] Most systems now accept that termination will not affect the application of clauses such as arbitration clauses which were intended to apply despite termination.[75]

As regards "any provision of the contract for the settlement of disputes," it is frequently applied to an arbitration clause; for instance, in [United States 14 April 1992 Federal District Court [Southern Dist. NY] (*Filanto v. Chilewich*)], it is stated that:[76]

> "contracts and the arbitration clauses included therein are considered to be 'severable', a rule that the Sale of Goods Convention itself adopts with respect to avoidance of contracts generally."

As regards "any other provision of the contract governing the rights and obligations of the parties consequent upon the avoidance of the contract," this language has been applied to preserve, despite avoidance of the contract in which it was contained, the legal efficacy of a "penalty" clause

70 *See* Comment and Notes to PECL Art. 8:102: Comment A; available at: <http://www.cisg.law.pace.edu/cisg/text/peclcomp45.html>.
71 Comment 2 on Art. 7.3.5 UNIDROIT Principles; *supra.* n. 39.
72 *See Denis Tallon, supra.* n. 2; p. 603.
73 *See* Comment and Notes to PECL Art. 9:305: Comment B; available at: <http://www.cisg.law.pace.edu/cisg/text/peclcomp81.html>.
74 *See Fritz Enderlein & Dietrich Maskow, supra.* n. 34; p. 342.
75 Note 3 to PECL Art. 9:309; *supra.* n. 12.
76 *See Filanto v. Chilewich*, Judgment by U.S. District Court, Southern District of New York [federal court of first instance]; 14 April 1992; No. 92 Civ. 3253 (CLB); available at: <http://www.cisg.law.pace.edu/cases/920414u1.html>.

requiring a seller who failed to deliver to make certain payments to buyer.[77] For instance, it is held in [ICC March 1999 *International Court of Arbitration*, Case 9978]:[78]

> "Art. 81(1) CISG provides that avoidance does not affect the validity of any contract provision governing the rights and duties of the parties consequent upon the avoidance of the contract. It is generally agreed (emphasis added) that this rule also applies to P/LD [penalty/liquidated damages]-clauses (citations omitted)."

It is also noted in [Austria 29 June 1999 *Oberster Gerichtshof* [Supreme Court]], Art. 81(1) preserves other contractual provisions connected with the undoing of the contract, such as clauses requiring the return of delivered goods or other items received under the contract.[79]

Indeed, the second category of clauses is "a description of general features;" what is referred to here is "not only those rights and obligations which are ancillary to an avoidance of the contract, like a respective penalty, but such which are to help solve a conflict between the parties (citation omitted) and which, of course, are of special importance when that conflict aggravates so that the contract is terminated early."[80] Generally speaking, whether or not a clause qualifies under the prerequisites, is a question of contractual interpretation on a case-by-case basis.[81]

In sum, notwithstanding the general rule that termination of the contract releases both parties from their duty to effect and to receive performance, there may be provisions in the contract which survive its termination. This is the case in particular with provisions relating to dispute settlement but there may be others which by their very nature are intended to operate even after termination.[82] One should note, however, that the rule does not remedy deficiencies which lead to non-validity of such a clause under national law, including that based on other conventions.[83] That is to say, the rule preserving certain clauses, would not make valid an arbitration clause, a penalty clause, or other provision in respect of the settlement of disputes if such a clause was not otherwise valid under the applicable national law. The rule states only that such a provision is not terminated by the avoidance of the contract.[84]

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77 UNCITRAL Digest 4 on CISG Art. 81; *supra.* n. 5.
78 *See* Judgment of ICC Arbitration Case No. 9978 of March 1999; *supra.* n. 58.
79 *See* Judgment by Oberster Gerichtshof [Supreme Court], Austria 29 June 1999; *supra.* n. 10.
80 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 342. They further state: "The surviving conditions can *be multifaceted* (citation omitted). They relate to general questions of cooperation between the parties, like agreement of general business terms whose individual elements again have to be examined according to that criterion, agreements on the form of declarations, a general obligation to cooperate, obligations to maintain secrecy, a reservation of title up to restitution, limitation of claims, and the applicable law (annotation omitted). Another group of conditions refers to the modalities of performance, i.e., commercial terms, risk bearing, packaging, procurement of licenses, which can play a role where the return of the goods or of the price is concerned. Of particular practical relevance are those agreements which deal with liability, such as penalties, liquidated damages and damage clauses, including possibilities of exemption and restrictions, the amount of interest, etc." (*Ibid.,* p. 343.)
81 *See Florian Mohs*; *supra.* n. 14.
82 Comment 3 on Art. 7.3.5 UNIDROIT Principles; *supra.* n. 39.
83 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 342.
84 Comment 5 of Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*; *supra.* n. 4.

4.4 Other obligations surviving

It is particularly noted in the Secretariat Commentary, the enumeration in Art. 81(1) of two particular obligations arising out of the existence of the contract which are not terminated by the avoidance of the contract is not exhaustive. Some continuing obligations are set forth in other provisions of this Convention. For example, Art. 86(1) provides that "If the buyer has received the goods and intends to reject them, he must take such steps to preserve them as are reasonable in the circumstances"; and Art. 81(2) permits either party to require of the other party the return of whatever he has supplied or paid under the contract. Other continuing obligations may be found in the contract itself or may arise out of the necessities of justice.[85]

According to Enderlein & Maskow, however, the Secretariat's Commentary's declaring non-exhaustive the two named conditions which continue in existence, is not convincing because the second condition actually is a description of general features.[86] It is here recalled, that in comparing the CISG approach and the UNIDROIT Principles approach, Mohs notes, the structure of Art. 7.3.5 shows that the obligations which continue to exist are exhaustively (emphasis added) identified by paras. (2) and (3) of Art. 7.3.5 UNIDROIT Principles.[87]

Whether or not structured in an exhaustive or non-exhaustive manner, the relevant rules clearly indicate that an avoided contract "is not entirely annulled by the avoidance," and certain contractual obligations remain viable even after avoidance.[88] On the other hand, under the Convention, the obligations which characterize the contract as a sales contract and which are stipulated in Arts. 30 and 53 end or have to be returned in goods or in price.[89] This pertains to the restitution of the past and will be discussed below.

5. Restitution of the past

5.1 Restitution in general

(a) CISG Art. 81(2)

It will often be the case that at the time the contract is avoided, one or both of the parties will have performed all or part of his obligations. Sometimes the parties can agree on a formula for adjusting the price to the deliveries already made. However, it may also occur that one or both parties desires the return of that which he has already supplied or paid under the contract.[90]

Thus, for parties that have wholly or partially performed their contractual obligations, the first sentence of Art. 81(2) creates a right to claim restitution from the other side of whatever the party has "supplied or paid under the contract."[91] According to the Secretariat Commentary, this

85 Comment 6 of Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*; *supra.* n. 4.
86 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 342.
87 *See Florian Mohs*; *supra.* n. 14.
88 UNCITRAL Digest 4 on CISG Art. 81; *supra.* n. 5.
89 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 341.
90 Comment 7 of Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*; *supra.* n. 4.
91 UNCITRAL Digest 5 on CISG Art. 81; *supra.* n. 5.

provision differs from the rule in some countries that only the party who is authorized to avoid the contract can make demand for restitution. Instead, it incorporates the idea that, as regards restitution, the avoidance of the contract undermines the basis on which either party can retain that which he has received from the other party.[92]

On the other hand,the second sentence of Art. 81(2) emphasizes that, where both parties are required under the first sentence of the provision to make restitution (i.e., where both parties have "supplied or paid" something under an avoided contract), then mutual restitution is to be made "concurrently."[93] Consistent with the principle of mutual restitution, the Tribunal in [China 30 October 1991 CIETAC Arbitration award] has ordered simultaneous restitution of the goods by an avoiding buyer and restitution of the price by a breaching seller;[94] the Court in [Germany 5 April 1995 *Landgericht* [District Court] Landshut] holds, where the prerequisites for a declaration of avoidance are satisfied, under CISG Art. 81(2) second sentence, the parties must make restitution concurrently.[95] Thus, it is held in [Australia 28 April 1995 Federal District Court, Adelaide (*Roder v. Rosedown*)], an avoiding seller need not make restitution of the buyer's payments until delivered goods were returned.[96] In this context, in a bilateral contract, avoidance constitutes the reverse of performance.[97]

Apart from the mutual restitution rule, it is "a condition for the claim to return what has been supplied or paid that the right to such return is asserted. This is justified because the parties may wish to leave what has been supplied or paid, respectively, with the other party."[98] Thus, the restitution is not available where the other party has not asserted the right to such return. Furthermore, one should also note that the right of either party to require restitution as recognized by CISG Art. 81(2),[99]

> "may be thwarted by other rules which fall outside the scope of the international sale of goods. If either party is in bankruptcy or other insolvency procedures, it is possible that the claim of restitution will not be recognized as creating a right in the property or as giving a priority in the distribution of the assets. Exchange control laws or other restrictions on the transfer of goods or funds may prevent the transfer of the goods or money to the demanding party in a foreign country. These and other similar legal rules may reduce the value of the claim of restitution. However, they do not affect the validity of the rights between the parties."

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92 Comment 9 of Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*; *supra.* n. 4.
93 UNCITRAL Digest 8 on CISG Art. 81; *supra.* n. 5.
94 *See* Judgment by China International Economic and Trade Arbitration Commission [CIETAC] (PRC), China 30 October 1991; No.: CISG/1991/04: 19 *Journal of Law & Commerce* (2000) 283-293. English translation by *Yu Weizhong and Frank N. Fisanich*; available at: <http://www.cisg.law.pace.edu/cases/911030c1.html>.
95 *See* Judgment by Landgericht [District Court] Landshut, Germany 5 April 1995; No.: 54 O 644/94. English translation by *Dr. Peter Feuerstein*, translation edited by *Ruth M. Janal*; available at: <http://www.cisg.law.pace.edu/cases/950405g1.html>.
96 *See* Judgment by Federal Court, South Australian District, Adelaide, Australia 28 April 1995; No.: SG 3076 of 1993; FED No. 275/95; available at: <http://www.cisg.law.pace.edu/cases/950428a2.html>.
97 *See Denis Tallon, supra.* n. 2; p. 605.
98 *See Fritz Enderlein & Dietrich Maskow, supra.* n. 34; p. 343.
99 Comment 10 of Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*; *supra.* n. 4.

Of most significance, it has been almost universally recognized that avoidance of the contract is a precondition for claiming restitution under Art. 81(2).[100] Thus, for instance, it is held in [Germany 11 October 1995 *Landgericht* [District Court] Düsseldorf]:[101]

> "An obligation of the [seller] for the repayment of the purchase price exists under Art. 81(2) CISG only after an avoidance of the sales contract by the buyer, the preconditions of which [avoidance] are regulated by Art. 49 CISG [for seller's right to avoidance, by CISG Art. 64]."

Moreover, even in cases where such substantial preconditions of avoidance specified under CISG Art. 49/64 are satisfied, it is to be kept in mind, that it is only where the party's declaration of avoidance was validly expressed according to Art. 26 by sending a notice to the other party, that the avoiding party is consequently entitled to restitution of the performance already tendered according to CISG Art. 81(2) sentence one.

In any event, once the avoiding party's declaration validly causes the termination of his contract pursuant to the system of the CISG, this contract will be altered into "a relationship for restitution."[102] In this regard, it is held in [Germany 11 October 1995 *Landgericht* [District Court] Düsseldorf]:[103]

> "An obligation of the [seller] for the repayment of the purchase price exists under Art. 81(2) CISG only after an avoidance of the sales contract by the buyer, the preconditions of which [avoidance] are regulated by Art. 49 CISG. The avoidance of the contract is thus a constitutive right (emphasis added) of the buyer, which changes the contractual relationship into a restitutional [winding-up] relationship (Arts. 81-84 CISG)."

Among other things, "the true nature of the restitution system established in Art. 81 et seq. CISG" should not be misinterpreted; according to the Court in [ICC March 1999 *International Court of Arbitration*, Case 9978]:[104]

> "This system does not establish a condictio indebiti in the proper sense. For this reason, a reference to the rules of unjust enrichment of the applicable domestic law is neither necessary nor permissible (citation omitted). Rather, the system is based on the Roman law model of actio quanti minoris (citation omitted)."

Put another way, the restitutionary obligation imposed by Art. 81(2) is not intended to put the other party in the position it would have been in had the contract been fully performed or had not been concluded, but instead requires the restitution of the actual goods delivered, even if those goods are damaged during that return.[105] This is the ruling found in [Austria 29 June 1999 *Oberster Gerichtshof* [Supreme Court]]:[106]

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100 UNCITRAL Digest 5 on CISG Art. 81; *supra.* n. 5.
101 *See* Judgment by Landgericht [District Court] Düsseldorf, Germany 11 October 1995; No. 2 O 506/94. English translation by *Dr. Peter Feuerstein*, translation edited by *Ruth M. Janal*; available at: <http://www.cisg.law.pace.edu/cases/951011g1.html>.
102 *See* Judgment by Handelsgericht [Commercial Court] St. Gallen, Switzerland 3 December 2002; *supra.* n. 28.
103 *See* Judgment by Landgericht [District Court] Düsseldorf, Germany 11 October 1995; *supra.* n. 101.
104 *See* Judgment of ICC Arbitration Case No. 9978 of March 1999; *supra.* n. 58.
105 UNCITRAL Digest 5 on CISG Art. 81; *supra.* n. 5.
106 *See* Judgment by Oberster Gerichtshof [Supreme Court], Austria 29 June 1999; *supra.* n. 10.

> "Along with restitution [Art. 81(2)], the results of the (partial) performance of the contract must be dislodged, but not through the establishment of a hypothetical goal such as 'as if the contract had been duly performed' or 'as if the contract had never been concluded.' Rather, as in Roman law, the claim for the return of the rendered performance (Rückforderung) is permitted and thereby tied to the item of performance itself (Leistungssache) and to its fate (emphasis added)."

In particular, as regards the restitution under the Convention, the result should be in conformity with that described by the Court in [Switzerland 3 December 2002 *Handelsgericht* [Commercial Court] St. Gallen], which states:[107]

> "The aforementioned relationship of restitution is predominantly influenced and governed by the result that both parties will be released from any contractual obligations under their sales contract subject to any due and payable claims for damages (Art. 81(1) CISG). In the event that one of the parties has partly or wholly performed his obligations thereunder, this party may claim restitution of his performance (Art. 81(2) CISG). [...]."

(b) UNIDROIT Principles Art. 7.3.6

Under the UNIDROIT Principles, Art. 7.3.6(1) provides in the first sentence that: "On termination of the contract either party may claim restitution of whatever it has supplied, provided that such party concurrently makes restitution of whatever it has received."

According to the Comment, this Article provides for "a right for each party to claim the return of whatever it has supplied under the contract provided that it concurrently makes restitution of whatever it has received"; it also applies to:

> "the situation where the aggrieved party has supplied money in exchange for property, services etc. which it has not received or which are defective. Money returned for services or work which have not been performed or for property which has been rejected should be repaid to the party who paid for it and the same principle applies to custody of goods and to rent and leases of property."[108]

Thus, compared with the CISG, both sets of rules provide for restitution of what has been performed under the contract, Art. 81(2) CISG / Art. 7.3.6(1) first sentence UNIDROIT Principles.[109]

However, it would be inconvenient to treat a contract which has been terminated as being retrospectively cancelled in the sense that performances received must be returned or restitution made of their value. This is not appropriate where the contract was to be performed over a period of time when there can be termination for the future without undoing what has been achieved already.[110] Consequently, Art. 7.3.6(2) UNIDROIT Principles continues, providing that, "*if*

107 *See* Judgment by Handelsgericht [Commercial Court] St. Gallen, Switzerland 3 December 2002; *supra.* n. 28.
108 *See* Comment on Art. 7.3.6 UNIDROIT Principles: Comment 1; available at: http://www.cisg.law.pace.edu/cisg/principles/uni81,82.html>.
109 *See Florian Mohs*; *supra.* n. 14.
110 Comment B on PECL Art. 9:305; *supra.* n. 73.

performance of the contract has extended over a period of time and the contract is divisible, such restitution can only be claimed for the period after termination has taken effect." Two points are to be stressed regarding this rule: (a) the rule "only applies if the contract is divisible"; (b) in such a case, restitution can "only be claimed in respect of the period after termination."[111] On the other hand, a party can also, contrary to the misleading language of Art. 7.3.6(2) UNIDROIT Principles, avoid with respect to the (past) defective performance, if failure to deliver a later installment makes the earlier installments useless.[112] In such cases, CISG Art. 73(3) enables the avoidance of the contract as a whole.

Indeed, even under CISG, if the contract is partially avoided, the rules governing its effects are also only relevant to that part of the contract, which has been avoided.[113] Therefore, in the case of a partial avoidance this restitution (under CISG Art. 81(2)), naturally, applies only insofar as the performance already made is concerned.[114] Particularly, restitution will not take place for deliveries already made if the installments are independent according to Art. 73 CISG, which, however, does not address the question of avoidance of contracts extending over a period of time in general as under Art. 7.3.6(2) UNIDROIT Principles, but does address the most relevant situation in international sales law practice, i.e., the contract for delivery of goods by installments. The CISG and the UNIDROIT Principles provisions will, however, quite often produce the same or, at least, similar results.[115]

(c) PECL Arts. 9:307 and 9:308

Under the PECL, Art. 9:305 states the general rule that termination of a contract has no retroactive effect. It does not follow from the fact that the contract has been terminated that the party which has performed can get restitution of what it has supplied.[116]

However, even though termination is forward looking in the way just explained, "there are situations in which it is appropriate to 'undo' what has taken place before termination. Thus the aggrieved party may need the right to reject a performance already received if termination means that it is of no value to it; either party may need to recover money already paid to the other party if nothing has been received in return; and either may need to be able to recover other property which has been transferred."[117]

Therefore, the PECL "give a restitutionary remedy after termination, where one party has conferred a benefit on the other party but has not received the promised counter-performance in exchange. The benefit may consist of money paid (Article 9:307), other property which can be returned (Article 9:308) or some benefit which cannot be returned, e.g. services or property which has been used up (Article 9:309)."[118] These points are dealt with in PECL Art. 9:306 ("A party which terminates the contract may reject property previously received from the other party if its value to the first party has been fundamentally reduced as a result of the other party's non-

111 Comment 3 on Art. 7.3.6 UNIDROIT Principles; *supra.* n. 108.
112 *See Florian Mohs*; *supra.* n. 14.
113 *See Anna Kazimierska, supra.* n. 31; p. 147. *See also* Comment 3 of Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*; *supra.* n. 4.
114 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 343.
115 *See Florian Mohs*; *supra.* n. 14.
116 *See* Comment and Notes to PECL Art. 9:307: Comment A; available at: <http://www.cisg.law.pace.edu/cisg/text/peclcomp81.html>.
117 Comment C on PECL Art. 9:305; *supra.* n. 73.
118 Comment A on PECL Art. 9:307; *supra.* n. 116.

performance.") as well. Thus Art. 9:306 provides "the right to reject the useless property," where "there is a possibility that the aggrieved party may have received from the other some property which is of no value to it because of the other party's non-performance itself or because it has terminated the contract and will therefore not receive the rest of the performance."[119]

Of more specific relevance are PECL Arts. 9:307 and 9:308, which both "subject the restitution to the instance where one party has conferred a benefit but has not received the promised counter-performance."[120] Respectively, under PECL Art. 9:307 ("On termination of the contract a party may recover money paid for a performance which it did not receive or which it properly rejected."), "a party may claim back money which it has paid for a performance which it did not receive. This rule has general application where a party which has prepaid money rightfully rejects performance by the other party or where the latter fails to effect any performance, Article 9:301. It applies equally to contracts of sale, contracts for work and labor and contracts of lease."[121]

On the other hand, PECL Art. 9:308 ("On termination of the contract a party which has supplied property which can be returned and for which it has not received payment or other counter-performance may recover the property.") introduces "the same principle although it deals with property other than money."[122] PECL Art. 9:308, "provides restitution after termination where a party has supplied a performance other than money without receiving the counter-performance, and the performance can be restored. If the contract is terminated it may claim back what it has supplied under the contract."[123]

Thus, the PECL introduces a set of rules, among others, the principle that restitution of the money paid is subject to the circumstance that the party who paid for a performance did not receive it or it was properly rejected (9:307); and the rule according to which the party who supplied property will be entitled to restitution, where possible, only in absence of payment or counter-performance by the other party (9:308).[124]

As for partial restitution, it is recalled that under the CISG, partial restitution is allowed expressly in accordance with Art. 81, whereas under the UNIDROIT Principles, this possibility must be deduced from the text of Art. 7.3.6.[125] Nevertheless, partial restitution is made possible under either the CISG or the UNIDROIT Principles. The PECL makes no difference on this point. It is stated in the Comment on PECL Art. 9:307: "Where a contract is to be performed over a period of time, or in installments, and the performance is divisible, the rule applies to payments made in respect of so much of the performance as was not made or has been rejected. [...]. If the aggrieved party is entitled to terminate under Article 9:302 in respect of a part of a contract, it may recover a payment made in respect of that part."[126] It is also stated that PECL Art. 9:308 "applies to contracts which are to be performed in parts. If the aggrieved party is entitled to terminate in respect of a part under Article 9:302, it may recover property transferred under that part of the contract."[127]

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119 *See* Comment on PECL Art. 9:306; available at: <http://www.cisg.law.pace.edu/cisg/text/peclcomp81.html>.
120 *See Francesco G. Mazzotta, supra.* n. 38.
121 Comment B on PECL Art. 9:307; *supra.* n. 116.
122 *See Francesco G. Mazzotta, supra.* n. 38.
123 *See* Comment and Notes to PECL Art. 9:308: Comment A; available at: <http://www.cisg.law.pace.edu/cisg/text/peclcomp81.html>.
124 *See Francesco G. Mazzotta, supra.* n. 38.
125 *See Florian Mohs*; *supra.* n. 14.
126 Comment C on PECL Art. 9:307; *supra.* n. 116.
127 Comment D on PECL Art. 9:308; *supra.* n. 123.

5.2 Approaches regarding impossible or inappropriate restitution

(a) CISG Arts. 82 and 83

Whereas Art. 81(2) gives the parties to an avoided contract a claim for restitution of whatever such party has supplied or paid under the contract, Art. 82 deals with the effect of an aggrieved buyer's inability to make restitution of goods substantially in the condition in which they were delivered.[128] Under Art. 82, a buyer's inability to make restitution of delivered goods "substantially in the condition in which he received them" will, subject to important exceptions, forfeit the buyer's right to avoid the contract (or to require the seller to deliver substitute goods).[129]

Specifically, Art. 82(1) embodies a principle, generally accepted in domestic law,[130] that the buyer's right to avoidance is conditioned in the following way:

> *The buyer loses the right to declare the contract avoided or to require the seller to deliver substitute goods if it is impossible for him to make restitution of the goods substantially in the condition in which he received them.*

According to the Secretariat Commentary, this rule recognizes that "the natural consequences of the avoidance of the contract [...] is the restitution of that which has already been delivered under the contract. Therefore, if the buyer cannot return the goods, or cannot return them substantially in the condition in which he received them, he loses his right to declare the contract avoided" under CISG Art. 49.[131] Thus, the ability to return the goods is "a prerequisite for avoiding a contract," and if the aggrieved buyer cannot return the goods, he is barred from avoiding the contract.[132]

In respect of this forfeit, it is to be noted that Art. 81(2) relates merely to the right of the buyer to avoid the contract.[133] It is pertinently held in [ICC March 1999 *International Court of Arbitration*, Case 9978]:[134]

> "While the buyer's right to avoid the contract and claim restitution may be foreclosed if he is unable to restitute the goods received by him in an unimpaired condition (Art. 82 CISG), a similar rule does not exist with respect to the purchase price received by the seller. The restitution system is based on the notion that monies received by the seller from the buyer can always be restituted. This is why Art. 84(1) CISG imposes an automatic duty upon the seller to pay interest on the purchase price. This duty is automatic because it is assumed that the seller has benefited from being in possession of the purchase price since the moment of payment to him (citation omitted)."

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128 *See UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods* (8 June 2004), A/CN.9/SER.C/DIGEST/CISG/82: Digest 1; available at: <http://www.uncitral.org/english/clout/digest_cisg_e.htm>.

129 UNCITRAL Digest 5 on CISG Art. 81; *supra.* n. 5.

130 *See John O. Honnold, Uniform Law for International Sales under the 1980 United Nations Convention*, 3rd ed., Kluwer Law International, The Hague (1999), p. 509; available at: <http://www.cisg.law.pace.edu/cisg/biblio/ho82.html>.

131 *See* Secretariat Commentary on Art. 67 of the 1978 Draft *[draft counterpart of CISG article 82]*: Comment 2; available at: <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-82.html>.

132 *See Peter Schlechtriem, supra.* n. 30; p. 105.

133 *See Fritz Enderlein & Dietrich Maskow, supra.* n. 34; p. 346.

134 *See* Judgment of ICC Arbitration Case No. 9978 of March 1999; *supra.* n. 58.

In any event, from the provision of Art. 82(1), it follows that the buyer's right to avoid the contract lapses when the goods can no longer be restituted.[135] Actually speaking, this restriction does not lead to serious injustice to an aggrieved buyer: Even if the buyer may not avoid the contract or require the seller to deliver substitute goods the buyer may recover damages resulting from the seller's breach of contract (Arts. 74-76).[136]

Indeed, there are so many important exceptions to this principle that the principle itself should constitute an exception.[137] Above all, it is to be made clear, that loss or damage to the goods "does not in all cases eliminate the right to avoid the contract"; according to Art. 82(1), "insubstantial damage is irrelevant."[138] It is clearly stated in the Secretariat Commentary:[139]

> "It is not necessary that the goods be in the identical condition in which they were received; they need be only in 'substantially' the same condition. Although the term 'substantially' is not defined, it indicates that the change in condition of the goods must be of sufficient importance that it would no longer be proper to require the seller to retake the goods as the equivalent of that which he had delivered to the buyer even though the seller had been in fundamental breach of the contract."

Further, Art. 82(2) "creates three very broad exceptions to the rule of article 82(1)":[140]

> *(a) if the impossibility of making restitution of the goods or of making restitution of the goods substantially in the condition in which the buyer received them is not due to his act or omission;*
> *(b) if the goods or part of the goods have perished or deteriorated as a result of the examination provided for in article 38; or*
> *(c) if the goods or part of the goods have been sold in the normal course of business or have been consumed or transformed by the buyer in the course of normal use before he discovered or ought to have discovered the lack of conformity.*

In respect of the above three exceptions, while the construction of Arts. 82(2)(b) and 82(2)(c) is rather straightforward, some explanation is required as to Art. 82(2)(a). It is generally understood that under Art. 82(2)(a), the buyer is responsible for damages caused by acts or omissions by his personnel and by third persons, if he made it possible, by means of acts or omissions, for them to damage the goods. In particular, as to damages provoked by third persons, it is deemed that "that the buyer must not merely have provided the opportunity for third persons or force majeure to affect the goods, but also have increased this chance by his act or omission."[141]

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135 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 346.
136 *See John O. Honnold*, *supra.* n. 130; p. 510.
137 *See Fritz Enderlein & Dietrich Maskow*, *supra.* n. 34; p. 346.
138 *See Peter Schlechtriem, supra.* n. 30; p. 106.
139 Comment 3 of Secretariat Commentary on Art. 67 of the 1978 Draft *[draft counterpart of CISG article 82]*; *supra.* n. 131.
140 UNCITRAL Digest 1 on CISG Art. 82; *supra.* n. 128.
141 *See Francesco G. Mazzotta* in "Commentary on CISG Article 82 and PECL Article 9:309" (2003). Available online at <http://cisgw3.law.pace.edu/cisg/text/peclcomp82.html>. *Schlechtriem* notes in respect of this exception as specified in CISG Art. 82(2)(a): "Therefore, where defects have caused the damage or loss, the buyer's right to demand substitute goods or to avoid the contract is not affected. Additionally, the fact that a defect causes further deterioration of an item, thus leading to its (further) impairment or complete destruction is not attributable to the buyer's behavior as long as he could not have recognized and prevented it. In any case, under Article 82(2)(a), the buyer is presumably responsible for the acts or omissions of his personnel. On the other hand, in my opinion, the acts of third persons can only be attributed to the buyer if his act or – especially – his omission has made it possible for the third persons to affect the goods. These questions do not turn on whether the buyer was at fault. On

Since, particularly Art. 81(2) states "three exceptions that make deep inroads on this general rule,"[142] the principle contemplated in Art. 81(1) is "finally of minor interest."[143] Thus, while, on the one hand, by Art. 81(1) "the Convention clearly requires that whatever is exchanged between the parties because of the contract must be returned, and if this is not possible, subject to the exceptions considered by CISG Article 82, avoidance of the contract is no longer an option";[144] on the other hand, according to Art. 82(2), "the principle of returning the goods undamaged as a prerequisite to exercising the right of avoidance suffers considerable restrictions which turn the principle into an exception (citation omitted)."[145]

Moreover, Art. 83 expressly states that the buyer who has lost the right to declare the contract avoided in accordance with Art. 82 retains "all other remedies under the contract and this Convention," which includes, for instance, the right "to claim damages" under Art. 45(1)(b), "to require that any defects be cured" under Art. 46, or "to declare the reduction of the price" under Art. 50.[146] Art. 83, although perhaps unnecessarily,[147] will thus alleviate the scruples of judges who, owing to their national tradition, are disinclined to draw all the consequences implicit in the texts of the articles of the Convention.[148]

(b) UNIDROIT Principles Art. 7.3.6(1), second sentence

In a comparison of the rules on restitution of both the CISG and the UNIDROIT Principles, one discovers that "they do not correspond on the legal mechanism to apply in situations where it is impossible for the avoiding party to return what it had received under the contract: the CISG generally bars the aggrieved party from avoiding the contract whereas the UNIDROIT Principles grants the other party an allowance in money."[149]

In this respect, the second sentence of UNIDROIT Principles Art. 7.3.6(1) states: "*If restitution in kind is not possible or appropriate allowance should be made in money whenever reasonable.*" Thus, if the non-performing party cannot make restitution it must make allowance in money for the value it has received.[150] The considerations seem to be:[151]

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the other hand, more than mere physical causation is probably required before the buyer's remedies are lost. Otherwise, destruction caused by an accident or *force majeure* could be attributed to the buyer – *e.g.*, his taking possession unless the goods would have been destroyed while under the seller's control as well. The words 'due to', however, permit the restrictive interpretation that the buyer must not merely have provided the opportunity for third persons or *force majeure* to affect the goods but also have increased this chance by his act or omission." (*See Peter Schlechtriem, supra.* n. 30; p. 106.)

142 *See John O. Honnold*, *supra.* n. 130; p. 509.

143 *See Denis Tallon* in *Commentary on the International Sales Law: The 1980 Vienna Sale Convention*, *Cesare Massimo Bianca & Michael Joachim Bonell* eds., Milan (1987), p. 609; available at: <http://www.cisg.law.pace.edu/cisg/biblio/tallon-bb82.html>.

144 *See Francesco G. Mazzotta, supra.* n. 38.

145 *See* Judgment by Oberster Gerichtshof [Supreme Court], Austria 29 June 1999; *supra.* n. 10.

146 *See* Secretariat Commentary on Art. 68 of the 1978 Draft *[draft counterpart of CISG article 83]*; available at: <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-83.html>. If the contract contains a penalty clause, the statement buyer "retains all other remedies under the contract" also makes it clear that the buyer has the right to avail himself of the remedy provided in that clause (to the extent permitted by the gap filling law), even though the buyer has lost the right to declare the contract avoided. (*See* also *Fritz Enderlein & Dietrich Maskow*; *supra.* n. 34; p. 348.)

147 *See John O. Honnold*, *Uniform Law for International Sales under the 1980 United Nations Convention*, 3rd ed., Kluwer Law International, The Hague (1999), p. 513; available at: <http://www.cisg.law.pace.edu/cisg/biblio/ho83.html>.

148 *See Denis Tallon* in *Commentary on the International Sales Law: The 1980 Vienna Sale Convention*, *Cesare Massimo Bianca & Michael Joachim Bonell* eds., Milan (1987), p. 610; available at: <http://www.cisg.law.pace.edu/cisg/biblio/tallon-bb83.html>.

149 *See Florian Mohs*; *supra.* n. 14.

150 Comment 1 on Art. 7.3.6 UNIDROIT Principles; *supra.* n. 108.

151 Comment 2 on Art. 7.3.6 UNIDROIT Principles; *supra.* n. 108.

> "There are instances where instead of restitution in kind, allowance in money should be made. This is the case first of all where restitution in kind is not possible. [...]. Allowance in money is further envisaged by para. (1) of this article whenever restitution in kind would not be 'appropriate'. This is so in particular when the aggrieved party has received part of the performance and wants to retain that part."

Under some systems, a party who has received property may not be permitted to terminate the contract either as a whole, where it was for a single performance, or, where it was by installments, in relation to the part already received, if he cannot return what he has received, for instance because he has consumed or resold it. Generally, this rule applies where the inability to restore is attributable to the acts of the party who received the goods.[152] As indicated above, Art. 82 follows this approach, albeit it is subjected to certain exceptions.

On the other hand, however, there are good reasons to advocate an entirely different solution for the problem of restitution or inability of the avoiding party to restitute, namely, treating this as a problem of responsibility of the parties for performance of their obligation to restitute and not as one of a bar to avoidance.[153] It is the approach of the UNIDROIT Principles, which differs in this respect from the CISG:[154]

> "The main difference in concept is that, according to Art. 82(1) CISG, the Convention, in principle, bars the buyer from avoiding the contract if he cannot make restitution of the goods whereas the UNIDROIT Principles treat this situation as a question of liability, Art. 7.3.6(1) second sentence UNIDROIT Principles."

(c) PECL Arts. 9:306 and 9:309

As indicated above, unlike CISG Art. 82, inability to restore is not a bar to termination under the UNIDROIT Principles. In a comparison of the rules on restitution of both the CISG and the UNIDROIT Principles, it has been said that the CISG approach is based on a Roman law principle and was already antiquated at the time the Convention had been drafted. The UNIDROIT Principles approach is modern and, more importantly, sensible and has thus been implemented into the PECL and into various domestic laws of contract by reform statutes.[155]

The general approach adopted in the PECL is that, upon termination of a contract, both parties are released from their duties to effect and to receive performance (PECL Art. 9:305). A restitution duty, which does not affect the right to terminate the contract, may arise only where one party has conferred a benefit on the other party without receiving the promised counter-performance in exchange.[156] However, in many contracts a literal restoration is not possible. This applies to work and labor, services, the hiring out of goods, the letting of premises, and the

152 Note 6 to PECL Art. 9:309; *supra.* n. 12.

153 *See Peter Schlechtriem,* in "Some Observations on the United Nations Convention on Contracts for the International Sale of Goods": *The Frontiers of Liability*, Vol. 2 (Peter Birks ed. 1994).

154 *See Florian Mohs*; *supra.* n. 14.

155 *Ibid.* It is nevertheless noted that, "the CISG provisions must be applied *de lege lata* and thus cannot be overruled by means of interpretation using a totally different concept, such as that of the UNIDROIT Principles. Even in situations governed, but not expressly settled by the CISG, the principles *of the Convention* and not the principles of the UNIDROIT Principles are to be used to fill any gaps." (*Ibid.*)

156 *See Francesco G. Mazzotta, supra.* n. 38.

carriage and custody of goods. A party which has received a performance of this kind cannot give it back. On the other hand, the aggrieved party cannot claim back the goods or other tangibles when it has become impossible or would involve the defaulting party in an unreasonable effort or expense.[157] Particularly, in contracts for sale or barter, restoration may become impossible when the goods have perished or have been consumed or resold. In all these situations, the party which has received a performance which it cannot return might restore the value of it and various legal systems provide for such a restitution.[158]

Thus, PECL Art. 9:309 provides that: "On termination of the contract a party which has rendered a performance which cannot be returned and for which it has not received payment or other counter-performance may recover a reasonable amount for the value of the performance to the other party." According to PECL Art. 9:309, recovery for performance that cannot be returned, is subject to the following requirements:[159]

> "(i) that there is a termination of the contract; (ii) that a party has rendered performance and has not received payment or counter-performance for it; and (iii) that performance cannot be returned by the other party."

If these requirements are met, the entitled party may recover a reasonable amount for the value of the performance rendered to the other party. Among other things, PECL Art. 9:309 sets the rules on how to calculate the amount of recovery, i.e., a reasonable amount. Specifically, the PECL Comment states:[160]

> "The party which has received the benefit should not be required to pay the cost to the other of having provided it, if the net benefit to it is less, since it is only enriched by the latter amount. [...]. Occasionally it may happen that the net benefit to the recipient is greater than the cost of providing it. Then the recipient should not be liable under this article for more than an appropriate part of the contract price."

Here the UNIDROIT Principles should be recalled, where it is stated:[161]

> "The purpose of specifying that allowance should be made in money 'whenever reasonable' is to make it clear that allowance should only be made if, and to the extent that, the performance received has conferred a benefit on the party claiming restitution."

In any event, it frequently happens that after a contract has been terminated one party is left with a benefit which cannot be returned – either because the benefit is the result of work which cannot be returned, or because property which has been transferred has been used up or destroyed – but for which it has not paid. The other party may have a claim for the price, but this will depend upon the agreed payment terms and the price may not yet be payable. It may have a claim for damages, but the party which has received the benefit may be the aggrieved party, or, though it is the one which has failed to perform, it may not be liable for damages because its non-performance

157 Comment H on PECL Art. 9:308; *supra.* n. 123.
158 Comment A on PECL Art. 9:307; *supra.* n. 116.
159 *See Francesco G. Mazzotta, supra.* n. 141.
160 Comment B on PECL Art. 9:309; *supra.* n. 12.
161 Comment 2 on Art. 7.3.6 UNIDROIT Principles; *supra.* n. 108.

was excused. It would be unjust to allow it to retain this benefit without paying for it, and PECL Art. 9:309 requires it to pay.[162]

In certain other circumstances, under many different types of contract there is a possibility that the aggrieved party may have received from the other some property which is of no value to it because of the other party's non-performance itself or because it has terminated the contract and will therefore not receive the rest of the performance.[163] In such cases, it should have the right to reject the useless property and PECL Art. 9:306, which "clearly is not compatible with the CISG set of rules,"[164] so provides, which states that: "A party which terminates the contract may reject property previously received from the other party if its value to the first party has been fundamentally reduced as a result of the other party's non-performance." Also, in such cases the aggrieved party could in the alternative claim damages or reduction in price for the reduced value that the property received now has to it. However, it will often be more convenient for it simply to return the unwanted property than to have to dispose of it some other way and, since it is by definition the aggrieved party, it seems appropriate to give it the right to reject. There will be a considerable advantage in rejecting the property if the aggrieved party has not yet paid for it, as the party can thus avoid having to pay even a reduced price.[165]

As either PECL Art. 9:309 or Art. 9:306 indicates, the difference between the CISG and the PECL is clear: "while the CISG tends to eliminate the consequences of an already partially performed contract, the PECL tends to maintain the exchange when it is satisfactory for both parties."[166] In a comparison of the restitution between the CISG and the PECL, it is stated:[167]

> "The two sets of rules contained in the respective regimes of the Sales Convention and the Principles of European Contract Law are quite different. CISG Article 82 deals exclusively with whether avoidance is still possible even when goods cannot be returned. As a general rule in the Convention, avoidance of the contract is not possible, unless one of the exceptions listed in CISG Article 82(2) occurs. [...]. Pursuant to CISG, if the buyer cannot make restitution for what he received, the contract cannot be avoided unless one of the exceptions set by CISG Article 82(2) is met. The PECL do not require any restitution as a condition for avoidance. Therefore, while under the CISG restitution is an obligatory step toward the avoidance of a contract, under the PECL restitution is only a possible consequence of the avoidance of a contract. In fact, a restitution remedy arises only where there was a performance for which payment was not made."

Nevertheless, it is recalled that in a comparison of the rules on restitution of both the CISG and the UNIDROIT Principles (which seems to indicate the relationship between the CISG and the PECL), one argues, "due to the wide range of exceptions to the bar of avoidance under Art. 82(2)(a) to (c) CISG and the objective equalization of benefits according to Art. 84(2) CISG, restitution under the two set of rules will quite often produce the same or, at least, a similar result.

162 Comment A on PECL Art. 9:309; *supra.* n. 12.
163 Comment on PECL Art. 9:306; *supra.* n. 119.
164 *See Francesco G. Mazzotta, supra.* n. 38.
165 Comment on PECL Art. 9:306; *supra.* n. 119.
166 *See Francesco G. Mazzotta, supra.* n. 38.
167 *See Francesco G. Mazzotta, supra.* n. 141.

Furthermore, one should give broad application to the exceptions of para. (2) and thereby limit the bar of Art. 82(1) CISG."[168]

Of particular significance is CISG Art. 84. Under Art. 84(2), a buyer who must make restitution of goods to a seller must also "account to the seller" for all benefits it derived from the goods before making such restitution; similarly, a seller who must refund the price to the buyer must also, under Art. 84(1), pay interest on the funds until they are restored, although it has been held that, beyond such right to interest, a seller is not liable in damages for losses caused when it refused to give restitution of the price to the buyer.[169] This Article 84 thus reflects "the principle that a party who is required to refund the price or return the goods because the contract has been avoided [...] must account for any benefit which he has received by virtue of having had possession of the money or goods."[170]

(d) A summary

In sum, both the PECL and the UNIDROIT Principles introduce "the idea that there are circumstances in which it might be inappropriate to make the restitution"; such an idea is not shared with the CISG, however.[171] Specifically speaking, "they do not correspond on the legal mechanism to apply in situations where it is impossible for the avoiding party to return what it had received under the contract: the CISG generally bars the aggrieved party from avoiding the contract whereas the UNIDROIT Principles [or the PECL] grants the other party allowance in money."[172]

Alternatively, in cases where restitution is impossible or too onerous, it is said that the rules on right to performance (PECL Arts. 9:101 to 9:103) "apply mutatis mutandis to the claim for restitution." In any event, the aggrieved party cannot claim back the goods or other tangibles when it has become impossible or would involve the defaulting party in an unreasonable effort or expense.[173]

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168 *See Florian Mohs*; *supra.* n. 14.

169 UNCITRAL Digest 5 on CISG Art. 81; *supra.* n. 5.

170 *See* Secretariat Commentary on Art. 69 of the 1978 Draft *[draft counterpart of CISG article 84]*: Comment 1; available at: <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-84.html>. Under this Article, where the seller is under an obligation to refund the price, he must pay interest from the date of payment to the date of refund (CISG Art. 84(1). However, where the buyer must return the goods, it is less obvious that he has benefited from having had possession of the goods. Therefore, CISG Art. 84(2) specifies that the buyer is liable to the seller for all benefits which he has derived from the goods only if (1) he is under an obligation to return them or (2) it is impossible for him to make restitution of the goods or part of them but he has nevertheless exercised his right to declare the contract avoided or to require the seller to deliver substitute goods. (*Ibid.*; Comment 3.)

171 *See Francesco G. Mazzotta, supra.* n. 38.

172 *See Florian Mohs*; *supra.* n. 14.

173 Comment H on PECL Art. 9:308; *supra.* n. 123. It is additionally noted in the UNIDROIT Principles Comment that: "Both the rule in Art. 7.1.3 on the right to withhold performance and Art. 7.2.2 on specific performance of non-monetary obligations apply with appropriate adaptations to a claim for the restitution of property. Thus the aggrieved party cannot claim the return of goods when this has become impossible or would put the non-performing party to unreasonable effort or expense (see Art. 7.2.2 (a) and (b)). In such cases the non-performing party must make allowance for the value of the property. See Art. 7.3.6(1)." (Comment 4 on Art. 7.3.6 UNIDROIT Principles; *supra.* n. 108.)

5.3 Problems concerning the restitution

As a whole, as indicated by the above discussions, the rules on restitution of both the CISG and the UNIDROIT Principles (or the PECL), "correspond with regard to the fact that restitution takes place on avoidance or termination of the contract, respectively, to the fact that partial restitution is possible, on the question of what contractual provisions survive avoidance of the contract, and that, if both parties had already received performance, restitution must be made concurrently."[174] As convincing as this rule may sound,[175] it is not superfluous to mention that neither the Convention nor the PECL (or the UNIDROIT Principles) has any specific provisions dealing with: (i) the expenses incurred in making restitution; (ii) the rights acquired by third parties; (iii) the location where the restitution must be made and (iv) the buyer's responsibility when the goods that must be returned are destroyed after the effective date of a declaration of avoidance.[176]

(a) Question (i): expenses incurred in making restitution

Among these questions, it is believed question (i) may be settled exhaustively by, for instance, the CISG itself. Firstly, with respect to compensation for loss of use, Art. 84 CISG applies, which grants the seller a claim for all benefits which the buyer derived from the goods. Secondly, although the Convention does not expressly address the issue of compensation for expenditure, general principles of the Convention can be used to fill this internal gap in accordance with Art. 7(2) CISG by way of a damages claim.[177] This is supported in the Secretariat Commentary, which states:[178]

> "The person who has breached the contract giving rise to the avoidance of the contract is liable not only for his own expenses in carrying out the restitution of the goods or money, but also the expenses of the other party. Such expenses would constitute damages for which the party in breach is liable. However, the obligation under article 73 [draft counterpart of CISG article 77] of the party who relies on the breach of the contract to 'take such measures as are reasonable in the circumstances to mitigate the loss' may limit the expenses of restitution which can be recovered by means of damages if physical return of the goods is required rather than, for example, resale of the goods in a local market where such resale would adequately protect the seller at a lower net cost."

In a word, "the non-performing party may be required by the other party to cover all costs incurred to return that which has been supplied or paid. This rule, although not provided in the Convention, is acknowledged by the doctrine."[179]

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174 *See Florian Mohs*; *supra.* n. 14.
175 *See Fritz Enderlein & Dietrich Maskow*; *supra.* n. 34; p. 344.
176 *See Francesco G. Mazzotta, supra.* n. 38.
177 *See Florian Mohs*; *supra.* n. 14.
178 Comment 11 of Secretariat Commentary on Art. 66 of the 1978 Draft *[draft counterpart of CISG article 81]*; *supra.* n. 4.
179 *See Anna Kazimierska, supra.* n. 31; p. 147.

(b) Question (ii): rights acquired by third parties

As for question (ii), various outcomes seem to follow in accordance with the applicable national law. For instance, under the Convention, an avoiding seller's right to restitution of delivered goods under Art. 81(2) can come into conflict with the rights of third parties (e.g., the buyer's other creditors) in the goods. Such conflicts are particularly acute where the buyer has become insolvent, so that recovery of the goods themselves is more attractive than a monetary remedy (such as a right to collect the price or damages) against the buyer.[180]

In substance, however, the Convention governs "only [...] the rights and obligations of the seller and the buyer arising from such a contract." Thus, question (ii) is beyond the scope of the Convention; whether the buyer's restitution obligations to the seller can prevail over claims of his other creditors are matters to be decided by domestic law, which also governs the details of the transfer in restitution.[181] The CISG approach is basically followed by UNIDROIT Principles Art. 7.3.6:[182]

> "In common with other articles of the Principles, Art. 7.3.6 deals with the relationship between the parties and not with any rights which third persons may have acquired on the goods concerned. Whether, for instance, an obligee of the buyer, the buyer's receivers in bankruptcy, or a purchaser in good faith may oppose the restitution of goods sold is to be determined by the applicable national law."

The PECL makes no difference in this respect:[183]

> "Like other Principles Article 9:308 deals exclusively with the relationship between the parties and not with the effect which the contract may have on the property in goods sold or bartered. Whether a creditor of the buyer, the buyer's receivers in bankruptcy, or a bona fide

180 UNCITRAL Digest 9 on CISG Art. 81; *supra.* n. 5.
181 *See Peter Schlechtriem, supra.* n. 30; p. 107. Several decisions have dealt with this conflict. For instance, in [28 March 2002 U.S. District Court [Illinois] (*Usinor Industeel v. Leeco Steel Products*)], a court found that an avoiding seller's restitutionary rights under article 81(2) were trumped by the rights of one of buyer's creditors that had obtained and perfected, under national law, a security interest in the delivered goods: the court ruled that the question of who had priority rights in the goods as between the seller and the third party creditor was, under CISG article 4, beyond the scope of the Convention and was governed instead by applicable national law, under which the third party creditor prevailed. This was the result even though the sales contract included a clause reserving title to the goods in the seller until the buyer had completed payment (which buyer had not done), because the effect of that clause with respect to a non-party to the sales contract was also governed by national law rather than the CISG, and under the applicable law the third party's claim to the goods had priority over seller's. Another court, in contrast, found in [Australia 28 April 1995 Federal District Court, Adelaide (*Roder v. Rosedown*)] that an avoiding seller could recover goods from a buyer that had gone through insolvency proceedings after the goods were delivered. In this case, however, the seller had a retention of title clause that was valid under applicable national law and that had survived the buyer's now-completed insolvency proceedings, and there apparently was no third party with a claim to the goods that was superior to seller's under national law. Thus the two cases described in this section do not appear to be inconsistent. Indeed, the later case cited the earlier case in support of its analysis.
182 Comment 5 on Art. 7.3.6 UNIDROIT Principles; *supra.* n. 108.
183 Comment B on PECL Art. 9:308; *supra.* n. 123.

purchaser may oppose the restitution of goods sold is to be determined by the applicable national law."

(c) Question (iii): location where the restitution must be made

Related to question (iii), several decisions address the problem of where the obligation to make restitution under CISG Art. 81(2) should be performed. This question has arisen either as a direct issue, or as a subsidiary matter related to a court's jurisdiction or to the question of who bears risk of loss for goods that are in the process of being returned by the buyer.[184]

For instance, in determining whether an avoiding buyer offered the breaching seller restitution of delivered goods at the proper location, the Court in [Germany 5 April 1995 *Landgericht* [District Court] Landshut] has held that the issue of the place for restitution is not expressly settled in the CISG, nor can the CISG provision dealing with the place for seller's delivery (Art. 31) be applied by analogy, so that the matter must be resolved by reference to national law – specifically (in this case), the law governing the enforcement of a judgment ordering such restitution.[185] Employing somewhat similar reasoning, the Court in [France 14 January 1998 *Cour d'appel* [Appellate Court] Paris] holds, the CISG does not expressly settle where a seller must make restitution of the price under Art. 81(2), that the CISG provision governing the place for buyer's payment of the price (art. 57(1)) did not contain a general principle of the Convention that can be used to resolve the issue, and thus that the matter must be referred to applicable national law.[186]

However, in contrast to the reasoning of the foregoing decisions which led to the application of national law to the issue of the place for restitution, the Court in [Austria 29 June 1999 *Oberster Gerichtshof* [Supreme Court]], notes that the CISG does not expressly deal with the question, but resolves the issue by reference to the CISG itself without recourse to national law: it fills the "gap" pursuant to Art. 7(2) by identifying a general principle that the place for performing restitutionary obligations should mirror the place for performing the primary contractual obligations.[187]

(d) Question (iv): buyer's responsibility when goods destroyed

A fourth matter left open is the buyer's responsibility when the goods to be returned are destroyed after the effective date of a declaration of avoidance.[188] Enderlein & Maskow submit in this regard, "basically it should be proceeded analogously to how one would have proceeded before the declaration of avoidance. Where the impossibility is caused because of circumstances under [CISG Art. 82] paragraph (2) (of which only subpara. (a) is of relevance here), the right to avoid the contract remains in effect on the general conditions."[189]

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184 UNCITRAL Digest 7 on CISG Art. 81; *supra.* n. 5.

185 *See* Judgment by Landgericht [District Court] Landshut, Germany 5 April 1995; *supra.* n. 95.

186 *See* CLOUT Abstract No. 312 [Cour d'appel Paris France 14 January 1998]; available at: <http://www.cisg.law.pace.edu/cases/980114f1.html>.

187 *See* Judgment by Oberster Gerichtshof [Supreme Court], Austria 29 June 1999; *supra.* n. 10.

188 *See Peter Schlechtriem, supra.* n. 30; p. 108.

189 *See Fritz Enderlein & Dietrich Maskow*; *supra.* n. 34; p. 346. According to them, this is justified because it presupposes a fundamental breach of contract by the seller. Where the impossibility is caused by grounds which would have led to the lapsing of the right to avoidance, the implementation of the avoidance of the contract would also be thwarted by it. This also follows from the synallagmatic connection of the obligations involved in restitution. There may be modifications to the disadvantage of the seller when he delays a justified avoidance or does not demand restitution of the goods within a reasonable period. Even more

In [Germany 28 January 1998 *Oberlandesgericht* [Appellate Court] München], however, the Court finds that the seller's claim was not governed by CISG Art. 81(2) because that provision deals only with what a party has "supplied or paid under the contract," whereas the seller was seeking reimbursement for a refund made after the contract was cancelled. Instead, the Court holds, the seller's claim was based on unjust enrichment principles and was governed by applicable national law.[190]

In any event, the Convention does not completely regulate the effects of avoidance;[191] not all restitution claims arising out of a terminated sales contract are governed by the CISG.[192] Nevertheless, it has been clarified that the rule also applies when the aggrieved party has made a bad bargain.[193] Restitution may be claimed when the aggrieved party has performed all its obligations under the contract and only the other party's obligation to pay the price remains outstanding. It does not matter that the property is worth more than was to be paid for it so that by obtaining restitution the aggrieved party escapes a bad bargain.[194]

radical solutions, even though not applicable in the view of *Enderlein & Maskow*, are offered by those authors who infer from Art. 70 a deferral of the passing of risk or a falling back of the risk on the first party. (*See Fritz Enderlein & Dietrich Maskow*; *supra.* n. 34; p. 346.) However, this Art. 70 is deemed a fourth exception in the Secretariat Commentary: "A fourth exception to the rule states in article 67(1) *[draft counterpart of CISG article 82(1)]* is to be found in article 82 *[draft counterpart of CISG article 70]* which states that if the seller has committed a fundamental breach of contract, the passage of the risk of loss under article 79, 80 or 81 *[draft counterpart of CISG article 67, 68 or 69]* does not impair the remedies available to the buyer on account of such breach." (Comment 5 of Secretariat Commentary on Art. 67 of the 1978 Draft *[draft counterpart of CISG article 82]*; *supra.* n. 131.)

190 *See* Judgment by Oberlandesgericht [Appellate Court] München; Germany 28 January 1998. No. 7 U 3771/97. English translation by *Ruth M. Janal*, translation edited by *Camilla Baasch Andersen*; available at: <http://www.cisg.law.pace.edu/cases/980128g1.html>. (That Court rules: "Contrary to the decision of the Court of First Instance, the [seller's] claim for restitution of *IT£* 88,000,000 cannot be based on Art. 81(2) CISG. The [seller] does not claim restitution of what he has supplied under the contract, but of the reimbursement made to the [buyer] of her supposed advance payment. The [seller's] claim is justified on account of unjust enrichment. The remedy is the *condictio indebiti*, as the [seller] intended to perform an obligation under a supposed legal cause, which turned out to be non-existent when the [buyer's] check went to protest. The claim underlies the Italian provisions on unjust enrichment, since the *condictio indebiti* is governed by the law applying to the agreement which the performance was based upon (citations omitted). In the present dispute, a supposed advance payment was to be reimbursed following the cancellation of the sales contract. The law governing the contract is the CISG and, on matters not settled by the Convention, Italian law, as the [seller's] performance was to characterize the contract (annotation omitted).")

191 *See Peter Schlechtriem, supra.* n. 30; p. 108.

192 UNCITRAL Digest 6 on CISG Art. 81; *supra.* n. 5.

193 Comment 1 on Art. 7.3.6 UNIDROIT Principles; *supra.* n. 108.

194 Comment G on PECL Art. 9:308; *supra.* n. 123.