

CISG Advisory Council* Opinion No. 18

Set-off under the CISG

To be cited as: CISG-AC Opinion No. 18, Set-off under the CISG, Rapporteur: Professor Doctor Christiana Fountoulakis, University of Fribourg, Switzerland. Adopted by the CISG Advisory Council following its 24th meeting in Antigua, Guatemala, on 2 February 2018

Reproduction of this opinion is authorised.

Michael Bridge, Chair

Yesim Atamer, Eric Bergsten, Joachim Bonell, Harry Flechtner, Lauro Gama, Alejandro Garro, Roy Goode, John Gotanda, Han Shiyuan, Johnny Herre, Pilar Perales Viscasillas, Ulrich Schroeter, Ingeborg Schwenzer, Hiroo Sono, Claude Witz, Members

Sieg Eiselen, Secretary

OPINION [BLACK LETTER RULES]

- 1. Monetary claims governed by the CISG, whether they arise out of the same contract or not, may be set off by either party in conformity with the general principles underlying the CISG.**
 - 2. Set-off has the same effect as the performance of a monetary obligation by payment.**
 - 3. Set-off is exercised by a declaration made by notice. The notice must reach the other party but does not take effect before both claims are due.**
 - 4. Exercising the right to set off does not require the claims to be liquidated or to be in the same currency.**
 - 5. The applicability of the CISG to set-off does not affect matters of res judicata or counterclaims.**
-

COMMENTS

A. Introduction

- 0.1 A set-off of monetary claims is usually referred to as the mechanism by which the amount which a party owes to the other party is reduced by the amount that the second party owes to the first, to the effect that that first party only has to pay the balance.¹ The CISG does not use the term ‘set-off’, whereas it is often used in case law² and legal

* The CISG-AC started as a private initiative supported by the Institute of International Commercial Law at Pace University School of Law and the Centre for Commercial Law Studies, Queen Mary, University of London. The International Sales Convention Advisory Council (CISG-AC) is in place to support understanding of the United Nations Convention on Contracts for the International Sale of Goods (CISG) and the promotion and assistance in the uniform interpretation of the CISG.

The CISG-AC started as a private initiative supported by the Institute of International Commercial Law at Pace University School of Law and the Centre for Commercial Law Studies, Queen Mary, University of London. The International Sales Convention Advisory Council (CISG-AC) is in place to support understanding of the United Nations Convention on Contracts for the International Sale of Goods (CISG) and the promotion and assistance in the uniform interpretation of the CISG. At its formative meeting in Paris in June 2001, Prof. Peter Schlechtriem of Freiburg University, Germany, was elected Chair of the CISG-AC for a three-year term. Dr. Loukas A. Mistelis of the Centre for Commercial Law Studies, Queen Mary, University of London, was elected Secretary. The founding members of the CISG-AC were Prof. Emeritus Eric E. Bergsten, Pace University School of Law; Prof. Michael Joachim Bonell, University of Rome La Sapienza; Prof. E. Allan Farnsworth, Columbia University School of Law; Prof. Alejandro M. Garro, Columbia University School of Law; Prof. Sir Roy M. Goode, Oxford, Prof. Sergei N. Lebedev, Maritime Arbitration Commission of the Chamber of Commerce and Industry of the Russian Federation; Prof. Jan Ramberg, University of Stockholm, Faculty of Law; Prof. Peter Schlechtriem, Freiburg University; Prof. Hiroo Sono, Faculty of Law, Hokkaido University; Prof. Claude Witz, Universität des Saarlandes and Strasbourg University. Members of the Council are elected by the Council. At subsequent meetings, the CISG-AC elected as additional members Prof. Pilar Perales Viscasillas, Universidad Carlos III, Madrid; Professor Ingeborg Schwenzer, University of Basel; Prof. John Y. Gotanda, Villanova University; Prof. Michael G. Bridge, London School of Economics; Prof. Han Shiyuan, Tsinghua University, Prof. Yesim Atamer, Istanbul Bilgi University, Turkey, Prof. Ulrich Schroeter, University of Mannheim, Prof. Laura Gama Jnr, Pontifical Catholic University, Justice Johnny Herre, a Justice of the Supreme Court of Sweden, and Prof. Harry M. Flechtner, University of Pittsburgh. Prof. Jan Ramberg served for a three-year term as the second Chair of the CISG-AC. At its 11th meeting in Wuhan, People’s Republic of China, Prof. Eric E. Bergsten of Pace University School of Law was elected Chair of the CISG-AC and Prof. Sieg Eiselen of the Department of Private Law of the University of South Africa was elected Secretary. At its 14th meeting in Belgrade, Serbia, Prof. Ingeborg Schwenzer of the University of Basel was elected Chair of the CISG-AC. At its 24th meeting in Antigua, Guatemala, Prof. Michael G. Bridge of the London School of Economics was elected Chair of the CISG-AC.

¹ See Pichonnaz/Gullifer, *Set-off in Arbitration and Commercial Transactions*, Oxford 2014, para. 2.02; Wood, *English and International Set-off*, London 1989, para. 1 *et seq.*; Fountoulakis, *Set-off Defences in International Commercial Arbitration*, Oxford 2011, 1; Rodner, *Unilateral Setoff and the Principle of Unidroit*, in Lévy & Derains (eds), *Liber amicorum en l’honneur de Serge Lazareff*, Paris 2011, 545; The UNIDROIT Principles of International Commercial Contracts 2016 have adopted a similar definition of set-off in Article 8.5 and Comment 1 to Article 8.1.

² See the cases cited in footnotes 8 and 13 as well as, e.g., District Court Badalona (Spain), 22 May 2006, CISG-online 1391; Oberlandesgericht Hamburg, 26 November 1999, CISG-online 515; Oberlandesgericht München, 9 July 1997, CISG-online 282; Oberlandesgericht München, 19 October 2006, CISG-online 1394; Oberlandesgericht Köln, 19 May 2008, CISG-online 1700; Gerechthof Arnhem, 15 April 1997, CISG-online 1330; RB Middleburg, 25 January 1995, CISG-online 374 ; Bundesgericht (Switzerland), 20 December 2006, CISG-online 1426; Tribunale di Padova, 25 February 2004, CISG-online 819; Decision 43945/2007 of the Single-Member Court of First Instance of Thessaloniki (Greece), 2008 (Pace).

writing³ relating to the Convention. The notion ‘set-off’ is also found in numerous international legal uniform instruments, such as the 1974 Limitation Convention⁴, the UNCITRAL Model Law on Secured Transactions⁵, the UN Convention on the Assignment of Receivables⁶ and the Principles of International Commercial Contracts (hereafter the PICC)⁷.

0.2 The CISG does not explicitly address the question of set-off. This might explain, at least in part, why the majority of case law and authors hold that a set-off arising out of a contract governed by the Convention is subject to the law applicable by virtue of the rules of private international law, in accordance with article 7(2) *in fine*.⁸ Only a few

³ See, e.g., Schwenger and Hachem in Schwenger (ed.), Schlechtriem & Schwenger, *Commentary on the UN Convention on the International Sale of Goods (CISG)*, 4th ed., Oxford 2016 (hereinafter: author in Schlechtriem & Schwenger), *ad Art. 4 para. 27-28*; Bridge in Kröll, Mistelis and Perales Viscasillas (eds.), *UN Convention on Contracts for the International Sale of Goods (CISG), Commentary*, 2nd ed., Munich/Oxford/Portland 2018 (hereinafter: author in Kröll/Mistelis/Perales Viscasillas), *ad Art. 84 para. 8-9*; Fountoulakis in Schlechtriem & Schwenger, *ad Art. 81 para. 23 et seq.*; Djordjevic in Kröll/Mistelis/Perales Viscasillas, *ad Art. 4 para. 38 et seq.*; Perales Viscasillas in Kröll/Mistelis/Perales Viscasillas, *ad Art. 7 para. 55*; Ferrari in Ferrari/Flechtner/Brand (eds.), *The Draft UNCITRAL Digest and Beyond: Cases, Analysis and Unresolved Issues in the U.N. Sales Convention*, Munich/London 2004, pp. 167-168; Magnus, in von Staudinger (ed.), *Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen*, Berlin 2018 (hereinafter: Magnus in Staudinger), *ad Art. 4 para. 47*; Kröll, *Selected Problems Concerning the CISG’s scope of Application*, 25 J L & Com (2005) 39, 50 *et seq.* Cf. also the literature cited in footnotes 8 and 13.

⁴ UN Convention on the Limitation Period in the International Sale of Goods of 14 June 1973 as amended by the Protocol of 11 April 1980, article 25 para. 2.

⁵ UNCITRAL Model Law on Secured Transactions of 2016, articles 64 and 65 in particular.

⁶ UN Convention on the assignment of receivables in international trade of 2004, articles 18 and 19 in particular.

⁷ PICC 2016, Chapter 8 (articles 8.1 *et seq.* in particular).

⁸ In case law, see, e.g., Bundesgerichtshof (Germany), 9 January 2002, CISG-online 651; Oberlandesgericht Celle, 29 January 2015, CISG-online 2618, *Internationales Handelsrecht* 2015, 247; Oberlandesgericht Düsseldorf, 28 May 2004, CISG-online 850; Oberlandesgericht Köln, 19 May 2008, CISG-online 1700; Oberlandesgericht Düsseldorf, 22 July 2004, CISG-online 916; Oberlandesgericht Karlsruhe, 20 July 2004, CISG-online 858, *Internationales Handelsrecht* 246 (251); Oberlandesgericht Stuttgart, 20 December 2004, CISG-online 997 and 21 August 1995, CISG-online 150; *Maxxsonics USA, Inc. v. Fengshun Peyjing Electro Acoustic Co. Ltd.*, N.D. Ill., 21 March 2012, CISG-online 2372; Appellationsgericht Basel-Stadt, 26 September 2008, CISG-online 1732; Kantonsgericht Freiburg, Switzerland, 23 January 1998, CISG-online 423; Handelsgericht Zurich, 22 December 2005, CISG-online 1995; Handelsgericht St. Gallen, 3 December 2002, CISG-online 727; Tribunale di Padova, 25 February 2004, CISG-online 819; Landgericht München, Germany, 6 May 1997, CISG-online 341; Landgericht Bamberg, 23 October 2006, CISG-online 1400, *Internationales Handelsrecht* 2007, 113; Landgericht Hagen, Germany, 15 October 1997, CISG-online 311; Landgericht Duisburg, Germany, 17 April 1996, CISG-online 186; Rechtbank Arnhem, 25 February 1993, CISG-online 98; Rechtbank Middelburg, Netherlands, 25 January 1995, UNILEX, Case No. 153; Rechtbank Roermond, Netherlands, 6 May 1993, UNILEX, Case No. 94 —In legal writing, cf., e.g., Ferrari in Schlechtriem, Schwenger & Schroeter (eds.), *Kommentar zum Einheitlichen UN-Kaufrecht*, 7th ed., Munich 2019, *ad Art. 4 para. 39*; idem, *Scope of Application: Articles 4-5*, in Ferrari, Flechtner & Brand (eds.), *The Draft Uncitral Digest and Beyond: Analysis and Unresolved Issues in the U.N. Sales Convention*, Munich 2004, 96 (108); idem, *Gap-Filling and Interpretation of the CISG. Overview of International Case Law*, (2003) 7 *Vindobona Journal* 63 (88); Tallon in Bianca & Bonell (ed.), *Commentary on the International Sales Law*, Milan 1987, *ad Art. 81 notes 2.6, 2.7*; Honnold and Flechtner, *Uniform Sales Law for International Sales under the 1980 United Nations Convention*, 4th ed., Alphen aan den Rijn 2009, *ad Art. 81 para. 444A*; Schlechtriem and Schroeter, *Internationales UN-Kaufrecht*, 6th ed., Tübingen 2016, para. 199; Gillett and Walt, *The UN Convention on Contracts for the International Sale of Goods, Theory and Practice*, 2nd ed., Cambridge: CUP, 2016, 76; Bonell, *The CISG, European Contract Law and the Development of a World Contract Law*, (2008) 56 *Am. J. Comp. L.* 1 (3); Förster, *Wesentliche Vertragsverletzung und Aufrechnung von Forderungen nach UN-Kaufrecht*, *Neue Juristische Wochenschrift* 2015, 830 (832); P. Huber, *UN-Kaufrecht: Bewährtes zu den Leistungsstörungen und Neues zur Aufrechnung*, *IPRax* 2017, 268; Mankowski in *Münchener Kommentar zum Handelsgesetzbuch*, 4th ed., Munich 2018, *ad Art. 4 para. 22*; Lorenz in Witz,

cases or authors explain this view. Those who do generally consider that the CISG does not only not provide for any express rules on set-off, but that such rules cannot be derived from the existing provisions either.⁹ More recently, however, the highest instance courts in some Contracting States, including the German Supreme Court¹⁰, the Austrian Supreme Court¹¹ and, implicitly, the Swiss Federal Tribunal¹², have held that a set-off of claims governed by the CISG falls within the scope of the Convention if both claims arise out of the same contract. The applicability of the CISG to a set-off in such a constellation has also been admitted by numerous other courts and authors.¹³

- 0.3 The case law applying the CISG to a set-off usually does so implicitly. Typically, a judgment will order the defendant to pay only the difference between the claimant's and his own claim; as this is done without searching for a specific law that would govern set-off, it must be inferred that the court impliedly admits the application of the Convention.¹⁴
- 0.4 It is the goal of this Opinion and its comments to elaborate the question of set-off under the CISG, to work out the details of the provisions and general principles of the Convention, and to provide for a unified approach to set-off within the four corners of the CISG. The Advisory Council is of the opinion that such a unified solution from

Salger & Lorenz, *International Einheitliches Kaufrecht*, 2nd ed., Frankfurt 2016, *ad Art. 4 para. 29*; cf. also P. Huber in *Münchener Kommentar zum Bürgerlichen Gesetzbuch*, 7th ed., Munich 2016, *ad Art. 4 para. 39*; Martiny in Reithmann & Martiny (eds), *Internationales Vertragsrecht*, 8th ed., Cologne 2015, para. 6.63.

⁹ See., e.g., Mankowski in *Münchener Kommentar zum Handelsgesetzbuch*, *ad Art. 4 para. 22*; Ferrari in Schlechtriem, Schwenger & Schroeter, *ad Art. 4 para. 39*; Tallon in Bianca & Bonell, *ad Art. 81 note 2.6*.

¹⁰ Bundesgerichtshof (Germany), 24 September 2014, CISG-online 2545, *Internationales Handelsrecht* 2015, 9.

¹¹ Oberster Gerichtshof (Austria), 10 May 2017, *Internationales Handelsrecht* 2018, 241; cf. also Oberster Gerichtshof (Austria), 22 October 2001, CISG-online 614, *Internationales Handelsrecht* 2002, 27.

¹² Bundesgericht (Switzerland), 20 December 2006, CISG-online 1426, *Internationales Handelsrecht* 2007, 127.

¹³ For case law, see, e.g., Oberlandesgericht Wien, 23 January 2017, *Internationales Handelsrecht* 2018, 241; Kantonsgericht Zug, 14 December 2009, CISG-online 2026; Oberlandesgericht München, 19 October 2006, note 3, CISG-online 1394; Oberlandesgericht Köln, 14 August 2006, note II.2.d), CISG-online 1405; Oberlandesgericht Düsseldorf, 21 April 2004, note II.2, CISG-online 915 (*implicit*); Oberlandesgericht München, 9 July 1997, CISG-online 282; Oberlandesgericht Hamburg, 26 November 1999, note I.b), CISG-online 515; Oberlandesgericht Hamburg, 5 October 1998, CISG-online 473 (*implicit*); Landgericht Mönchengladbach, 15 July 2003, note II.2, CISG-online 813 ; Handelsgericht St. Gallen, 14 June 2012, CISG-online 2468, *Internationales Handelsrecht* 2014, 15 (21); Amtsgericht Duisburg, 13 April 2000, CISG-online 659. For authors, see, e.g., Magnus, *UN-Kaufrecht – Aktuelles zum CISG*, *Zeitschrift für Europäisches Privatrecht* 2017, 140 (148-149) (holding that the application of the CISG should not be limited to claims arising out of the same contract); Magnus in Staudinger, *ad Art. 4 para. 46 and Art. 81 para. 15*; Magnus, *Internationale Aufrechnung*, in Leible (ed.), *Das Grünbuch zum Internationalen Vertragsrecht*, Munich 2004, pp 209, 221 *et seq.*; Schwenger and Hachem in Schlechtriem & Schwenger, *ad Art. 4 para. 28*; Fountoulakis in Schlechtriem & Schwenger, *ad Art. 81 para. 23*; Piltz, *Internationales Kaufrecht*, 2nd ed., Munich 2008, para. 5-326; Brunner, Murmann and Stucki in Brunner (ed.), *UN-Kaufrecht – CISG -*, 2nd ed., Bern 2014, *ad Art. 4 para. 52-53*; Djordjevic in Kröll/Mistelis/Perales Viscasillas, *ad Art. 4 para. 41*; Kröll, (2005) 25 *J L & Com* 39, 52-53; Martin-Davidson, *Selling Goods Internationally: Scope of the U.N. Convention on Contracts for the International Sale of Goods*, 17 *Mich. St. J. Int'l L.* (2008), 657 (691); Achilles, *Kommentar zum UN-Kaufrechtsübereinkommen (CISG)*, 2nd ed., Eschborn 2018, *ad Art. 4 para. 10*; Saenger in Bamberger & Roth, Beck'scher Online-Kommentar BGB, *ad Art. 4 para. 19* (only with regard to a set-off after avoidance of the contract); Saenger/Sauthoff, *Die Aufrechnung im Anwendungsbereich des CISG*, *Internationales Handelsrecht* 2005, 189, 190 (only with regard to a set-off after avoidance of the contract).

¹⁴ See the cases cited in footnote 13. For a decision where the court explained in detail why it applied the CISG to set-off see Bundesgerichtshof (Germany), 24 September 2014, CISG-online 2545, *Internationales Handelsrecht* 2015, 9.

within the Convention is consistent with the nature, the scope of application, and the goals of the CISG. Furthermore, a unified approach derived from the Convention avoids the complexity and unpredictability that are linked to the application of domestic law to a set-off. In fact, the domestic laws of set-off may differ considerably from one another.¹⁵

- 0.5 Thus, the ‘Latin’ model, found in French law and the many legal systems influenced by the French Code civil,¹⁶ provides that set-off takes place *ipso iure* (automatically) as of the time two parties hold mutual claims against each other.¹⁷ There is an automatic discharge of those mutual obligations to the extent of their respective amounts, even without the parties’ knowledge. The claims need not arise out of the same contract or be otherwise connected, but because Latin set-off operates automatically, both claims must be due, ascertained, and enforceable. As set-off takes place as soon as the claims coexist, neither party is in default from that time on; the duty to pay interest on a sum ceases to exist at that moment, and any contractual penalties do not become due. All the described elements show that Latin set-off is an automatism provided by substantive law. The court or arbitral tribunal only finds (‘*constater*’) that the claims have been set off.
- 0.6 Set-off under the German model¹⁸ is a matter of substantive law too. Unlike French law however, which imposes set-off on both parties, the German model gives the parties just the right to declare set-off.¹⁹ If there is no set-off declaration, the claims continue to exist independently from each other until they are extinguished by fulfilment of the respective obligations. German set-off thus considers set-off as a defence (figuratively speaking; it is not a judicial defence of procedural law); the party wishing to set off intends the extinction of the claims, whereas the other party arguably does not. This explains why, under German law, the claim with which set-off is declared must be

¹⁵ For a detailed description of domestic laws of set-off, see Zimmermann, *Comparative Foundations of a European Law of Set-Off and Prescription*, Cambridge 2002; Fountoulakis, *Set-off Defences in International Commercial Arbitration*, London 2011, 37-127; Pichonnaz/Gullifer, *Set-off in Arbitration and Commercial Transactions*, Oxford 2014, chapters 5 and 6.

¹⁶ This includes, among other states, Belgium, Luxembourg, Portugal, Spain, Italy, Argentina, Brazil, Chile, Colombia, Kuwait, Louisiana, Mexico, Panama, Quebec, the Philippines, and Venezuela.

¹⁷ Cf. article 1195 of the Spanish Civil code: ‘*Tendrá lugar la compensación cuando dos personas por derecho propio, sean recíprocamente acreedoras y deudoras la una de la otra.*’. See also, e.g., article 921 of the Código Civil y Comercial de la Nación of 2015 (Argentina): ‘*La compensación de las obligaciones tiene lugar cuando dos personas, por derecho propio, reúnen la calidad de acreedor y deudor recíprocamente...*’. Former article 1290 of the French Code Civil was very explicit on that point: ‘*Set-off is brought about as of right by the sole operation of the law, even without the knowledge of the debtors*’. The new article 1347 para. 2 French Civil code provides that ‘*[la compensation] s’opère, sous réserve d’être invoquée, à due concurrence, à la date où ses conditions se trouvent réunies*’. French commentators unanimously hold that the new wording simply clarifies that the fact that set-off has taken place must somehow be invoked in order to be considered by the judge, but that article 1347 Code civil has not eliminated the concept of *compensation légale*. Malaurie/Aynes/Stoffel-Munck, *Droit des obligations*, 8th ed., Paris 2016, n. 1191; Fages, *Droit des obligations*, 6th ed., Paris 2016, n. 512; Mekki D. 2016 Chron., n. 614; Dissaux/ Jamin, *Commentaire Dalloz en ligne*, ad article 1347 *et seq.* CC.

¹⁸ The German model can be found in the laws of Germany, Switzerland, Austria, the Scandinavian countries Norway, Sweden and Denmark, Turkey, Greece, to name just a few.

¹⁹ Cf., e.g., Bürgerliches Gesetzbuch (Germany), § 388 para. 1: ‘*Set-off is brought about by declaration to the other party.*’; Code of Obligations (Switzerland), Article 124 para. 1: ‘*Set-off only becomes effective to the extent that the debtor indicated to the creditor that he wants to make use of his right to set off.*’.

enforceable, that is, admissible for legal action: the addressee of the set-off declaration must accept the extinction of its claim only if and insofar as the other party could claim fulfilment of its own claim. In contrast, the claim against which set-off is declared need be neither due nor enforceable. The claims need not arise out of the same contract or otherwise be connected with each other, and, unlike French law, they need not be liquidated either. Interestingly, and for historical reasons, set-off has retroactive effect: once set-off has been declared, the two claims are considered as having been extinguished as of the time they were eligible for set-off, as is the case under French set-off.

- 0.7 The common law provides for several categories of set-off.²⁰ To take English law as an example, the traditional way of set-off is an instrument of procedural law (*independent set-off, statutory set-off*). It is only available in a pending action, and only if both claims are liquidated. Set-off is brought about as of the date of judgment. Until that date, the claims continue to exist. Interest accrues and penalty clauses apply. Besides independent set-off, English courts have developed another type of set-off which is said to be an instrument of substantive law (*equitable set-off, transaction set-off*). Its effect, however, differs from the law of set-off of civil law jurisdictions. The debtor who, himself, has a claim against the creditor may deduct the sum owed to him and pay just the balance, very much like in German and French law. Alternatively, the debtor may ask for an injunction which will preclude the creditor from claiming his debt in full before judgment. But the two claims remain in existence until they are extinguished by judgment. Equitable set-off does thus not qualify as a purely substantive defence since it is the judgment which brings about the set-off. Once set-off has been pronounced by the court, the debtor who has already deducted the amount owed to him from the creditor's claim is not considered as having been in default until the pronouncement of set-off by the court. There is thus a partial retroactive effect to equitable set-off. Equitable set-off only operates where both claims arise out of the same transaction. It is not required that they arise from the same contract, but the claim which is set off against the creditor's claim must be inseparably connected with the transaction that gave rise to the first claim. Furthermore, the party invoking set-off must show some equitable ground for being protected from its adversary's demand; the court may deny set-off, despite the fact that both claims are closely connected, if the case does not give rise to an equity. The lack of ascertainment of the debtor's claim may prevent equitable set-off. The court has considerable leeway. Finally, another category of English set-off is *abatement*, which has a very narrow scope. It is limited to contracts for the sale of goods or for work and labour and allows the buyer or customer to deduct from the seller's or contractor's claim a reasonable amount corresponding to the diminution in value of the goods or services provided. It is very much comparable to the right of price reduction in Article 50 CISG. A similar mechanism is provided in the American Uniform Commercial Code (UCC) in section 2-717 ('The buyer on notifying the seller of his intention to do so may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the same contract.'). In a contractual context, US law may allow for the equitable defence of '*recoupment*', defined as the setting up of a demand arising from the same transaction as the plaintiff's

²⁰ For a detailed analysis see Wood, *English and International Set-off*, London 1989; Derham, *The Law of Set-off*, 4th ed., Oxford 2010; Pichonnaz/Gullifer, *Set-off in Arbitration and Commercial Transactions*, Oxford 2014, chapter 5; Fountoulakis, *Set-off Defences in International Commercial Arbitration*, Oxford 2011, 100-123.

claim, to abate or reduce that claim.²¹ UCC, § 2-717 and recoupment are considered as different to actual set-off,²² the latter being similar to English independent set-off.

- 0.8 Differences among the various domestic laws do not only concern the mechanism of set-off as such, but also conflict of laws rules applicable to set-off. This concerns not so much the choice-of-law rules in Europe, where the Rome I Regulation provides for the same choice-of-law regime for all Member States except for Denmark.²³ But differences remain on a global level and especially in international arbitration, where manifold theories and approaches exist.²⁴
- 0.9 The short and, certainly, to some extent schematic overview shows that the questions of whether there is a possibility for set-off, how set-off is brought about and what its effects are, are answered differently depending on the applicable domestic law. The differences are considerable. They lead to a certain complexity and, as the case may be, unpredictability of the case. These difficulties are exacerbated by the wide variety of existing conflict of laws rules; they add to the said unpredictability – an unpredictability that the parties who have chosen the CISG as a unified law certainly wished to avoid. These elements taken together invite knowledgeable parties to forum shop and lead to unforeseen situations for less informed parties.
- 0.10 In contracts governed by the Convention, the difficulties described arise when set-off is regarded as an issue not governed by the Convention, to be determined by the applicable rules of private international law at the place of the court and to be resolved under national law (Article 7 para. 2 *in fine*). The difficulties do not arise if the question of whether the buyer and the seller under a CISG contract may set off their mutual claims can be answered by the Convention itself (Article 7 para. 2 *in initio*). The Advisory Council is of the opinion that the set-off of claims governed by the CISG is a matter governed by the Convention for which the general principles on which the CISG is based provide clear and adequate rules for the characteristic aspects of such a set-off between seller and buyer. It has therefore adopted the rules that are presented and explained in detail below.

²¹ *Reiter v. Cooper*, 113 S. Ct. 1213, 1218 n.2 (1993); *Bull v. United States*, 295 U.S. 247, 262 (1935).

²² *In re Izaguirre*, 166 B.R. 484, 490-93 (Bankr. N.D. Ga. 1994) ('[R]ecoupment merely adjusts the claim of the plaintiff under the contract. Hence, recoupment asserted as a defense is not an "offset" to a claim ... ; recoupment speaks not simply to the net amount due from one party to the other computed by subtracting one claim from the other, but rather to the amount of the plaintiff's claim alone on a particular contract, transaction or event.').

²³ See Regulation (EC) No. 593/2008 ('Rome I Regulation') of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations, Article 17. See Pichonnaz/Gullifer, *Set-off in Arbitration and Commercial Transactions*, Oxford 2014, chapter 4.

²⁴ See Fountoulakis, *Set-off Defences in International Commercial Arbitration*, Oxford 2011, 152 *et seq.*

B. Specific Comments

1. Monetary claims governed by the CISG, whether they arise out of the same contract or not, may be set off by either party in conformity with the general principles underlying the CISG.

1.1 **Monetary claims.** The rule formulates the principle that the Convention governs the set-off of monetary claims, for example, where the seller claims the purchase price whereas the buyer claims damages,²⁵ or where the buyer claims restitution of the price and the seller counters with a claim for damages,²⁶ or where the seller demands the equalization of benefits further to the avoidance of the contract and the buyer relies on damages,²⁷ or certain other constellations.²⁸ Non-monetary claims are not considered. In fact, even though the PICC, the PECL or domestic laws standing in a civil law tradition provide for a right to set off claims relating to goods of the same kind ('similar goods', 'fungible goods'), the situation where the buyer and the seller hold reciprocal claims relating to goods of the same kind will hardly arise under the CISG, as the Convention governs sales contracts, that is, contracts referring to the exchange of goods against money. The situations in which a set-off of claims relating to the 'same kind of goods' are of practical importance, such as a set-off of obligations for company shares or other negotiable papers, or goods in futures trading²⁹, have been excluded from the scope of application of the CISG (Article 2(d)). To the extent the CISG applies to barter agreements³⁰, it is very unlikely that the barter agreement involves goods of the same kind.

1.2 **Set-off as a matter governed by the CISG.** The set-off of monetary claims both governed by the CISG is to be settled in conformity with the general principles underlying the Convention. Even though the CISG does not state explicit general rules for set-off, it acknowledges the principle of set-off as such. For instance, where the party bound to preserve the goods sells those goods, Article 88(3) states that that party is

²⁵ See, e.g., Oberlandesgericht Düsseldorf, 28 May 2004, CISG-online 850; Oberlandesgericht Karlsruhe, 20 July 2004, CISG-online 858; Oberlandesgericht München, 9 July 1997, CISG-online 282; Landgericht Stuttgart, 29 October 2009, CISG-online 2017; Amtsgericht Duisburg, 13 April 2000, CISG-online 659.

²⁶ See, e.g., Oberlandesgericht Köln, 19 May 2008, CISG-online 1700; Oberlandesgericht Düsseldorf, 21 April 2004, CISG-online 915; Handelsgericht St. Gallen, 3 December 2002, CISG-online 727; Oberlandesgericht München, 19 October 2006, CISG-online 1394.

²⁷ See, e.g., District Court Badalona (Spain), 22 May 2006, CISG-online 1391.

²⁸ See Bundesgerichtshof (Germany), 24 September 2014, CISG-online 2545, where the buyer set off its costs of repair against the seller's claim for the remaining purchase price; Oberlandesgericht Hamburg, 26 November 1999, CISG-online 515, where the buyer countered the seller's claim for payment of the proceeds of sale under Article 88(3) with a claim for damages.

²⁹ See, e.g., Bundesgerichtshof (Germany), 5 November 1998, *Neue Juristische Wochenschrift* (1999) 635; Cour de Justice de Genève (Switzerland), 9 October 1998, CISG-online 424; Handelskammer Zürich (Switzerland), 31 May 1996, CISG-online 1291.

³⁰ See, e.g., CIETAC China International Economic & Trade Arbitration Commission (China), 13 June 1989, CISG-online 865; Federal Arbitration Court for the Moscow Region (Russia), 26 May 2003, CISG-online 836; Tribunal of International Commercial Arbitration at the Ukraine Chamber of Commerce and Trade (Ukraine), 10 October 2003, CISG-online 923; Tribunal of International Commercial Arbitration at the Ukraine Chamber of Commerce and Trade (Ukraine), 15 April 2004, CISG-online 1270; Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry (Russia), 9 March 2004, CISG-online 1184; Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry (Russia), 17 June 2004, CISG-online 1240; see also Schwenger & Kee, *Barter Contracts and the CISG*, *Internationales Handelsrecht* (2009) 219 *et seq.*; Mohs in Schlechtriem, Schwenger & Schroeter (eds), *ad Art. 53 para. 28*.

entitled to retain from the proceeds of sale its reasonable expenses of preserving and selling the goods. Provisions of the CISG other than Article 88(3), without expressly providing for a right of set-off, state the rule that performance must be made concurrently (Articles 58(1), 81(2)). The principle of concurrent performance and the right of set-off are based on a similar idea. In both cases, the main rationale is to prevent a party from recovering all that is owed to it while the other party is left with the risk of having to assert its claim before a court or arbitral tribunal.³¹

- 1.3 Articles 58(1), 81(2), 88(3) reflect the idea of a fair balance of interests in the course of exchanging performances. As far as Article 88(3) is concerned, the CISG focuses on an efficient and expedited way for settling reciprocal money debts between the parties. Ultimately, the provisions deal with the way in which mutual payment obligations are performed; the question is a ‘matter governed by this Convention’ (Article 7(2)).
- 1.4 Set-off is the accentuated version of concurrent performance. To take the situation dealt with in Article 88(3), if the buyer sold the goods on account of the seller for, say, \$10,000 and had preservation and selling costs of \$800, the buyer, in strict application of the principle of concurrent performance, would give \$10,000 to the seller and would receive, a couple of seconds later, \$800 from him. This to and fro shifting of sums of money can be cut short in that the buyer pays only the difference between the resale price and his costs, that is, \$9,200. Instead of proceeding to a real concurrent exchange of a sum of money against another sum of money, the exchange is merely ‘virtual’; it ‘happens’ when calculating the difference between the sums that the parties owe each other.³² Article 88(3) explicitly provides for this manner to ‘accelerate’ concurrent performance. The Convention does not limit this way to proceed to the situation of Article 88(3). On the contrary, it is inherent in the ideas underlying the principle of concurrent performance, namely a fair distribution of risks as well as efficiency, that a party may limit itself to paying the difference between its own and the other party’s claim instead of having to engage in an effective exchange of sums. This mere paying of the difference is the characteristic of a set-off as it is understood under the CISG (see above, para. 0.1). The Advisory Council has already had the occasion to state that ‘a general denial of set-off as a subject dealt with by the Convention is too widely stated’³³, and has admitted that ‘concurrency in making restitution ... is most effectively promoted by permitting set-off’³⁴. In this Opinion, the Advisory Council confirms its position whilst broadening the scope by holding that the set-off of monetary claims arising from the CISG is a question governed by the Convention, even if the only place where it is settled expressly is Article 88(3).³⁵

³¹ See Zimmermann, *Comparative Foundations of a European Law of Set-Off and Prescription*, Cambridge 2002, p. 29, with further references; Pichonnaz/Gullifer, *Set-off in Arbitration and Commercial Transactions*, Oxford 2014, para. 2.61 *et seq.*; see also CISG Advisory Council Opinion No. 9, Consequences of Avoidance of the Contract, para. 3.11: ‘The concurrence of the parties’ obligations means that each party has a type of security in not having to give credit to the other.’

³² See, e.g., Fountoulakis, *Set-off Defences in International Commercial Arbitration, A Comparative Analysis*, Oxford 2011, 7; Wood, *English and International Set-Off*, London 1989, para. 1-4.

³³ CISG Advisory Council Opinion No. 9, Consequences of Avoidance of the Contract, para. 3.23.

³⁴ *Ibid.*

³⁵ See also Bundesgerichtshof (Germany), 24 September 2014, CISG-online 2545, note 56, *Internationales Handelsrecht* 2015, 9; Magnus in Staudinger, *ad Art. 4 para. 47.*

- 1.5 ***Application of general principles of the CISG.*** Matters governed by the CISG but not expressly settled in it are subject to the general principles on which the Convention is based, unless no such general principles exist (Article 7 para. 2). Black letter rule No. 1 states the rule that a set-off of monetary claims arising under the CISG are governed by the Convention's general principles. The rationale behind this rule is twofold: (a) the setting off of monetary claims is a mode of payment; (b) from the rules of the CISG regarding payment, general principles can be derived that indicate the way a set-off can take place, as well as its effects. The content of each of those general principles, their legal basis, and their application to set-off are exposed in detail in the comment on Rules No. 2 to 4. For some specific questions, no general principle can be derived from the Convention; those questions are therefore governed by the otherwise applicable law (Article 7 para. 2 in fine). However, this shall not hinder the application of the CISG to the other aspects of the set-off (below, paras 4.8 *et seq.*).
- 1.6 ***Claims governed by the CISG.*** The cases (quite numerous by now) where the Convention has been held to apply to a set-off all concerned claims that were both governed by the CISG (see above, para. 0.2). As far as can be seen, it has never happened so far that the Convention was applied in a situation where one of the claims in a set-off had its legal basis in a law other than the CISG. This is in line with the view of this Opinion. In fact, as is generally known, the Convention is limited in its scope: it governs the buyer's and the seller's claims arising out of the sales contract, but does not deal with other, not sales-specific claims, such as claims in tort or unjust enrichment, or claims relying on the invalidity of the contract (Article 4). Those claims are governed by the law designated by the applicable choice-of-law rules (Article 7 para. 2). It is thus that other law, and not the CISG, that states whether such a claim has arisen, whether it must be asserted or whether courts and arbitral tribunals must consider it *ex lege*, whether it is subject to time limits, etc.
- 1.7 The fact that those claims are outside the scope of the CISG thus excludes the applicability of the Convention to a set-off that would include such a 'CISG-external' claim. This is based on the following considerations. A set-off is a way to perform monetary obligations which is not explicitly settled in the Convention (cf. above, para. 1.4, and below, para. 2). The CISG deals with performance and, more specifically, with payment only as far as the parties' duties arising out of the sales contract *stricto sensu* are concerned. From those rules on performance and payment, general principles can be derived. Those general principles are applicable to 'matters governed by the Convention' (Article 7 para. 2). As for the matters not governed by the CISG, Article 7 para. 2 cannot dictate that they be governed by general principles of the CISG, as this is a question that has to be answered by the law governing that CISG-external matter. In other words, set-off is a matter of the CISG only to the extent it concerns claims arising out of the CISG, and it is only with regard to such a set-off that the CISG can stipulate the application of its general principles. Thus, the CISG's general principles can only be applied to set-off to the extent that the set-off is between 'CISG-internal' claims.
- 1.8 ***Claims arising out of the same contract or out of different contracts.*** Rule No. 1 states the rule that, as long as both claims are governed by the CISG, the fact that the claims do not arise out of the same contract does not prevent the application of the Convention to the set-off. The reason for this will be explained in relation with Rule No. 5 (below, paras 5.1 *et seq.*).
- 1.9 ***Parties' agreement taking precedence.*** Rule No. 1 does not explicitly state that the parties may derogate from or vary the rules on set-off derived from the general rules of

the Convention. These possibilities are a matter of course, derived from Article 6 of the CISG. In practice, the parties do often provide for contractual arrangements. They may, for instance, agree that, in a specific case, their mutual claims do not have to be settled in kind, but that only the party that owes the greater amount will pay it to the other party (also called ‘set-off by agreement’). Especially in long-standing business relationships, the parties may also provide for so-called ‘netting’ clauses, in which the parties agree on a mechanism of continuous discharge of liabilities.³⁶ Contrariwise, the parties may also exclude the possibility of setting off claims which they hold against each other. This too is not unusual³⁷ and usually serves the purpose of preserving a party’s cash flow. Common ways of excluding the right to set-off are payment clauses such as ‘net cash’, ‘cash on delivery’, ‘cash against documents’ or ‘documents against payment’.³⁸ Where no such agreement exists, the CISG provides the legal basis for one party’s right to set off its claim against the other party’s claim, and without that other party’s consent, under the requirements and to the effect derived from the Convention’s general principles.

2. Set-off has the same effect as the performance of a monetary obligation by payment.

According to the understanding underlying set-off under the CISG, set-off produces a balance, which is the difference between both monetary claims (above, para. 0.1). The residual amount remains due. This effect is explicitly provided for in Article 88(3) CISG, which states that the party entitled to resell the goods on account of the other party may retain out of the proceeds of the sale the amount corresponding to the reasonable expenses of reselling the goods and must account for the balance. The same effect has been accorded in all the other situations where a set-off has been admitted under the CISG: the party relying on the set-off is exempted from actually paying the claim addressed to it and owes only the difference between the two amounts.³⁹ In other words, the party relying on set-off does not really pay, but nevertheless fulfils the claim the other party has against it, by setting off its own claim against the other party’s claim. The payment consists, so to speak, in the fact that the party setting off waives/renounces its right to receive actual payment for its own claim. Of course, the effect of actual payment and the effect of set-off are not exactly identical, because the party faced with the set-off may not accept the existence of the other party’s claim and will have to, as

³⁶ Netting arrangements serve the purpose of controlling certain types of risk (see, e.g., Firth, *Derivates: Law and Practice*, London 2013) and are, among other types of transactions, often used in futures contracts, which may fall under the CISG.

³⁷ See Oberlandesgericht Hamburg, 5 October 1998, CISG-online 473, where the parties were held to have excluded the possibility of set-off by integrating the clause ‘net 40 days’ in their contract. The court held that the net-payment clause prohibited the buyer from deducting any alleged damages from the purchase price. See also Oberlandesgericht München, 11 March 1998, CISG-online 310 (set-off excluded by § 10(2) of the Standard Conditions of the German Textile and Clothing Industry); Vienna Arbitration proceeding S 2/97 (Barley case), 10 December 1997, CISG-online 351 (set-off excluded in seller’s general terms and conditions).

³⁸ See the cases cited in footnote 37; in legal writing, see Mohs *in* Schlechtriem, Schwenzler & Schroeter (eds), *ad* Art. 61 para. 19; Magnus *in* Staudinger, *ad* Art. 53 para. 13; Huber *in* Münchener Kommentar, *ad* Art. 53 para. 15, with further references.

³⁹ E.g., Bundesgerichtshof (Germany), 24 September 2014, CISG-online 2545, *Internationales Handelsrecht* 2015, 9; Oberlandesgericht Wien, 23 January 2017, *Internationales Handelsrecht* 2018, 241; Kantonsgericht Zug, 14 December 2009, CISG-online 2026; Oberlandesgericht München, 19 October 2006, note 3, CISG-online 1394; Oberlandesgericht Köln, 14 August 2006, note II.2.d), CISG-online 1405.

the case may be, assert this fact in court or before an arbitral tribunal. But this risk on behalf of the first party is inherent in a set-off and, to the extent a set-off is considered as a matter governed by the Convention (above, para. 1.2), accepted as such under the CISG. It is rather the mechanism of set-off as it operates under the CISG that matters, and which produces the effect that actual payment of the debt would have: the party relying on set-off ‘pays’ the other party by retaining the sum owed to it and remains liable only for the difference.⁴⁰

3. Set-off is exercised by a declaration made by notice. The notice must reach the other party but does not take effect before both claims are due.

- 3.1 *Set-off is declared by making notice.* In case law dealing with set-off under the Convention, there is usually only a general indication that the defendant is relying on a right of set-off, without further specifications of the manner or the modalities in which set-off is evoked.⁴¹ Sometimes, a set-off is asserted no earlier than during the judicial proceedings.⁴² However, there are also some cases in which it is clear that a set-off has been ‘claimed’ or ‘effectuated’ before judicial proceedings were commenced.⁴³
- 3.2 Rule No. 3 poses the principle that a set-off governed by the CISG must be declared by making notice to the other party. This is based on the following considerations: Set-off is meant to reduce the amount owed to the creditor by the amount which the creditor owes to the debtor (above, para. 1.4). Either party can rely on set-off, provided that they both hold a monetary claim against each other. Set-off avoids the need for each party to perform its obligation by making actual payment (above, paras 1.2 *et seq.*). Nonetheless, where the parties have not agreed on a netting mechanism where mutual debts are automatically balanced on a regular basis at an agreed date (above, para. 1.9), set-off usually is of interest to one of the parties only, whereas the other party rejects the set-off, often by denying the very fact that the first party holds a claim against it, and by insisting on actual payment. Because of this constellation, set-off is to be considered as a means of defence that is put forward by the party who argues that there is no need to make actual payment, since it (that party) has a claim against the other party, too. In other words, the party who refers to set-off invokes the *right* not to make actual payment.
- 3.3 Under the Convention, rights which are granted to one of the parties have legal effect only if they are *declared* to the other party. This can be derived from a number of provisions, such as Articles 14 *et seq* (offer and acceptance), Article 26 (declaration of avoidance), Article 39 (notice of lack of conformity), Articles 47 and 63 (fixing an additional period of time), Article 48(2)-(4) (notice of exercising the right to cure), Article 50 (price reduction), Article 65 (specification concerning features of the goods), Article 71 (notice of suspension), Article 72 (notice of avoidance for anticipatory

⁴⁰ It is to be noted that the idea to compare set-off with a short-cut payment is not unanimously shared in domestic laws. The differences in perception are due to the qualification of set-off as either procedural or substantive, cf. Pichonnaz/Gullifer, *Set-off in Arbitration and Commercial Transactions*, Oxford 2014, para. 2.61; Fountoulakis, *Set-off Defences in International Commercial Arbitration*, Oxford 2011, 8-9.

⁴¹ See, e.g., Oberlandesgericht München, 9 July 1997, CISG-online 282.

⁴² See Oberlandesgericht Köln, 19 May 2008, CISG-online 1700.

⁴³ District Court Badalona (Spain), 22 May 2006, CISG-online 1391 (the seller paid back a part of the purchase price after having ‘discounted’ a certain amount as bank transfer costs); Oberlandesgericht Düsseldorf, 21 April 2004, CISG-online 915, in which the seller was held to have impliedly declared set-off by refusing to make full restitution of the purchase price because it allegedly held a damages claim against the buyer; Landgericht Stuttgart, 29 October 2009, CISG-online 2017.

breach), Article 73 (notice of avoidance of an instalment contract), and Articles 85-88 (notices relating to the duty to preserve the goods). Article 88(3), which deals with set-off with respect to the party who is entitled to sell the goods which it was bound to preserve, states that that party ‘has the right to retain out of the proceeds of sale an amount equal to the reasonable expenses of preserving the goods and selling them’ and that it ‘must account to the other party for the balance’. By using these words, Article 88(3) implicitly requires the party intending to set off to express this intention to other party.⁴⁴

3.4 Those provisions show that the Convention has subscribed to the principle of declaration, meaning that rights on which a party wishes to rely under the Convention must be communicated to the other party by way of declaration. In fact, as has been pointed out many times, the CISG has rejected both the concept that a party’s rights must be asserted by way of a judicial claim as well as the concept that rights are effectuated *ipso facto*.⁴⁵ The principle of declaration applies without exception to all rights under the Convention. It can thus easily be identified as a ‘general principle on which it is based’ (Article 7 para. 2) and may be used as a basis for set-off under the Convention.⁴⁶ Rule 3, 1st sentence, therefore states that a party who wants to rely on a set-off under the CISG must declare it to the other party.

3.5 ***Absence of form requirements.*** The Convention is based on the principle of freedom from form. This is shown in Article 11, according to which a contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form,⁴⁷ and very generally in most, if not all other provisions of the CISG, which do not reserve a particular form for exercising a right, or for any other kind of communication. Accordingly, it has often been said that a ‘general principle’ within the meaning of Article 7 para. 2 can be derived, stating that all declarations and communications provided for in the Convention are free from requirements as to form.⁴⁸ This general principle can be used for set-off under the CISG. Certainly, as set-off is not explicitly settled in the Convention, ‘declaring set-off’ is not a declaration expressly provided for in the Convention. However, there is unanimity on the point that the principle of freedom from form requirements does not only apply to declarations explicitly settled in the Convention, but also to declarations referring to matters governed by but not expressly settled in the CISG (Article 7 para. 2).⁴⁹ This is the case

⁴⁴ Magnus *in* Leible (ed), 209 (221) *et seq.*; Fountoulakis *in* Schlechtriem, Schwenger & Schroeter, *ad* Art. 81 para. 21.

⁴⁵ See UNCITRAL YB III (1972) 41-54, UNCITRAL YB III (1972) 85-86, paras 28-47; Hellner, *Ipsa facto avoidance*, in Ehmann (ed), *Privatautonomie, Eigentum und Verantwortung*, Festgabe für Hermann Weitnauer zum 70. Geburtstag, Berlin 1980, 85 *et seq.*

⁴⁶ Bundesgerichtshof (Germany), 24 September 2014, CISG-online 2545, note 58, *Internationales Handelsrecht* 2015, 9; Magnus *in* Staudinger, *ad* Art. 4 para. 47; Fountoulakis *in* Schlechtriem & Schwenger, *ad* Art. 81 para. 21.

⁴⁷ An exception to this is Article 96, which allows States whose legislation requires contracts of sale to be concluded in or evidenced by writing to issue a reservation in accordance with Article 12, to the effect that the principle of freedom from form requirements enshrined in the Convention does not apply where any party has its place of business in that State.

⁴⁸ See, e.g., Schmidt-Kessel *in* Schlechtriem & Schwenger, *ad* Art. 11 para. 10; Perales Viscasillas *in* Kröll/Mistelis/Perales Viscasillas, *ad* Art. 11 para. 14; Magnus *in* Staudinger, *ad* Art. 11 para. 7.

⁴⁹ Schmidt-Kessel *in* Schlechtriem & Schwenger, *ad* Art. 11 para. 11; Perales Viscasillas *in* Kröll/Mistelis/Perales Viscasillas, *ad* Art. 11 para. 6.

as regards set-off (above, para. 1.2). The principle of freedom from form requirements is therefore applicable to it. Of course, the parties can agree otherwise in the contract and, for instance, subject the declaration of set-off to a writing requirement.⁵⁰

- 3.6 ***The declaration must reach the other party but does not take effect before both claims are due.*** Another question is the point in time at which the declaration of set-off becomes effective. The question comprises two aspects. The first point to be answered is the moment in time from which on the declaration is considered as having been made (below (a)). The second point concerns the question of when set-off takes effect, that is, the moment at which both claims are set off against each other (below (b)).
- 3.7 To answer those questions, the Advisory Council is guided by the following two considerations: On the one hand, the set-off must be declared (above, para. 3.2), and on the other hand, the set-off has the same effect as a payment (above, para. 2).
- 3.8 (a) *The declaration must reach the other party.* As regards the question of when the declaration is considered as having been made, the CISG operates the distinction between communications that only become effective once they have been received by the other party (such as in Article 47 para. 2, 1st sentence, Article 63 para. 2, Article 65, or Article 79 para. 4), and other communications. Those other communications are governed by Article 27 CISG. Although the wording of this provision deals only with the risk of delay and distortion, it is usually treated as also providing for the rule that a declaration becomes effective upon dispatch.⁵¹
- 3.9 The rationale underlying Article 27 is that the addressee of the communication is the party in breach, and that it is therefore for that party to assume the risk of loss or delay in the transmission of the communication.⁵² Where neither party is in breach, or where the consequences triggered by the declaration are significant, the principle of receipt rather than the principle of dispatch applies. This must also hold true in relation to the declaration of set-off. Where the parties have mutual claims, none of the parties is ‘more in breach’ than the other; rather, both parties owe each other performance of their respective duty. Of course, it may be that one of the claims arises out of a breach of contract, e.g., where the buyer sets off a claim for damages against the seller’s claim for the purchase price. It might also be that both claims arise out of a breach of contract; this is the case where, e.g., the buyer claims an amount corresponding to the reduction of the purchase price to which it is entitled according to Article 50, and the seller holds a claim for interest because of late payment of the purchase price (Article 78). However, this is not decisive for the purposes of determining the appropriate rule regarding the point in time the set-off declaration is made. In fact, the rule in Article 27 aims at putting the risk of loss or delay on the addressee in the course of the execution of the sales contract, e.g., where the buyer notifies a non-conformity (Article 39), or where buyer or seller fix an additional period of time for performance (Article 47 para. 1, Article 63 para. 1), claims performance (Article 46 para. 1, Article 62), or where a party terminates the contract (Article 26). In other words, Article 27 applies to situations in which the addressee is supposed to know that something in the execution of its obligations is

⁵⁰ See also Oberlandesgericht Düsseldorf, 21 April 2004, CISG-online 915 (impliedly declared set-off considered being valid in terms of form).

⁵¹ Schlechtriem and Schroeter, *Internationales UN-Kaufrecht*, 6th ed., Tübingen 2016, para. 315; Schroeter in Schlechtriem, Schwenzler & Schroeter, *ad Art. 27* para. 28, with references; Magnus in Staudinger, *ad Art. 27* para. 24; Benicke in Münchener Kommentar HGB, *ad Art. 27* para. 13 *et seq.*

⁵² Schroeter in Schlechtriem, Schwenzler & Schroeter, *ad Art. 27* para. 2.

‘improper’ and calls for correct fulfilment. This is not the case with a set-off declaration, the only goal of which it is to inform the addressee of the fact that there will be a set-off instead of actual payment. The principle of Article 27 is thus not suited to be applied to a declaration of set-off, and it is the receipt rule rather than the dispatch rule that must apply to the declaration of set-off. This means that the declaration of set-off must reach the other party; if it is not received, the declaration must be considered as not having been made.

- 3.10 This finding is corroborated by one further aspect. In fact, as set-off is understood as one way to perform a monetary obligation, that is, as an alternative to payment (above, para. 2), the rules of the CISG on the time of payment must be taken into account. In this regard, the Convention stands for the view that payment occurs once the creditor of the monetary claim has received it.⁵³ Merely having initiated the payment process does not yet constitute payment. The rules on payment in the Convention thus follow the ‘receipt theory’, so to speak, and not the theory of dispatch. Applying this idea to set-off, it becomes evident that the notification with which set-off is declared must be received by the other party in order to be effective.
- 3.11 *(b) Set-off does not take effect before both claims are due.* The moment in time at which set-off is declared must be distinguished from the moment a set-off becomes effective, that is, the time the claims are actually set off. Set-off, despite its assimilation to payment, rests on a declaration. Declarations can be made early (or retroactively) under the CISG; that is, what is stated in the declaration need not necessarily become effective immediately upon its having been declared. A party may, for example, declare the contract avoided in two weeks’ time, or may declare the contract avoided as of last week. The declaration of avoidance as such becomes effective upon dispatch, but the moment the declaration’s content takes effect is prior or later than that point in time. The same holds true for set-off, which may be declared before the claims are actually set off.
- 3.12 As set-off has the same effect as payment (above, para. 2), it seems appropriate to determine the moment set-off takes effect according to the rules governing the claim for payment of the purchase price or other sums. According to Article 61 CISG, the right to claim the purchase price, or damages, requires that the buyer has failed to perform its contractual obligation. As long as performance is not due, the buyer who does not pay the price (or otherwise does not perform) is not in breach of contract. Similarly, according to Article 81(2), a claim to pay back the purchase price cannot be raised as long as this duty to make restitution has not become due. The Convention thus establishes the rule that a monetary claim must be due in order to be claimable.⁵⁴ Applied to set-off, as a set-off enables the party who relies on it to recover the claim that it has

⁵³ Piltz, *Münchener Anwaltshandbuch, Internationales Wirtschaftsrecht*, Munich 2017, § 7 para. 202; Piltz, *Internationales Kaufrecht*, 2nd ed., Munich 2008, para. 4-124; Mohs in Schlechtriem & Schwenger, *ad Art. 53* para. 12; Fountoulakis in BeckOGK, *ad Art. 53* para. 25.

⁵⁴ See Article 59, which provides that the buyer must pay the purchase price on the date fixed or determinable from the contract and the Convention, in other words, at the time it is due. From this provision, a general principle is derived according to which the payment of sums other than the purchase price follow the same rule, that is, they must be paid on the date they become due. Honnold and Flechtner, *Uniform Law for International Sales*, para. 340; Schwenger and Hachem in Schlechtriem & Schwenger, *ad Art. 7* para. 35; Ferrari in Schlechtriem, Schwenger & Schroeter, *ad Art. 7* para. 55; Mankowski in Ferrari et al., *ad Art. 59* para. 11; Mohs in Schlechtriem, Schwenger & Schroeter, *ad Art. 59* para. 6; Fountoulakis in BeckOGK, *ad Art. 59* para. 8, 13; Oberlandesgericht Hamburg, 25 January 2008, CISG-online 1681.

against the other party, the claim of the party declaring set-off must be due.⁵⁵ As long as it is not due, a set-off, even if it has been declared, cannot have any effect. In fact, just as a party cannot claim payment before the due date, so the party who sets off instead of asking for actual payment must await the due date for recovering its claim by way of set-off.

- 3.13 Another question is whether the claim against which set-off is declared must be due, too. In this regard, the Opinion bases its considerations on Article 58, which deals with the time of payment. In application of this provision, it has almost unanimously been held that the buyer is not entitled to pay earlier than at the date determined in the contract. In case of early payment, the seller can refuse its acceptance.⁵⁶ The seller who accepts early payment may reserve its right to compensation of possible exchange rate losses.⁵⁷ The seller's right to refuse acceptance of early payment, although not explicitly stated in Article 58, corresponds to the deliberations and the finding of the Drafting Committee. As Schlechtriem states, '[w]hile a motion to clarify this point [i.e., the seller's right to return the payment made before the due date] was rejected, it was nevertheless generally assumed that the seller could decline premature or partial payments. It was believed that only the question of whether the seller must return the money at once needed negotiation.'⁵⁸
- 3.14 This rule, derived by interpretation of Article 58, can be generalised for all sorts of monetary claims under the CISG and, in a next step, analogously applied to a set-off. In fact, as the debtor who relies on set-off is making a short-cut payment to the creditor (above, para. 2), it should not be entitled to do so before the creditor's claim has become due. Just as it is held to not be possible to impose acceptance of an early payment on the seller, set-off cannot take effect before the creditor's claim is mature. Of course, as with actual payment, the creditor is free to accept set-off even if its monetary claim is not yet due.
- 3.15 One further point that needs clarification in this respect is the moment a claim becomes due. This point in time is determined either by the contract or the CISG.⁵⁹ Absent a

⁵⁵ In case law, the fact that the claim that is used for set-off must be due seems to have been underlying all cases in which the right to set-off was considered. The requirement of maturity of that claim is usually not explicitly examined. It rather appears as a commonly accepted general rule that this claim must fulfil the requirements which must be met in order to make a (separate) claim for payment (Oberlandesgericht München, 19 October 2006, CISG-online 1394; Oberlandesgericht Köln, 14 August 2006, CISG-online 1405; Oberlandesgericht Düsseldorf, 21 April 2004, CISG-online 915; Oberlandesgericht München, 9 July 1997, CISG-online 282; Oberlandesgericht Hamburg, 26 November 1999, CISG-online 515; Oberlandesgericht Hamburg, 5 October 1998, CISG-online 473; Landgericht Mönchengladbach, 15 July 2003, CISG-online 813 ; Amtsgericht Duisburg, 13 April 2000, CISG-online 659).

⁵⁶ Schlechtriem and Schroeter, *Internationales UN-Kaufrecht*, 6th ed., Tübingen 2016, para. 530; Magnus *in* Staudinger, *ad* Art. 58 para. 31; Piltz, *Internationales Kaufrecht*, 2nd ed., Munich 2008, para. 4-146; Butler and Harindranath *in* Kröll/Mistelis/Perales Viscasillas, *ad* Art. 58 para. 33; Mankowski *in* Ferrari/Kieninger/Mankowski/Otte/Saenger/Schulze/Staudinger (eds.), *Internationales Vertragsrecht*, 2nd ed., Munich 2018, *ad* Art. 59 para. 10; Huber *in* Münchener Kommentar BGB, *ad* Art. 58 para. 28; Fountoulakis *in* BeckOGK, *ad* Art. 58 para. 44; *contra* Mohs *in* Schlechtriem & Schwenger, *ad* Art. 58 para. 20.

⁵⁷ Maskow *in* Bianca & Bonnell, *ad* Art. 58 note 2.4; Magnus *in* Staudinger, *ad* Art. 58 para. 31; Butler/Harindranath *in* Kröll/Mistelis/Perales Viscasillas, *ad* Art. 58 para. 33, with further references.

⁵⁸ Schlechtriem, *Uniform Sales Law – The UN-Convention on Contracts for the International Sale of Goods*, Vienna 1986, p. 82 footnote 329, with references to A/Conf. 97/C.1/L.206=O.R., p. 123 and A/Conf. 97/C./SR.25 at 9 O.R., p. 370.

⁵⁹ Opinion No 14, Interest Under Article 78 CISG, Rule 3, sentence 2.

parties' agreement, the due date for a monetary claim is fixed, or can at least be derived, from the various provisions dealing with the different monetary claims. For instance, a claim for payment of the purchase price is governed by Article 58, which provides that, absent an agreement between the parties to the contrary, the price must be paid when the seller places the goods or documents controlling their disposition at the buyer's disposal. A claim for damages becomes due at the moment the loss occurs.⁶⁰ Interest on the purchase price that must be paid back after avoidance of the contract becomes due on the date the purchase price was originally paid,⁶¹ etc. Applied to a set-off under the Convention, the question of when each of the claims becomes due will depend on their nature. For example, a set-off of the seller's claim for payment of the purchase price and the buyer's claim for damages can take place at the earliest once the seller's claim has become due (which can be the moment the seller places the goods at the buyer's disposal or some other date before or after that point in time, depending on the parties' agreement) *and* the buyer's loss has occurred (which gives right to its damages claim, which is immediately due).

- 3.16 ***Set-off has no retroactive effect.*** As set-off is seen as an alternative form of payment, its effect must be similar to the effect payment has. In case of actual payment, the party owing a monetary claim has performed its obligation at the moment the other party can dispose of the sum which is owed to it. As long as the first party has not paid, its obligation to pay persists. Likewise, if a party is in arrears with payment, it is bound to pay interest on the sum which is due until the moment it makes the payment (Article 78).⁶² If liquidated damages have been agreed on in case of late payment, the party who does not pay on time must pay the amount provided for in the liquidated damages clause. In other words, payment deploys its effect only for the future and is not dated back to some earlier point in time (*ex-nunc*-effect as opposed to *ex-tunc*-effect).
- 3.17 The same must hold true for set-off. A set-off replaces actual payment of a monetary obligation. As long as it has not taken place, the debtor has not performed its obligation to pay. Thus, if the debtor sets off the claim that it has against the creditor after the creditor's claim has become due, the debtor has been in arrears with payment during the period in which payment had to be effectuated but was not. The debtor must pay interest for that time and, as the case may be, liquidated damages or penalties. In other words, set-off must have an *ex-nunc*-effect, too, as does actual payment. There is no reason to treat the party who sets off better than the party that makes actual payment.
- 3.18 The solutions found in certain civil law legislative instruments, according to which a set-off, once it has been evoked, dates back to the time the claims were eligible for set-off (above, paras 0.5 and 0.6), finds no support under the CISG. There are historical reasons for the retroactive effect of set-off under those legislative instruments that have no legitimate basis under the Convention. Rather, set-off under the CISG must be derived from the Convention itself, in particular from its rules on payment, according to which the debtor has not fulfilled its obligation until the sum is paid.

⁶⁰ Bacher *in* Schlechtriem, Schwenger & Schroeter, *ad* Art. 78 para. 9; Fountoulakis *in* BeckOGK, *ad* Art. 59 para. 14, and 14.1.

⁶¹ Fountoulakis *in* BeckOGK, *ad* Art. 59 para. 14.

⁶² Bacher *in* Schlechtriem, Schwenger & Schroeter, *ad* Art. 78 para. 25a.

4. Exercising the right to set off does not require the claims to be liquidated or to be in the same currency.

- 4.1 *Set-off need not be expressed in the same currency.* Quite often, the claims to be set off will be expressed in different currencies, for example, where a claim for payment of the purchase price is set off against a claim for damages. Whereas the parties will usually have agreed on the currency in which the purchase price must be paid, the currency of the damages claim will normally be the one in which that party suffered the loss,⁶³ which usually is its place of business.⁶⁴ As the case may be, the loss might also occur in another currency, for example, where the loss consists in expenditure incurred in debt collection.⁶⁵
- 4.2 Unlike, e.g., the PICC 2016, the CISG does not specifically address questions of currency or, more specifically, the question of whether a monetary claim expressed in a certain currency may be fulfilled in another currency. However, most authors and tribunals agree that currency is a question governed by the Convention.⁶⁶
- 4.3 For the question of whether a set-off may take place where the claims are not in the same currency, Article 88(3) and Article 84 are of guidance. The first provision states a party's right to retain out of the proceeds of sale 'an amount equal to the reasonable expenses of preserving the goods and of selling them'. The provision also applies where the buyer reselling the goods on the seller's account had already paid the purchase price. In this case, the seller must pay back the purchase price in the currency that was fixed for the payment of the purchase price,⁶⁷ whereas the buyer must account 'for the proceeds of the sale' (Article 88(3)). Those will be in the currency agreed on for the resale with the third party and may thus differ from the currency in which the seller has to make restitution of the purchase price. Similarly, Article 84 provides that the seller who is bound to refund the price must pay interest on it, whilst the buyer must account to the seller for all benefits derived from the goods. It is generally admitted that the claims can be set off.⁶⁸ At the same time, not infrequently, the two claims will not be expressed in the same currency. In fact, interest on the price to be paid back is held to be payable in the currency of payment,⁶⁹ whereas the benefits for which the buyer must

⁶³ OLG Hamburg, 28 February 1997, CISG-online 261; Schwenger *in* Schlechtriem & Schwenger, *ad* Art. 74 para. 63, with further references.

⁶⁴ Magnus *in* Staudinger, *ad* Art. 74 para. 56; Magnus, *Währungsfragen im Einheitlichen Kaufrecht. Zugleich ein Beitrag zu seiner Lückenfüllung und Auslegung*, *RabelsZ* 53 (1989) 116, 134-135.

⁶⁵ Magnus *in* Staudinger, *ad* Art. 74 para. 56; Magnus, *RabelsZ* 53 (1989) 116, 134-135; Mankowski *in* Münchener Kommentar HGB, *ad* Art 74. para. 14.

⁶⁶ Cf. Magnus, *RabelsZ* 53 (1989) 116, 127 *et seq.*; Magnus *in* Staudinger, *ad* Art. 53 para. 20, with references; Brunner, Murmann and Stucki *in* Brunner (ed.), *UN-Kaufrecht – CISG* -, 2nd ed., Bern: Stämpfli, 2014, *ad* Art. 4 para. 54; Fountoulakis *in* BeckOGK, *ad* Art. 53 para. 11 *et seq.*; Martiny *in* Reithmann & Martiny, para. 6.64; contra Schlechtriem and Witz, *Convention de Vienne sur les contrats de vente internationale de marchandises*, Paris 2008, para. 279.

⁶⁷ CISG Advisory Council Opinion No. 9, Consequences of Avoidance of the Contract, Rule No. 2.4.

⁶⁸ CISG Advisory Council Opinion No. 9, Consequences of Avoidance of the Contract, para. 3.23.

⁶⁹ CISG Advisory Council Opinion No. 9, Consequences of Avoidance of the Contract, para. 3.26.

account will often have arisen in another currency, probably in the currency of the buyer's country.

- 4.4 Thus, both Article 84 and Article 88(3) provide for a set-off of claims of different currencies. The rule can be generalised to the effect that a set-off should be possible even if the claims are expressed in different currencies. This principle finds its limits where the claim that is used to declare set-off is expressed in a non-convertible currency, as this would make it impossible to determine the amount of that claim and thus also the amount that has been set off. The addressee of the set-off declaration who suffers currency losses will have a claim for damages under Article 74.⁷⁰
- 4.5 The rule will not apply where the parties have excluded the right to set off claims of different currency. As the case may be, it may matter to a party to receive payment in a foreign currency which is stronger or more reliable than its own currency, or that party might wish to receive payment only in one particular currency, e.g., the currency of its place of business. The contract may provide for individual or standard foreign currency clauses to make it clear that payment in a currency other than the agreed one is excluded. A set-off of claims expressed in different currencies is not possible in that case.
- 4.6 ***The claims need not be liquidated.*** Set-off under the Convention will often involve a claim for damages, mostly on behalf of the party who declares the set-off. Not infrequently, the amount of the loss which is claimed will not yet be determined ('liquidated'). Rule No. 4 adopts the view that set-off is not precluded in such a case. This is based on considerations developed in the light of the rules of the Convention on interest (Article 78). Under the CISG, interest starts to accrue from the moment a 'sum is in arrears'. As far as damages are concerned, they become due as soon as the loss occurs (above, para. 3.15). Therefore, the party in breach of contract is in arrears from the day the loss occurred and has to pay interest on the claim for damages from that date on, regardless of whether the exact amount of the loss has been established or not.⁷¹ The term 'sum' used in Article 78 thus includes unliquidated monetary claims. In other words, the debtor of a damages claim, the exact amount of which is yet to be determined, is under an obligation to pay a sum which is likely to cover the creditor's loss in order to avoid having to pay interest accruing on that sum.⁷²
- 4.7 For the sake of consistency in the interpretation of the Convention's notions, a 'sum' ('monetary claim') in relation to a set-off must involve unliquidated sums, too. It would be inconsistent for a debtor of a damages claim to be bound to pay a sum approximately covering the loss incurred (in order to avoid too high a sum of interest accruing on it), but not to be allowed to fulfil that same payment obligation by setting off its claim that it has against the creditor. Likewise, set-off must be possible where the claim which is used to declare set off is not yet ascertained as to its amount. Whether it is the claim that is put to set-off which is unliquidated or whether the claim of the other party is not yet ascertained as to its amount, in both cases the risk lies on the party setting off its claim to do so in an amount that is likely to correspond to the unliquidated claim. For example, if the debtor of an unliquidated damages claim estimates that the loss will amount to

⁷⁰ See, for payment of the purchase price in another currency, Fountoulakis *in* BeckOGK, *ad* Art. 53 para. 14; for other situations see, e.g., CISG Advisory Council Opinion No. 9, Consequences of Avoidance of the Contract, para. 3.8.

⁷¹ Opinion No 14, Interest Under Article 78 CISG, Rule 3 letter b and Rule 4, Comment 3.10.

⁷² Opinion No. 14, Interest Under Article 78 CISG, Rule 3 letter b and Rule 4, Comment 3.10.

50,000 € and sets off its payment claim in that same amount against the first party, and if it later turns out that the loss is 60,000 €, that same debtor has been in arrears with payment in the amount of 10,000 € since the occurrence of the loss. Similarly, if the debtor of a payment claim of 50,000 € sets off with a claim for damages that it expects to amount to 50,000 € as well, whereas its loss is later fixed at 40'000 €, it will have been late on payment of the purchase price since the moment the other party's claim for payment was due.

- 4.8 ***Questions for which no rules can be derived from the CISG.*** Having shown that rules can be derived from the general principles on which the CISG is based that can be applied to a set-off of CISG-internal claims, there are a number of questions regarding set-off where this is not possible. For instance, the question may be raised whether a set-off is possible where one of the parties has become insolvent, or where one of the claims is time-barred, or where a claim which initially existed between the parties has been assigned to a third party. These situations involve matters that are, generally speaking, outside the scope of the Convention.⁷³ This does not constitute an obstacle to the application of the CISG to a set-off.
- 4.9 Just as, in a sales contract governed by the CISG, matters of insolvency, prescription, or assignment are resolved in application of the respective domestic laws, or international rules of law, a set-off that would raise similar questions will have to comply with the applicable respective rules, notwithstanding the fact that the aspects that do not concern 'CISG-external' matters will remain governed by the Convention.
- 4.10 More precisely, for the question of set-off in insolvency, the decisive factor must be the extent to which the applicable domestic law regulates the operation and the effect of set-off in a mandatory manner. In fact, insolvency set-off may differ significantly from one legal system to the other, e.g., as concerns the automatic effect of set-off as soon as a party enters insolvency proceedings (as is the case in English law) or, in other jurisdictions, the date up to which a set-off is possible, whether insolvency set-off is mandatory or can be excluded by agreement, the date at which the account is taken, the requirements as to the nature of the claims that are set off, etc.⁷⁴ If the insolvency proceedings do not modify the way set-off operates but merely provides for a cut-off date after which no set-off is possible, it is the CISG that governs the question of whether the requirements for a set-off are met; domestic law in that case only states whether the party relying on set-off may still do so after commencement of the insolvency proceedings.⁷⁵ In contrast, where, according to the applicable insolvency law, the entering of a party into insolvency proceedings actually creates a (new) set-off situation, this insolvency set-off is, in its entirety, subject to domestic law.

⁷³ For many, see Ferrari, *in* Schlechtriem, Schwenger & Schroeter, *ad* Art. 4 para. 33, 35-38; Schwenger and Hachem, *in* Schlechtriem & Schwenger, *ad* Art. 4 para. 47, 50. This does not exclude that there remain interactions between domestic insolvency laws and the CISG, as is emphasised by those authors.

⁷⁴ See Pichonnaz/Gullifer, *Set-off in Arbitration and Commercial Transactions*, Oxford 2014, chapters 12 and 13.

⁷⁵ This is generally the case in civil law jurisdictions see Pichonnaz/Gullifer, *Set-off in Arbitration and Commercial Transactions*, Oxford 2014, para. 13.09 *et seq.*

- 4.11 If the question arises whether the claim with which set-off is declared is time-barred, and whether it may still be set off against the other party's claim, the fact that the CISG does not provide for rules on prescription does not hinder its application to the other aspects of the set-off; just as in any other CISG-contract, the question of prescription, including its effects, must be resolved in conformity with the law, or rules of law, applicable by virtue of the rules of private international law (Article 7 para. 2 in fine); the other points (e.g., the question of how set-off is brought about, questions of currency, *ex-nunc* effect of a set-off, etc.) remain governed by the CISG. The same holds true where the question arises of whether and under what conditions a party to a CISG-contract may set off its claim against the other party's claim where that other party has assigned its claim to a third party, or where one of the parties has acquired a claim against the other party from a third party by way of assignment: in the absence of any provision on the matter in the CISG, the specific question of whether a set-off of claims that have been assigned is governed by the otherwise applicable rules of law, such as the PICC,⁷⁶ or the applicable domestic law (Article 7 para. 2 in fine).
- 4.12 Finally, many domestic laws, and rules of law such as the PICC, prohibit set-off by law in certain constellations. Often, set-off is barred with regard to claims that cannot be transferred by law, such as salaries and pensions of civil service employees, or with regard to claims based on intentional civil wrongs. In other words, set-off is prohibited essentially where vital claims are concerned, or claims aimed at the compensation of gross injustice. The CISG does not address these questions and does not establish general prohibition rules, as this is outside its scope (Article 4). Thus, no rule can be derived from the CISG as to whether set-off is prohibited in certain situations. However, exactly because the set-off restrictions provided for in domestic laws concern claims that do not fall within the scope of the CISG, the absence of rules in this respect that would be derivable from the Convention is irrelevant. In fact, the CISG has the authority to consider itself applicable only with respect to matters that fall within its scope, and it thus applies to a set-off only to the extent that the claims that are set off are governed by it. This concerns claims for payment of the purchase price or monetary contractual claims for breach of contract (above, para. 1.6). The set-off of such claims does not raise the question of its admissibility. The fact that the CISG does not provide for rules on prohibition of set-off is thus not be an obstacle to the application of the Convention to a CISG-internal set-off.

5. The application of the CISG to a set-off does not affect matters of *res judicata* or counterclaims.

- 5.1 The rule must be read together with rule No. 1, which states that monetary claims governed by the CISG may be set off in conformity with the general principles of the Convention, regardless of whether they arise out of the same contract or not. The latter rule has been adopted because the application of the CISG to a set-off does not affect matters of *res judicata* (below, paras 5.7 and 5.8) or the possibility of a counterclaim (below, para. 5.9), and affects the question of judicial competence only to the extent the set-off under the CISG operates as a defence to the claim and not as an independent set-off of procedural nature (below, paras 5.4 *et seq*).

⁷⁶ For a case relying on the PICC and the Principles of European Contract Law in relation to the question of whether a party had fulfilled its obligation of payment by setting it off against claims it had against the creditor where the creditor had assigned its claim to a third party, see Internationales Schiedsgericht der Wirtschaftskammer Österreich, SCH-4921, 11 March 2006, <http://www.unilex.info>.

- 5.2 **Judicial competence.** As a world-wide undisputed rule, the question of whether a court or arbitral tribunal is competent to hear a claim is a matter of civil procedural law or arbitration law as the case may be. A set-off may raise rather difficult questions where the claims to be set off would not be subject to the same jurisdiction, were they raised individually. In contract law matters, this situation arises if the claims arise out of different contracts which do not have the same jurisdiction. The scenarios may vary: it may be that the claim against which set-off is declared arises out of a contract that is subject to a jurisdiction clause, whereas the contract out of which the second claim arises is not, and *vice versa*. It is possible that different forum selection clauses exist for both contracts, conferring, as the case may be, exclusive jurisdiction to the respective prorogated court. Other constellations include claims arising out of contracts that are subject to different and diverging arbitration clauses, or claims originating from contracts of which the first one is subject to arbitration and the second one subject to state court jurisdiction, or *vice versa*.
- 5.3 If a party brings a claim before the court or arbitral tribunal competent to hear that claim and the defendant raises a right of set-off (which may either consist in the assertion that a set-off has taken place, or that the court or arbitral tribunal seized pronounce the set-off in the proceedings), the question arises whether the court or arbitral tribunal may hear the set-off defence.⁷⁷ This will depend on the applicable laws or rules of the forum or place of arbitration, on the one hand, and the specific constellation in which the question arises, on the other hand.⁷⁸ Broadly speaking, the following approaches are either provided by law or applied by courts and arbitral tribunals: the court seized by the first party is competent to hear the set-off defence despite the absence of jurisdiction over the claim of the party relying on set-off; or the court stays the proceedings on the first claim, or execution, pending resolution of the second claim in the other jurisdiction; or the court declines to hear the set-off defence.⁷⁹ Where the first claim is subject to an arbitration clause whereas the second claim is not, or is subject to another arbitration clause, approaches also differ. To the extent the arbitration agreement cannot be interpreted conclusively, the question whether set-off will be entertained by the arbitral tribunal will depend on the approach taken in the applicable laws or rules or adopted by the arbitral tribunal. The approaches vary and are altogether similar to those developed under state court jurisdiction, even though the general trend moves towards an ‘attraction of competence’, that is, the permissibility of set-off despite lacking jurisdiction over the claim relied upon for the purposes of set-off.⁸⁰ Finally, the first claim may be subject to state court jurisdiction whereas the second claim is subject to an arbitration clause. Again, different courts have come to different solutions as regards

⁷⁷ The term ‘defence’ is used in a non-technical manner.

⁷⁸ Pichonnaz/Gullifer, *Set-off in arbitration and commercial transactions*, Oxford 2014, para. 3.03 et seq.

⁷⁹ Pichonnaz/Gullifer, *Set-off in arbitration and commercial transactions*, Oxford 2014, para. 3.20 et seq., with further references.

⁸⁰ Mourre, The Set-off Paradox in International Arbitration, *Arb. Int.* 2008, 387 et seq.; Schöll, Set-off defences in international arbitration. Criteria for Best Practice – A Comparative Perspective, *ASA Special Series No. 26* (2006), 97 et seq.; Kee, Set-off in International Arbitration – What Can the Asian Region Learn?, 1 *Asian Int. Arb. J.* (2005), 141 et seq.; Gabriel and Meier, Set-off Defences in Arbitration – Conclusions from a Swiss Civil Law Perspective, 5(2) *Indian Journal of Arbitration* (2017), 55 et seq.

the question of whether the court that has been seized should entertain the set-off defence.⁸¹

- 5.4 Allowing or not allowing the set-off defence to be heard, staying the proceedings, or proceeding yet in another manner: that question is, in principle, not linked to the one on the applicability of the CISG to a set-off. Applying the Convention to CISG-internal claims does not modify the existing rules on judicial competence, which remains a question of civil procedure law or arbitration law as the case may be. A court may thus, in application of its procedural *lex fori*, refuse to hear a set-off defence if the claim of the party that relies on set-off is subject to an arbitration clause.⁸² From a comparative perspective, this is quite obvious for civil law legal systems, which consider set-off as a matter of substantive law and where there is *a priori* no overlap between the question of which law is applied to the set-off and the question of whether a court or arbitral tribunal may entertain the set-off defence. For legal systems where set-off is, in the first place, an instrument of procedural law, the divide between applicable law and competence to hear the set-off might be less obvious, but those systems also have well known situations in which a set-off operates as a substantive defence to the claim. This is particularly the case in situations with which this Opinion is concerned, that is, in sales contracts arising out of the same contract or transaction.⁸³ The position taken here is thus less foreign to sales laws of common law jurisdiction than it could seem at first glance, even though one should not overemphasise similarities with domestic concepts, as the approach under the CISG is autonomously derived from within the Convention and is independent from solutions found under national laws.
- 5.5 Rule 1 in conjunction with Rule 5 thus states that the set-off of claims arising out of a contract governed by the CISG takes place according to the rules derived by the CISG. The rule does not raise questions of competence, as both the first and the second claim originate from the same contract, and the forum or arbitral tribunal competent to hear the dispute is the one chosen in the contract or determined in application of the relevant procedural rules.⁸⁴ The court or arbitral tribunal competent to hear the first claim is also competent to adjudicate the question of a set-off (always provided that the set-off concerns CISG-internal claims). This is not precluded by the fact that, in the absence of a specific party agreement, several places of jurisdiction may be possible for the contractual dispute.
- 5.6 Rule 1 further states that a set-off of claims arising out of different contracts both governed by the CISG operates according to the rules derived from the CISG and has the effect provided by it. The application of the CISG is thus not limited to a set-off arising out of the same contract. In fact, there is no valid reason to consider that, where the set-off concerns claims from the same contract, the CISG provides for general

⁸¹ Ibid.

⁸² Cf., e.g., Kantonsgericht Zug, 14 December 2009, CISG-online 2026, para. 14.

⁸³ Cf. § 2-717 UCC, on the one hand, and equitable set-off, on the other hand (above, para. 0.7). Whereas the first is limited to the same contract, equitable set-off requires that the claims arise out of the same transaction, which is appreciated by the court and may, as the case may be, give rise to set-off even if the claims stem from separate contracts, see *The Angelic Grace* [1980] 1 Lloyd's Rep. 288; *National Westminster Bank plc v Skelton* [1993] 1 WLR 72, 76.

⁸⁴ Theoretically, the parties could provide otherwise in a forum selection or arbitration clause, but considering the difficulties arising from such an agreement, this seems very unlikely.

principles governing the set-off, but does not so provide where similar claims, though arising from different transactions, are set off.

- 5.7 This approach does not modify the existing procedural rules on judicial competence as such. However, as with the requirements for set-off of CISG-internal clauses, its operation and its effect are governed by the Convention. Further, as a set-off under the Convention need not be asserted before a court or arbitral tribunal and does not depend on a judgment or award, a set-off of CISG-internal claims constitutes a defence to the main claim provided for by the Convention, that is, by substantive law. A court whose domestic law provides for procedural set-off can therefore not simply apply the criteria applicable to a set-off under its own law but must take account of the fact that the set-off it is asked to adjudicate is a matter of unified sales law. For example, a court which, in applying its own procedural law, would deal with a set-off only where a claim is liquidated cannot bar the defendant's unliquidated set-off defence where the set-off is governed by the CISG. This is because the Convention allows for a set-off of unliquidated claims (above, paras 3.16 and 3.17).
- 5.8 **Res judicata.** Where the parties' dispute is brought before a court or arbitral tribunal, the latter will admit or deny that the claims have been set off. The question may arise whether each of the claims may independently be raised in a new trial or whether the fact that there has been a judicial decision in the matter precludes adjudication by another court. The problem, known as *res judicata* (preclusion), is subject to the applicable procedural law. Generally speaking, in civil law countries, *res judicata* applies only to the operative part of the judgment (dispositif du jugement; fallo de la sentencia; prononcé; Urteilstenor). For example, where the defendant in a law suit argues that the plaintiff's claim must be rejected in the amount the defendant has a claim that it has set off and the court follows this argument by approving the plaintiff's claim only to the extent it exceeds the defendant's set-off claim, the operative part of the judgment will be 'Order to pay X and dismissal of the remainder of the plaintiff's claim'. The reason why part of the plaintiff's claim is dismissed – the fact that the defendant could rely on set-off – is just the motive and does not belong to the operative part of the judgment. However, by now, most domestic procedural rules contain a rule which extends *res judicata* to set-off,⁸⁵ or which entitles the plaintiff to demand an interim decision on the existence or non-existence of a right of set-off.⁸⁶ *Res judicata* in common law is considerably stricter than in civil law. Broadly speaking, a final judgment on the merits has to be reached for it to be conclusive between the parties as to all matters that were litigated or that could have been litigated in that action, which includes claims there were brought as a set-off in the proceedings, or could have been brought but were not.⁸⁷ The principle of *res judicata* has also been upheld in arbitration law.⁸⁸

⁸⁵ E.g., Swedish Code of Judicial Procedure, Chapter 17, Section 11 para. 2; German ZPO, § 322 para. 2; Ley de enjuiciamiento civil (Spain), article 408.3.

⁸⁶ Austrian ZPO, § 236.

⁸⁷ See Federal Rules of Civil Procedure, Rule 13(a)(1), according to which the defendant is obliged to state as a counterclaim (including set-off) any claim that he has against the opposing party if the claim arises out of the transaction (or occurrence) that is the subject matter of the plaintiff's claim.

⁸⁸ See judgment of the Swedish Supreme Court of 3 April 1998, Stockholm Arbitration Report 1999/2, 77 et seq. and also reported in Söderlund, Lis Pendens, Res Judicata and the Issue of Parallel Judicial Proceedings, 22(4) *Journal of International Arbitration* 2005, 301, 317-318: against the majority vote of the arbitrators and based on the domestic law of civil procedure, the Supreme Court found that legal finality in respect of an arbitral award extended to any claim that has been invoked for set-off purposes, even if the set-off claim exceeds the

- 5.9 The procedural rules on *res judicata* remain unaffected by the application of the CISG to set-off. The question of the law applicable to set-off and the matter of *res judicata* are separate questions. The CISG governs the question of whether the claims have been set off. Whether another court, or an arbitral tribunal, may come back to the question of whether there has been a set-off is a matter of procedural law.
- 5.10 **Counterclaim.** Finally, the application of the CISG to a set-off has no impact on the question of whether the claim in dispute can be brought as a counterclaim instead of being set off against the plaintiff's claim. Even though the terminology is not everywhere the same, and that under the US American Federal Rules of Civil Procedure, e.g., the term 'counterclaim' includes (procedurally operating) set-off,⁸⁹ there are important differences between a set-off under the CISG and a counterclaim as it is habitually defined. From a comparative perspective, the most important difference is that a counterclaim requires a pending action, that is, it operates only before a court or arbitral tribunal. A counterclaim has the advantage that it enables the defendant to enforce its claim against the plaintiff even if the proceedings have been initiated by the plaintiff, and it may exceed the amount claimed by the plaintiff. Depending on the applicable procedural law, a counterclaim may also allow third parties to be involved in the litigation. However, a counterclaim requires a pending action, can be subject to time limits and formalities, has an effect on the court fees and the bearing of the costs of procedure, and usually requires that the counterclaim can be conducted in the same type of proceedings as the action.⁹⁰ All those aspects, in particular availability, requirements and effects of a counterclaim, are subject to the procedural *lex fori* or *lex arbitri*. A counterclaim is thus an instrument that differs from any type of domestic set-off, also from procedurally operating set-off, and that differs considerably from a set-off under the CISG. For a party confronted with a claim arising from a sales contract, set-off and counterclaim present different possibilities to react, depending on the circumstances of the case. Obviously, where a party decides to raise a counterclaim rather than to rely on a set-off, in the merits, its claim will be governed by the CISG, but the applicability of the Convention is limited to it, and the admissibility and operation of the counterclaim is subject to the applicable procedural law.

main claim. See also Poudret/Besson, *Comparative Law of International Arbitration*, 2nd ed., London 2007, 279-280; Günes, *Res Judicata in International Arbitration: To What Extent Does an Arbitral Award Prevent the Re-Litigation of Issues?*, 12(6) *Transnational Dispute Management* 2015, 1, 20.

⁸⁹ Cf. Federal Rules of Civil Procedure, Rule 13(c).

⁹⁰ For further differences between set-off and counterclaim and their respective advantages and disadvantages see Pichonnaz/Gullifer, *Set-off in arbitration and commercial transactions*, Oxford 2014, para. 5.13 *et seq.*