



THE DUTY TO PAY INTEREST ON ADVANCE PAYMENTS UNDER ART. 84 (1) CISG

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ABSTRACT

One of the primary effects of contract avoidance is the restitution of performances already made. In this regard, Art. 81.2 CISG authorizes either party to the contract who has performed in whole or in part to claim the return of whatever he has supplied or paid under the contract. Furthermore, the parties must return all benefits of possession – profits and advantages of use. The buyer is only bound to return the benefits he actually derived from using the goods, or part of them (Art. 84.2 CISG). Likewise, if the seller is bound to refund the price, it must also pay interest on it, from the date on which the price was paid (Art. 84.1 CISG). A closer look to the CISG reveals, however, that the Convention does not settle – at least not expressly – the applicable interest rate under Art. 84.1. This article attempts, accordingly, to determine the extent to which this issue is regulated in the CISG and how a possible gap is to be filled. Special attention is paid to the practice of national courts on this matter.

1. Introduction

(1.) The 1980 U.N. Convention on the International Sale of Goods, hereinafter CISG, regulates in Arts. 81-84 the effects of contract avoidance. The primary effect is that prescribed in Art. 81.1 CISG: both parties are released from their obligations under the contract, subject to any damages which may be due. It is likely that either party may be left with property transferred by the other or with a payment made by the other. In that case, the parties can agree on a formula for adjusting the price to the deliveries already made. But, either party may also wish to rid itself of a performance received because it is of no value to it; recover money transferred to the other party if nothing has been received in return and/or recover property. For this reason, Art. 81.2 CISG authorizes either party to the contract, who has performed in whole or in part, to claim the return of whatever he has supplied or paid under the contract. Accordingly, under the CISG either party may claim restitution of performances already made, independently of whether the party demanding restitution is entitled to avoid the contract *cif.* Art. 81.2 CISG. On this point, the CISG adopts a different approach than other legal systems, where only the aggrieved party can make demand for restitution.¹ According to the Secretariat Commentary on Art. 66 of the 1978 Draft – draft counterpart of Art. 81 CISG – the underlying idea is that the avoidance of the contract undermines the basis on which either party can retain that which he has received from the other party.² Therefore, the parties must return all benefits of possession – profits and advantages of use. The buyer is only bound to return the benefits he actually derived from using the goods, or part of them (Art. 84.2 CISG). Likewise, if the seller is bound to refund the price, it must also pay interest on it, from the date on which the price was paid (Art. 84.1 CISG). A closer look to the CISG reveals, however, that the Convention does not settle – at least not expressly – the applicable interest rate under Art. 84.1. This article attempts, accordingly, to determine the extent to which this issue is regulated in the CISG and how a possible gap is to be filled. Special attention is paid to the practice of national courts on this matter.

2. Interest rates and gap-filling of the CISG

As known, Art. 7.2 CISG deals with gap-filling of the Convention. Pursuant to Art. 7.2, “questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.” It follows from this provision that national law should be the last recourse for

1 Civil law systems generally allow restitutionary claims by a defaulting party. See notes to PECL arts. 9:305-9:309, Lando, O. and Beale, H., *Principles of European Contract Law, Parts I and II*, Kluwer Law International, 2000, p. 426 ss. Common law is, however, more restrictive. Except in a claim for the recovery of monies paid, (*Dies v. British & International Mining & Finance Co.*, (1939) 1 K.B. 724, appvd. in *Stockloser v. Johnson* (1954) 1 Q.B. 476, C.A.), a party in breach cannot bring a successful restitutionary claim unless he has substantially completed his performance or unless the other party is deemed to have accepted or agreed to the deficient performance: *Cutter v. Powell* (1795) 6 T.R. 320; *Britain v. Rossiter* (1879) 11 Q.B.D. 123; Cheshire & Fifoot, *The Law of Contract*, 9th ed., pp. 523-24. See Ziegel, J., *Report to the Uniform Law Conference of Canada on Convention on Contracts for the International Sale of Goods*, available at <http://www.cisg.law.pace.edu/cisg/text/ziegel81.html>.

2 <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-81.html>.

the purpose of gap-filling in the Convention. Only when an autonomous rule cannot be derived from the CISG, resort is to be made to private international law. Finally, for gaps in matters totally excluded from the scope of the Convention, such as the matters contemplated in CISG arts. 4 and 5, national law applies.

The application of Art. 7.2 presupposes, accordingly, the existence of a veritable gap, an issue that is not expressly addressed by CISG, but which falls under a matter covered by the Convention. The problem is that there are many issues arising from international sales that are not expressly settled by CISG, but very few matters not governed by the Convention. Indeed, CISG deals with restitutionary claims in Arts. 81-84. Yet, the absence of an express regulation of the applicable interest rate to price refunds may, perhaps, respond to the drafters' will to exclude them from the scope of the Convention. In consequence, one should be very careful in filling hypothetical gaps in the CISG by reading into it something that is not there.

Insofar as the application of Art. 7.2 CISG is verified, it is necessary to ascertain the *general principles on which the Convention is based*, applicable to the issue at hand. In this regard, the expression "general principles" refers to the *internal principles* found within the Convention itself, in its legislative history, in the underlying objectives of each provision and the whole text. These principles may also be found through the analogous application of other CISG provisions, which deal with a similar conflict of interest as the issue in question.³ The general principles of the Convention are different from *external principles*, which may be taken from other legal texts such as *The UNIDROIT Principles of International Commercial Contracts*, hereinafter UP.⁴ The scholarly debate has largely concentrated on the role of the UP to fill the gaps in the CISG⁵ and this is not the place to consider this discussion. Briefly explained, some scholars are of the opinion that as far as the UP are inspired by the CISG, the decision maker should turn to the UP before resorting to national law.⁶ Such opinions have found support in practice, in particular, in establishing the rate of interest to which a party is entitled under Art. 78 CISG. As far as this provision does not endorse how to determine such a rate, at least three arbitral awards⁷ have made recourse to UP Art. 7.4.9 (2), which indicates that the applicable interest rate shall be the average bank short-

3 See Gebauer, M., "Uniform Law, General Principles and Autonomous Interpretation", *ULR* 2000-4, pp. 683ff.

4 UNIDROIT - *International Institute for the Unification of Private Law - Principles of International Commercial Contracts*, Rome, UNIDROIT, 1994; *UNIDROIT Principles of International Commercial Contracts* 2004.

5 See e.g. Garro, A., "The Gap-Filling Role of the UNIDROIT Principles in International Sales Law", *69 Tulane Law Review*, p. 1149ff; Bonell, M.J., "Unification of Law by Non-legislative Means: The UNIDROIT Draft Principles for International Commercial Contrats", *40 Am.J.Comp.L.*, 1992, pp. 628ff; Basedow, J., "Uniform Law Conventions and the UNIDROIT Principles of International Commercial Contracts", *ULR* 2000-1, pp. 129ff; Drobniq, U., "The Use of the UNIDROIT principles by National and Supranational Courts", *UNIDROIT Principles for International Commercial Contracts: A New Lex Mercatoria?*, ICC Publication n. 490/1, 1995, pp. 223-32.

6 Garro, A., *69 Tulane Law Review*, pp. 1156-7; Bonell, M.J., *40 Am.J.Comp.L.*, at p. 629; Drobniq, U., ICC Publication n. 490/1, at p. 228; Contrary, Basedow, J., *ULR* 2000-1, at pp. 133-5.

7 *Internationales Schiedsgericht der Bundeskammer der gewerblichen Wirtschaft*, Wien, Schiedsspruche SCH 4318 and SCH 4366 of 15 June 1994: see them published in the original German version in *RIW*, 1995, p. 590ff., with note by Schlechtriem, P. (p. 592ff.); for an English translation see Bonell, M.J. (ed.), *UNILEX. International Case Law & Bibliography on the UN Convention on Contracts for the International Sale of Goods*, Transnational Publishers, Inc., Ardsley, NY, December 1998 release, E.1994-13 and E.1994-14. For a succinct presentation in French, see Seidl-Hohenveldern, I., in *JDI*, 1995, pp. 1055-1056. Source: www.unilex.info.

term lending rate to prime borrowers prevailing for the currency of payment at the due place of payment or, in the absence of such a rate, the rate fixed by the law of the state in which the payment has to be made.

Contrary to this opinion, some argue that internal principles have priority over external principles⁸ and, only when it is proven that the solution provided by the UP does not contradict a teleological and systematic interpretation of CISG, may the former be applied to fill a gap within the Convention.

In any case, pursuant to Art. 7.2 CISG, as far as it is not possible to infer a principle in the Convention applicable to the issue at hand, national law shall apply.

Turning back to restitutionary claims, it follows from these considerations that in order to ascertain the applicable interest rate to advance payments, it is essential to establish whether we are dealing with matters that fall outside the scope of the CISG, or whether the gap is *praeter legem*, that is to say, a matter governed but not expressly settled by the Convention (Art. 7.2 CISG). Finally, for gaps *praeter legem*, it will be necessary to infer a principle from the Convention applicable to the issue at hand or, in the absence of such, recourse will have to be made to national law.

3. The duty to pay interest

As mentioned, the CISG incorporates the idea that the avoidance of the contract undermines the basis on which either party can retain that which he has received from the other party. As a result, the parties must return all benefits of possession – profits and advantages of use. The CISG deals with this duty to return all benefits of possession in Art. 84. Pursuant to Art. 84.1 CISG, if the seller is bound to refund the price, he must also pay interest on it, from the date on which the price was paid. The provision does not settle – at least not expressly – what the applicable interest rate under Art. 84.1 is.

The duty to pay interest under Art. 84.1 CISG is not the only provision in the Convention on interest. Indeed, Art. 78 CISG deals generally with this subject and neither does this article establish the rate of interest and the method of calculating it. The different approaches on how to establish the rate of interest to which a party is entitled under Art. 78 CISG are widely known.⁹ Here, opinions range from a connection to domestic law to the application of a general principle under the Convention, with or without a reference to instruments external to the Convention, such as the UP.

8 Gebauer, M., *ULR* 2000-4, at p. 702.

9 See e.g. Honnold, J. O., *Uniform Law for International Sales under the 1980 United Nations Convention*, 3rd ed. (1999), Kluwer Law International, pp. 465-471; Perales Viscasillas, M. P., “La determinación del tipo de interés en la compraventa internacional”, *Cuadernos Jurídicos* (julio-agosto 1996) No. 43, 5-12, available at: <http://www.cisg.law.pace.edu/cisg/biblio/78art.html>.

Logically, the discussion has been transferred to the context of Art. 84.1 CISG. In this regard, the solutions provided in case law and by the doctrine do not always coincide. According to a first approach, the CISG does not deal with the issue on the rate of interest. Subsequently, differences appear as to the method to calculate the interest payable. Another approach maintains that the calculation of the rate of interest lies within the framework of the Convention and that the gap shall be filled according to general principles.

3.1 *The leading view: the application of national law*

The leading view is that the calculation of the rate of interests falls outside the scope of the Convention and shall be established according to the applicable domestic law.¹⁰ This has been confirmed in a considerable number of cases.¹¹ To provide a recent example, a decision of the *Oberlandesgericht Köln* from 2002¹² can be mentioned. The dispute concerned a contract for the sale of high quality seasonal women's clothes, concluded between an Italian seller and a German buyer. Following the non-conformity of the goods, the buyer avoided the contract and requested the refunding of the partial payment already made. After that, the seller commenced an action to recover full payment. As to the merits of the case, the Court held that the buyer had validly avoided the contract in accordance with Art. 49.1(a) CISG and was entitled to be refunded of the partial payment made in accordance with Art. 81.2 CISG, plus interest at the rate determined according to the otherwise applicable law (Art. 1284 of the Italian Civil Code).

3.2 *The rate currently used in international trade*

Pursuant to another view, the calculation of the rate of interest also falls outside the scope of the Convention, although the method to calculate the rate of interest differs from that of the leading view. Hence, under this approach the rate shall be fixed by way of reference to the rate currently used in international trade. This was, at least, the approach of the arbitrators in the ICC Award No. 6653/1993.¹³ The dispute concerned a contract for the sale of steel bars concluded between a German seller and a Syrian buyer. Following the non-conformity of some of the goods received the buyer asked the seller to cease delivery, take back the goods and refund the price paid. In this regard, the Arbitral Tribunal found that some of the lots of steel bars delivered were of non-conforming weight, and entitled the buyer to partial avoidance of the contract and a refund of

10 Schlechtriem, P., *Einheitliches UN-Kaufrecht*, 3. Auflage, 2000, at p. 94.

11 See e.g. Case no. 12 O 153/92, *Landgericht Krefeld*, 24 November 1992, available at www.unilex.info; ICC Award no. 7660/JK, 23 August 1994, available at www.unilex.info; Case no. 8 HKO 24667/93, *Landgericht München*, 8 February 1995, available at www.unilex.info; Case no. 54 O 644/94, *Landgericht Landshut*, 5 April 1995, available at www.unilex.info; Case no. 20 U 76/94, *Oberlandesgericht Celle*, 24 May 1995, available at www.unilex.info; Case no. T.171/95, *Bezirksgericht der Saane*, Switzerland, 20 February 1997, available at www.unilex.info; Arbitral Award from the *Schiedsgericht Hamburger Freundschaftliche Arbitrage*, 29 December 1998, available at www.unilex.info; Case no. 12.97.00193, *Tribunale di Appello di Lugano, seconda camera civile*, 15 January 1998, available at www.unilex.info and, the ICC Arbitral award no. 9978/99, March 1999, available at www.unilex.info.

12 Case no. 16 U 77/01, *Oberlandesgericht Köln*, 14 October 2002, available at www.unilex.info.

13 ICC Award no. 6653/1993, 26 March 1993, available at www.unilex.info.

the price already paid for the non-conforming lots. In accordance with Arts. 78 and 84 CISG the buyer was awarded interest on the price to be refunded, accruing from the date of payment for each non-conforming lot of steel bars. The court finally held that as CISG does not determine the rate of interest, the applicable rate was to be the one currently used in international trade with respect to eurodollars, the currency in which payment had to be made. The court subsequently applied the annual London International Bank Offered Rate (LIBOR).

3.3 *The applicable rate at the seller's place of business*

Under a third view, the calculation of the rate of interest falls within the scope of the Convention. Within the framework of Art. 7.2 CISG, the calculation of the rate of interest shall be made according to the law of the seller's place of business, based on the principle of equalization of benefits under Arts. 81.2 and 84 CISG.¹⁴ As the seller was able to use the sum received from the buyer and work with it, once the contract is avoided, he is no longer entitled to retain those benefits. Indeed, it is the possible benefit of the seller which must be removed.¹⁵ This approach is supported by the Secretariat Commentary on Art. 84 CISG, which proclaims that '[...] since the obligation to pay interest partakes of the seller's obligation to make restitution and not of the buyer's right to claim damages, the rate of interest payable would be based on that current at the seller's place of business'.¹⁶ The decision from the Commercial Court of Zürich from 5 February 1997¹⁷ also seems to affirm this view. The case concerned a contract for the sale of Italian sunflower oil concluded by a German buyer and two French sellers. Following a non-delivery, the buyer declared the contract avoided. The buyer brought an action to recover the advance payment and damages. In the Court's opinion, the buyer had validly avoided the contract and, *inter alia*, was entitled to receive restitution of the advance payment as a consequence of the avoidance of contract (Art. 81.2 CISG). The Court held, in this regard, that according to Art. 84 CISG the buyer was entitled to interest on the advance payment, to be calculated from the date payment had been made. As to the applicable rate of interest, the court applied the interest rate of the sellers' place of business, 'that being the place in which the sellers usually invest their money'.

3.4 *Joint application of interest rates?*

A Finnish decision from 1997¹⁸ may be reflecting a fourth view on the applicable rate under Art. 84.1 CISG. The case concerned a contract for the delivery of butter concluded between a Lithuanian buyer and a Finnish seller. Following a non-delivery, the buyer commenced action

14 Hornung, R., "Effects of avoidance" in Schlechtriem, P. and Schwenzer, I., *Commentary on the UN Convention on the International Sale of Goods (CISG)*, Second Edition, 2005, Oxford, p. 883ff.

15 *Ibid*, p. 885.

16 *Secretariat Commentary on Art. 69 of the 1978 Draft* - draft counterpart of Art. 84 CISG - available at <http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-84.html>.

17 Case no. HG 95 0347, *Handelsgericht Zürich*, 5 February 1997, available at www.unilex.info.

18 Case no. S 96/605, Court of Appeal of Eastern Finland, 27 March 1997, available at www.unilex.info.

against the seller demanding, *inter alia*, the return of the advance payment. The Court held, among other things, that according to Art. 84 CISG the seller had to refund the price and pay interest on it. Furthermore, according to Art. 74 CISG, the seller had to pay the buyer damages for lost profits. In this regard, the Court found that the seller knew that the buyer had to take credit to finance the advance payment and therefore the damages also included compensation for interest loss. But, as it was not shown that the seller knew or should have known about the interest rates in Lithuania, namely 7% per month and 0.5% per day interest in arrears, which essentially differs from interest rates in Western Europe, the Court found that the seller should have estimated a loss of about 10% of the sale price. The seller, accordingly, had to compensate for this loss. Finally, the Court found that the seller had to pay interest according to Art. 78 CISG, which was determined by the interest rate of the Bank of Finland added with 7%.

It is difficult to establish whether the interest awarded in this decision was based on the loss suffered by the aggrieved buyer rather than on a restitutionary approach to prevent unjust enrichment by the seller under Art. 84 CISG. Normally, in situations such as in this case, where it is necessary for the buyer to take a loan at a higher rate of interest, the claim for interest in excess is deemed to fall within the scope of Art. 74 CISG, as a general damages rule.¹⁹ This loss was apparently recovered by the buyer – although limited by the principle of foreseeability of the loss – when it was awarded 10% of the sale price in damages. Being so, the interest awarded in the decision must have corresponded to the right to interest under Art. 84.1 CISG. Now, the Court awarded the interest rate of the Bank of Finland – the sellers' place of business – added with 7%. This added percentage was, in fact, the applicable interest rate in Lithuania. Although the Finnish Court did not clarify whether it considered the calculation of the interest rate to fall within the scope of the Convention, the method used by the Finnish court appears to be a joint application of the interest rates at the seller and the buyer's place of business.

4. Assessment

As seen, the calculation of the interest rate under Art. 84.1 CISG is an unsettled issue. From the different approaches found in theory and in caselaw the application of the interest rate of the seller's place of business within the framework of Art. 7.2 CISG seems to be in better accordance with the purpose behind Art. 84.1.

The practical details of restitutionary duties are regulated in Arts. 81-84 and, apparently, there were no major discussions on the drafting of the duty to pay interest on advance payments, as in the case of the general duty to pay interest under Art. 78 CISG.²⁰ In consequence, the calculation of the rate of interest applicable to the refund of advance payments falls, *prima facie*, within the scope of the CISG and should be solved according to the general principles on which the Convention is based. In this regard, Article 84.1 CISG operates irrespective of which party

19 Hornung, R., *Commentary on the UN Convention*, at p. 884.

20 On the legislative history of Art. 84 see <http://www.cisg.law.pace.edu/cisg/text/matchup/matchup-d-84.html>.

breached the contract.²¹ It is founded on the idea that contract avoidance destroys the basis on which the seller can retain the sums it has received from the buyer. Following from this, the provision is not aimed at compensating the buyer's loss, but at preventing unjust enrichment of the seller, who may have invested the sum prepayed by the buyer and obtained benefits from it. For this reason, the discussions on the applicable interest rate under Art. 78 CISG should not be transferred to the context of restitution and *viceversa*.²² Considering that Art. 84 CISG, as a whole, reflects the principle of equalization of benefits, it seems logical to apply the interest rate of the place where the money is likely be invested – the seller's place of business.

21 Hornung, R., *Commentary on the UN Convention*, at pp. 883 ff.

22 See e.g., Perales Viscasillas, M. P., *Cuadernos Juridicos*, under III.