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Can Economic Sanctions be Grounds for Exemption under the CISG?

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Abstract

Purpose – This paper studies whether economic sanctions can be used as grounds for a party to an international sales contract to get an exemption if he fails to meet his contractual obligation. Because the answer can differ depending on the governing law of the contract, this study focuses on CISG, the most widely recognized international uniform legal instrument as the governing law of the international sale of goods.

Design/methodology – This paper focuses on analyzing the conditions to meet before getting an exemption under CISG. For such analysis, this paper examined various scholarly writings, cases, and hypothetical examples reflecting a wide variety of economic sanction measures.

Findings – The findings of this paper are as follows. The main provision for exemption under CISG is Article 79(1), which provides for an exemption for a party that failed to perform if such failure was caused by an impediment that was uncontrollable, unforeseeable, and unavoidable; either a seller or a buyer may rely on the Article for his non-performance, delay, or defective performance. The Article is applicable not only where the economic sanction caused impossibility of performance but also where it caused hardship. The economic sanction will likely be found to be an uncontrollable impediment; however, it will be relatively more difficult to prove it to be unforeseeable or unavoidable.

Originality/value – The subject of this paper is whether a party can be exempted from liability under CISG when he fails to perform his contractual obligations due to economic sanctions. Given that this issue is now actually faced by many involved in international trade, it is expected to provide practical help to practitioners and companies alike.

Keywords: Article 79, CISG, Economic Sanctions, Hardship, Impediment, Impossibility
JEL Classifications: K12, K40

1. Introduction

Since the creation of the United Nations after World War II, the use by states of economic sanctions as one of the main tools for advancing foreign policy goals has been expanding.[1] For the most recent example, after the Russian invasion of Ukraine in February 2022, many Western countries, including the United States of America and the European Union member states, decided to impose various economic sanction measures upon Russia, including an asset freeze, restrictions on import and export, prohibition of transactions with Russian banks, and the exclusion of several Russian banks from the SWIFT (Society for Worldwide Interbank Financial Telecommunication) system.[2]

Economic sanctions can hinder or intervene in international trade in various ways.[3] Among others, due to its very nature, economic sanctions can pose various disruptions to the implementation of international trade contracts, especially those for the sale of goods.[4] First, economic sanctions may order the parties to an international sales contract not to perform it.

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For example, the fact that the United States government bans the import of oil from Russia could mean that a person under the jurisdiction of the United States that already made a Russian oil purchase agreement is prohibited from complying with it. Even in case it is not completely mandatory, a prohibition imposed by an economic sanction can make the performance of the contract extremely onerous. For example, if a frequently used trade route is closed by a sanction, a party obligated to deliver the goods may incur a significant increase in cost, sometimes too big to bear.

Furthermore, in view of today's extremely globalized market circumstances, for an international contract to be not directly involved in the conflict between the sanctioning and sanctioned States does not guarantee that it will not be affected by the sanctions.[5] Let us consider a following hypothetical situation. Shortly after the Western countries decided to impose economic sanctions on Russia in March of 2022, nickel and oil prices skyrocketed around the globe because Russia is a major exporter of natural resources. Among such resources, nickel is a key component in lithium-ion battery cells used in the majority of electric devices, including electric vehicles. Several months before the Russian invasion of Ukraine, a Japanese car seller and a South Korean buyer made a contract for the sale of electric vehicles made by the former. The seller normally used lithium-ion batteries purchased from a US supplier that mainly relied on nickel imported from Russia. While the seller tried to place a purchase order for the batteries from the US supplier as usual, the invasion broke out and the supplier told the seller that the batteries couldn't be delivered in the time the seller asked for. The supplier also informed the seller that there would be a significant delay in the production of batteries, and that the price needed to be adjusted significantly. Under such circumstances, the seller is most likely not going to be able to deliver the electric vehicles as agreed under the sales contract, or it will incur an extreme deficit which could even threaten the sustainability of the business.

As a matter of the general principle of contract law, a contract must be performed as agreed upon between the parties:[6] if a party fails to perform as agreed, he will be found liable. However, there are several excuses that may exempt a party from liability for such non-

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[1] Paul Szasz, "The Law of Economic Sanctions", International Law Studies, 71.1 (1998) p. 455.

[2] US Department of the Treasury, Press Releases, "U.S. Treasury Announces Unprecedented & Expansive Sanctions Against Russia, Imposing Swift and Severe Economic Costs", February 24, 2022, available at https://home.treasury.gov/news/press-releases/jy0608 (last visited: April 1, 2022); Europea Commission, Press Release, "Ukraine: EU agrees to exclude key Russian banks from SWIFT", March 2, 2022, available at https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1484 (last visited: April 1, 2022).

[3] Dr. Mercedeh Azeredo da Silveira, "Chapter 7. Economic Sanctions, Force Majeure and Hardship" in Fabio Bortolotti and Dorothy Ufot, eds. *Hardship and Force Majeure in International Commercial Contracts: Dealing with Unforeseen Events in a Changing World*. Kluwer Law International BV (2019)(hereinafter referred to as "Silverira 2019") p. 161; Daniel Martin, "Chapter 2, International Trade Sanctions", in Andrew Chamberlain, Holly Colaço and Richard Neylon, eds., *The Shipping Law Review*, 8th ed., Law Business Research Ltd (2021), p. 15.

[4] Silveira 2019., p. 161.

[5] As an article related to the issue, See The Conversation, "From soaring gas prices to another world war, economic sanctions can lead to dire unintended consequences", March 11, 2022, available at https://theconversation.com/from-soaring-gas-prices-to-another-world-war-economic-sanctions-can-lead-to-dire-unintended-consequences-178873 (last visited: April 1, 2022).

[6] UNIDROIT Principles of International Commercial Contracts 2016 (hereinafter referred to as the "PICC"), Article 1.3, Comment 1. The principle pacta sunt servanda, p. 9.

performance.[7] Then, can an economic sanction be grounds for such an exemption? In other words, can a party to an international sale of goods contract that could not be performed as agreed upon because of economic sanctions be exempted? If so, based on what excuse can they be exempted?

The answer as to how this kind of legal predicament is to be overcome will depend on the terms and conditions of the relevant contract and its governing law. In order to find its answer, this study looks into the United Nations Convention on Contracts for the International Sale of Goods (hereinafter referred to as the "CISG"),[8] known as the most important international legal instrument that governs international contracts for the sale of goods.[9] Here, the key question to ask is whether economic sanction measures can be seen as a ground under CISG for exemption given to a party's non-performance of an international sales contract. Before seeking an answer, the paper first tries to tell what economic sanctions are and how they can affect a party's contractual performance by looking into different types of economic sanctions. Then, there is a focus on the exemptions allowed under CISG, especially under Article 79 of the Convention, and also on the conditions which need to be met in order for a party that claims to be affected by economic sanctions to successfully rely on the Article. Although Article 79 of CISG has been reviewed many times since the making of the convention[10], there seem to be no previous studies which specifically dealt with the issue of whether economic sanctions can be used as a ground for exemption under the article, and if so, under what conditions. Therefore, it is believed this paper will contribute to shedding a clearer light on this matter, which is of particular practical importance these days.

2. Typology of Economic Sanctions

In general, economic sanctions refer to economic means for exercising pressure against a

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[7] Peter J. Mazzacano, "Force Majeure, Impossibility, Frustration & the Like: Excuses for Non-Performance; the Historical Origins and Development of an Autonomous Commercial Norm in the CISG", *Nordic Journal of Commercial Law* (2011), pp. 1-54.

[8] Adopted in 1980, the CISG currently has 94 member states as of March 2022. See United Nations Treaty Collection, Depositary, Status of Treaties, Chapter X International Trade and Development, 10. United Nations Convention on Contracts for the International Sale of Goods, https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=X-10&chapter=10 (last visited: April 1, 2022).

[9] Christoph Brunner, Force majeure and hardship under general contract principles, exemption for non-performance in international arbitration, Wolters Kluwer Law & Business (2009), p. 17, fn. 94.

[10] Among such many previous studies on Article 79 of CISG, the most noteworthy from South Korea include: Won-Suck Oh, "Study on Shortcomings of Force Majeure clause(Art. 79) Under CISG", *Korea International Commercial Review*, 13(3) (1998); SurJimin, Choi, June Sun, "A Study on the Cases concerning Impediment concept under the CISG Article 79", *SungKyunKwan Law Review*, 24(2) (2012); Jin, Do-Wang, "The Legal Treatment of the Delivery of Nonconforming Goods under the CISG Article 79", *Korean Forum on International Trade and Business Law,* 24(1) (2015); Kim, Son Guk, "Several Issues regarding Article 79 (Exemption) of the U.N. Convention on Contracts for the International sale of Goods(CISG)", *The International Commerce & Law Review*, 67 (2015); Song, Young-Min, "The Legal Principles of Impediment in CISG Article 79", Wonkwang Law Review, 28(4) (2012); Choi Sung Soo, "Trends in national case law on the Exemption under Article 79 of the CISG", *CAUJLS*, 40(1) (2016); Cheonsoo Lee, "A Study on the Requirements and Effects of the Exemption in CISG Article 79", *JITC,* 6(1) (2010); Kyujin Kim, "CISG Article 79 and Hardship :Focusing on the CISG AC Opinion No. 20", *Korean Forum on International Trade and Business Law*, 30(1) (2021); and Hyung-Jin Chung, "Hardship in Article 79 of the CISG", *Journal of Business Administration & Law*, 28(1), 2017.

target State, entity, or individual.[11] There is, however, no single universal definition of the term, and it can be clothed in many different forms and contents. Since sanctions can have different impacts on the performance of contractual obligations depending on type, we need first to see the types economic sanctions can take, and what the potential impacts on contractual obligations are.

2.1. Multilateral Sanctions v. Unilateral Sanctions

To start, economic sanctions are very commonly divided into multilateral and unilateral, depending on the number of countries that engage in economic sanctions against a specific target.

Multilateral sanctions refer to those measures adopted by a plurality of States, often under the aegis of international organizations on the universal or the regional level, like the United Nations or the European Union.[12] Among multilateral sanctions, those contained in the resolutions adopted by the United Nations Security Council pursuant to Article 41 of Chapter VII of the United Nations Charter (the "Charter") can have the strongest legally binding force, in which case they must be complied with by all member states of the de facto universal Organization in accordance with Article 25 of the Charter.[13] For this reason, the economic sanctions adopted by the United Nations Security Council are sometimes even referred to as "universal sanctions" in order to be distinguished from other types of multilateral sanctions, like those adopted by the EU, which can be only binding upon its 27 member states as they stand now.[14]

The concept of unilateral sanctions, as opposed to multilateral, is used when sanctions are imposed by a single State against a target without being engaged by other countries.[15][16] Such sanctions will be binding on the people within the jurisdiction of the State issuing such sanctions, but some may also have a long-arm or extraterritorial effect. Specifically, unilateral sanctions adopted by a country with exceptional strength in the world order, such as the United States, arguably, may exert more influence upon a target than the multilateral ones under the UN regime, which tends to cause heated controversies as to the legality of such measures in the eyes of public international law.[17]

In any case, the legality of the sanctions on the one hand and their effectiveness on the other

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[11] Szasz, op. cit., p. 456; Angelo De Lauro, The UN Sanctions Regime-Striking a balance between the maintenance of international security and the protection of individual rights (2019), p. 12.

[12] Lauro, op. cit., pp. 20-22.

[13] Golnoosh Hakimdavar, A Strategic Understanding of UN Economic Sanctions: International Relations, Law and Development. Routledge (2013), p. 25.

[14] Lauro, op. cit., p. 21.

[15] Lauro, op. cit., p. 20; Charlotte Beaucillon, "Practice Makes Perfect, Eventually? Unilateral State Sanctions and the Extraterritorial Effects of National Legislation", in Natalino Ronzitti, *Coercive Diplomacy, Sanctions and International Law*, Brill Nijhoff (2016), p. 103.

[16] The most typical examples of unilateral sanctions are the US sanctions against Cuba, Iran, and Libya.

[17] For example, in 1995, the United Nations General Assembly adopted a resolution on "Economic Measures as a Means of Political and Economic Coercion against Developing Countries", and later further adopted other resolutions including "Unilateral Economic Measures as a Means of Political and Economic Coercion Against Developing Countries" which urged to "eliminate the use by some developed countries of unilateral coercive measures against developing countries which are not authorized by relevant organs of the United Nations or are inconsistent with the principles contained in the Charter of the United Nations..."

are different issues, and must be treated separately. Against this perspective, it will be undeniable that the stronger position the sanction-imposing (issuing) state occupies in the world economy, the more effective they can be.[18] For example, the economic sanctions adopted by ten States that have little share in international trade against a State who, however, has dominance in international trade will be less impactful than those adopted by the dominant State against the other ten States. Therefore, the issue of whether the impact of a specific economic sanction on a contractual obligation is great enough to allow an exemption for non-performance needs to be assessed on a case-by-case basis, rather than by focusing on the type of sanctions being either multilateral or unilateral.

However, some courts and commentators seem to believe otherwise[19]; they often attempt to mix this issue with the one of the legality (or illegality) of economic sanction measures, especially when those come from another jurisdiction, extraterritorially.[20] More often than not, the courts of this view deny exemption to the parties claiming to be affected by an economic sanction unilaterally imposed by another jurisdiction. While understandable in a way, such an approach seems to needlessly confuse the matter.

2.2. Primary Sanctions v. Secondary Sanctions

Another way of distinguishing economic sanctions is to typify them as either primary or secondary sanctions. If a sanction targets its intended addressee point-blank, it is called a primary sanction[21]. The US government's freezing of the assets and interests of North Korean officials belongs to this category;[22] the EU's prohibition of exports or imports to or from Russia of certain goods and of new investments in certain economic sectors in Russia does as well.[23] These primary sanctions are usually adopted and enforced within the jurisdiction of the sanctioning State.

By contrast, a secondary sanction is intended to 'deter or influence' the behavior of those who may attempt to have business with, or provide assistance to, the addresses of the primary sanction.[24] To put it another way, this is aimed at those "doing business with, or giving

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[18] For the arguments supporting the effectiveness of unilateral sanctions, see Drezner Daniel, "Bargaining, Enforcement, and Multilateral Sanctions: When is Cooperation Counterproductive?", International Organization (2000), 54(1) pp. 709–731; Miers Anne C., and Morgan T. Clifton, "Multilateral Sanctions and Foreign Policy Success: Can Too Many Cooks Spoil the Broth?", International Interactions (2002) 28(2), pp. 137–164.

[19] Azeredo da Silveira, "Economic Sanctions and Contractual Disputes Between Private Operator" in Larissa van den Herick (ed), Research Handbook on UN Sanctions and International Law, Edward Elgar Publishing (2017), p. 340.

[20] The Netherlands: District Court at the Hague Judgment in Compagnie Europeenne Des Petroles S.A. v. Sensor Nederland B.V. (Extraterritoriality of U.S. Export Administration Regulations; Contractual Obligations), International Legal Materials, Vol. 22, No. 1 (JANUARY 1983), pp. 66-74.

[21] This type of sanction is also called "targeted sanctions". See Economic Sanctions - Agencies Assess Impacts on Targets, and Studies Suggest Several Factors Contribute to Sanctions' Effectiveness - (October 2019) https://www.gao.gov/assets/gao-20-145.pdf; https://www.atlanticcouncil.org/blogs/econographics/ole-moehr-3/ (last visited: April 1, 2022).

[22] *See, e.g.*, Executive Order 13551.

[23] *See, e.g.*, EU sanctions against Russia following the invasion of Ukraine, available at https://ec.europa. eu/info/strategy/priorities-2019-2024/stronger-europe-world/eu-solidarity-ukraine/eu-sanctions-against-russia-following-invasion-ukraine_en (last visited: April 1, 2022).

[24] Economic Sanctions - Agencies Assess Impacts on Targets, and Studies Suggest Several Factors Contribute to Sanctions' Effectiveness - (October 2019), pp. 23-24 available at https://www.gao.gov/

support and/or facilities to, the addressees or targets of the primary sanction", thereby sending to such third persons the message that their commercial risks will likely increase if they trade with those targeted by the primary sanction. The main purpose of the secondary sanction is to "make it more difficult [for the targets of primary sanction] to avoid or adapt to sanctions".[25] The US government's designation of foreign financial institutions such as "Banco Delta Asia" as a "primary money laundering concern"[26] is a typical example of a secondary sanction, in the sense that it sent the message to other foreign financial institutions that it would be too risky to have business with North Korea. Secondary sanctions can appear in the form of the blocking of the property and interests in property of any foreign person found to "have engaged…in activities or transactions that have materially contributed to… the proliferation of weapons of mass destruction" or to "have provided…financial, material, technological, or other support for, or goods or services in support of, any such activity or transaction, or any person whose property and interests in property are blocked" under other economic sanctions.[27]

Primary sanctions tend to cause a legal impossibility to perform to the contractual party that is either directly targeted or in the jurisdiction of the sanctioning State, whereas secondary sanctions tend to make a contractual party face an economic "hardship" rather than an impossibility, especially when he is outside of the jurisdiction of the sanctioning State. As a result, the party affected by the primary sanctions would generally have better chance to get an exemption than one affected by secondary sanctions, which, however, should not be understood as there being no possibility for the latter to be exempted from his obligation to perform.

2.3. Trade Sanctions v. Financial Sanctions

Economic sanctions can be imposed in the form of either trade restrictions or financial restrictions.[28] Trade restrictions include the prohibition (or restriction that does not amount to a total prohibition) of import or export of specific goods; the partial or total prohibition of import or export to or from a specific country (or a group of countries), which is commonly referred to as "embargos"; the partial or total prohibition of commercial transactions with a specific person or persons designated as the target; and restrictions on the movement, registration, ownership, and use of ships and aircraft, among others. Financial restrictions include an asset freeze, or the banning specific persons or banks directly related to the primary target from access to the financial market; banning financial investment in a primary target; and other ways of prohibiting or restricting financial transactions, including secondary sanctions against banks not directly related to the primary target of the sanctions.

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assets/gao-20-145.pdf (last visited: April 1 2022).

[25] *Id.*, Jeffrey A. Meyer, "Second thoughts on secondary sanctions", University of Pennsylvania Journal of International Law, vol. 30 (2008) p. 906.

[26] Department of the Treasury, Notice of Finding by FinCEN, "Finding That Banco Delta Asia SARL Is a Financial Institution of Primary Money Laundering Concern", Federal Register, Vol. 70, No. 181 (September 20, 2005), p. 55,214.

[27] See, e.g., Executive Order 13382.

[28] Daniel W. Drezner, "Targeted sanctions in a world of global finance", International Interactions 41.4 (2015), pp. 755-764.

2.4. Impacts of Economic Sanctions on the Contractual Performances

The main obligations of the parties to an international sales contract consist of the delivery of goods and the corresponding payment of the contract price. As for the seller, the delivery of goods must be made timely, and the goods delivered must meet "the quantity, quality, and description required by the contract" as well as the governing law.[29] The corresponding logic applies to the buyer; the payment of the contract price must be made timely in accordance with the contractual terms and the governing law.[30] In the case of an international sales contract, the parties will, additionally, agree on who is responsible for the export or import customs clearance of goods, transportation, and insurance.[31] Such performance obligations can be affected by economic sanctions in various ways.

Although it might not be always the case, in general, sellers will be more affected by trade restrictions, such as restrictions on import and export and trade-route restrictions, whereas buyers are more impacted by financial restrictions, such as an asset freeze or secondary boycott measures on financial institutions.

Both multilateral and unilateral sanctions can impede a party's performance; the possibility or the extent of an impediment a party may experience due to an economic sanction might not necessarily be affected by it being multilateral or unilateral. The possibility of success of a party's invocation of economic sanctions as a ground for exemption may differ, because more deference is likely to be paid to multilateral sanctions rather than unilateral. Unlike multilateral sanctions, such as those from the UN Security Council, unilateral sanctions issued by a country tend to be challenged in other jurisdictions based on their apparent illegality or extraterritorial application. Similarly, although both primary and secondary sanctions can impede a party's performance, it will be a better option for a party to invoke primary sanctions as grounds for an exemption for non-performance than to invoke secondary sanctions. This is because a party affected by primary sanction is more likely to prove the sanction as a direct cause of his failure to perform, whereas secondary sanctions tend to function in general as an indirect cause of failure.

3. Exemption under the CISG

Above, we have seen the types of economic sanctions and their potential impacts on the parties' failures in performing contractual obligations. We will now see the possible ways under CISG to get exemptions from the liabilities arising out of such a failure.

3.1. Exemptions for Non-Performance under CISG: Article 79

On the domestic law plane, there are several grounds available for exemption for non-performance, like impossibility, force majeure, frustration of purpose, impracticability, and hardship.[32] Under CISG, such exemptions can be found in Article 79 of the Convention,

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[29] CISG Article 35(1).

[30] CISG Article 54.

[31] For such terms, parties to international sales contracts often adopt the "INCOTERMS" terms published by the International Chamber of Commerce. The most current version of INCOTERMS came out in 2020.

[32] *See* Klaus Peter Berger and Daniel Behn. "Force Majeure and Hardship in the Age of Corona: A

which consists of five paragraphs.[33] The conditions for the application of the exemption are contained in Paragraphs 1 and 2, and the rest of the paragraphs provide for the notice requirement, duration of exemption, and the relationship between this article and other articles of the Convention.

More specifically, Paragraph 1 of Article 79 enumerates the conditions which the party who wants to get an exemption needs to prove. According to the paragraph, "[a] party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences". Therefore, in order to determine whether this paragraph is applicable to a case related to economic sanctions, one needs to understand the following issues:

(1) what is the "failure to perform"?
(2) what is the "impediment"?
(3) when can an impediment be seen as "beyond [the party's] control"?
(4) when can such an impediment be seen as not reasonably foreseeable?
(5) when can such an impediment be seen as unavoidable?

Paragraph 2 provides for a situation wherein the "party's failure is due to the failure by a third person whom he has engaged to perform the whole or a part of the contract". In such a case, the exemption is only allowed if the conditions of Article 79(1) are met by the party that wants to invoke an Article 79 exemption and the third person alike.[34] This paragraph can be of particular relevance in an economic sanction related to non-performance by the supplier or its subcontractor affecting the seller's delivery obligation, or by a financial institution affecting the buyer's payment obligation is at issue.

The exemption from damages is the only remedy provided for in Article 79. Once it is found that the Article is applicable, the party affected by the impediment will be exempted from liability for damages.[35] Such exemption is, however, available only "for the period during which the impediment exits".[36] In addition to the exemption, some argue that other remedies, such as renegotiation or adaptation of the contract, are also available under the Article.[37] While the issue on the remedies available under Article 79 is a fascinating and interesting

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Historical and Comparative Study", McGill J. Disp. Resol. 6 (2019); Joseph M Perillo, "Force majeure and hardship under the UNIDROIT principles of international commercial contracts", Tul. J. Int'l & Comp. L. 5 (1997); Ingeborg Schwenzer, "Force majeure and hardship in international sales contracts", Victoria U. Wellington L. Rev. 39 (2008).

[33] Larry A. DiMatteo, "Contractual Excuse Under the CISG: Impediment, Hardship, and the Excuse Doctrines." Pace Int'l L. Rev. 27 (2015).

[34] CISG-AC Opinion No. 7, Exemption of Liability for Damages under Article 79 of the CISG, Rapporteur: Professor Alejandro M. Garro, Columbia University School of Law, New York, N.Y., USA. Adopted by the CISG-AC at its 11th meeting in Wuhan, People's Republic of China, on 12 October 2007.

[35] CISG Art. 79(1).

[36] CISG Art. 79(3).

[37] See e.g., CISG-AC Opinion No. 7; CISG-AC Opinion No. 20, Hardship under the CISG, Rapporteur: Prof. Dr. Edgardo Muñoz, Universidad Panamericana, Guadalajara, Mexico. Adopted by the CISG Advisory Council following its 27th meeting, in Puerto Vallarta, Mexico on 2 – 5 February 2020; Kyujin Kim, "CISG Article 79 and Hardship: Focusing on the CISG AC Opinion No. 20", *Korean Forum on International Trade and Business Law*, 30(1) (2021).

topic, this paper will focus on the conditions of its applicability since the main issue of this paper is about whether economic sanctions can be seen as grounds for exemption under CISG. In order to find the answer to the question, this paper looks into the conditions for the application of Article 79, Paragraphs 1 and 2, the relevant hypotheses, and the relevant cases brought before domestic courts and international arbitral tribunals.

3.2. Failure to Perform

In order for a contractual party to claim that he should be given an exemption under Article 79 of CISG, he first needs to prove that he "failed to perform" because of economic sanctions. The issue which needs to be clarified here is, then, what can be seen as "failure to perform" under the Article.

First, the wording of Article 79, Paragraph 1, shows that both the seller and the buyer may rely on the Article, and so the failure can be that on the part of either the seller or buyer.[38] Also, Paragraph 1 shows that the failure of "any obligation" may be exempted under the Article. Therefore, the Article applies to the failure of both the seller's obligation of delivery of goods (and documents) and the buyer's obligation of payment[39] and acceptance of delivery, and also to either party's failure in thier obligations related to the customs clearance for export or import, transportation, and insurance.

Secondly, we need to know what kind of "failure" of performance is covered by the Article. Does it only refer to "non-performance" and "delay"? Or does it also include "defective performance"? There is no doubt that the complete non-performance by a party of any obligations would constitute "failure". As to the issue of "delay", there seems to exist little debate. Reading Article 79, Paragraph 3, which provides that the exemption under Article 79, Paragraph 1, is available only during the period of time when the impediment exists, delay or temporary failure to perform can clearly be seen as "failure" under Article 79, Paragraph 1.[40] So, for example, after the conclusion of the contract and before the time of delivery, if the seller's government places an export prohibition on the product which the seller is obligated to deliver to the buyer within a week, and then eventually lifts the prohibition two weeks later, the seller may rely on Article 79(1) for exemption from liability for the delay.

As to defective performance, however, there was considerable debate, especially about whether the seller's delivery of non-conforming goods can be seen as "failure" covered under Article 79(1).[41] Professor John Honnold suggested that considering the drafting history of the Article, the Convention's no-fault liability approach, and the notice requirement of Paragraph 4 of the Article, it makes more sense to conclude that the delivery of non-conforming goods cannot be excused under Article 79.[42] However, other commentators such as Professor Stoll[43]

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[38] John O. Honnold, Uniform Law for International Sales under the 1980 United Nations Convention, 4th Edition, Wolters Kluwer (2009), para 426, p. 616.

[39] However, because as for the buyers, the possibility of insolvency is most likely to be seen as something which could be reasonably considered when concluding the contract, the failure for the buyer to meet the payment obligation would most likely not be exempted under the provision. See Joseph Lookofsky, *Understanding the CISG*, 3rd Edition, Wolters Kluwer (2008), § 6.32, p. 154.

[40] Honnold, op. cit., paras. 427, 435, p. 616, p. 636.

[41] CISG AC Opinion No. 7, paragraphs 6-13.

[42] Honnold, op. cit., paragraph 427, pp. 616-619.

[43] Hans Stoll & George Gruber, Art. 79 para 6. In Schlechtriem & Schwenzer, CISG Commentary, 2nd Ed. (2005).

and Professor Looksky[44] believed otherwise, and several decisions[45] support their opinion that defective performance can also be a “failure to perform” under Article 79(1). The CISG Advisory Commission also supported the idea that, although it might be difficult for a seller to actually be exempted from liability under Article 79 for delivering non-conforming goods, this does not mean that the seller can never be exempted for such a failure under the Article.[46]

The seller’s delivery of non-conforming goods is not the only example of defective performance. Partial delivery (or acceptance) of goods – like the delivery of 400 units of a product when 1000 units of the product are supposed to be delivered under the contract,- can also be seen as a defective performance. Partial payment of the price by the buyer is also an example of defective performance. Such partial failure of performance or imperfect performance can also be seen as the “failure” under Article 79.[47]

3.3. Impediment

The next challenge for a party that wants to be exempted under Article 79, using economic sanctions as an excuse, is that he needs to show that the economic sanction which made him fail to perform as agreed is an “impediment” under the Article. In other words, he needs to find out whether the “impediment” refers to the well-defined domestic law concept of “impossibility” only, or if it includes broader concepts such as “hardship”.[48]

First, it is evident that “impossibility” is included in the term “impediment” under Article 79.[49] Impossibility can be physical or legal.[50] Physical impossibility means a situation in which the performance is physically impossible, such as when a house is burnt down after sale but before delivery; the delivery of the house became physically impossible due to the fire. Legal impossibility means the situation where a party’s performance is impossible because, if performing, he would be violating the law.

Among these two types of impossibility, economic sanctions will mostly lead to legal impossibility. For example, a seller’s delivery of a product may be prohibited by an export ban measure on the part of his government. Likewise, the buyer’s obligation to make payment can be prohibited by his government’s ban on providing any type of monetary payment to persons such as the seller. The suspension by the government of the payment of foreign debts can also lead to a buyer’s inability to make the payment. In such cases, the parties arguably can still perform, albeit they may face certain consequences, but one cannot force a party to

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[44] Lookofsky, op. cit., p. 139.

[45] *See, e.g.*, Bundesgerichtshof, Civil Panel VIII, Germany, 24 March 1999, CLOUT Case No. 271, available in English translation at <http://cisgw3.law.pace.edu/cases/990324g1.html> (hereinafter referred to as the "Vine wax case).

[46] See CISG AC Comment No. 7, Paragraph 13 stating that “Article 79 will gain in certainty and fairness if this straightforward interpretation is adopted, thus precluding dubious distinctions between excuses for failure to comply with the obligation to deliver conforming goods and those that may exonerate a party's failure to comply with other obligations arising out of the contract (e.g., failure to pack the goods in accordance with the contract under Article 35(2)(d))”.

[47] Honnold, op. cit., para 435.2, p. 637-638.

[48] CISG AC Opinion No. 7; CISG-AC Opinion No. 20.

[49] DiMatteo, op. cit., pp. 277-278.

[50] This is how Korean civil law commonly understands the term impossibility. Although the concept is universally recognized in each country’s contract law, Impossibility itself can be of various contents depending on each jurisdiction.

breach the law by forcing him to perform.[51] Therefore, parties in such cases will face little difficulty in finding that they are under the "impediment" of Article 79.

Whether "hardship" can also be seen as "impediment" under Article 79 is, however, less evident, and this aroused a lengthy debate since the making of the CISG.[52] Here, hardship means a situation "where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased, or because the value of the performance a party receives has diminished".[53] As to whether "hardship" can be regarded as an "impediment" under Article 79, a variety of opinions are presented. Some argue that "hardship" is not governed by CISG at all, therefore it cannot be regarded as impediment under the article.[54] Others argue that hardship is "governed but not settled" by CISG, and that therefore, it should be settled under the general principles underlying CISG; the people endorsing this idea often support the applicability of other international uniform law instruments, such as the PICC as a supplement for the interpretation of CISG.[55] In other words, under this view, hardship can be seen as an impediment under Article 79, provided that all the conditions are met, and the remedies allowed for such an impediment include not only the exemption from damages but also the renegotiation and adaptation of the contract. There is yet another view which argues that the issue of hardship is exclusively governed and settled by Article 79, and that, therefore, no such supplementary interpretation is needed, or even allowed.[56] According to this view, hardship can be seen as an impediment under Article 79, but the allowed remedy for such an impediment is limited to exemption from damages. In any case, today, the majority of commentators and courts seem to have reached an agreement that hardship also can be a form of impediment under Article 79.[57] Therefore, it is possible to rely on Article 79 even when an economic sanction caused just hardship, but not reaching impossibility.

Although secondary sanctions are more likely to cause "hardship" while primary sanctions lead to "impossibility", they both can cause "hardship". For example, primary sanctions in the form of trade route restriction may make performance by a party that runs a business in the sanctioning State not impossible, but merely "onerous". Primary sanctions that the freeze assets of a target that happens to be the buyer of an international sales contract may not make the party's payment obligation impossible, but rather onerous to perform, because he might hold assets that are not under the jurisdiction of the sanctioning State. The secondary sanctions directed at foreigners or those not subject to the sanctioning State's jurisdiction will

[51] See, e.g., Uniform Commercial Code, § 3-305. DEFENSES AND CLAIMS IN RECOUPMENT (a)(1)(ii).

[52] Rodrigo Momberg Uriber, The Effect of a Change of Circumstances on the Binding Force of Contracts Comparative perspectives, Utrecht University Doctoral dissertation (2011), pp. 239-246.

[53] PICC Art. 6.2.2.

[54] Niklas Lindström "Changed Circumstances and Hardship in the International Sale of Goods", Nordic Journal of Commercial Law, Issue 1, 2006, pp. 14-15; Hans Stoll in Peter Schlechtriem (ed), Commentary on the UN Convention on the International Sale of Goods, 2nd ed, Clarendon Press, 1998, Article 79 para. 39; Dionysios Flambouras, "Comparative Remarks on CISG Article 79 & PECL Articles 6: 111, 8: 108", Guide to Article, 2002, available at: http://www.cisg.law.pace.edu/cisg/text/peclcomp79. html#er (last visitied: April 1, 2022).

[55] Uriber, op. cit., p. 266; Lindström, op. cit., pp. 11-12; Sonja Kruisinga, (Non-) conformity in the 1980 UN Convention on Contracts for the International Sale of Goods: a uniform concept?. Vol. 46. Intersentia nv, 2004 p. 153.

[56] CISG AC opinion 20.

[57] CISG AC opinion 20.

almost always cause "hardship" instead of "impossibility". For example, a secondary sanction issued by the US government which targets businesses or banks doing business with a specific primary target, such as the North Korean government, may make it extremely difficult for South Korean companies to do business in, or to trade with, North Korea.[58] Such secondary sanctions, however, cannot be considered a legal impossibility because the US government lacks the prescriptive or law-making jurisdiction to order Korean companies to act in a certain specific way. They merely make it more risky and costly for South Korean companies to run such businesses.

Based on this, some commentators argue that secondary sanctions cannot be seen as "impediments". For example, Dr. Mercedeh Azeredo da Silveira stated that "[t]hese measures do not amount to legal impediments to performance given the absence of prescriptive jurisdiction of the sanctioning state, which can only threaten with penalties persons and entities that would maintain commercial and/or financial ties with the targets of a primary sanctions programme".[59] Interestingly, however, the same commentator stated in the same article that "primary economic sanctions – namely sanctions that prohibit persons and entities under the prescriptive jurisdiction of the sanctioning state from performing certain transactions – are deemed to constitute some form of exonerating obstacle, even if they do not make performance technically impossible".[60] These two statements seem to be inconsistent with each other. The more logically consistent understanding will be that, regardless of the jurisdictional concerns, economic sanctions that can be seen to be causing either legal impossibility or hardship shall all be entitled to be seen as "impediment" under Article 79(1), provided all other conditions are met.

3.4. Uncontrollability

The third hurdle lying before a party that wants to rely on Article 79 is the requirement that he is to show that the impediment in the form of economic sanctions is "beyond his control". Although the condition of uncontrollability is one of the trickiest hurdles to overcome for most of the force-majeure or hardship claims since "a party should always be deemed 'in control' of his own business and financial condition in general",[61] when it comes to the case of economic sanctions, it will be almost always the case that such an impediment is beyond the relevant party's control since the measures are most often not coming from the contracting party, but rather from a government. Indeed, state interventions such as import or export restrictions, blockades, exchange controls, the closing of traffic routes, and the prohibition of the transfer of funds are "in principle deemed to lie beyond the control of private operators."[62]

One CISG case supports such a finding. In *Macromex Srl. v. Globex International Inc.*[63]

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[58] Kyujin Kim, "Legal issues on Inter-Korean Economic Cooperation under the US Sanctions on North Korea - focusing on the "Otto Warmbier" Act, etc. - ", Korean Forum on International Trade and Business Law 28(2) (2019), pp. 121-127.

[59] Silveira 2019, p. 175.

[60] *Ibid,* p. 174.

[61] Lookofsky, op. cit., p. 139.

[62] Christoph Brunner, Force Majeure and Hardship Under General Contract Principles-Exemption for Non-Performance in International Arbitration, Wolters Kluwer (2009), pp.206-207.

[63] Macromex Srl. v. Globex International Inc, American Arbitration Association, 50181T 0036406, 12-12-2007.

(hereinafter referred to as the "Romanian Chicken Leg case"), a US seller and a Romanian buyer entered into a contract for chicken legs. The goods were originally to be delivered to a Romanian port by a certain date. After the conclusion of the contract, however, avian flu broke out and the Romanian government suddenly banned the import of chickens entirely. The sole Arbitrator found that such a government decision was beyond the seller's control.

3.5. Unforeseeability

The "unforeseeability" of an impediment also needs to be proved for the invocation of Article 79. In other words, the party that wants an exemption under the Article must prove that "he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract". Theoretically, this condition can be very difficult to meet since "nearly all potential impediments to performance, even wars, fires, embargoes, and terrorism, are increasingly foreseeable in the modern commercial environment".[64] However, this does not mean that this condition is insurmountable.

Generally, courts and arbitral tribunals tend to find that government regulations or legislation existing at the time of the conclusion of the contract are "foreseeable" impediments and that, therefore, they do not warrant the invocation or application of Article 79. In a suit in the Netherlands[65], a Dutch seller attempted to rely on Article 79 for his failure to deliver milk powder conforming to relevant Singaporean food regulations, arguing that the regulations were an unforeseeable impediment. In response to such an argument, the Dutch court decided that the seller could not rely on Article 79 because the regulations existed even before the conclusion of the contract, and that, therefore, he must have been well aware of them. Likewise, in a Bulgarian Chamber of Commerce and Industry award[66] where a Ukrainian seller attempted to rely on Article 79 for his failure to deliver the contractual goods (coal), alleging that his government's prohibition of coal amounts to the unforeseeable "impediment" under the Article, the arbitral tribunal found that since the prohibition had been already in force at the time of the conclusion of the contract, it was a foreseeable impediment and that Article 79 could not apply.

By the same logic, government regulations or legislations that did not exist at the time of the conclusion of the contract are likely to be found to be "unforeseeable". In the Romanian Chicken Leg case mentioned above, the Romanian government's ban on all chicken imports due to an avian flu outbreak after the conclusion of the contract was not reasonably foreseeable at the time of its conclusion.[67] In a Ukrainian Chamber of Commerce and Industry award,[68] a change in the Ukrainian legislation making it impossible to obtain the license needed to export corn, which was not known at the time of the conclusion of the contract, was recognized as an unforeseeable impediment, which allowed the Ukraine seller to be exempted under Article 79.

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[64] Lookofsky, op. cit., p. 139.

[65] Malaysia Dairy Industries Pte. Ltd. v. Dairex Holland BV, Netherlands, Rechtbank's-Hertogenbosch, rolnr. 9981 / HA ZA 95-2299, 02-10-1998.

[66] Bulgarska turgosko-promishlena palata (Bulgarian Chamber of Commerce and Industry), 56/1995, Arbitral Award, 24-04-1996.

[67] *Macromex Srl. v. Globex International Inc*, American Arbitration Association, 50181T 0036406, 12-12-2007.

[68] Int'l Commercial Arbitration Court at the Ukrainian Chamber of Commerce and Industry, 218y/2011, Ukraine, 23-01-2012.

However, such an assessment cannot be made mechanically. Rather, the determination of unforeseeability, especially when it comes to the unforeseeability of economic sanctions, must be made on a case-by-case basis. Specifically, depending on the industry, the goods in trade and other factors, there can be situations where heightened consideration for potential economic sanctions is required.[69] For example, in a Swiss case[70] involving the sale of a nuclear power generation product, the court stated in *obiter dictum* that a party engaged in a nuclear-related business, such as the seller in this case, should be well aware of the fact that governmental authorities may impose sanctions on the export of nuclear equipment at any time, and so, if sanctions are actually imposed, they should be considered foreseeable to such parties. Also, considering the prevalent usage of economic sanctions these days, if the possibility of conflict between relevant nations is disclosed to the public, or if a country relevant to the international sales contract in question shows the tendency of imposing or suffering economic sanctions, the existence of such factors at the time of the conclusion of the contract may be found to be sufficient to make the actual imposition of economic sanctions after the conclusion of the contract foreseeable.

3.6. Unavoidability

The last hurdle before the application of Article 79 is the "unavoidability" requirement, which means that the party claiming the exemption under the Article must prove that "he could not reasonably be expected...to have avoided or overcome [the impediment] or its consequences."[71] This element can be an almost insurmountable hurdle for obligations where many commercially reasonable substitution options are available.[72] In contrast, the more specifically described an obligation, the more likely it becomes that an impediment that restricts the relevant party from performing as specified is found to be "unavoidable". For example, if a seller is obligated to deliver "1000 tons of corn", then difficulties the seller may face when his main supplier located in Ukraine is banned from exporting the corn by the Ukrainian government would likely be found to be avoidable because there could be other sources of supply that the seller may use to fulfill his delivery obligation. However, if the same seller is obligated to deliver "1000 tons of corn which is of Ukrainian origin" and the Ukrainian government bans export of corn after the conclusion of the contract, the impediment the seller encounters will likely be found to be unavoidable.

Also, if economic sanctions do not absolutely ban certain transactions, but rather subject them to a certain government authorization regime by, for example, requiring the parties to obtain prior licenses, the more possible it is for the relevant party to obtain such license, the more likely it is for the economic sanctions or the consequences thereof to be seen as avoidable.[73] If license application is possible, the party that wants to rely on Article 79 must either at least try to get the license, or must show that it is absolutely useless to try to get the license because it is, as a matter of fact, impossible to obtain.[74]

[69] Silveira 2019, p. 177.
[70] Bank K und T AG v. M Co., 3 September 1985, Swiss Federal Tribunal 111 II 352, c 2a, JdT 1986.
[71] CISG Article 79(1).
[72] Lookofsky, op. cit., p. 139.
[73] Silveira 2019, p. 179.
[74] *See* Melli Bank v Holbud [2013] EWHC 1506 (Comm).

3.7 Relationship between Articles 79(1) and 79(2)

Article 79(1) of CISG provides for the main rule related to the exemption, and Article 79(2) states a stricter rule for the application of the exemption in the case "the party's failure is due to the failure by a third person whom he has engaged to perform the whole or a part of the contract". Article 79(2) stirred up much debate and confusion[75] because it can be interpreted as essentially removing any possibility of the application of Article 79(1) to contracts which involve third persons in performance by the contractual parties. Specifically, a seller who cannot perform a contractual obligation due to the failure of his supplier to supply goods or raw materials for the goods could be confused in deciding on whether to invoke Article 79(1) or 79(2).

This problem seems now, however, more or less settled. Today, it is understood that Article 79(2) applies if and only if the "seller actually delegates all or part of his performance obligations to a third-party subcontractor".[76] If the seller's failure to perform is caused by the failure of other types of third persons, such as his "general suppliers of the goods or raw materials", he doesn't have to be conscious of Article 79(2); it suffices to rely on Article 79(1).[77]

In a case where the seller cannot perform his contractual obligation of delivery of goods because his supplier of the relevant goods or raw material is impacted by economic sanctions, all he needs to do in deciding on his exemption under CISG is to see if the elements of Article 79(1) have been met. Likewise, if a buyer cannot perform his obligation to pay the contract price because one of his banks was sanctioned or became a potential target of sanctions, he must look into Article 79(1) instead of Article 79(2).

If, however, the seller has delegated the securing of raw materials of goods or the manufacturing of goods to an independent subcontractor and cannot perform the contract because his subcontractor cannot keep his promise due to economic sanction measures, he needs to rely on Article 79(2) instead of Article 79(1). By the same token, if the buyer has delegated acceptance of delivery or payment to an independent third person, Article 79(2) applies. In such a case, it will be difficult to get an exemption because both the third person and the contractual party must show that they have met all of the requirements under Article 79(1). As to the use of the third person, the "uncontrollability" or the "unavoidability", or both, will likely be difficult to meet.

4. Concluding Remarks

The several years before the 2022 Russian invasion of Ukraine have witnessed the decline of globalization. The worries of those engaged in international business or trade will most likely deepen as the trend foretells a greater activation of economic sanctions. Against this backdrop, this paper examined whether economic sanctions can be grounds for a party to an international sales contract to get an exemption under CISG.

Under CISG, the rules related to the exemption for the failure to perform are embedded in Article 79. According to this Article, any party, either the seller or the buyer, may argue that this failure of performance must get an exemption because the economic sanctions facing

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[75] CISG AC Opinion No. 7.

[76] Lookofsky, op. cit., pp. 142-143.

[77] Ibid.

him "impede" his performance. The Article cannot be invoked only in the case where a party completely fails to perform or delays; it can also be invoked in a case where the contractual obligation is partially or otherwise defectively performed.

Similarly, since the "impediment" under Article 79 includes both impossibility and hardship, it can be triggered not only when a party's performance becomes impossible because of economic sanctions but also when it becomes extremely onerous. This conclusion shows that the Article can also be invoked where the economic sanctions at issue are secondary, not primary.

Article 79 is only applicable when the impediment is of the "uncontrollable", "unforeseeable", and "unavoidable" nature. While it might not be difficult to prove that an economic sanction is an "uncontrollable" event for the party that wants to rely on the provision, proving the other two elements might be more challenging.

In finding out whether an economic sanction was unforeseeable, one needs to conduct a case-by-case analysis, taking into consideration everything including the existence or otherwise of the sanctions at the time of the conclusion of contract, the existence or otherwise of armed conflicts, or any other circumstances which may lead to the imposition of economic sanctions. From that perspective, the nature of the industry the party is involved in, the nature of the goods being traded in the case at hand, and other factors should be taken into consideration.

In order to determine unavoidability, one needs to see if there is a commercially reasonable substitute available, and if any government license process is available.

In addition, in a case where a third person's performance was affected by economic sanctions and caused a contractual party's failure of performance, if such a third person can be seen as a general supplier, then the contractual party may simply rely on Article 79(1), whereas if such a third person is to be seen as an independent subcontractor, then the contractual party must rely on Article 79(2) rather than 79(1).

Although world economic leaders are now even suggesting that "the day of Globalization is over",[78] the author hopes that the future proves otherwise. It is ideal to believe that there must be a way for different nations and individuals to peacefully coexist, depending upon and respecting each other. However, the present circumstances require us to prepare for a time of more conflicts, disputes, and economic sanctions. Given this reality, it is hoped that this paper will provide practical help to practitioners and companies engaged in international trade until a better day comes.

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[78] *See* New York Times, "Wall Street Warns About the End of Globalization", March 24, 2022, available at https://www.nytimes.com/2022/03/24/business/dealbook/globalization-fink-marks.html (last visited: April 1, 2022).

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