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RIGHT TO WITHHOLD PERFORMANCE UNDER IBERO-AMERICAN LAW

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Abstract

Modern practice shows that the most efficient remedies for breach of contract are still those that avoid the unnecessary transfer of assets among the parties. Thus, for example, the right to withhold performance protects one party from incurring unnecessary loss caused by performing his own obligation without receiving the counter-performance from the other party, likewise, the right to avoid the contract, even before the time of performance, if it becomes apparent that one of the parties will not duly fulfil his obligations, prevents expenses in an unnecessary continuation of a contract. As these remedies evidently oppose the core *pacta sun servanda* principle of contract performance, a revision of their notion, conditions and effects becomes necessary to understand the solutions proposed by the Ibero-American laws to the evident breach of one party's obligation before performance is due. This article reviews the topic from a comparative approach.

Key words:

Exceptio non adimpleti contractus, Ibero-American contract law, remedies for breach of contract.

Resumen

La práctica moderna demuestra que las acciones más eficaces en el incumplimiento contractual son aquellas que evitan la transferencia innecesaria de bienes entre las partes. Así, por ejemplo, el derecho a suspender la ejecución del contrato protege a una de las partes del gasto innecesario que significa cumplir su obligación sin recibir el cumplimiento de la obligación de la otra parte. De igual forma, el derecho a resolver el contrato, aún antes de que la ejecución se deba, si resulta evidente que la otra parte no cumplirá sus obligaciones, evita muchos gastos innecesarios que implicarían continuar el contrato, dado que estas acciones evidentemente se oponen al principio toral de pacta sun servanda en la ejecución de los contratos, es necesario revisar su concepto, criterios, condiciones y efectos a efecto de entender las soluciones que el sistema Ibero-Americano de los contratos ofrece al evidente incumplimiento de las obligaciones antes de que dichas deban ser cumplidas. Este artículo realiza una revisión del asunto desde una perspectiva comparada.

Palabras Clave

Excepción de contrato no cumplido,derecho contractual ibero Americano, remedios por incumplimiento contractual.

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I. Introduction

The Ibero-American laws allow one of the parties to withhold performance of his obligations[1]. This possibility is known under the doctrine of *exceptio non adimpleti contractus* and has two different purposes, First, it aims to protect one party from incurring any loss caused by performing his own obligation without receiving the counter-performance from the other party, Second, it seeks to exercise some sort of pressure over the other party so that he performs his obligations as agreed upon the contract[2]. The rule is clearly exposed in the Paraguayan and the Peruvian Civil Codes, according to which in contracts with reciprocal and simultaneous obligations, each of the parties has the right to suspend performance until the counter-performance has been fulfilled or guaranteed, unless one of the parties must perform first[3].

Thus, simultaneous performance in the context of *exceptio non adimpleti contractus* infers that normally one of the parties has a well-founded fear that the other party will fail to perform one of his obligations, at the moment where both parties were expected to have their obligations performed, so that the first party can exercise his *right to withhold* performance[4]. As explained by an ICC Arbitral Tribunal, the exception of *non adimpleti contractus* can be raised only where the contract governs reciprocal obligations and does not determine which party must first give performance[5].

Yet, the party withholding performance must be ready to perform[6]. A good example of the readiness to perform is cases of the retention of the letter of credit opened by the buyer until the seller delivers the goods[7].

In a case relating to the transport of Gas LP, the Bolivian Supreme Court upheld that the respondent, a gas producer, could not raise

the *exception* to pay for the non-executed transport services of the claimant since he was unprepared to perform, and indeed had failed to execute one of the ancillary obligations[8]. The contract called for the transportation of Gas LP in special containers to be provided by the respondent. In multiple occasions, the claimant had requested for the containers with no response from the respondent. On that basis, the Court recognised the legality of the damages awarded to the claimant by a lower instance Court and dismissed the *exceptio non adimpleti contractus* raised by the respondent[9].

On the other hand, the practice of modern sales shows that the "simultaneous performance rule" is usually derogated by the agreement of the parties[10], Indeed, when a contractual clause or usages require that one of the parties fulfils first his obligation, the general principle is that such party cannot exercise his right to withhold performance based on the belief that the other party may not perform his future obligation[11]. As explained by an ICC Arbitral Tribunal, where performance is to be given successively, the contracting party which is bound to perform its obligation prior to the other party cannot refuse to carry it out on the assumption that the other party will not perform its obligation, as is the case in contracts of deferred execution which are similar to the supply of goods contracts[12].

Hence, for example, if the parties have agreed in their contract that the buyer will pay the price of the remaining goods once the seller has delivered the whole of the goods, the seller cannot withhold performance of his own obligation, and seek the avoidance of the contract, alleging a supposed future buyer's breach to pay the price[13]. On the other hand, if under the contract the delivery of the goods would have to take place any time during a five month period at the option of the seller, and the price would have to be paid on the first day of the mentioned period against the invoice, then, it is evident that the seller preserves his right to withhold delivery of the goods after he handed over the invoice, as under the contract the price was to be paid before the delivery of the goods and the buyer cannot seek avoidance of the contract on that basis[14].

Furthermore, the exceptio *non adimpleti contractus* can be raised only in relation to obligations which are mutually dependent,

Where the obligations are not mutually dependent, the contracting parties cannot raise the exception. For example, a party cannot stop performing his main obligation on the grounds that the other party has failed to fulfil an ancillary obligation, unless such ancillary obligation was of considerable importance for the fulfilment of the whole contract[15].

The interdependence requirement was discussed by an ICC Arbitral Tribunal in application of the Brazilian law, In the case at stake, the seller and buyer agreed on the sale/purchase of 240 wagons, with an initial payment of 20% of the price equivalent to 48 wagons which were to be delivered first, and the remaining 80% payment being dependent on the buyer's ability to obtain a loan from a bank, The buyer fulfilled his first obligation with the advance payment in respect of the price for the first 48 wagons; the seller did not deliver the 48 wagons in the manner and within the time limit agreed, Later on, when the buyer obtained the loan for the remaining 192 wagons, the buyer refused the 80% payment of the remaining price arguing that its refusal to complete the order was justified under the *exceptio non adimpleti contractus* principle, The Tribunal dismissed the claim on the basis that the buyer's obligation to complete the order, once the bank loan had been approved, was not dependent on, nor was it simultaneous with, the seller's obligation to deliver the first 48 wagons in the manner and within the time limit agreed[16].

The above being said, the CISG and also many Ibero-American systems recognise an exception to the general principle, A party may have the right to withhold performance, even if he was required to perform first, in the event of deterioration of the other's party economic situation, or whenever other circumstances will evidently affect the performance of the contract[17], Some laws recognise this special *exceptio* generally to all contracts[18], while the rest of the codes contain a special exception in favour of the seller who may be under a duty to deliver before being paid[19].

An ICC Arbitral Tribunal recognised this exception to the exception, explaining that it is true that, by way of exception, in contracts involving staggered performance, the *exceptio non*

adimpleti contractus may be invoked if, once the contract is concluded, the other party's resources are diminished in such a way that it jeopardizes or throws doubt on the party's ability to carry out the obligation which it undertook[20], In such a situation, the party which is obliged to carry out its obligation first may refuse to do so until such time as the other party performs the obligation incumbent on it, or gives the first party a sufficient guarantee that it will do so.

The Ibero-American codes mention specific threats such as bankruptcy or insolvency of the buyer[21] concerning the right of the buyer to suspend payment, some codes also specify the applicability of the defence upon specific threats such as perturbation of the property rights on the goods by third parties or a founded fear to be perturbed, giving the buyer the right to suspend payment[22].

In countries like Chile, Colombia, Ecuador and El Salvador, the buyer has no right to retain the price as such, rather, he has to make deposit of the price in a competent court, and the price shall be kept within the court until the seller stops the third party claims or guarantees his performance and the cost of possible law suits[23]. However, this has been considered inequitable, some have recognised the possibility of the buyer to keep under his custody the price since, on the other hand, the seller has indeed the right to retain the goods in cases of threats such as bankruptcy or insolvency of the buyer[24].

Closer to the CISG approach, Paraguay and Peru's Civil Codes enlarge the scope of the right to withhold performance as they do not limit the right to specific cases but the defence applies to general threats and circumstances affecting the implementation of the contract[25].

Interestingly, the Argentinean law has a provision allowing the exercise of the right to withhold performance in a case of partial fulfilment of the other party's obligation, also known with the Latin expression of *exeptio non rite adimpleti contractus*[26], Argentina's Civil Code article 1426 establishes that the buyer can refuse payment if the seller did not deliver exactly what the contract required, The buyer may also refuse payment if the seller intends

to deliver goods of a different description, quantity or quality as required by the contract[27].

In addition, an important example of partial performance, which is present in other Ibero-American countries[28], involves the delivery of goods which are encumbered by third parties' property or intellectual property rights, and which also gives the buyer a right to withhold payment of the goods[29]. Indeed, some authors and the Venezuelan jurisprudence have maintained that, even though this provision expressly refers to threats or actual perturbation of the property rights; the general principles of the law would permit to withhold performance in the case of delivery of goods containing hidden defects[30].

Finally, the right to suspend the contract is available in the sale of goods by instalments, In the event that some instalments have already been fulfilled, the suspension will operate for the outstanding instalments[31].

II. Standards and Conditions

Withholding performance may not be always so easily justified in every jurisdiction, On the one hand, under the Bolivian sales subject to payment against delivery, if the goods and their packages are not in apparent bad conditions the buyer shall not withhold or refuse payment at the time of delivery[32].

On the other hand, the right to withhold performance requires that the party who intends to do so has a well-founded claim against the other party, these are objective facts, serious reasons and not mere suggestions, which are to be assessed by a competent court in due course[33]. For example, a Mexican Tribunal has sustained that the fact that the buyer had discovered in the Registry of Property that the immovable goods, which are the object to the contract, appeared to be the property of a different person than the seller, met the requirement of "founded fear", which consecutively allowed the buyer to withhold payment of the price[34].

In addition, a Mexican Collegiate Tribunal has explained that the foreseeable breach of one party's obligation is not enough, by itself, to justify the non- performance of the other party, since it is

required that the breach is of such importance to leave unsatisfied the interest of the party withholding performance, taking into consideration the functional interdependence of the respective performances[35]. The Tribunal based its reasoning on the principle of good faith that aims to prevent *abuse of right* situations derived from foreseeable breaches of minor importance.

On this issue, the Peruvian Supreme Court has found, in two different occasions, that the non-performance of obligations categorised as collateral, such as the registry of the sale and the release of encumbrances, does not constitute an exception for performance of the buyer's obligation to pay the price, unless the parties had otherwise agreed[36], all the more since the seller's main obligation was already performed[37].

In all Ibero-American systems, the right to withhold performance also requires that the circumstances or the deterioration in the situation of the other party affecting the performance occurs subsequent to the conclusion of the contract[38]. However, the doctrine concurs that when such circumstances or deterioration existed prior to the contract, the party may still withhold performance if he ignored them at the conclusion of the contract[39].

On the other hand, none of the Ibero-American laws contain the CISG express duty to give notice to the other party about one party's intent or actual suspension[40]. However, the same requirement should follow from the principle of good faith[41], all the Ibero-American laws require contracts to be performed in good faith, thus, the parties may be required to inform their counter-parts of any issue concerning the performance of the contract, if such follows from the nature of the contract, the equity or the usages[42].

III. Collateral Securities

As in the CISG[43], most Ibero-American laws recognise that the party, against who the right of *exceptio* is intended to be exercised, can stop the insecurity defence by providing adequate collateral securities to the other party[44]

IV. Effects

If the prerequisites for the right to suspend performance are satisfied and the other party has not provided adequate collateral securities, the principle in the Ibero-American statutory laws[45] and in the jurisprudence[46] is that the party entitled to *exceptio* is not guilty of non-performance of his own obligation, In other words, that party does not breach the contract even if, and during the time in which, he has not formally invoked the exceptio[47].

Indeed, the effects of the *exceptio* are that a party can withhold his performance until the danger to suffer the failure to counter-perform, in due manner and time, disappears[48]. This normally happens when the party corrects the deficiencies the goods, recovers his solvency, or provides adequate assurance of his performance depending on the case[49].

V. Anticipatory Breach

The Ibero-American laws do not have an independent concept of, or rules on, anticipatory breach, as it exists under the CISG[50]. However, scholars agree on the validity of an agreement to avoid the contract, even before the time of performance, if it becomes apparent that one of the parties will not duly fulfil his obligations[51].

CISG article 72 establishes the following requirements, First, the foreseen breach must be fundamental under the concept established by the same CISG,[52] e,g, the expected non-delivery of the goods or the failure to pay the price of the goods, Second, such fundamental breach must be foreseeable, i,e, manifest or clear, On this, objectively known cases can include the total destruction of the seller's premises, the enactment of governmental regulations on the transfer of money abroad, the imposition of export or import embargos on the goods concerned, etc.,[53].

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ICC Final Award Case 12035 *Lex Contractus* Mexican Law.

ICC Final Award Case 13524 *Lex Contractus* Mexican Law.

Foot Notes

1 The following provisions acknowledge the doctrine generally to all contracts: Argentina Art 1201 CC; Bolivia Art 576 CC; Brazil Arts 476, 477 CC; Costa Rica Art 425 Com C; Guatemala Art 682 Com C; Paraguay Arts 719, 720 CC; Peru Arts 1426, 1427 CC; Portugal Arts 428-431 CC; Venezuela Arts 122, 123 Com C; Other provisions apply the doctrine to the contract of sale in specific: Argentina Arts 1418, 1419, 1428 CC & Art 464 Com C (Exceptio for seller) & Art 1426 CC (Exceptio for buyer); Bolivia Art 623 CC (Exceptio for seller) Art 638 CC & Art 862 C Com (Exeptio for buyer); Brazil Art 495 CC (Exceptio for seller); Chile Art 1826 CC & Arts 147, 151, 155 Com C (Exceptio for seller) & Art 1872 CC (Exceptio for buyer); Colombia Art 1882 CC & Art 926 Com C (Exceptio for seller) & Art 1929 CC (Exceptio for buyer); Costa Rica Arts 1072, 1073 CC (Exceptio for seller) & Art 1089 CC (Exceptio for buyer); Ecuador Art 1793 CC & Arts 193, 196 Com C (Exceptio for seller) & Art 1839 CC (Exceptio for buyer); El Salvador Art 1629 CC (Exceptio for seller) & Art 1674 CC (Exceptio for buyer); Mexico Arts 2286, 2287 CC (Exceptio for seller) & Art 2299 CC (Exceptio for buyer); Panama Arts 1236, 1237 CC (Exceptio for seller) & Art 1273 CC (Exceptio for buyer); Portugal Art 468 Com C (Exceptio for seller); Spain Arts 1.466, 1.467 CC (Exceptio for seller) & Art 1.505 CC (Exceptio for the buyer); Uruguay Art 526 para 2 Com C (Exceptio for the seller); Venezuela Art 1493 CC & Art 148 Com C (Exceptio for seller) & Art 1530 CC (Exceptio for the buyer).

2 Argentina Bueres (1995), Art 1201, 57; Jones/Schlechtriem (1999), 62, § 86.

3 Paraguay Art 719 CC; Peru Art 1426 CC. See also Portugal Art 428 CC; Paraguay Supreme Court, Judgement 219, 17 May 2001, *Baúl De La Felicidad S.A. v. Pony Automotores– Mitsuservice Import S.R.L.*

4 Bolivia Kaunea (1996), Vol. 2, 134; Mexico León (2004), 154; Mexico Supreme Court, *Octava Época.* SJF I, First Part, January-June 1988, 295: stating that the *exceptio adimpleti* can only work on bilateral contracts where the performance of the obligations are simultaneous.

5 ICC Final Award Case No. 14083 *Lex Contractus* Brazilian Law.

6 Jones/Schlechtriem (1999), 65, § 98: the party invoking the *exceptio* must be willing and ready to perform. Interestingly, the Supreme Court of Chile has sustained that if both parties are reluctant to perform the contract is not avoided for ordinary breach but terminate for lack of intent to conclude the contact, see Chile Supreme Court, RDJ, Vol. 28, Sec. 1, p 689 cited in Chile Díez (1993), 123, n 237.

7 See for example Bolivia Art 865 Com C; Venezuela Art 122 para 1 Com C.

8 Bolivia Supreme Court, *Sala Civil* 1, 25 October 2005, *Elizabeth Chávez Guzmán v. Yacimientos Petrolíferos Fiscales Bolivianos.*

9 Bolivia Supreme Court, *Sala Civil* 1, 25 October 2005, *Elizabeth Chávez Guzmán v. Yacimientos Petrolíferos Fiscales Bolivianos.*

10 Jones/Schlechtriem (1999), 62, § 91.

11 See expressly Costa Rica Art 425 Com C; Jones/Schlechtriem (1999), 63, § 91; Brazil Gomes (2008), 110; Brazil Da Silva (2003), § 215; ICC Final

Award Case 12035 *Lex Contractus* Mexican Law: "In a bilateral agreement, i.e. a contract providing for mutual obligations of the parties, neither party may seek performance unless he has performed his own duties"; Mexico Supreme Court, *Octava Época*. SJF I, First Part, January-June 1988, p 295: declaring that in cases where one of the parties must perform first so that subsequently the other party fulfils the counter-performance none of the parties is entitled to raise the exception.

12 ICC Final Award Case No. 14083 *Lex Contractus* Brazilian Law.

13 Mexico Collegiate Tribunals, *Novena Época*, Registry 185'427, SJF XVI, December 2002, 759.

14 Spain AT Pamplona, 15 December 1988.

15 ICC Final Award Case 11853 *Lex Contractus* Mexican Law; ICC Final Award Case 13524 *Lex Contractus* Mexican Law.

16 ICC Final Award Case No. 14083 *Lex Contractus* Brazilian Law.

17 Bolivia Kaune (1996), Vol. 2, 134, 135; Brazil Gomes (2008), 110; Chile Díez (1993), 146, 147; El Salvador Miranda (1996), 191-193; Spain O'Callaghan (2004), Art 1.467, 1475; Venezuela Aguilar (2008), 220-221; see also Art 71 (1) (a) (b) CISG.

18 Bolivia Art 576 CC; Brazil Art 477 CC; Paraguay Art 720 CC; Peru Art 1427 CC; Portugal Art 429 CC; Venezuela Art 123 (1) (2) Com C.

19 Argentina Art 1419 CC; Brazil Art 495 CC; Bolivia Art 623 (II) CC; Chile Art 1826 para 4 CC & Art 147 Com C; Colombia Art 1882 para 4 CC & Art 926 Com C; Costa Rica Art 1073 CC; Ecuador Art 1629 para 4 CC & Art 193 Com C; El Salvador Art 1629 para 4 CC; Mexico Art 2287 CC; Panama Art 1237 CC; Portugal Art 468 Com C; Spain Art 1.467 CC; Uruguay Art 1688 CC & Art 526 para 2 Com C; Venezuela Art 1493 CC.

20 ICC Final Award Case No. 14083 *Lex Contractus* Brazilian Law.

21 Argentina Art 1419 CC; Bolivia Art 623 CC; Chile Art 1826 CC; Colombia Art 1882 CC; Costa Rica Art 1073 CC; Ecuador Art 1793 CC; El Salvador Art 1629 CC; Mexico Art 2287 CC; Panama Art 1237 CC; Portugal Art 468 Com C; Spain Art 1.467 CC; Venezuela Art 1.493 CC.

22 Argentina Art 1425 CC; Bolivia 638 (1) CC; Chile Art 1872 CC; Colombia Art 1929 CC; Ecuador Art 1839 CC; El Salvador Art 1674 CC; Mexico Art 2299 CC; Panama Art 1273 CC; Spain Art 1.502 CC; Venezuela Art 1.530 CC; see also Bolivia Kaune (1996), Vol. 2, 157.

23 Chile Art 1872 CC; Colombia Art 1929 CC; Ecuador Art 1839 CC; El Salvador Art 1674 CC; see also, Chile Díez (1993), 174, 175; El Salvador Miranda (1996), 278-280.

24 Colombia Tamayo (2004), 198-200; El Salvador Miranda (1996), 280, 281.

25 Paraguay Art 720 CC; Peru Art 1427 CC.

26 Brazil Gomes (2008), 110.

27 See on this Argentina Borda (2004), 229.

28 Bolivia Art 638 (1) CC; Chile Art 1872 CC; Colombia Art 1929 CC; Ecuador Art 1839 CC; El Salvador Art 1674 CC; Mexico Art 2299 CC; Panama Art

1273 CC; Spain Art 1.502 CC; Venezuela Art 1.530 CC.

29 Mexico Collegiate Tribunals, *Novena Época*, Registry 195'846, SJF VIII, August 1998, p 838: applying Art 2299 CC.

30 See Venezuela Aguilar (2008), 220, 221 and the Venezuelan Jurisprudence cited in the same work.

31 Mexico Art 2299 CC; Mexico Collegiate Tribunals, *Novena Época*, Registry 195'846, SJF VIII, August 1998, 838; see also Jones/Schlechtriem (1999), 70, § 110.

32 Bolivia Art 862 Com C.

33 Argentina Borda (2004), p 229; Spain O'Callaghan (2004), Art 1.467, 1476.

34 Mexico Collegiate Tribunals, Registry 195'846, *Novena Época*, SJF VIII, August 1998, p 838: applying Art 2299 CC.

35 Mexico Collegiate Tribunals, *Novena Época*, Registry 183'878, SJF XVIII, July 2003, p 1061.

36 Peru Supreme Court, *Sala civil transitoria*, Resolution 004010-2001, 17 May 2002.

37 Peru Supreme Court, *Sala civil transitoria*, Resolution 000114-1998, 24 February 1999.

38 See expressly Uruguay Art 526 para 2 Com C; Jones/Schlechtriem (1999), 63, § 91.

39 Argentina Clusellas (1995), Art 1419, 601, § 2.

40 Article 71 (3) CISG imposes to the party who decides to exercise his right of suspension the duty to inform the other party about his intention to suspend performance.

41 Portugal De Lima Pinheiro (2005), 323.

42 Argentina Art 1198 CC; Bolivia Art 465 CC & Art 803 Com C; Brazil Art 422 CC; Chile Art 1546 CC; Colombia Art 1603 CC & Art 863 Com C; Cuba Art 6 CC; Ecuador Art 1589 CC; El Salvador Art 1417 CC; Guatemala Art 17 CC; Mexico Art 1796 CC; Paraguay Art 689 CC; Peru Art 1362 CC; Portugal Art 227 CC; Spain Art 1258 CC & Art 57 Com C.

43 Art 71 CISG.

44 Chile Art 147 Com C; Ecuador Art 193 Com C; Guatemala Art 684 Com C; Portugal Art 468 Com C; Venezuela Art 122 *in fine* CC. And also *in fine* of the following individual countries provisions: Argentina Art 1419 CC; Brazil Art 477 CC; Bolivia Arts 576, 623, 638 (1) CC; Chile Arts 1826, 1872 CC; Colombia Arts 1882, 1929 CC; Costa Rica Art 1073 CC; Ecuador Arts 1793, 1839 CC; El Salvador Arts 1629, 1674 CC; Mexico Arts 2287, 2299 CC; Panama Arts 1237, 1273 CC; Paraguay Art 720 CC; Peru Arts 1426, 1427 CC; Portugal Art 428 (2) CC; Spain Arts 1.467, 1.502 CC; Uruguay Art 526 para 2 Com C; Venezuela Arts 1.493, 1.530 CC; Argentina Borda (2004), p 231; Portugal De Lima Pinheiro (2005), p 322.

45 Argentina Art 510 CC; Chile Art 1552 CC; Colombia Art 1609 CC; Ecuador Art 1542 CC; El Salvador Art 1423 CC; Honduras Art 1356 CC; Nicaragua Art 1859 CC; Panama Art 985 CC; Spain Art 1.100 CC.

46 See Argentina National Civil Chamber, *Sala A*, LL, 1990-D-328 cited in Argentina Iturraspe (1995), Art 1201, 58.

47 Bolivia Kaune (1996), Vol. 2, p 157.

48 See for example Guatemala Art 685 Com C: stating that the right to withhold performance does not cease even if the debtor has transferred the property of the goods retained. On this see also Venezuela Art 122 para 3 Com C.

49 Argentina Borda (2004), p 230; Spain O'Callaghan (2004), Art 1.467, 1476.

50 Paraguay Sierralta Ríos (2000), n 74; Portugal De Lima (2005), 324; Jones/ Schlechtriem (1999), 90, § 140. CISG article 72 establishes that if prior to the date of performance of the contract it is clear that the other party will commit a fundamental breach of the contract, the other party may declare the contract avoided. The party who intends to avoid the contract must give reasonable notice to the other party, unless there is not time to do so or the other party has already declared that he will not perform his obligation.

51 Paraguay Sierralta (2000), n 74.

52 Art 25 CISG.

53 Spain Calvo (1998), Art 72, II, 570.