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Ex Tunc or *Ex Nunc* Effects of the Rescission of Contract and the Right to Damages under Korean Law and CISG*

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Ⅰ. Introduction

A defaulted party who does not receive the performance in accordance with a contract may wish to pursue one or more of the following contractual remedies: enforced performance like repair or replacement; rescission of the contract; damages for expectation or consequential loss, or the other costs; price reduction and etc. The remedy of rescission is ultimately to put an end to further performance and as far as possible to put matters back into the position where he was before performance on either side was begun.[1] Where the defaulted party legitimately rescinds

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the contract, there are three main effects of rescission of the contract. First, it releases both parties from their future primary obligations either wholly or in part. Second, notwithstanding the release of the parties from their obligations, the defaulting party may be liable to pay damages if any as a result of default.[2] Third, the parties must restore whatever one party has received from the other party.

A difficulty in relation to the second effect arises from theoretical arguments on whether rescission of the contract renders a *ex tunc (retrospective)* effect or a *ex nunc (prospective)* effect. The principle of *ex tunc* operation may generate even a doubt on the possibility of combining rescission with damages; where the parties are to be put back into the position in which they would have been if the contract had never been made, how can damages be awarded for its breach? Although the arguments do not seem to cause a matter in combining rescission with damages under Korean law due to a specific provision for that under the Korean Civil Code(*here-in-after* KCC),[3] such arguments have been broadly extended to limit the scope of damages.

Having said that, this paper purposes as follows. The first is to describe and analyze discussions on the matter of *ex tunc* effect or *ex nunc* effect of rescission under Korean law in comparison with those under the United Nations Convention on International Sale of Goods 1980(*here-in-after* CISG). The second is to scrutinize the various rules on the right to damages as

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1) The right has been variously expressed in the use of terminology; 'rescission' in Korean law. 'avoidance' in the CISG (CISG Art. 49). and 'electing to treat the contract as at an end', 'justifiable repudiation', 'cancellation', 'termination', and probably most commonly 'rescission' in English law, being distinct from that of termination. Prof. Treitel indiscriminately uses 'rescission' which may include to describe 'rescission *ab initio*'. See Treitel, *Remedies for Breach of Contract* (Sweet & Maxwell, 1988), at p. 320. Cf. For the discussion as to its use of terminology in English law, see Birds and Bradgate (ed.), *Termination of Contracts*, (Chancery Law Publishing, 1995), at pp. 9 ff.

2) An arbitration or prorogation clause remains in effect as well as a clause fixing liquidated damages and, if valid, a penalty clause.

3) The KCC Art. 551.

an effect of rescission in a comparative way. The third is to compare the rules of one jurisdiction with those of other jurisdictions and to evaluate them in light of the discipline of comparative law the basic question of which is whether a solution from one jurisdiction may facilitate the systematic development and reform of another jurisdiction.

Ⅱ. *Ex Tunc* or *Ex Nunc* Effects of the Rescission of Contract

1. Korean Law

1) The Direct Effect Theory (*Jikcheop-Hyokwa Seol*)

This theory[4] places its logical premise on the *ex tunc* extinguishment of contract. That is to say, the contractual relationship between parties is terminated *ex tunc* by the excercise of the right to rescind the contract. The effect of *ex tunc* termination of contract by one party is to put the parties in the same position as if there had never been a contract. Thus all obligations in the contract which have not been performed are 'automatically'[5] extinguished, *i.e., release effect.*[6] At the same time, the obligations which have been already performed are under the control of the doctrine of unjust enrichment because the obligations lose their legal basis on the original contract due to the *ex tunc* effect of rescission.

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4) *See* Yun-jik Kwak, *Particulars of Obligatory Law* (Revised ed., Pak-Young Sa, 2003), at pp. 100 *et seq.*; Young-bok Park, *Lectures in Civil Law - Particulars of Obligatory Law -* (Intel-education, 2003), at p. 69; Ki-sun Kim, *Particulars of Korean Obligatory Law* (Pub-Mun Sa, 1982), at pp. 79 *et seq.*; Joo-soo Kim, *Particulars of Obligatory Law* (Sam-Young Sa, 1997), at pp. 147 *et seq.*; Tae-jae Lee, *Particulars of Obligatory Law* (Jin-myoung Mun-Haw Sa, 1985), at pp. 123 *et seq.*

5) This is due to the retrospective effect of rescission.

6) This tends not to be problematic unless there is a problem about identifying the time of rescission.

The proponents of this theory argue that the provision of the KCC Art. 548(1) is specially stipulated to be suitable in terms of restitution for the purpose of rescission of contract. The reason for this is that the scope of restitution in rescission is to restore subject-matter to the original state of affairs whereas the principle of restitution in unjust enrichment[7] is to restore the value that subject-matter still remains. The theory, therefore, persists that the KCC Art. 548(1) is the special provision to override the general provision as to unjust enrichment[8] though the nature of restitution in rescission takes the nature of restitution in unjust enrichment.[9] The restitution in rescission is particularly under control of *the doctrine of modified unjust enrichment.*[10]

As to the nature of claim for damages, it is accepted the Japanese leading view: the *ex tunc* effect is limited for the claim of damages.[11] The difficulty of squaring the right to damages with the *ex tunc* effect of rescission is met in the following way; First, it is reasonable to compensate the aggrieved party by the award of damages for the losses which is not liquidated by restitution in the light of the principle of equity. Second, though the contract is extinguished *ex tunc,* damages for non-performance under the original contract still remain. Therefore, the nature of the damages is damages of expectation (positive) interest rather than damages of reliance (negative) interest. It is argued that this result meets the principle of equity.

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7) The KCC Art. 748.

8) The KCC Art. 748(1).

9) The nature of restitution in both rescission and unjust enrichment is similar in that there is no legal basis for the obligations performed due to retrospective effect.

10) With regard to the nature of restitution, this view seems to be similar to the Japanese dominant view irrespective of the name of doctrine.

11) As the Japanese view, the theory argues that the KCC Art. 551, which stipulates that the rescission does not affect the right to claim damages, limits the retrospective effect.

2) The Indirect Effect Theory(*Kan-Jeop Hyokwa Seol*)

This theory[12] assumes that the contract does not extinguish *ex tunc* after rescission. Rescission does not terminate the contract *ex tunc* but *'stops'* operation of the contract. Therefore, rescission generates two rights: the right to refuse the performance of duty which has not been performed, and the right to claim restitution of the performance of duty which has already been performed. It is argued that the contractual relationship terminates only after restitution has been performed.

As the premise of this theory does not assume the *ex tunc* termination of contract, damages for non-performance of contract still remain.

Regarding the proprietary effect, the property already transferred as a performance of contract is not automatically restored due to no *ex tunc* effect.

However, this theory does not seem to explain logically the nature of restitution and the extinguishment of the original contractual relationship followed by the performance of restitution as restitution does not have nothing to do with unjust enrichment due to *ex nunc* effect.[13]

3) The Liquidation Theory(*Cheong-San Kwangeo Seol*)

The theory is basically to negate the *ex tunc* effect so that the duty which has not been performed until the time of rescission terminates *ex nunc* but the original contractual relationship which has existed until the time of rescission enters into the stage of liquidation.[14] It is said that, at

12) The theory was introduced in early 20th century by Denburg, Crome, Endemann in Germany. In Korea, It was insisted only by one scholar in 1960's. *See* Han-yeol Lee, *Introduction to the Korean Civil Law* (Park-Young Sa, 1962), at pp. 449 *et seq.*

13) Hyung-bae Kim, *Particulars of Obligatory Law-Contract Law* (Park-Young Sa, 1997), at p. 229. In contrast, the liquidation theory explains in the light of reshaping of the original contract.

14) Oh-seung Kwon, "The Effects of Rescission", (April, 1983) *Judicial Administration*, at pp. 42 *et seq.*; Yong-dam Kim, "A Study on the effects of Rescission", (May, 1983) *Judicial Administration*, at pp. 11 *et seq.*; Jeung-han Kim & Hak-dong Kim, *Particulars of Obligatory Law* (Pak Young Sa, 2006), at pp. 147 *et seq.*; Hyoung-bae Kim, *Study of*

the time of entering into the stage of liquidation, the original contractual relationship before rescission alters the nature into the new contractual relationship for restitution. That is to say, the contract schedule is only redirected without breaking the continuity of the contractual relationship between the parties. By the method which the theory constructs the effects of rescission *ex nunc*, damages and restitution stand on the line of the extension of the original contract.

Unlike the direct effect theory, with regard to the right to claim restitution, the duty to make restitution is not a duty under the doctrine of modified unjust enrichment, i.e., the statute based obligation by the unjust enrichment law. It is said that the restitution in rescission is very different from the one in unjust enrichment in terms of the rationale and the nature of institution. The restitution in rescission is to effect a balance between the performance of the aggrieved party and the counter-performance of the breaching party. So the aggrieved party who has performed his or her duty seeks to restore to the original state 'within the contractual framework' against his or her duty already performed. The obligation of restitution of the defaulting party is governed by the new contractual relationship and it is called 'the contractually based obligation'. The restitution in rescission, therefore, is not any more a statute based obligation governed by unjust enrichment law insofar as the contract still governs the restitution in rescission.

With regard to damages as a effect of rescission, there is no reason to dispute about the logical basis on the claim for damages in this theory since they deny apparently the *ex tunc* effect.[15]

Civil Law (Park Young Sa, 1986), at pp. 212 *et seq.*; Eun-young Lee, *Particulars of Obligatory Law* (Park-Young Sa, 2005), at pp. 251 *et seq.*.

15) In fact, due to the expressive stipulation of damages co-existing with rescission(the KCC Art. 551), there is no difference between the direct effect theory and the liquidation theory in terms of the matter of existence of the right to damages. The scope of damages, that is, the compensation of expectation (positive) interest, is even similar between a prevailing view within the direct effect theory and the liquidation theory. However, the direct effect theory sees the KCC Art. 551 as the provision for

2. CISG

Unlike in the KCC, the CISG stipulates expressive provisions about the effects of avoidance.[16] The effects of avoidance[17]under the CISG are described in articles 81 to 84. The primary effects of the avoidance of contract by one party are stipulated in the CISG Art. 81. The main effect is that both parties are released from their obligations to carry out the contract.[18] Thus, the seller need not deliver the goods and the buyer need not take delivery or pay for them. However, the avoidance of contract does not terminate either the breaching party's obligation to pay any damages caused by his or her failure to perform or any provisions in the contract for the settlement of disputes.[19] It also does not affect any other provision of the contract governing the rights and obligations of the parties consequent upon the avoidance of the contract.[20] The CISG Art. 81(2) provides that either party to the contract who has performed in whole or in part may claim the return of whatever he or she has supplied or paid under the contract. The party who makes demand for restitution, subject to the CISG Art. 82(2), must also make restitution of that what he has received from the other party. If both parties are required to make restitution, they must do so concurrently[21]. According to the Secretariat Commentary, it should be noted that the right of either party to require restitution as recognized by Art 81 may[22] not prejudice the position of the buyer's creditors or interfere with the bankruptcy rules of the buyer's

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the limitation of the retrospective effect to rescission whereas the liquidation theory sees as the remarking provision stipulated as a matter of course.

16) The CISG Art. 81(1) (Release from Obligations and Damages), Art. 81(2) (Restitution)

17) The wording of the CISG uses the term 'avoidance' to designate the rescission under the KCC.

18) The CISG Art. 81(1), the first sentence.

19) The CISG Art. 81(1), the second sentence.

20) The CISG Art. 81(1), the second sentence.

21) The CISG Art. 81(2), the second sentence.

22) Kritzer, *Guide to Practical Applications of the United Nations Convention on Contracts for the International Sale of Goods* (Kluwer Law and Taxation Publishers, 1994), at p. 664.

jurisdiction.

It is clear that once the avoidance of contract has been validly declared by one of the parties, both parties, as a rule, are released from all their obligations for the future, *i.e., ex nunc.*[23] The obligations which have not been performed terminates *ex nunc* whether avoidance terminates the contract *ex tunc* or *ex nunc.*[24] In other words, the result in release effect is same in both the *ex tunc* and the *ex nunc* effect of avoidance.

As regards whether there is *ex tunc* or *ex nunc* effect under the CISG, Kahn said that the parties are, to the extent possible, in the same situation as they were at the conclusion of the contract insofar alludes more to an *ex tunc* effect.[25] In addition, Tallon distinguishes two consequences which result from the avoidance of contract; first, as to the future, the parties are released from their obligations. Second, as to the past, they must return what has been supplied or paid under it.[26] He insists that, insofar as the past is concerned, the CISG Art. 81(2) implies the retrospective disappearance of the contract. He continues to say that by undermining the juridical basis of the contract, *i.e.*, that on which the parties have performed their obligations, the avoidance renders any act accomplished prior to it void.[27]

In addition to those scholars' views, ex *tunc* effect can be drawn in other aspects of the CISG. First, it is possible to interpret the CISG Art. 81(1) '..., subject to any damages which may be due.' as a provision to

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23) It is derived from the term of *release* of the CISG Art. 81(1).

24) As discussed above in both theories under the KCC, the release effect of unperformed obligations for the future can be drawn whether avoidance has *ex tunc* or *ex nunc* effect. The way to reach the release effect is, merely, different in both theories under the KCC.

25) Kahn, "La Convention de Vienne du 11 avril 1980 sur les contrats de vente internationale de marchandises", *Revue internationale de droit comparé*, 1981/4, at p. 978.

26) Bianca & Bonell *et al., Commentary on International Sales Law: The 1980 Vienna Sales Convention* (Giuffrè, 1987), at p. 602.

27) *Ibid.* at p. 604. He maintains that this situation entails the application of the rules known in French law as *répétition de l'indù(condictio indebiti)* or, more widely, those of unjust enrichment or quasi-contracts.

limit the *ex tunc* effect of the CISG. This interpretation is possible on the premise of *ex tunc* effect under the CISG. Otherwise its stipulation would be superfluous. Secondly, the CISG Art. 81(2) the second sentence, *i.e.*, the concurrent performance of restitution is another aspect to show the *ex tunc* effect of the CISG. This provision is inevitable for the performance of the obligation of restitution because when contract is terminated *ex tunc* rescission terminates also the bilateral nature of contract.[28] Thirdly, as to the seller's restitution of the price,[29] it is not logical for the seller to pay interest on it from the date on which the price was paid. The reason for this is that on the assumption of the *ex nunc* termination of contract the price in the hand of seller should be justified until the avoidance of contract is declared. That is to say, as the premise of *ex nunc* effect is not to negate the contractual relationship prior to the excercise of the right to avoid the contract, there is no reason to pay interest from the date on which the price was paid. Provided that interest had to be paid on the assumption of the *ex nunc* termination, the amount should be interest from the date on which the contract was avoided. The result of the construction of the *ex tunc* termination of contract under the CISG seems to generate the problem of the application of the domestic law in the parties' actions about restitution.[30]

On the other hand, Schlechtriem argues that the contract schedule is only redirected and the avoidance does not void the contract *ex tunc*.[31] According to Enderlein and Maskow, the contract remains in existence as long as there are still claims of the parties under it, including claims for returning the goods and the price.[32] They argue that the avoidance of

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28) The concurrent performance would be automatically reached without the stipulation because the nature of bilateral contract would still remain if the contract extinguished *ex nunc* and the contractual relationship was redirected to the new relationship of liquidation.

29) The CISG Art. 84(1).

30) Bianca & Bonell *et al., op. cit.*, at pp. 604 *et seq.*

31) Schlechtriem, *Uniform Sales Law - The UN Convention on Contracts for the International Sale of Goods* (Manzsche, 1986), at p. 107.

contract under the CISG is thus still within the contractual framework rather than domestic law about unjust enrichment.[33] [34]

In addition to those sholars' views, the aspects of the negation of *ex tunc* effect can be seen in as follows under the CISG; First, the right to claim both avoidance and damages[35] can not be explained logically if avoidance has *ex tunc* effect.[36] Secondly, the CISG Art. 81 (2) the second sentence, *i.e.*, the concurrent performance of restitution can be seen as an inevitable provision for the performance of the obligation of restitution because rescission also extinguishes the bilateral nature of contract when the contract terminates *ex tunc*. However, unlike in the above interpretation, the stipulation is merely to show the bilateral nature inherent in the obligation of restitution after rescission. This is because, in a bilateral contract, avoidance constitutes the reverse of performance.[37] Thirdly, the second sentence of the CISG Art. 81(1),[38] *i.e.*, other provisions preserved after avoidance, is an evidence to prove that the contract is not terminated until the claims under the contract have been settled. Fourthly, it can be derived from the term of *'release'* in the CISG Art. 81(1) the first sentence.[39] If there was *ex tunc* effect, the expression of 'release' would be superfluous because release effect for the future could be automatically

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32) In favor of this view, *see* Leser, Vertragsaufhebung und Rekabwicklung unter dem UN-Kaufrecht, in: Schlechtriem ed., *Einheitliches Kaufrecht und nationales Obligationenrecht* (Nomos, 1987), at p. 238; Schlechtriem (ed.), (Eng. trans. by Thomas), *Commentary on the UN Convention on the International Sale of Goods* (Clarendon, 1997), at p. 634.

33) They argue that the right to avoid the contract is insofar nearer a right to withdraw from the contract than a right to terminate the contract.

34) Enderlein & Maskow, *International Sales Law: UN Convention on Contracts for the International Sale of Goods* (Oceana, 1992), at p. 341.

35) The CISG Art. 45, 61 and Art. 81 (1) the first sentence.

36) This is because damages can not exist where the contract terminates as if there had been no contract.

37) Bianca & Bonell et al., *op. cit.*, at p. 605.

38) The CISG Art. 81(1) ... Avoidance does not affect any provision of the contract for the settlement of disputes or any other provision of the contract governing the rights and obligations of the parties consequent upon the avoidance of the contract.

39) The CISG Art. 81(1) Avoidance of the contract *releases* both parties from their obligations under it, subject to ...

achieved. Fifthly, it seems to be not reasonable that the matters of restitution are governed by the rule of unjust enrichment of domestic law in the light of a policy of the CISG to minimize the confusion inherent in conflicts rules and avoid the application of domestic law.[40]

Undoubtedly the rule seems to be casuistic rather than practical. On the other hand, the rule is not very precise in their general formulations and it leaves important problems open.[41] However, generally speaking, the latter view, *i.e.*, the negation of *ex tunc* effect, seems to be more persuasive.

Ⅲ. The Right to Damages

1. Comparisons on Nature and Scope of the Right to Damages

1) Korean Law

① The Direct Effect Theory

The KCC expressly stipulates that rescission can be combined with damages.[42] However, despite of the expressive provision, scholars and cases do not agree in the nature and scope of the right to claim damages. It is ultimately due to being in disagreement in regard to the matter of whether there is *ex tunc* effect. Thus the nature and scope should be examined in the line of extention of the matter of *ex tunc* effect.

The direct effect theory which is a leading view among scholars[43] and

40) The policy is achieved by the CISG Art. 7(2), *ie.*, the invitation for the interpretation of the CISG to consider its general principles on which it is based before turning into domestic law.

41) Enderlein & Maskow, *op cit.*, at p. 342.

42) The KCC Art. 551.

43) *See supra* n. 4.

an opinion of the cases[44] generally maintains that damages which was generated by the breach of contract still remain although the obligations which have not been yet performed extinguish and the obligations which have been already performed are restored into the original situation. The theory argues that the right to claim damages of the KCC Art. 551 is not the one created newly by rescission but the other which was raised by non-performance of the obligations and existed before the exercise of the right to rescission. Thus it is reasonable to say that the defaulting party who is in fault for non-performance is liable to pay damages and the scope of damages is expectation interest (positive interest) rather than reliance interest (negative interest).[45]

Having said that, the direct effect theory is again divided into three groups in regard to the nature of the right to claim damages in the KCC Art. 551. The first group maintains that the damages of the KCC Art. 551 is to compensate *reliance interest (negative interest)* so that it avoids the theoretical contradiction of the direct effect theory which is due to its construction of the *ex tunc* effect of rescission.[46] It explains that the scope of damages in rescission is expenses or other losses

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44) The Korean Supreme Court, 24/5/1983, Da Ka 1667, The Supreme Court Decision, Book 31, Volume 3, Civil Case, at p. 17; " --- In case a party to contract exercises the right to rescission, the rescission terminates *ex tunc* the contractual relationship to the credits and debts of the parties, there would be no matter of damages to non-performance of the obligations. Notwithstanding that, in the event of rescission the KCC Art. 551 is especially stipulated damage claims which can be combined with rescission for the purpose of protection of the creditor. The parties are obliged to restore the other party into the situation prior to the conclusion of contract, such as returning the money or the subject-matter which they received from the other party as a performance of contract. In addition, as the claim of damages in rescission is not different from the claim of damages raised by non-performance of the obligations, the creditor may claim *compensatory damages* for the interests which he or she would have gained if the contract had been performed, so called *the expectation (positive) interests.* --- "

45) It is tempting to go on to say that the damages would be for reliance interest because of the *ex tunc* effect of rescission. However the theory says that the damages are for expectation interest on the premise that the damages are caused by non-performance notwithstanding its *ex tunc* effect.

46) Joo-soo Kim, *op. cit.*, at p. 155 *et seq.* Its contradiction is based on the alleged logical difficulties in the matter of coexistence of the right to claim damages and rescission.

incurred in the creditor's belief which the contract was made validly.[47] The right to claim damages is *newly created by rescission* and nothing related to the performance of contract, *i.e.*, non-performance. In this sense it can avoid the theoretical contradiction because the creditor's reliance on the validity of the contract can be applied to the situation in which the contract is terminated *ex tunc* by rescission.[48] The second group contends that as only release from the obligations and restitution of benefits by the exercise of the right to rescission do not protect the creditor satisfactorily the KCC Art 551 is specially stipulated to limit the *ex tunc* effect of rescission in the light of practical equity for the protection of the creditor.[49] It means the *ex tunc* effect does not extend to the right to claim damages for non-peformance. Therefore, the scope of damages in rescission is to compensate the creditor for loss or other expenses caused by the debtor's *non-performance, i.e., expectation interest (positive interest).* The third group insists that rescission does not terminates *ex tunc* the contractual relationship to the new credit and debt for damages raised in the result of irregularities of performance in accordance with the contract, *i.e.*, non-performance. It terminates *ex tunc* only the contractual relationship to the original credits and debts of the contract.[50] Thus it argues that, insofar as the contractual relationship to the new credit and debt for damages is not terminated *ex tunc*, the damages are for non-performance and the scope of the damages should

47) *Ibid.*, at p. 156. He continues to say that in case the creditor relies in the contract made validly he or she normally also expects the performance of the contract. Thus the loss of expectation interest (positive interest) can be also included in reliance interest (negative interest).

48) Its insistence on reliance (negative) interest is influenced to great extent by Swiss law which provides that rescission may be coupled, if the other party can not disprove fault, with a claim for reliance (negative) interest. The Swiss Code of Obligation Art. 109 par. 2.

49) Yun-jik Kwak, *op. cit.*, at p. 106; The Korean Supreme Court, 24/5/1983, Da Ka 1667, The Supreme Court Decision, Book 31, Volume 3, Civil Case, at p. 17

50) Wook-kon Kim, "A Essay on the Theory of the Effects of Rescission", *Essays for Prof. Juk-in Hwang* (Pak-Young Sa, 1990) at pp. 747 *et seq.*; Chang-soo Yang, "A Impression on the Theories on the Effects of Rescission" (April, 1991), *Koshi Yeonkoo*, at p. 35.

be expectation interest (positive interest).

Generally, the difference between the first group and the second, third group is in that the first group does not admit the right to claim damages for non-performance due to the *ex tunc* effect, while the second and third group does. In result the first group insists reliance (negative) interest whereas the second and third group does expectation (positive) interest. The difference between the second group and the third group is in the matter of how the right to claim damages is derived from the KCC Art. 551, notwithstanding its *ex tunc* effect.

② The Liquidation Theory

The theory maintains that rescission alters the nature of the original contractual relationship into the one of new contractual relationship for liquidation, *i.e.*, restitution. In this theory the alteration of the nature of the contractual relationship is created by the declaration of the intention of rescission of a party to contract and the new contractual relationship keeps its identity to the original contractual relationship until all claims raised from the original contract are settled. Thus there is no need to consider the obligations not yet performed in sofar as the new contractual relationship for restitution is generated by rescission because the obligations are terminated by rescission. Yet, as the obligations already performed still remains after rescission in the new contractual relationship for restitution, it is definitely possible to claim damages for the irregularities of the obligations performed.[51] Unlike in the direct effect theory, there is no matter to consider the justification of the coexistence of damages and rescission in the liquidation theory due to the negation of the *ex tunc* effect of rescission. As a result, the damages is for *non-performance* and the scope of the damages should be *expectation interest (positive interest).*[52]

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51) Hyung-bae Kim, *op. cit.*, at pp. 244 *et seq.*; Eun-young Lee, *op. cit.*, at p. 250 *et seq.*

52) In the light of the result in damages for positive (expectation) interest, it is same as

2) CISG

The CISG expressly stipulates that avoidance does not prevent the aggrieved party from claiming damages on account of the non-performance by the defaulting party of one of his or her obligations.[53] This is reinforced by the CISG Art. 45 and 61 which made clear that claims for damages can be asserted apart from other legal consequences of breach of contract, thus also apart from avoidance. However the right to claim damages is precluded if the non-performance by the defaulting party is due to impediments under the CISG Art. 79. Concerning the scope of damages it would be tempting to contend that it should be expenses or other losses incurred in reliance on the contract, *i.e.*, reliance interest (negative interest) if we assume that avoidance terminates the contract *ex tunc*.[54] However, as it is proved by the provisions of the CISG,[55] the damages is for non-performance and the scope of the damages under the CISG does not limit its damages to reliance interest but extends to damages which can not be compensated by restitution, *i.e.*, expectation interest (positive interest).[56] Thus the damages may include expectation loss, such as loss of profit.[57] In this case the damages is assessed by the CISG Art. 74 which is a general provision for damages.[58]

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the second and the third group of the direct effect theory. However the liquidation theory is different from the direct effect theory in that the result is derived from the negation of the *ex tunc* effect of rescission unlike the direct effect theory. On the other hand, the direct effect theory derives its result from the limitation of *ex tunc* effect or the application of *ex tunc* effect to the contractual relationship to the original credits and debts.

53) The CISG Art. 81(1) the first sentence.

54) *See supra* n. 16-43 and accompanying texts.

55) The CISG Arts. 74, 75, and 76.

56) For the defaulting party's claim to damages, the CISG Ars. 75 and 76 is applied first for damages in rescission and then the CISG Art. 74 for further damages including loss of profit.

57) Treitel, *op. cit.*, at p. 396.

58) The CISG Arts. 75 and 76.

2. Critiques

1) Korean Law

Concerning the provision for damages in the event of rescission of the KCC Art. 551, if rescission extinguishes the contract *ex tunc* as the leading view or the cases about the effects of rescission maintains, the damages for non-performance of the obligations can not exist logically. Its contradiction is based on the matter of how damages claim can exist if the contract has been terminated *ex tunc* as if the contract had never been made. This is because damages can only exist on the premise of the existence of the contract and can be raised by non-performance of the contract.

This contradiction is especially related to the views of the second and the third group in the direct effect theory which argues that the scope of damages is expectation interest (positive interest). It says that as the damages caused by non-performance of the obligations before rescission still remain after rescission the damages should be settled by the exercise of the right to claim damages. It insists that, notwithstanding that there is no legal ground for damages due to the *ex tunc* extinguishment of the contract, *i.e.*, non-performance which is the prerequisite of the existence of the right to claim damages. However, unlike in the second and third group's insistence to claim damages with the *ex tunc* extinguishment of the contract, the contractual relationship to the parties should be maintained for raising the right to claim damages. The reason for this is that the right to claim damages which is based on the contractual relationship is, in nature, to render a secondary obligation for the debtor to pay the damages which is occurred by irregularities of performance of the primary obligations. Thus the existence of the contractual relationship is inevitable to raise the right to claim damages with rescission. In this sense the first and second group's contentions seem to be in contradiction.

In regard to the insistence of the first group in the direct effect theory,

it does not seem to generate the matter of prerequisite of non-performance to raise the right to claim damages due to its contention damages are created newly by rescission not by non-performance. It, thus, continues to say the scope of damages is reliance interest (negative interest). However its insistence should be reexamined in the light of the followings; First, its contention seems to be based on the Swiss Code of Obligations which stipulates expressly the compensation of reliance (negative) interest for damages in rescission.[59] In contrast the KCC does not have that provision like Swiss law, which means the first group derives its insistence on reliance interest by the method of construction of law. Yet it should be careful to award the compensation of reliance interest insofar as it is much related to the validity of the contract. In this light the compensation of reliance interest should not be allowed unless there is special provision for the compensation like the Swiss Code of Obligations.[60] Secondly, it should be examined in the light of the theories to assess the amount of damages. Generally, it is assessed by the KCC Art. 393 in accordance with the general principles based on the KCC Arts. 390 to 393. There seems to be no argument to assess the amount of damages in the event of rescission in accordance with these provisions.[61] Two theories are mainly employed to assess the amount under the KCC Art. 393 ; the exchange theory and the difference theory.[62] There is some difficulties to apply the former because

59) The Swiss Code of Obligations Art. 109 par. 2.

60) Seok-woo Kim, *Particulars of Obligatory Law* (Pak-Young Sa, 1978), at p. 138; The Korean Supreme Court, 22/2/1962, 4294 *Min-Sang* 667.

61) Even a scholar who pertains reliance interest agrees in that. *See* Joo-soo Kim, *op. cit.*, at p. 156; Yun-jik Kwak, *op. cit.*, at p. 106; Hyung-bae Kim, *op. cit.*, at p. 245.

62) In civil law jurisdictions, there are two main theories to assess the amount of damages; the exchange theory (Austauschtheorie) and the difference theory (Differenztheorie). According to the exchange theory the creditor is entitled to the full value of the performance promised to him (and now impossible or overdue) but only on condition of performing his own promise. The rival theory is the so called the difference theory by which the creditor is on account of the debtor's default released from his obligation to perform his own promise and is entitled to claim the difference in value between the performance which was promised to him and that which was promised by him. The latter is adopted as a general principle by the German, Swiss, and Austrian courts. *See* generally Treitel, *op. cit.*, at pp. 124 *et seq.*

it is premised on performing the creditor's own obligation notwithstanding that his or her release of obligation is good ingredient of rescission. On the other hand, there is much more room to apply the latter. As the purpose of rescission is to put matters back to the original position (*status quo ante*), it results in that rescission is ultimately to claim the difference between the hypothetical status of assets of the creditor as if the contract had never been made and the present status of assets which is raised in the result of rescission. By a claim based on the difference theory, the aggrieved party can, even though he or she puts an end to the contract, recover the amount of money by which the value of the performance due to him or her exceeded the value of his or her own performance which he or she retains or recovers(as the case may be). This is in reality a sort of protection of expectations: it certainly can not be explained simply on the basis of reliance or restitution.

In addition, the comparative study with CISG supports the liquidation theory in that the scope of damages does not limit its damages to reliance interest but extends to damages which can not be compensated by restitution, *i.e.*, expectation interest (positive interest).

2) CISG

As examined above, the amount of the damages of the KCC 551 will be, it appears, assessed in accordance with the general principles based on the KCC Arts. 390 to 393. Of course if, as a result of rescission, the aggrieved party gets back his or her own performance, he or she will have to give credit for its value, so that the first element of his or her damages will be difference between the value of that performance and the performance promised to him. Yet recovery of expectation loss occured by non-performance is not precluded by rescission; nor, it seems, is recovery of reliance loss such as expenses incurred in reliance on the contract.

The problem here is whether compensatory damages[63] which is generally allowed for non-performance are also allowed in the event of rescission. Under Korean law compensatory damages, *i.e.*, damages of full value, does not seem to arise in rescission because restitution arises first by either way of restitution of actual goods or restitution in value in the event of impossibility of restitution of the actual goods.[64] Thus, as a result of rescission, if the seller gets back his or her own goods or the value of the goods, he or she will have to give credit for its value, so that compensatory damages in full value will be reduced to the difference between the value of the goods and the price promised to him or her. On the other hand, under the CISG, compensatory damages in full value seems to arise in rescission because it does not allow restitution in value of the goods in the event of impossibility of restitution. Of course, if the seller gets back his or her goods, compensatory damages in full value do not arise since there is restitution of the actual goods. The damages would include the unpaid price and interest.[65]

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63) The Korean Civil Code distinguishes between two kinds of default; delay in performance(the KCC Arts. 387, 392, 395, 544) and impossibility for which the debtor is responsible(the KCC Arts. 390, 546). The former gives rise to a claim for damages for delay, called moratory damages. Such damages are, in general, only recoverable if a notice of default has been given. Besides, a further requirement of a *nachfrist* is as a general rule imposed if the creditor wishes to rely on the delay in order to put an end to the contract or to claim damages for non-performance as opposed to damages for delay. A claim for damages for delay may be coupled with one for non-performance, or for damages for non-performance where the creditor exercises his or her right to refuse to accept performance on account of the delay. The latter gives rise to a claim for damages non-performance. Unlike the claim for delay in performance, the claim for damages for non-performance can not be coupled with one for performance. Of course since this damages is for non-performance there is no reason to consider restitution. In this sense it is described *the compensatory damages in full value*. There is another default which is recognized by scholars and courts; positive breach of contract. It is raised where performance is rendered in due time but, defectively. Though the KCC does not make any special provisions as to damages for this kind of default, damages for positive breach of contract are in principle assessed on the same basis as damages for impossibility.

64) Eun-young Lee, *op. cit.*, at pp. 264 *et seq.*

65) The CISG Arts. 74 and 78.

This difference is significant in the case of impossibility of restitution of the goods after rescission as follows; A is the seller who is entitled to avoidance and B is the buyer who is bound to make restitution of the goods but destroyed just before the risk to the goods is transferred to B, *e.g.*, just before the goods are delivered to the first carrier(as the case may be)[66] without his or her imputability as it is under those provisions of the CISG Art. 79. A avoids the contract and claim restitution of the goods without knowledge of the destruction of the goods. Under Korean law, A can still claim restitution in value of the goods regardless of B's exemption to damages due to no his or her imputability. This is because the nature of restitution in value is still dealt as a restitution of the actual goods rather than compensation of damages. On the other hand, under the CISG, it does not specifically regulate the case in which the goods to be returned have been damaged or destroyed after avoidance of the contract. However, provided that avoidance redirects the obligations in the event of avoidance so that A's remedies correspond to those available to B when the duty to deliver is not fulfilled, B would be excused to damages to the extent of the value of the goods, appling to the CISG Art. 79 due to no his or her imputability to impossibility of restitution of the actual goods after rescission. This result would cause severe inequality to the seller, A.[67] This seems to come from that the CISG does not admit restitution of the goods in value.[68]

66) The CISG Art. 67.

67) Practically speaking, in this case, the claim to the price would be better for the seller rather than avoidance.

68) The restitution in value can be justified in that the right to claim restitution by either the goods itself or the vlaue of the goods in the event of impossibility of the physical restitution is in nature merely to restore the goods already performed by the original contract whereas the provision of claims for damages is to allow the creditor to be compensated damages which is not complemented by restitution.

Ⅳ. Concluding Remarks

In accordance with the purposes of this article, it has been attempted, first, to describe and analyze discussions on the matter of *ex tunc* effect or a *ex nunc* effect of rescission under Korean law in comparison with those under CISG, second, to scrutinize the various rules on the right to damages as an effect of rescission in a comparative way, third. to compare the rules of Korean law with those of CISG and to submit critiques in light of the discipline of comparative law.

It has found that the question whether rescission of the contract operates *ex tunc* or *ex nunc* has given rise to much discussion particularly in Korean law which may be divided broadly into two theories; the direct effect theory and the liquidation theory. The study shows that the latter theory is more close to the CISG in that there is no *ex tunc* effect in rescission and in other aspects, although there are certain aspects of *ex tunc* effect in rescission which can be found under the provisions of the CISG. It is submitted that the construction of the effects of rescission in accordance with the liquidation theory seems to be more plausible and consistent with the CISG when one considers it has become a part of Korean law since current ratification of the CISG.

In addition, the theoretical analysis and the comparative study with the CISG has shown that the *ex nunc* effect should be extended to interpretation of the scope of damages under Korean law. Thus, it is submitted that the scope of damages does not limit its damages to reliance interest but extends to damages which can not be compensated by restitution, *i.e.*, expectation interest (positive interest).

Furthermore, the comparative study has found that, on the assumption of *ex nunc* effect and the redirection of obligations in avoidance under the CISG, especially the restitution in value of the goods in the event of impossibility of the physical restitution should be justified in some cases which the damage claims can not be awarded for the seller due to the application of the CISG Art. 79.

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ABSTRACT

Ex Tunc or *Ex Nunc* Effects of the Rescission of Contract and the Right to Damages under Korean Law and CISG

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This article attempts to describe and analyze discussions on the matter of *ex tunc* effect or a *ex nunc* effect of rescission under Korean law in comparison with those under the CISG). In addition, it tries to scrutinize the various rules on the right to damages as an effect of rescission in a comparative way. Furthermore, it compares the various rules of Korean law with the CISG as to the right to damages and evaluates them in light of the discipline of comparative law. It maintains that the liquidation theory in Korean law is more close to the CISG in that there is no *ex tunc* effect in rescission and in other aspects. It also argues that the construction of the effects of rescission in accordance with the liquidation theory is more plausible when one considers Korea is one of the contracting states of the CISG. In addition, the theoretical analysis and the comparative study with the CISG shows that the insistence of *ex nunc* effect and its interpretation on the scope of damages extends to damages for expectation interest. It is also submitted that the position under the CISG on the assumption of *ex nnuc* effect, is regretted in that the restitution in value of the goods in the event of impossibility of the physical restitution is not allowed in some cases which the damage claims can not be awarded for the seller due to the application of the CISG Art. 79.

Key Words : Rescission of Contract, CISG, Effects of Rescission of Contract, Korean Civil Code, Damages, Retrospective Effects, Prospective Effects