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Damages under the CISG – old and new challenges

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Contents

I	Introduction	5
II	Article 74 in a Nutshell.....	6
III	Art 74 and its Implementation: The Issue of Ethical Standards.....	9
	A The Protection of the Economic Outcome – Loss as Actual Economic Loss	9
	B Shift to a Broader Understanding of Full Compensation Principle	11
	1 The aims of damages in the four corners of the CISG	12
	2 Economic value approach often sufficient for protection of the performance interest	15
	3 Compensation measured by gains – Disgorgement of profit under the CISG?.....	17
	a. Gap-filling pursuant to art 7.....	18
	i. Art 84 (2).....	19
	ii. Art 74	19
	1. National tendencies and comparative analysis.....	19
	a. Common Law jurisdictions.....	19
	b. Civil Law jurisdictions	22
	c. Mixed jurisdictions	23
	2. ‘Uniform interpretation’ via ‘Uniform evolution’	25
	iii. Principle of good faith, fair dealing and favor contractus	26
	b. Summary.....	27
	C Where Is the Boundary – Full Compensation Measured by Economic Value vs. Full Compensation Measured by Gain.....	27
	1 Considerations of specific performance	28
	2 Non-economic or subjective interest in performance.....	29
	3 Negative covenants and the subject matter of the contract.....	30
	4 Principle of foreseeability and causation as further limitation.....	31
	D Summary	31
IV	Legal Costs Under Art 74	31
	A General Resistance Towards the Distinction Between Procedural and Substantive Law	33
	B Was It the Intent of the Drafters to Solve that Issue by Substantive Law?.....	34
	1 Plain Wording.....	34
	2 Drafting History.....	35
	3 Purpose of Art 74 by Outcome Orientated Approach: No Change to the Equality in the Procedural Relationship	36
	4 CISG Advisory Council Approach is hiding the qualification as procedural matter	37
	C Summary	37

V Contractual Changes to Art 74: Agreed Sums Payable Upon Breach.....	38
A Reasons to Include Agreed Sums.....	38
B Agreed Sums Under National Law	39
1 Common law systems	39
2 Civil Law systems.....	40
C Agreed Sums Under the CISG	41
1 Question of validity	41
2 Equivalent solution within the CISG.....	42
a. Art 74 and Art 6	42
b. How strong is the principle of party autonomy?.....	43
c. Agreed sums with a punitive character	44
D Summary	45
VI Final Conclusion.....	46
VII Bibliography	47

Abstract

The United Nations Convention on Contracts for the International Sale of Goods (CISG) is the first sales law treaty to win acceptance on a worldwide scale. In fact, with its current 84 contracting States, all major industrial nations among them (except the United Kingdom), the CISG applies to more than two-thirds of all world trade and the official CISG case law database includes more than 3,000 cases.

This paper deals with one of the most important provisions under the CISG: The recovery of damages after breach of contract, dealt with in art 74. The uniform interpretation and application of this rather short and easy sounding provision is subject to continuous debate among scholars and due to its practical relevance is a challenging task for judges.

This paper examines three specific issues. Firstly, in light of current trends in national jurisdictions, this paper will discuss whether the CISG is able to and ought to provide for damages consisting of the profit the other party made as a result of the breach (disgorgement of profit). The second issue is the question whether art 74 can be interpreted to include the recovery of attorneys' fees occurred during litigation. Lastly this paper addresses the contentious question whether agreed sums payable upon breach – in Common Law countries referred to as penalty clauses or liquidated damages clauses – can be dealt within the uniform rules of the CISG.

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I Introduction

The United Nations Convention on Contracts for the International Sale of Goods (CISG)¹ is said to be “the most significant piece of substantive contract legislation in effect at the international level”.² In fact, since the adoption of the Convention in 1980 84 States have acceded to the CISG, including all major industrial nations (except the United Kingdom).³ The success of the CISG shows that the international trade and commerce considers the CISG to be a modern legal instrument that provides a uniform set of rules for cross border sales contracts and therefore meets their practical needs in times of economic globalisation. The CISG has made international trade easier and more efficient by reducing transaction costs and has enhanced legal certainty for businesses in case of a dispute.

However, the CISG reflects a carefully drafted compromise between different legal systems, which was never intended to be a comprehensive piece of law. Hence, the basic principles may be clear but the details can be controversial.

This paper deals with the provision for damages after the breach of contract in art 74. Indeed, among the provisions of the CISG the articles on damages are the most litigated and written about.⁴ This is the result of the rather general wording of the provision, which does not provide many guidelines. Hence, art 74 confronts courts and scholars with particular challenges to a uniform and autonomous interpretation devoid of domestic perceptions, when particular heads of damages are concerned. Furthermore the CISG, just as any other (national) law, needs to cope with new developments and challenges that arise in international trade and try to find answers.

This paper addresses three controversial issues concerning the interpretation of art 74 CISG and points out opportunities but also the limits the CISG faces.

As an introduction this paper gives a brief overview of the basic principles of art 74 and its current interpretation (II). The following part of this paper (III) starts with a

¹ United Nations Convention on Contracts for the International Sale of Goods 1498 UNTS 3 (adopted 11 April 1980, entered into force 1 January 1988).

² Joseph Lookofsky “The 1980 United Nations Convention on Contracts or the International Sales of Goods” in Blanpain (ed) *International Encyclopaedia of Laws: Contracts* (Kluwer Law International, The Hague, 2000).

³ A list of all 84 contracting States is available at <www.cisg.law.pace.edu>.

⁴ See generally Bruno Zeller *Damages under the Convention on Contracts for the International Sale of Goods* (2nd ed, Oxford University Press, New York, 2009); and Djakhongir Saidov *The Law of Damages in International Sales: The CISG and other international Instruments* (Oxford and Portland (Hart Publishing, Oregon, 2008); and John Y. Gotanda “Awarding Damages Under the United Nations Convention on the International Sales of Goods: A Matter of Interpretation” (2005) 37 *Geo J Int L* 95.

case example that reveals the current question regarding disgorgement of profit in contract law. This paper argues that the CISG should shift to a broader conception of compensation and provide for disgorgement of profit as an ultima ratio remedy (III B). This finding is based on an analysis of the general aim of remedies under the CISG and a further analysis of the general principles that call for a uniform evolution towards the availability of disgorgement of profit. Ultimately the chapter closes with the outline of relevant factors when disgorgement of profit should be awarded (III C). The second still unresolved issue under art 74 is the recovery of attorneys' fees occurred in connection with litigation after a breach of contract (IV). This paper concludes that these costs are a matter outside of the scope of the CISG. An interpretation of art 74 with regard to the serious interference with the equity of the parties in their procedural relationship reveals that it was not the purpose of the drafters to include this kind of financial expenses in substantive contract law. Ultimately this paper addresses the important question of agreed sums payable upon breach (V) which in Common Law countries are often referred to as either penalty clauses or liquidated damages clauses. Against the traditional approach that such contractual stipulations are a matter excluded from the CISG, this paper supports the view that the CISG governs agreed sums in their entirety, thereby preventing a recourse to national law.

II Article 74 in a Nutshell

This first part of the paper aims to give a brief overview of the position of article 74 in the CISG and its general principles. Art 74 is the general rule for the calculation of damages upon breach of contract and provides as follows:

Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.

Art 74 only deals with the scope of damages, whereas the right to claim damages can be found in art 45(1)b for the buyer and art 61(1)b for the seller. Both provisions stipulate a strict liability for the party in breach because they do not require any fault of the party in breach. In the remedial system of the CISG the right to claim damages sits within two other remedies. The CISG recognizes for both parties the right to claim specific performance and the right to avoid the contract.

Art 45(2) and 61(2) clarify that the aggrieved party may combine the claim for damages with the aforementioned remedies. Therefore art 74 has a key position within the CISG's remedial matrix, as Honnold states it is "brief but powerful".⁵

The first sentence of art 74 shows two things: Firstly, the award of damages is always a monetary award ("sum equal to"). Secondly, the aim is to compensate the aggrieved party for any loss, including loss of profit, suffered because of the breach. The underlining principle of art 74 is called the "full compensation" principle.⁶ This principle is not new, in fact it is the notion of the law of damages in numerous legal systems and was found as a common core of damages law when the CISG was drafted.⁷ Its aim is "to place the injured party in the same economic position in which it would have been had the contract been performed".⁸

Imagine buyer B contracted for the delivery of 100 smartphones with seller S. S does not deliver on time. B has to undertake a cover purchase which is 500 NZD higher than the original price. Furthermore, B is not able to deliver to sub-buyers.

In this case, B can claim damages in the amount of 500 NZD plus his lost profit, because this is the economic position he would have been in, if S had performed duly. This amount could be seen as the monetary substitute for the performance he expected and therefore it protects the so called "expectation interest" of the aggrieved party, a term used in many national legal systems.

The drafters of the CISG deliberately did not determine what constitutes a loss nor did they include any categories of losses in the CISG, except the express naming of loss of profit. This reference serves merely as clarification, because some legal systems do not recognise a loss of profit under their national concept of loss.⁹ According to the

⁵ John O. Honnold *Uniform Law for International Sales under the 1980 United Nations Convention* (3rd ed, Kluwer Law International, The Hague, 1999) at 403.

⁶ Ingeborg Schwenzer "Art 74" in Ingeborg Schwenzer (ed) *Commentary on the UN Convention on the International Sales of Goods (CISG)* (3rd ed, Oxford 2010) at [5]; CISG Advisory Council "Opinion No. 6: Calculation of Damages under CISG Article 74" <www.cisg.law.pace.edu> at 1.

⁷ Schwenzer, above n 6, at [2]; and Djakhongir Saidov "Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods" (2002) 14 *Pace Intl L Rev* 307 at 310.

⁸ Art 70 of the UNCITRAL Secretary General "Commentary on the Draft Convention on Contracts for the International Sale of Goods" Doc A/CONF. 97/5 reprinted in John O Honnold *Documentary History of the Uniform Law of International Sales* (Kluwer Law and Taxation Publisher, Deventer, 1989) at 448. [Secretariat Commentary on the 1978 Draft]. The Secretariat Commentary is the closest counterpart to an official commentary on the CISG; it is based on the 1978 Draft of the CISG. Art 70 of the 1978 Draft and Art 74 CISG are substantively identical.

⁹ Secretariat Commentary on the 1978 Draft, above n 8, art 70 at [3].

Secretary Commentary on the 1978 Draft the courts and tribunals must “calculate that loss in a manner which is best suited to the circumstances.”¹⁰ The provision must be understood in a broad manner. Every calculation is possible as long as it fits within the overall objective of the CISG to place the aggrieved party in the same position she would have enjoyed ‘but for’ the breach.¹¹ This is why recoverable losses under the principle of full compensation may also include losses that go beyond the lost value of the promised performance and may include wasted expenses the aggrieved party made in reliance on the contract (reliance interest in the contract) or any consequential damages to the buyers property (integrity interest).¹² Usually the calculation of the economic value of the loss follows the concrete calculation, namely looking at the actual economic situation of the aggrieved party. However, there are tendencies that an abstract calculation may be appropriate in some cases and is not expressly excluded under the CISG.¹³

As extensive as art 74 seems because of its strict liability and the principle of full compensation, there are some limitations. The Convention itself does explicitly exclude losses resulting from death and personal injury in art 5. Additionally moral losses such as suffering and pain are not covered by the CISG.¹⁴ Furthermore the principle of full compensation itself limits the scope of compensation. The injured party shall be compensated for any disadvantage resulting from the breach, but should not make profit out of the breach, so that any gains resulting from the breach must be deducted from an award of damages.¹⁵ Nevertheless, some argue that overcompensation must be accepted, if – under exceptional circumstances – the purpose of ‘full compensation’ cannot be reached otherwise.¹⁶ The avoidance of overcompensation is also the reason why punitive damages may not be awarded under art 74.¹⁷ Furthermore, for loss to be recoverable there must be a causal link between breach and loss (loss “as a consequence” of the breach), however, the simple ‘but for rule’ is sufficient.

The second sentence of art 74 counterbalances the strict liability with the so called foreseeability rule. The aggrieved party is only compensated for damages the other

¹⁰ See Secretariat Commentary on the 1978 Draft, above n 8, art 70 at [4].

¹¹ Saidov, above n 4, at 172.

¹² Zeller, above n 4, at 73.

¹³ Schwenger, above n 6, at [41].

¹⁴ At 39.

¹⁵ CISG-Advisory Council, above n 6, at [9]; John Gotanda “Art 74” in Stefan Kröll, Lukas Mistelis and Pilar Perales Viscasillas *UN Convention on Contracts for the International Sale of Goods (CISG)* (Beck, Munich, 2011) at [32].

¹⁶ Schwenger, above n 6, at [42].

¹⁷ CISG-Advisory Council, above n 6, at [9].

party subjectively had foreseen or – from an objective point of view – could have foreseen when concluding the contract.

Two provisions outside from art 74 could also have influence on the scope of damages. Firstly, art 77 stipulates the duty of the injured party to mitigate losses. The underlining principle is that the law should not provide compensation for avoidable loss. Failure to comply with the duty to mitigate damages may reduce the award of recoverable damages. Secondly, art 79 frees the breaching party under very narrow conditions from any liability for breaching the contract.

III Art 74 and its Implementation: The Issue of Ethical Standards

As simple as art 74 seems from the wording, as difficult is its practical application. Zeller describes that “what art 74 suggests is a mechanical way rule to calculate losses”, but it does not include a definition of loss or full compensation.¹⁸ The next case will show that the application of art 74 is not always easy.

Imagine that S manufactures smartphones. B orders 100 smartphones. There is an explicit contractual stipulation that S ensures humanitarian working conditions, especially that no child labour is part of the manufacturing process.¹⁹ Although otherwise agreed on, S manufactures the goods using child labour. Thereby, he saves half of the production costs. B resells the smartphones making the normal profit. However, the fact that S has used child labour is discovered after the phones have been resold, but does not become public.

The violation of the contractual obligation is a breach of contract and leads to the right to claim damages.²⁰ When measuring the loss of B, the starting point must be the principle that B has to be put in the same position as if the contract had been properly performed.

A The Protection of the Economic Outcome – Loss as Actual Economic Loss

From an economic point of view loss is the difference of value of the goods obtained compared to the goods one expected to receive under the contract. At first sight, it may appear that B is exactly in the same position as if the contract had been performed properly. The problem is that the physical features of the smartphones are

¹⁸ Bruno Zeller, above n 4, at 39.

¹⁹ Example taken and slightly changed from Ingeborg Schwenzer and Pascal Hachem “The Scope of the CISG Provisions on Damages” in Djakhongir Saidov and Ralph Cunnington (eds) *Contract Damages: Domestic and International Perspectives* (Hart Publishing, Portland, 2008) 91 at 94.

²⁰ Art 45 (1) CISG.

the same, irrespective of how they have been produced. From this perspective, the way of production has no economic value, so there would be no loss in our example. The claim for damages would be dismissed. However, the problem can be solved, if the way of manufacturing was considered to have an economic value. On a consumer level, the way of production can have an influence on the market value. There is no reason why the commercial level should differ. Hence, nowadays different markets exist for products produced under fair conditions and products produced under unfair conditions. The CISG case law shows cases where a similar approach was taken regarding organic production.²¹ Having this in mind, the negative balance on the balance sheet results from the difference between the market value of the goods B received and the market value of the goods B expected to get.²²

However, the economic loss could be balanced out by the fact that B resold the products obtaining his normal profit. With the untainted goods he would not be in a better economic end position than he is in right now. If one remembers the general aim is to avoid that the aggrieved party profits from the breach and gets more than its expectation interest, the question is, whether the resale's profit must be offset against the loss to avoid an overcompensation of B? The CISG Advisory Council Opinion on art 74 provides that any benefit received as a consequence of the breach of contract should 'in principle' be offset against the economic loss.²³ However the words 'in principle' indicate that this rule can have exceptions. These exceptions derive from a normative view on the law of damages. This view questions if the strict application of a rule provides a fair solution thereby accepting the effect of overcompensation. In the case at hand, the resale's profit was not a direct consequence of the breach as such, but from B's normal business. It seems unfair that S benefits from that fact, considering that B could not detect the defect of the goods delivered.

In practice, B might have difficulty proving the exact difference between the market value. The contract could have provided help, if the parties had expressly declared that B pays a certain amount over the normal purchase price for the compliance with human rights.²⁴ In the provided example, however, the only certain number is the gain made by S, i.e. the costs saved in the production process. It then needs to be determined whether B can claim that the gain made by S through the breach of

²¹ With regard to organically produced goods see OLG Munich, Urteil v. 13. November 2002 (27 U 346/02), CISG-online 786, <<http://cisgw3.law.pace.edu/cases/021113g1.html>>.

²² Nils Schmidt-Ahrendt "Disgorgement of Profits under the CISG" in Ingeborg Schwenzer and Lisa Spangolo (eds) *Sate of Play: The 3rd annual MAA Schlechtriem CISG Conference* (Eleven International, Den Haag, 2011) 89 at 101.

²³ CISG Advisory Council, above n 6, at [9].

²⁴ So the example in Schwenzer and Hachem, above n 19, at 94.

contract is equivalent with his loss. S probably calculated the costs for normal workers when naming the purchase price. So there is a presumption that this difference is the minimal difference of the market value of the goods in question. The gains made by S serve merely as a yardstick to measure the difference in economic value of the goods.

However, this leaves the possibility for B to prove that the amount of saved production costs is higher than the difference in price between untainted and tainted goods. Schmidt-Ahrens, who discussed this possibility, argued that the seller is entitled to keep his profit, because there is no legal reason why the buyer should receive the “windfall”.²⁵ It is at this point, where the question arises whether the economic view of the expectation interest in such a case is satisfying? Certainly, B strived for compliance with the ethical standard not only because of the higher economical value, but also because of his interest to guarantee compliance with human rights in his supply chain. He had a special interest in the performance itself, not only in the economic value of the products. Are there cases where the aggrieved party is not fully compensated, even if his economic loss is compensated?

B Shift to a Broader Understanding of Full Compensation Principle

The common understanding that the loss suffered by a party is the actual loss of the economic value expected under the contract may be challenged, if one considers that in the example above the plaintiff has no legal instrument to ensure that his contracting party does keep the contract, because the defendant has an incentive to breach the contract whenever his financial benefit resulting from the breach exceeds the economic loss to the defendant.

The question is therefore, whether the CISG could and should develop the orthodox meaning of full compensation. Furthermore, if the law of damages and art 74 as the basic provision for the measurement of damages want to protect more than the economic outcome of the contract, how does this affect the meaning of loss and its calculation?

An answer to these questions requires, as a first step, to analyse the underlining principles of the remedial system under the CISG. Only with knowing the purposes of the law of damages can one decide how the CISG can react to new challenges.

²⁵ Schmidt-Ahrendt, above n 22, at 102.

1 *The aims of damages in the four corners of the CISG*

This analysis may seem superfluous having in mind that the aim of art 74 in the first part of this paper was stated as the protection of the expectation interest. However, the expectation interest is in itself a term that is open for interpretation. It can mean the merely economic expectation as a result of the performance or it can mean the expectation of performance as such. Therefore it is worth investigating the aims of remedies in general from a broader perspective by looking at the interplay of different principles that can be found in the CISG itself.

CISG is private contract law that provides default rules for international sales contracts. However, the basis is the existence of the contract itself which is a result of the parties' own will.²⁶ If the law does not provide means to give effect to these contractual obligations, the right resulting out of the contract would be a "hollow one, stripped of all practical force and devoid of all content".²⁷ So the first purpose of remedies can be defined as to ensure an effective operation of contract law by effectively protecting the contractual right to performance. An effective protection of the contractual right to performance creates security in commercial relationships and lets parties rely on their contract. If the law does not protect the contractual right to performance effectively parties will be reluctant to enter into contracts and the aim of the CISG to facilitate international trade would be ultimately undermined.²⁸

In regard to what constitutes an effective protection of the interest in performance in case of a failure to perform, the most rigorous answer would be a remedial right to require performance. Under art 46 (1) and art 62 the CISG generally acknowledges such a right and follows the principle of *pacta sunt servanda* (contracts must be performed). In this regard the CISG reflects the remedial system in most Civil Law systems.

However, the existence of some exceptions and restrictions to the general right to compel performance shows that the question 'what constitutes an effective protection of the interest in performance' is also influenced by economic considerations and a fair balance of parties' interests. Having in mind that the CISG concentrates on business to business relationships in international trade, it cannot be denied that the contracting parties want the law to provide security, but also to acknowledge that

²⁶ Named the "will theory" of contract law in L.L. Fuller and William R Perdue "The Reliance Interest in Contract Damages" (1936) 46 Yale LJ 52 at 58.

²⁷ David Pearce and Roger Halson "Damages for Breach of Contract: Compensation, Restitution and Vindication" (2008) 28 Oxford J of Legal Studies 73 at 73.

²⁸ Saidov, above n 4, at 18; and Katy Barnett *Accounting for Profit for Breach of Contract: Theory and Practice* (Hart Publishing, Oxford, 2012) at 30.

considerations of economic efficiency form in most cases the basis of their contractual relationship. Just the same as too little protection can hinder parties from contracting, too strict legal rules do not serve the purpose of the CISG to facilitate trade. In the case of non-conforming goods, special restrictions on the claim to performance can be found in art 46 (2) and art 46 (3). Para 2 requires a fundamental breach for the delivery of substitutive delivery and para 3 considers whether repair as one form of specific performance is “reasonable having regard to all circumstances”. Both provisions take into consideration expenses for the party in breach compared to the interest of the aggrieved party.

Apart from these specific provisions, even when the right to specific performance exists pursuant to the CISG, its enforcement may be limited pursuant to art 28. This provision opens the possibility for the court to refuse specific performance if it would not grant this remedy under its domestic law in respect of a similar contract. Art 28 is the result of the failure during the drafting process of the CISG to find a compromise between the divergent concepts on the availability of the right to require performance between European Civil Law systems and English and American Common Law systems.²⁹ Whereas specific performance is a standard remedy in Civil Law Systems, Common Law systems award damages as the primary remedy and allow specific relief only in particular circumstances when damages are considered as “inadequate”.³⁰ This development is deeply rooted in the history of these legal systems and influenced by economic reasons.³¹

In practice the existence of art 28 may lead to a case where a plaintiff’s claim for specific performance is rejected and replaced by a monetary award. However, this possibility is not at odds with the position of the CISG that the right to performance is the point of reference for any remedy.

²⁹ For an overview of the discussion during the drafting process see documents in Honnold, above n 8, at 672, 741, 524–526, 647.

³⁰ As example see s 52 (1) of the Sales of Goods Act 1979 (UK): “In any action for breach of contract to deliver specific or ascertained goods the court may, if it thinks fit, on the plaintiff’s application, by its judgment or decree direct that the contract shall be performed specifically, without giving the defendant the option of retaining the goods on payment of damages” and § 2–716 (1) of the Uniform Commercial Code in the United States of America: “Specific performance may be decreed where the goods are unique or in other proper circumstances”.

³¹ Historically Common Law countries such as England and Australia differentiated between Common Law courts which could only order the payment of money damages and courts of equity, controlled by the King through his Chancellor, which had the power to compel performance where money was not considered as effective relief. Economic reasons were the roots of the theory of efficient breach, referred to below in III B 2.

Firstly, the application of art 28 is at the discretion of the court. The court “is not bound to enter a judgment for specific performance”, but likewise it can do so, even if the national law does not provide for that.³² What the CISG pursues with art 28 is to create the necessary flexibility for both, common and civil law courts, to decide what is the best, or – considering all circumstances – the most appropriate, remedy for the breach of contract.

Secondly, the fact that art 28 has not been the subject of many decisions in more than thirty years of CISG’s existence proves that the difference between the Civil Law approach and Common Law approach is not as significant as thought. In practice even the aggrieved party often prefers to claim the financial loss than to enforce specific performance and likewise in cases where a party seeks specific performance the case’s circumstances justified an award of specific performance even under common law.³³ Imagine a case where a buyer can easily purchase replacement goods with money damages. He may not even want to continue his business relationship with the seller and also prefers to avoid risks and difficulties inherent in a claim for specific performance, especially its enforcement, if he considers his primary interest to obtain the goods is sufficiently satisfied by money.³⁴ In this example it is the most appropriate, because it is the easiest and commercially efficient, remedy for all parties.

A further means to secure an effective protection of the right to performance is the effect of remedies to deter parties, at least to some extent, from breaching the contract. An effective protection includes providing remedies that reduce the incentive to breach the contract as far as it’s necessary to recognise the interest the aggrieved party had in the contract. ‘As far as necessary’ demonstrates that different degrees of deterrence are possible. The most deterrent effect has the remedy to compel the party in breach to perform. If a party has to perform in any way, there is no incentive to breach the contract. However, it may be asked if strict deterrence is always necessary. Here the interaction with the aforementioned economic

³² Markus Müller-Chen “Art 28” in Ingeborg Schwenzer (ed) *Commentary on the UN Convention on the International Sales of Goods (CISG)* (3rd ed, Oxford, 2010) at [21]; Andreas Björklund “Art 28” in Stefan Kröll, Lukas Mistelis and Pilar Perales Viscasillas *UN Convention on Contracts for the International Sale of Goods (CISG)* (Beck, Munich, 2011) at [19].

³³ Only one case addressed art 28 directly, but also concluded that the requirements of the applicable national law are met: *Magellan International Corp v Salzgitter Handel GmbH*, 76 F Supp 2d 919, (ND Illinois 1999) available at <www.cisg.law.pace.edu>; the limited importance in practice is common view under scholars: see Müller-Chen, above n 32, at [4]; Björklund, above n 32, at [2].

³⁴ Honnold, above n 5, at 199; Anne-Florence Bock “Gewinnherausgabeansprüche gemäss CISG” in Andreas Büchler and Markus Müller-Chen (eds) *Private Law, national – global – comparative: Festschrift für Ingeborg Schwenzer zum 60. Geburtstag* (Bern, 2011) 175 at 185.

consideration and the interests of the contracting parties comes into play. In the beginning of this paper (see above II) a few contracts were mentioned, where even the plaintiff prefers or is at least equally satisfied with a monetary award instead of actual performance. Here the deterrent effect is less strong, because a strict deterrence is not needed to protect the aggrieved party. The seller will only be reluctant to breach the contract as long as the award of damages is higher than the economic benefits for him resulting from a breach.

The primary aim of the remedies under the CISG is, therefore, to provide an effective protection of the contractual right to performance, as there is a functional connection between the primary right to performance and the remedy available upon a breach of contract. The remedy can be seen as a making good or a recognition of the claimant's bargained for interest in performance.³⁵ When determining what constitutes an effective protection, one has to search for the best solution possible, taking into consideration and evaluating various points. First of all, the characteristics of the contract in question, furthermore the interests of both parties including economic considerations and the level of deterrence needed. Zeller concludes correctly that "devising correct and just remedies that take account of both parties' interests and are economically defensible are the key considerations for the success of any remedial system".³⁶

2 Economic value approach often sufficient for protection of the performance interest

After analysing that the core aim of a remedial system is to protect the contractual interest in performance, its influence on the award of damages needs to be discussed. Under the orthodox understanding of full compensation the aggrieved party receives the economic benefit it would have received if the contract had been properly performed. Hence, subject of compensation is actual economic loss. How can this approach, which seems to protect merely the economic end position of a contract rather than looking at the interest in the performance as such, be brought in line with an effective protection of the right to performance?

The answer is, that in most cases the economic difference in value the party suffered because of the breach reflects the value of the right of performance the party was deprived of.³⁷ If the aggrieved party can substitute the goods contracted for easily on the market, damages measured by the economic value reflect a monetary substitute of its right to performance. Only in this scenario of perfect substitutability of goods, is

³⁵ Barnett, above n 28, at 50; Pearce and Halson, above n 27, at 73.

³⁶ Bruno Zeller, above n 4, at 57.

³⁷ Barnett, above n 28, at 50; Pearce and Halson, above n 27, at 81.

the theory of efficient breach relevant.³⁸ This theory has its roots in the common law systems.³⁹ According to that theory a breach of contract may even be more efficient than its performance from an economic point of view. The aggrieved party is not worse off, because it is put in the same financial situation by the payment of damages, and the breaching party can allocate its resources where they have the highest value.⁴⁰ The theory relies on the presumption that the party, who is financially fully compensated, is indifferent between performance and the payment of damages. That is why the proponents of this theory conclude that the law should not discourage such an efficient breach.⁴¹

Even if this theory is rooted in common law, it still has some influence on the interpretation of damages in the CISG. As elaborated above, economic considerations cannot and should not be fully ignored when evaluating what constitutes an effective remedy. However, the deficiency of the efficient breach theory is that its focus is wrong. Rather than looking at the contract and the right contracted for, it looks primarily at the economic end result. It assumes that to restore the financial situation of the aggrieved party will always be an effective protection of the right to performance. That this is not always the case is apparent in the existence of specific performance under the CISG.⁴² But there is no reason, why – once specific performance is no longer available – the considerations made above for remedies under the CISG in general should be disregarded, when deciding what is the best way to grant compensation for the ‘lost performance’.

Consequently the economic approach may often constitute a sufficient protection of the right to performance, but there is nothing that strikes for the conclusion that the economic approach must remain the only available measure to receive full compensation for the infringed right to performance.

³⁸ For a comprehensive overview of the doctrine and a compilation of the criticism towards the doctrine see Barnett, above n 28, at 107–116.

³⁹ As ‘grandfather’ of this theory Justice Holmes is often cited who argued that “the duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, – and nothing else” in Oliver Wendell Holmes “The Path of the Law” (1897) 10 Harvard L Rev 457 at 462 as cited in Ingeborg Schwenzer, Pascal Hachem and Christopher Kee *Global Sales and Contract Law* (Oxford University Press, Oxford, 2012) at [44.25], n 60.

⁴⁰ Djakhongir Saidov, above n 4, at 29.

⁴¹ See Richard Posner *Economic Analysis of Law* (6th ed, Aspen Publishers, New York, 2007) at 119–126 who is one of the leading exponents of the theory of efficient breach.

⁴² Art 28 CISG, which has been discussed above is not at odds with this assumption.

3 *Compensation measured by gains – Disgorgement of profit under the CISG?*

If compensation is defined in a broader sense as a making good of the right to performance, this may open the way to another option to measure damages: Damages measured by the gains made by the contracting party as a result of the breach instead of the actual economic loss. Here a line must be drawn between (partial) disgorgement that is used to ease the evidentiary burden, where economic loss is indisputably caused but difficult to quantify, and full disgorgement of profit irrespective of economic loss. For the former the case at the beginning of this paper (goods produced under child labour conditions) may be an example. We have seen that the gains are a yardstick to measure the economic loss, therefore following the orthodox understanding of full compensation.

However, the more interesting question is if the CISG allows full disgorgement of profit. The consequence of such an award would be a preventive effect. Although disgorgement damages are awarded after breach of contract had already happened, the consequence of disgorgement is its influence on future behaviour. For the particular defendant the incentive to break a contract in the future is little, if he knows that ‘breach does not pay’. Likewise disgorgement has a general deterrence effect, as it warns other possible contract breakers of possible consequences.⁴³

The question whether the CISG provides for a claim of disgorgement of profit is not expressly stated in the CISG, nor expressly excluded as a possible calculation of damages. The drafting history of the CISG shows that the availability of “disgorgement” was not discussed.⁴⁴ However, this is not surprising, because when the CISG was drafted in the 1980s the issue of disgorgement of profit in contract law had not yet emerged neither in civil law countries nor in common law countries.⁴⁵ The CISG Advisory Council, which addresses from time to time emerging questions regarding the application and interpretation of the CISG, stated that the CISG does not provide for punitive damages, but did not mention the issue of disgorgement of profit.⁴⁶ At this point it is worth mentioning that the concepts of the aforementioned

⁴³ Barnett, above n 28, at 26; Robert Cooter and Thomas Ulen *Law and Economics* (4th ed, Pearson Addison Wesley, 2004) at 249; James Edelman “Gain-Based Damages and Compensation” in Andrew Burrows and Lord Rodger of Earlsferry *Mapping the Law: Essays in Memory of Peter Birks* (Oxford University Press, Oxford, 2006) 141 at 149.

⁴⁴ See the protocols of the UNCITRAL deliberations in Honnold, above n 8, at 191, 232, 238, 253 and 352; see also Secretariat Commentary on the 1878 Draft, above n 8, art 70.

⁴⁵ the development towards an award of disgorgement damages in contract law is a still developing field of law (see below II 3 a ii 1).

⁴⁶ CISG Advisory Council, above n 6, at 9.

consequences of breach of contract are different. Disgorgement is concerned to restore the breaching party in the same economic situation but for the breach, making the party indifferent between actual performance and breach. It does not go beyond this point. In contrast, the aim of punitive damages is to punish or make an example of the wrongdoer for “conduct which was outrageous in disregard of the plaintiff’s right” and could go beyond the actual gain.⁴⁷ The study of the opinions of the most common commentators on the CISG reveals that there is still open disagreement on the issue of disgorgement of profit, so that the question still needs to be addressed.⁴⁸

a. Gap-filling pursuant to art 7

Art 7 as the ‘gap-filling’ provision of the CISG helps to cope with new developments or questions that have not been foreseen or have been overlooked during the drafting process. Art 7(2) states that matters covered by the Convention but not expressly settled must be tried to be filled with the general principles of the Convention, leaving the recourse to applicable domestic law as ultima ratio. Remedies after a breach of contract are “rights arising from the contract”, hence matters covered by the CISG according to art 4.⁴⁹ While searching for general principles within the four corners of the CISG, attention must also be paid to the general aim to respect the international character of the Convention and to promote uniformity in the application.⁵⁰

As there is no enumeration of general principles in the CISG, general principles can be found in the explicit wording of provisions as well as in case law and literature where they are established progressively by judges and scholars interpreting the provisions of the CISG.⁵¹

The following part will examine possible principles in order to find an answer whether the CISG covers disgorgement of profit.

⁴⁷ *Kuddus v Chief Constable of Leicestershire Constabulary* [2002] 2 AC 122 (HL) at [68].

⁴⁸ In favour of disgorgement of profit: Schwenger, above n 6, at [43] with citations for the opposite view prevailing mainly amongst German scholars.

⁴⁹ It is the prevailing opinion in the literature that the CISG provides for a conclusive set of rights after a breach of contract. Generally speaking „domestic rules that turn on substantially the same facts as the rules of the Convention must be displaced by the Convention“, Honnold cited in Ingeborg Schwenger und Pascal Hachem „Art 4“ in Ingeborg Schwenger (ed) *Commentary on the UN Convention on the International Sales of Goods (CISG)* (3rd ed, Oxford 2010) at [19].

⁵⁰ Article 7(1) CISG.

⁵¹ An example for a principle clearly named in the CISG is the principle of good faith under art 7(1). Principles developed by scholars and case law are for example the principle of ‘venire contra factum proprium’ (art 16(2)b and art 29(2)) as well as the principle of party autonomy and freedom of contract embodied in art 6.

i. Art 84 (2)

At first sight, one provision seems attractive regarding the disgorgement of profit as a legal consequence of a breach of contract: Article 84 (2). This rule applies in cases of avoidance of contract. It is a supplement to the general consequence of avoidance that parties have to restore what they have received as a consequence of performance of the contract.⁵² Concerning the buyer, his obligation to return the received goods does include any benefit that he has derived from the goods.

The problem with the application of that rule to an award of disgorgement of profits is that art 84 (2) concerns the restoration of the economical *ex ante* situation for both parties, because the duty to perform ceases to exist after avoidance.⁵³ In contrast, damages concern the compensation for the non-performance of the contract.

Hence, no direct principal in regard to damages can be established from art 84 (2). However, it can be stated that at least the legal effect that a party is stripped of its actual profit is not totally unfamiliar to the CISG.

ii. Art 74

Disgorgement of profit in contract law constitutes a monetary award after the breach of a contract. Hence, it needs to be examined whether the principle of full compensation can serve as a gap-filling instrument. In the first part of the paper it was concluded that a broader conception of full compensation as a “making good” for the contractual right infringed could be derived from the general aim of remedies to establish an effective protection of the right to performance.

In fact, there is an international trend questioning if the economic approach to receive full compensation is always an effective protection of the right to performance. As art 7(1) guides us that every interpretation needs to bear in mind the international character of the CISG and its aim to create a uniform set of rules, any gap-filling should be guided by the search for a common understanding acceptable in all jurisdictions. The following comparative analysis aims at finding an internationally acceptable approach.

1. National tendencies and comparative analysis

a. Common Law jurisdictions

England has a pioneering role in the international trend to allow disgorgement of profit as a remedy in contract law. Originally English law provided for disgorgement of profit only in particular types of contract, as the breach of fiduciary duty, breach of

⁵² Article 81 (2) contains the general rule of restitution after avoidance of contract.

⁵³ Christiana Fountoulakis “Art 84” in Ingeborg Schwenzer (ed) *Commentary on the UN Convention on the International Sales of Goods (CISG)* (3rd ed, Oxford, 2010) at [6].

confidence and some proprietary torts.⁵⁴ Disgorgement of profit for a ‘pure’ breach of contract was first awarded in *Attorney-General v Blake*.⁵⁵ Blake was a Soviet spy, who worked for the British Secret Intelligence Service. Under his terminated employment contract he undertook to not disclose any information gained as a result of his employment, during as well as after his time as an informant. He breached the contract by publishing an autobiography about his time as an agent. The House of Lords awarded an account of all the profit of the book that Blake had not yet received from the publisher and based the award on the breach of the employment contract. Lord Nicholls acknowledged that this was a new step in English contract law and concluded that an account for profit should only be awarded “exceptionally”.⁵⁶ Although he stated that all circumstances need to be taken into account, he gave some guidance on what constitutes an exceptional case. Firstly, disgorgement is a remedy of last resort, when other remedies as damages measured by the economic loss are inadequate. Secondly the aggrieved party has to have a “legitimate interest” in preventing the party in breach from profit making.⁵⁷ Although Lord Hobhouse noted in his dissenting speech to the judgement that “to extend that exceptional case to commercial situations ... will require careful consideration” disgorgement damages were discussed and partly awarded shortly afterwards in several commercial cases.⁵⁸ Especially cases concerning a breach of a negative covenant which appear to be difficult as to find clear reasons whether an award of full disgorgement or only partial disgorgement is adequate.⁵⁹ Likewise the doctrinal basis of an award of disgorgement of profit is controversially discussed in the literature.⁶⁰

⁵⁴ See for a closer study of the mentioned categories where disgorgement is traditionally available in English Law: Stephen Watterson “Gain-Based Remedies for Civil Wrongs in England and Wales” in Ewoud Hondius and André Janssen (ed.) *Disgorgement of Profits: Gain Based Remedies throughout the World* (Springer International Publishing, Switzerland, 2015) 29 at 45–56.

⁵⁵ *Attorney General v Blake* [2001] AC 268 (HL).

⁵⁶ At 285 G.

⁵⁷ At 285 H.

⁵⁸ At 299 E.

⁵⁹ *Esso Petroleum Company Ltd v Niad Ltd* [2001] EWHC Ch 458 (Ch) Niad ran a petrol station selling exclusively Esso’s petrol. Under the contract, Niad undertook to follow a pricing agreement. Niad should stick to the resale price Esso dictated and Esso provided a discount to the sale price in recompense. Niad breached that price-watch agreement. The court granted total disgorgement of profit as it was difficult to assess the economic loss consisting in lost consumers because of higher resale prices.

The other two decisions *World Wide Fund for Nature v World Wrestling Federation Entertainment Inc* [2002] FSR 32 (Ch) and *Experience Hendrix LLC v PPX Enterprises Inc*, Edward Chalpin [2003] EWL 25 (CA) concerned breaches of settlement agreements. Rather than full disgorgement the courts ordered the breaching party to pay a reasonable part of its profits reflecting the value of a relaxation of the right under the settlement agreement.

⁶⁰ See Andrew Burrows “Are ‘Damages on the Wrotham Park Basis’ Compensatory, Restitutionary or Neither” in Djahongir Saidov and Ralph Cunnington (eds) *Contract Damages: Domestic and*

Australia has not yet followed the English example and has not extended the availability of disgorgement of profit in contract law. This has, to a large part, to do with present resistance of courts to detach availability of disgorgement of profit from its historic roots.⁶¹ Courts tend to adhere to the strict division between common law and equity, disgorgement of profit available only in the latter case. However, a number of Australian academics suggest a more flexible and modern approach of disgorgement of profit in private law.⁶²

In regard to New Zealand *Attorney-General for England and Wales v R* was the parallel case to the English *Blake* case.⁶³ However, the facts were slightly different, because the parties had expressly agreed on disgorgement as a remedy through a contractual provision. Until now New Zealand's courts have not been required to decide about a general availability of disgorgement of profit in contract law and its possible requirements.⁶⁴ Nonetheless, a hint towards a more flexible approach to disgorgement of profit is implied by the judgement of *Paper Reclaim Ltd v Aotearoa International Ltd*.⁶⁵ Although the judgment concerned the availability of punitive damages for a breach of contract, its reasoning is of relevance. One argument why punitive damages were considered as generally not necessary in contract law, was the fact that remedies exist which already fulfill some of the objectives of punitive damages: Disgorgement of profit in contract with reference to *Blake* was explicitly named in the list of contract remedies.⁶⁶

International Perspectives (Hart Publishing, Portland (Oregon), 2008) 165; and Ralph Cunnington "The Measure and Availability of Gain-based Damages for Breach of Contract" in Djahongir Saidov and Ralph Cunnington (eds) *Contract Damages: Domestic and International Perspectives* (Hart Publishing, Portland (Oregon), 2008) 207.

⁶¹ Katy Barnett "Disgorgement of Profits in Australian Private Law" in Ewoud Hondius and André Janssen (ed.) *Disgorgement of Profits: Gain Based Remedies throughout the World* (Springer International Publishing, Switzerland, 2015) 13 at 25; and Sirko Harder "Measuring damages in the law of obligations" (Hart Publishing, Oxford, 2010) at 226, where Harder suggests, based on the doctrine of restitution for wrongs, the availability of disgorgement of profit in cases of an exclusive entitlement to the right, including contractual rights.

⁶² Barnett, above n 61, at 25.

⁶³ *Attorney-General for England and Wales v R* [2002] 2 NZLR 91 (CA).

⁶⁴ In *Astra Pharmaceuticals (NZ) Ltd v Pharmaceutical Management Ltd* [2001] 1 NZLR 415 (CA) the breach of a contractual confidentiality clause was at issue. However the Court did not enter into a discussion of disgorgement of profit in contract law, because the case was ultimately treated as a loss of chance.

⁶⁵ *Paper Reclaim Ltd v Aotearoa International Ltd* [2006] 3 NZLR 188 (CA).

⁶⁶ At [182].

b. Civil Law jurisdictions

Similar to Common Law countries there is yet no general concept for the availability of disgorgement of profit in German law. Rather it is narrowly tied to specific cases in commercial law where there is a particular fiduciary relationship between the parties, for example between employees and business owners, partners of a commercial business or directors and administrators of a stock company. In those relationships disgorgement is provided explicitly for the prohibition of competition.⁶⁷ Apart from these provisions disgorgement often requires infringement of an absolute right rather than a contractual obligation.⁶⁸

However, it was recently discussed at the 66th German Jurists' Forum whether deriving from the existence of s 687 (2) German Civil Code (Bürgerliches Gesetzbuch), a general provision should be adopted, allowing to claim for disgorgement of profit in case of an intentional breach of a person's right.⁶⁹ Consequently such a provision would include contractual rights. At the moment s 687 (2) BGB has a very little scope of application, because the wording requires a benefit from an intentional management of another person's affairs without the person's knowledge. The prevailing view in literature and case law interprets 'management of another person's affairs' in a narrow way, hence, not including contractual situations.⁷⁰

The proposal for a general provision based on s 687 (2) BGB was finally rejected, presumably in part because of the very general wording that had only required an intentional infringement.⁷¹ However, there was a widespread agreement that disgorgement, with its absolute deterrent effect, is a preferable solution for the

⁶⁷ Section 61(1) and s 113(1) Handelsgesetzbuch (German Commercial Code); s 88(2) Aktiengesetz (Companies Act).

⁶⁸ See possibilities to disgorge profit after the infringement of an intellectual property right in s 139(2) Patentgesetz (Patent Law), s 79(2) Urheberrechtsgesetz (Copyright Law) and s 14(6) Markengesetz (Trademark Law); disgorgement was also seen as possible after the infringement of personality rights, where disgorgement was seen as one from of compensation, in order to achieve 'a real deterrent effect'; see *Caroline von Monaco* [2005] BGHZ 128, 1 at 16.

⁶⁹ Gerhard Wagner proposed to include the following subsection 3 to the general provision in German Civil Code (BGB) concerning the scope of damages in s 251 BGB (hence regulating breaches of tort as well as breaches of contract): "Where the person liable in damages has intentionally infringed the obligee's [the injured party's] right, the obligee can – instead of compensation – demand disgorgement of the profits achieved by the person liable in damages and that he renders account of those profits."

⁷⁰ German Federal Court (Bundesgerichtshof) *Neue Juristische Wochenzeitschrift* 1988, 3018 as cited in Tobias Helms "Disgorgement of Profits in German Law" in Ewoud Hondius and André Janssen (ed.) *Disgorgement of Profits: Gain Based Remedies throughout the World* (Springer International Publishing, Switzerland, 2015) 219 at 220 with further citations.

⁷¹ Helms, above n 70, at 220, n 8.

intentional infringement of another person's right.⁷² That fact implies that German scholars see at least partly a lack of effective protection of legal rights and a need for development.⁷³ One might not exclude that this also applies to contract law, irrespective of what the requirements for disgorgement might be.

France, likewise, has so far a 'sectoral' approach towards disgorgement of profit that concentrates on tort law. Disgorgement of profit is explicitly named in the legislation concerning the protection of intellectual property rights. In the past the infringement of personality rights through the press led to judgements allowing disgorgement of profits, even if the legal basis is unclear, because judges referred to a flexible way of calculating non-pecuniary loss. Scholars support the idea of a legal comprehensive framework for the availability of disgorgement of illicit profit. Even if the discussion seems to focus on a solution in the area of tort law, influences on contract law are shown by the preliminary draft bill for a reform of contract law proposed by a group of scholars led by Professor Terré in 2009. Art 120 provided for a partial or full disgorgement in cases of 'lucrative fraud', "i.e. where a party willfully fails to comply with the law, preferring to risk a conviction and damages so as to be able, for example, to conclude contracts elsewhere, in more advantageous conditions".⁷⁴ It has to be noted that this provision is more likely to be characterized as a proposal of punitive damages in contract law, as it merely requires a deliberate breach.⁷⁵

c. *Mixed jurisdictions*

Israel granted disgorgement of profit long before *Blake*. In fact Israeli law provides for an extensive set of remedies after a breach of contract; ones deriving from the law of contracts as well as ones deriving from the law of unjust enrichment. Disgorgement as a remedy under unjust enrichment law is therefore generally available in contract

⁷² Helms, above n 70, at 220, n 7.

⁷³ Disgorgement in German contract law has also been the question of recent scholarly writing: See Tobias Helms *Gewinnherausgabe als haftungsrechtliches Problem* (Mohr Siebeck, Tübingen, 2007) and Ole Böger *System der vorteilsorientierten Haftung im Vertrag* (Mohr Siebeck, Tübingen, 2009).

⁷⁴ Art 120 of the 'avant-projet de réforme Terré du droit des contrats': "Toutefois, en cas de dol, le créancier de l'obligation inexécutée peut préférer demander au juge que le débiteur soit condamné à lui verser tout ou partie du profit retiré de l'inexécution", as cited in Michel Séjean "The Disgorgement of Illicit Profits in French Law" in Ewoud Hondius and André Janssen (ed.) *Disgorgement of Profits: Gain Based Remedies throughout the World* (Springer International Publishing, Switzerland, 2015) 121 at 133, n 67 and translated as 'However, in the case of fraud, the creditor of the unperformed obligation may prefer to ask the judge that the debtor be ordered to pay him all or part of the profit made from the non-performance.'

⁷⁵ See Séjean, above n 74, at 133.

law irrespective of any loss.⁷⁶ Interestingly, the landmark decision for disgorgement in contract *Adras Building Material v Harlow & Jones GmbH* concerned an international commercial sales contract. In 1973 the defendant, a German company, contracted to sell the plaintiff, an Israeli company, iron for a pre-determined price.⁷⁷ Due to political instability in the buyer's region, the delivery was delayed. A few months later after a partial delivery the seller informed the buyer that he had to sell the iron to a third party due to high storage costs. In fact the market price for iron had spiked in the meantime and the seller was able to sell the iron to a third party for a profitable price. The buyer had not made a cover purchase and had not avoided the contract but claimed for damages consisting of the seller's profit under the Convention related to a Uniform law for the International Sale of Goods (ULIS, the predecessor of the CISG). The Court initially dismissed the claim under art 82 ULIS (equivalent to art 74 CISG), because the price for iron had dropped again at the time of the proceedings, so there was no loss, and under 84 ULIS because the provision required the avoidance of the contract which had not taken place.⁷⁸ However, the Court applied the national law of unjust enrichment and argued that:

The injured party has a right not only to compensation for breach of contract, but also to specific performance . . . Therefore, under Israeli law, a buyer in a contract of sale is entitled to receive the subject-matter of the sale, and an enrichment of the seller which infringes this right is an unjust enrichment at the buyer's expense.⁷⁹

Contrary to the wide approach in Israel an analysis of current developments in South Africa shows that even if some scholars favor a development towards disgorgement of profit, yet only in exceptional circumstances, they struggle to place disgorgement in South Africa's existing set of private law. Within the law of contract South Africa follows a strict rule of compensation for patrimonial loss, so that any gain based approach to calculate damages is unknown. It is argued that the law of unjust could provide a further doctrinal basis for disgorgement of profit, however, a condition is that the enrichment is unjustified which is prima facie questionable due to the

⁷⁶ Talia Einhorn "Disgorgement of Profits in Israeli Law" in Ewoud Hondius and André Janssen (ed.) *Disgorgement of Profits: Gain Based Remedies throughout the World* (Springer International Publishing, Switzerland, 2015) 299 at 302.

⁷⁷ *Adras Building Material v Harlow & Jones GmbH* (1995) 42(1) PD 221, translated in (1995) 3 *Restitution Law Review* 235 (SC of Israel, 1988), abstract available at <www.cisgw3.law.pace.edu>.

⁷⁸ Art 84 ULIS is the predecessor of art 76 CISG. However, the prevailing view today applies art 76 CISG also to cases where avoidance was not declared but the seller showed its definite and final refusal to perform, see Ingeborg Schwenzer "Art 76" in Ingeborg Schwenzer (ed) *Commentary on the UN Convention on the International Sales of Goods (CISG)* (3rd ed, Oxford 2010) at [3].

⁷⁹ At 271.

existence of a valid contract.⁸⁰ Nevertheless there are some local commentators who favor a development towards disgorgement of profit in contract law as an exceptional remedy.⁸¹

As a summary the comparative analysis shows that at this point there is no international ‘one-fits all solution’ under which circumstances disgorgement of profit is necessary in contract law. Notwithstanding, irrespective of the stage of ‘development’ the national jurisdictions are – reaching from scholar writing on one hand to existing case law on the other –, one fact can be stated: Jurisdictions all over the world discuss the issue of disgorgement in contract law. That implies that to a certain degree they see a deficiency in their existing set of remedies after a breach of contract.⁸²

2. ‘Uniform interpretation’ via ‘Uniform evolution’

Consequently, even if there has not yet emerged a uniform approach, it is the uniform development and discussion that the CISG should keep pace with in order to retain its successful standing in international commercial relationships. It is correct when Bock concludes that art 7 calls not only for a ‘uniform interpretation’ but also for a ‘uniform evolution’.⁸³ There are several reasons that support that finding.

Firstly, the CISG is not supposed to be a rigid law. Like national jurisdictions, it must keep pace with the new developments, finding internationally acceptable answers to practical realities in a more complex global world. International trade has developed since the 1980s and with it the idea what deserves protection under the law of damages. The history of the CISG shows the Convention has already demonstrated its flexibility to cope with new questions on the law of damages. The compensation for

⁸⁰ Jacque du Plessis and Daniel Visser “Disgorgement of Profit in South African Law” in Ewoud Hondius and André Janssen (eds) *Disgorgement of Profits: Gain Based Remedies throughout the World* (Springer International Publishing, Switzerland, 2015) 345 at 358.

⁸¹ See Blackie, J., and I. Farlam. “Enrichment by act of the party enriched” in R. Zimmermann, D. Visser, and K. Reid (eds) *Mixed legal systems in comparative perspective* (Oxford University Press, Oxford, 2004) at 469, 493 and Daniel Visser *Unjustified enrichment*. (Cape Town, 2008) at 696; Jacque du Plessis *The South African law of unjustified enrichment* (Cape Town, 2012); all as cited in Plessis and Visser, above n 80, at 359, n 72.

⁸² See Ewoud Hondius and André Janssen (eds) *Disgorgement of Profits: Gain Based Remedies throughout the World* (Springer International Publishing, Switzerland, 2015) 499 who, after a broader analysis of national reports on the availability of gain-based remedies in different branches of law, including contract law, conclude that “despite the many efforts towards preventing and disgorging unlawful profits, either through the (partial) use of disgorgement damages or through corresponding functional equivalents, the majority of the national reporters have criticised the inefficiency of their own legal system.”

⁸³ Bock, above n 34, at 184.

loss of reputation is one example.⁸⁴ However, a strong argument to negate damages that reflect the defendant's gain irrespective of any economic loss is the wording of art 74.⁸⁵ Indeed, the mentioning of "lost profits" in the provision implies that loss refers to actual economic loss and contradicts the availability of disgorgement as a gain-based damage award irrespective of any economic loss. However, it can be questioned whether the wording should hinder an evolution towards the availability of disgorgement under the principle of full compensation. The wording of art 74 represents the status quo in the 1980s. In this stage, the drafters thought their solution based on economic loss to be an appropriate one. However, the Commentary on the 1978 Draft shows that flexibility was considered as a core function of art 74.⁸⁶ Furthermore, from a practical point of view, any amendment to the text of the CISG requires a time consuming and complex process including plenary meetings of the contracting states and once a new wording is agreed on, a new ratification in each State. Even though practical issues cannot serve as justification for itself, they can support the idea that wording should not be the decisive factor.

Ultimately, one point should be stressed: To negate a possible claim for disgorgement for profit under the principle of full compensation, because an international coherent approach is not yet apparent, may eventually lead to the fact that the Convention undermines its principal aim to promote legal uniformity in international sales and becomes an out-dated set of rules. Even if we acknowledge that the development of disgorgement of profit is at an early stage, once national law has further developed, parties may opt out of the CISG and decide to govern their contract by national law which provides a more extensive set of remedies.⁸⁷

iii. Principle of good faith, fair dealing and favor contractus

After all, the principle of good faith and fair dealing, stated expressly in art 7(1) can be evoked in support of a disgorgement of profit claim. This principle must be applied with caution, because art 7(1) cannot establish complete new rights and obligations under the CISG. Rather the principle of good faith influences and shapes the existing

⁸⁴ It is widely accepted that this kind of loss can be considered in the calculation of damages. However the level of proof and whether the loss has to manifest itself in demonstrable financial loss or if this kind is compensation for non-pecuniary loss is still being discussed: See John Gotanda, above n 15, at [63] and Schwenger, above n 6, at [34].

⁸⁵ Seeing that as the decisive factor against disgorgement of profit under art 74: Schmidt-Ahrendt, above n 22, at 97.

⁸⁶ Secretariat Commentary on the 1978 Draft, above n 8, at [4]: "The court or arbitral tribunal must calculate that loss in the manner which is best suited to the circumstances".

⁸⁷ This concern is mentioned by all commentators who have discussed the issue of disgorgement of profit: Schmidt-Ahrendt, above n 22, at 95; Bock, above n 34, at 184; Schwenger and Hachem, above n 19, at 102.

content of the CISG.⁸⁸ Although, at first sight, disgorgement of profit appears as a new remedial right, it is not the principle of good faith that creates disgorgement of profit, but rather a broader concept of full compensation, which is influenced by the principle of good faith. Damages are a remedy after a breach of contract. The chapter about the aims of the remedial system under the CISG (above III B 1) has shown that remedies are needed to protect what the parties bargained for in the first place, namely the performance of the contract. Remedies therefore reflect a framework that aims to promote an efficient but also fair dealing, considering the interests of both parties as well as economic considerations. With its preventive effect disgorgement of profit could promote fair dealing also in the precontractual stage. Parties would be encouraged to consider more carefully whether they want to enter into a contract and to exchange information valuable to the other party beforehand rather than unilaterally breaching the contract afterwards. Likewise, such a development would also support the principle of the CISG to keep a contract alive as long as possible (*favor contractus*). The restrictive provisions regarding the avoidance of a contract clearly indicate that the threshold to terminate a contract is set deliberately high.⁸⁹ Ultimately the availability of disgorgement could prevent unnecessary disputes and enhance the efficiency of trade.⁹⁰

b. Summary

In conclusion, there are strong arguments to allow, in principal, a claim for disgorgement of profit under the CISG. However, one important question remains still unanswered: Which factors will decide whether disgorgement of profit is necessary to provide an effective protection of the right to performance? The next chapter will examine this question, however, the CISG, just like national systems, will have to consider with great caution which cases require disgorgement of profit after a breach of contract.

C Where Is the Boundary – Full Compensation Measured by Economic Value vs. Full Compensation Measured by Gain

Before examining which factors might be relevant, there are two statements that can be concluded as a starting point.

Firstly, the economic approach was considered to be an adequate compensation in most cases. Where the party is adequately compensated with the economic value,

⁸⁸ Ingeborg Schwenzer und Pascal Hachem “Art 7” in Ingeborg Schwenzer (ed) *Commentary on the UN Convention on the International Sales of Goods (CISG)* (3rd ed, Oxford 2010) at [19].

⁸⁹ See art 49 CISG and art 64 which require a special ground for a avoidance which can either be a fundamental breach or the expiry of a additional time limit to perform (*Nachfrist* procedure in art 49 (1)b for the buyer and 64(1)b for the seller).

⁹⁰ Considerations of good faith are also mentioned by Schmidt-Ahrendt, above n 22, at 94.

there is no need for the deterrent effect of disgorgement of profit. Likewise where the aggrieved party can claim performance itself, this is the best protection of its right to performance, as the party gets what it has bargained for. Therefore, disgorgement will always be the ‘ultima ratio’ remedy, only available if damages based on economic loss are an ineffective protection of the performance right and the claim to require performance itself is not available anymore.⁹¹

Secondly, and this follows from the previous paragraph, the mere fact that a party breached a contract intentionally cannot be a sufficient factor to claim disgorgement of profit. A general rule that ‘breach should never pay’ cannot be established, as this would contradict the rule of disgorgement as a last resort. Rather, the right point of reference is the right of performance under the specific contract.

The question is therefore which factors might constitute the special value of the right to performance, so that damages based on the economic value are inadequate?

It should be noted that the answer to this question should also be guided by a uniform approach, therefore developing factors that might be accepted internationally irrespective of the national legal system. However, solutions cannot be found out of nothing. Especially the literature discussing the English development can serve as a valuable source to shape rules that may influence the availability of disgorgement of profit in international sales contracts.

1 Considerations of specific performance

Some factors that influence the decision on specific performance are equally valuable for the decision on disgorgement of profit. This has to do with the fact that Common Law has already identified cases where damages are considered as an insufficient remedy.⁹² In fact disgorgement of profit is often referred to as the ‘monetised form’ of specific performance.⁹³ Similar to the effect that specific relief compels the defendant to perform, disgorgement of profit transfers this into the absolute deterrent effect to prevent future breaches of contract. Parallel to the availability of specific performance Barnett proposes to allow disgorgement of profit in second sales cases where the

⁹¹ Bock, above n 34, at 186.

⁹² Cunnington identifies five situations: Cases where no market substitute is available, cases where damages are difficult to quantify cases where the breaching party will not be able to pay damages, cases where only nominal damages are available and cases where the type of loss is not recoverable in Ralph Cunnington “The Inadequacy of Damages as a Remedy for Breach of Contract” in Charles EF Rickett *Justifying Private Law Remedies* (Hart Publishing, Oxford, 2008) 115.

⁹³ Jack Beatson *The Use and Abuse of Unjust Enrichment – Essays on the Law of Restitution* (Oxford, Oxford University Press, 1991) 17; a connection between disgorgement and specific relief is also drawn by Cunnington, above n 60, at 207.

goods are not able to (or difficult to) be substituted with money.⁹⁴ In international commercial contracts this scenario will be rather rare. Most of the time, commercial goods will be substitutable. However, the supply of natural resources is one example where a situation of no substitutability is feasible. In the decision mentioned above; *Adras Building Material v Harlow & Jones GmbH* the Court unfortunately did not make any reference in its reasoning to the question of whether the buyer would have been able to make a cover purchase on the market. This would have provided a reasonable limitation to the wide application that seems to allow disgorgement without restrictions.⁹⁵

Likewise, the breach of a contract that concerns the supply of goods over a long-term period may have a similar effect for the aggrieved party. Imagine the market for wine and assume that producers usually are bound by long-term contracts for the supply of a certain percentage of the annual harvest. If the seller breaches this contract to deliver profit to a third party, the aggrieved party will face difficulties to find a similar supplier due to the particularities of the market. In these two cases an award of the economic loss cannot place the party in a situation as good as actual performance because it had a special interest to obtain the goods as such.

2 *Non-economic or subjective interest in performance*

Another factor where damages based on the difference of the economic value may be inadequate is the fact that the buyer has a non-economic, intangible interest in the goods. An example additionally to the production under child labour is the contractual agreement involving the supply of natural resources with the obligation that the goods must not have their origin in political conflict areas, where trading of these resources is used to finance the conflicting parties.⁹⁶ Contract law should be able to provide an efficient protection of such contractual obligations. Compensation measured by the difference in value is inadequate, because the explicit duty that has been breached is a non-economic one. Here again the deterrent effect of disgorgement of profit in case of a breach is a last option to provide an effective protection of the right contracted for. Needless to say the protection of the above mentioned interests is also appreciated for public policy reasons. It is clear that public policy reasons cannot establish private law remedies; however, once parties willingly agree on ethical standards and transfer them into the private law sector, the law should recognise this.

⁹⁴ Barnett, above n 28, at 94.

⁹⁵ At 99.

⁹⁶ Example mentioned in Bock, above n 34, at 186.

3 *Negative covenants and the subject matter of the contract*

English case law following the Blake decision shows that special difficulties may arise from contracts containing a specific duty not to do something. There have been cases with a commercial background as *Esso Petroleum Company Ltd v Niad Ltd* where the defendant was ordered to disgorge all its profits;⁹⁷ on the contrary in cases like *World Wide Fund for Nature v World Wrestling Federation Entertainment Inc.* the breach of the negative obligation led only to a partial disgorgement, arguing that the amount represents the value of a fictional renegotiation between the parties.⁹⁸

The breach of negative covenants might arise under the CISG in regard to confidentiality clauses as well as the exclusive distribution agreements between producer and wholesaler that prohibit the import in other countries.⁹⁹ Even the example regarding the production without child labour can be seen as a negative covenant, as the wording as negative or positive obligation is a matter of coincidence. The problem here is, that the contracting party will argue to always have a legitimate interest in performance as such, because unlike a positive obligation it is not possible to substitute the performance with a monetary award.¹⁰⁰ However, following this approach, a breach of a negative covenant would always lead to disgorgement. The wide application of disgorgement of profit is not consistent with the above-mentioned hierarchy of remedies and disgorgement as last resort.

Establishing limiting factors is challenging. One factor could be to look at whether the compliance with the provisions constitutes a fundamental duty of the contract. However, this is also a flawed approach, because here as well parties will argue that they would not have agreed on the duty if it had not been of great importance to one party.

⁹⁷ *Esso Petroleum Company Ltd v Niad Ltd* [2001] EWHC Ch 458 (Ch); Niad ran a petrol station selling exclusively Esso's petrol. Under the contract, Niad undertook to follow a pricing agreement. Niad should stick to the resale price Esso dictated and Esso provided a discount to the sale price in recompense. Niad breached the price-watch agreement. Judge Morrit V-C granted total disgorgement of profit for three main reasons: Firstly because of the difficulty to calculate the economic loss, secondly because the obligation to implement and maintain the recommended pump prices was fundamental to Pricewatch, thirdly, because Esso undoubtedly has a legitimate interest in preventing Niad from profiting from its breach of obligation.

⁹⁸ *World Wide Fund for Nature v World Wrestling Federation Entertainment Inc* [2002] FSR 32 (Ch) and *Experience Hendrix LLC v PPX Enterprises Inc*, Edward Chalpin [2003] EWLR 25 (CA).

⁹⁹ See Stockholm Chamber of Commerce Arbitration Award of 5 April 2007 (Pressure sensors case) available at <www.cisgw3.law.pace.edu/cases/070405s5> where the breach of confidentiality clause was at issue and damages were measured by the gains over a period of 2 years; and SARL BRI Production 'Bonaventure' v Société Pan African Export Appellate Court Grenoble (France) 22 February 1995 available at <www.cisgw3.law.pace.edu/cases/950222f1.html>.

¹⁰⁰ Barnett, above n 28, at 125.

A further solution could be to allow full disgorgement only in cases of a subjective non-economic interest. This would mean that in the child labour case full disgorgement would be awarded but not necessarily in cases of breach of confidentiality. The confidentiality agreement will usually serve for the protection of economically valuable information, for example intellectual property or client databases. In these cases the gain made by the breaching party should serve as a yardstick to calculate the economic loss. In fact, this way of calculation could have the same effect as total disgorgement, if the court comes to the conclusion that the economic value represents the total amount of the gains, however, it is based on the compensation for economic loss.

4 Principle of foreseeability and causation as further limitation

Ultimately it needs to be emphasised that the rules of foreseeability and causation as limitations of art 74 also apply to the availability of disgorgement. The circumstances why the court ultimately decides for disgorgement as an appropriate remedy must have been known or ought to have been known by the party in breach at the moment of conclusion of the contract. Furthermore disgorgement of profit concerns only gains that could not have been made but for the breach.

D Summary

As a first conclusion, we can summarize that the CISG should provide for disgorgement of profit as an ultima ratio remedy, where damages measured by the difference of economic value are not an effective protection of the right to performance. Firstly, an analysis of the remedies under the CISG provides that the aim of remedies is to protect the right of performance effectively. The orthodox understanding of damages measured by the loss of economic value is often sufficient, but national tendencies imply that discussion about the acceptance of disgorgement as an additional way to award damages calls for a broader understanding of the full compensation principle in art 74 as the compensation or making good for the right that the aggrieved party has been deprived of. That there is no international comprehensive framework when disgorgement should be available in contract law yet should not hinder a parallel development towards disgorgement of profit under the CISG.

IV Legal Costs Under Art 74

An aggrieved party faces different financial detriments. There are the aforementioned that are closely linked to the subject of the contract, but parties also often suffer great financial expenses due to attorneys' fees as a result of necessary court proceedings.

On a national basis, two different approaches exist to the recovery of such expenses: The United States of America and Japan follow the so called ‘American Rule’ where each party bears its own costs irrespective of the outcome of the lawsuit. A reimbursement of costs is, apart from special circumstances, not possible. On the contrary European countries, together with the majority of countries around the world, decided that generally the successful party of a lawsuit is able to recover attorneys’ fees from the losing party. This approach is called the ‘English rule’ or the ‘loser pays principal’.

On an international level, the question whether art 74 also encompasses the recovery of attorneys’ fees for the successful claimant arose with the famous decision *Zapata Hermanos Sucesores SA v Hearthside Baking Co* in 2001. The US District Court deviated from the American rule and awarded the plaintiff its attorneys’ fees under art 74. The Court relied on the plain wording of the provision, which suggests that loss includes any financial detriment, and that the general aim is for an autonomous and uniform interpretation of the CISG.¹⁰¹ However, the US Circuit Court of Appeal reversed the judgment. The Court of Appeal named several arguments, which will be referred to below, why the recovery of legal expenses is a matter that must be decided in accordance with national law and not by art 74.¹⁰²

Considering that legal costs in most cases constitute a large part of the overall financial loss a party suffers, the question whether the CISG governs legal expenses is of utmost importance for all businesses, especially if their case is one decided by an American court, and therefore is subject to controversial discussions amongst scholars. Three main approaches to this topic can be distinguished. Some scholars argue that the recovery of legal costs is a matter excluded from the scope of the Convention, because they are best treated as a matter of procedural law.¹⁰³ Others see the legal costs as a part of the damages provision under art 74, but conclude that the principle of party equity impedes the availability of these damages under the CISG.¹⁰⁴

¹⁰¹ *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co*, 155 F Supp 2d 969, (ED of Illinois 2001) also available at <www.cisgw3.law.pace.edu>.

¹⁰² *Zapata Hermanos Sucesores SA v Hearthside Baking Co*, 313 F 3d 385 (7th Cir 2002).

¹⁰³ Harry Flechtner and Joseph Lookofsky “Viva Zapata! American Procedure and CISG Substance in a U.S. Circuit Court of Appeal” (2003) 7 VJ 93; Alastair Mullis “Twenty-Five Years On – The United Kingdom, Damages and the Vienna Sales Convention” (2007) 7 *Rebels Zeitschrift für ausländisches und internationales Privatrecht* 35; Harry M Flechtner “Recovering Attorney’s Fees as Damages Under the U.N. Sales Convention (CISG): The Role of Case Law in the New International Commercial Practice, with Comments on *Zapata Hermanos v Hearthside Baking*” (2001-2002) 22 *Nw J Intl L & Bus* 121; Peter Huber and Alastair Mullis *The CISG: A new textbook for students and practitioners* (Sellier European Law Publishers, 2007) at 278.

¹⁰⁴ CISG Advisory Council, above n 6, at [5]; Schwenger, above n 6, at [29].

A third opinion is that legal expenses are recoverable under art 74 in order to guarantee full compensation of the aggrieved party and any possible resulting imbalances between plaintiff and defendant are a result of the character of the CISG as an imperfect tool of legislation.¹⁰⁵

This paper agrees with the view that attorney costs are best considered as matters of procedural law and therefore outside of the CISG's scope of application. This view is even supported by the CISG Advisory Council Opinion on this issue, which in fact is better understood as a classification of legal fees as expenses governed by procedural law.

A General Resistance Towards the Distinction Between Procedural and Substantive Law

The argument that legal costs are part of the procedural law in most countries and therefore fall outside of the scope of application under the CISG was also made by Judge Posner in *Zapata*. He concluded that “the Convention is about contracts, not about procedure” and that the recovery of legal costs is a procedural matter that applies in all areas not only in contract law.¹⁰⁶ To decide the applicability of the CISG on the distinction between procedural and substantive law was heavily criticised by scholars. The differences between legal systems regarding the scope of procedural and substantive law impair a uniform application and circumvent art 7 (1) which aims for an international interpretation.¹⁰⁷ Furthermore classic procedural issues under national law, for example the burden of proof, are often “so closely connected with the application of the substantive provisions that it would be impractical to separate the two”;¹⁰⁸ hence, the CISG perhaps “inadvertently included procedural issues”.¹⁰⁹ What applies to the burden of proof may equally apply to the close connection between the recovery of legal fees and the substantive law of damages.¹¹⁰ Gotanda, cited by the CISG Advisory Council, concludes that “the practice of determining whether an issue is governed by applicable procedural law instead of the Convention is outdated, counterproductive, and should be abandoned.”¹¹¹

Are these scholars right? The simple answer is: Yes. To base a decision on whether a particular matter is governed by the CISG on the distinction between *domestic*

¹⁰⁵ Bruno Zeller, above n 4, at 139–159; Bruno Zeller “Attorney’s Fees – Last Ditch Stand” (2013) 58 *Vil L Rev* 761.

¹⁰⁶ *Zapata Hermanos Sucesores SA v Hearthsides Baking*, above n 102, at 388.

¹⁰⁷ Ingeborg Schwenzer and Pascal Hachem “Art 4” in Ingeborg Schwenzer (ed) *Commentary on the UN Convention on the International Sales of Goods (CISG)* (3rd ed, Oxford 2010) at [5].

¹⁰⁸ Stefan Kröll, cited in Zeller, above n 105, at 765, n 17.

¹⁰⁹ Zeller, above n 105, at 765.

¹¹⁰ At 765.

¹¹¹ Gotanda, above n 4, at 140; CISG Advisory Council, above n 6, at [5.2].

procedural and substantive law undermines the purpose of a uniform interpretation of the CISG. However, it is still true that the CISG ‘in principle’ governs the substantive law of contract and not procedural issues.¹¹² The CISG has certainly inadvertently included procedural issues, for example the necessary level of proof, into the substantive contract rules, however, such an inclusion is not necessarily equally appropriate for the question of legal fees. An interpretation of art 74 with regard to the consequences of an inclusion of legal expenses can still reach the conclusion, that the drafters themselves never intended to regulate this issue in the substantive law of contract under the CISG, because they classified it as a matter best governed by the existing law of procedure.¹¹³ In the system of the CISG, one question in art 7 (2) is whether the matter is governed at all by the CISG. Even the above-mentioned scholars propose a three-step mechanism. First to examine if the matter is governed by the plain reading of the CISG provisions, and if not, secondly, if it is deliberately excluded, and if not, whether it can be resolved with the principles the CISG is based on.¹¹⁴ It is at the second step where legal fees will be evaluated as excluded from the scope of the CISG.

B Was It the Intent of the Drafters to Solve that Issue by Substantive Law?

1 Plain Wording

The plain wording of art 74 shows that art 74 does not name any specific losses apart from the loss of profit. However, the underlining purpose of art 74, to put the aggrieved party in the same position but for the breach, seeks at first sight for the inclusion of legal fees under the term loss in art 74. Legal fees pass the simple causation test under art 74. Had the other party not breached the contract, the aggrieved party would not have had to afford legal advice. Furthermore the breaching party could have foreseen legal costs in case of a breach.

Interestingly Djordjevic argues that legal fees are excluded because they fail the causation test. According to her, the start of court proceedings changes the two person contractual relationship into a three person procedural relationship between plaintiff, defendant and judge. Legal fees are classified as a result of the litigation itself and not necessarily as a result of the breach, because they can exist even if the

¹¹² Stefan Kröll, Loukas Mistelis and Pilar Perales Viscasillas “Introduction to the CISG” in Stefan Kröll, Lukas Mistelis and Pilar Perales Viscasillas *UN Convention on Contracts for the International Sale of Goods (CISG)* (Beck, Munich, 2011) at [10]; See also the explicit wording of the Preamble “uniform rules which govern contracts”.

¹¹³ See Joseph Lookofsky & Harry Flechtner “Zapata Retold: Attorneys’ Fees Are (Still) not Governed by the CISG” (2003) 7 VJ 93.

¹¹⁴ CISG Advisory Council, above n 6, at [5.3]; Gotanda, above n 4, at 120.

court finds that there was no breach of contract.¹¹⁵ However, as Zeller argues, it cannot be denied that in cases where a breach exists, the start of court proceedings is a result of the breach itself, hence a financial loss caused by the breach.¹¹⁶ Considering that the CISG does not call for more than simple causation, Djordjevic's argument is not totally convincing, although the leading thought behind the argument is worth keeping in mind. There is a second relationship between the parties that is additional to the contractual relationship: The procedural relationship with the beginning of the court proceedings.

2 *Drafting History*

The plain wording of art 74 is not exclusively decisive for the question of whether loss under art 74 needs to be interpreted to include legal fees. The drafting history may still reveal that the drafters did not intend to include this issue under the substantive rules on damages. Unfortunately, according to the records of the drafting history of the CISG the matter of recovery of legal fees was not addressed at all during the negotiation and drafting process.¹¹⁷ Different opinions exist as to what can be inferred from that silence. Some conclude that there is a strong assumption that a radical change of civil procedural rules would not have happened by omission, especially but not exclusively, in countries which follow the American rule. Hence, the silence on this matter indicates a lack of intent to include legal fees under art 74.¹¹⁸ Others are of the opinion that the lack of discussion does not necessarily indicate the exclusion of legal fees. First of all because there is no definitive sign that the United States of America was not willing to abandon its domestic rule at least in an international setting.¹¹⁹ Secondly, it is equally likely that the matter was not discussed because it was considered as an obvious part of damages under the CISG.¹²⁰ The best approach towards the silence as to the matter of recovery of attorney fees is that the fact itself does not support either the inclusion of legal fees under art 74 nor

¹¹⁵ Milena Djordjevic "Art 4" in Stefan Kröll, Lukas Mistelis and Pilar Perales Viscasillas *UN Convention on Contracts for the International Sale of Goods (CISG)* (Beck, Munich, 2011) at [43].

¹¹⁶ Zeller, above n 105, at 769.

¹¹⁷ See for a compilation of the drafting and negotiation documents Honnold, above n 8. In none of the documents that were relevant for art 74 CISG is the recovery of legal fees ever mentioned.

¹¹⁸ Flechtner, above 103, at 151 who argues that even jurisdictions with the loser pays rule would have carefully considered a replacement of their special designed domestic procedural rules by the rather vague provisions of the CISG; and Peter Schlechtriem "Legal Costs as Damages in the Application of UN Sales Law" (2006-07) 26 *J L & Com* 71 at 77; Mulis "Twenty-Five Years On", above 103, at 45.

¹¹⁹ Milena Djordjevic "Mexican Revolution in CISG Jurisprudence and Case-Law: Attorneys' Fees as (Non)Recoverable Loss for Breach of Contract" in Mirko S. Vasiljevic (ed) *Private Law Reform in South East Europe: Liber Amicorum Christa Jessel-Holst* (Faculty of Law University of Belgrad, 2010) 199 at 209.

¹²⁰ Zeller, above n 4, at 149.

the exclusion from the scope of the CISG. If the matter was not discussed both aforementioned possibilities exist.

3 Purpose of Art 74 by Outcome Orientated Approach: No Change to the Equality in the Procedural Relationship

However, the possibility that the matter was not discussed, because it was never intended to be part of the substantive contract law is strengthened by an outcome-oriented analysis.

If legal fees were recoverable under art 74 the plaintiff and the defendant would be treated unequal in their procedural relationship. Whereas a successful plaintiff could always, including in jurisdictions that follow the American rule, recover its legal fees under the CISG, art 74 does not help the successful defendant. Art 74 does not apply because there is no breach of contract from the plaintiff. Consequently the successful defendant would have to bear its own costs in countries that follow the American rule.¹²¹ Flechtner and Gotanda pointed out correctly those anomalies, albeit to a lesser degree, would also be caused in loser pay jurisdictions. Domestic procedural rules often contain a maximum of legally recoverable fees, whereas the CISG does not contain such specific limitations apart from the general duty to mitigate loss in art 77. An unequal treatment of defendant and plaintiff still seems possible if the domestic limitations only apply to the defendant and the uniform interpretation of art 77 is not congruent with the domestic rules.¹²²

It is necessary to note that the equality at issue here is the one existing in the procedural relationship between the plaintiff and the defendant. In regard to the recovery of legal fees the equal treatment of defendant and plaintiff can also be explained with a fair risk allocation. In loser pays jurisdictions the possibility to recover ones own fees is compensated by the risk to pay the defendant's costs. In jurisdictions with the American rule the impossibility to recover own costs is balanced by the absence of a cost risk in regard to defendant's expenses.

To abandon the principle of party equity by including legal fees under substantive contract law was certainly not intended by loser pay jurisdictions nor by countries with the American rule, because both countries treat the parties equal in their own system. Scholars who see the issue of legal fees as a matter governed by the CISG as

¹²¹ This argument was also mentioned by Judge Posner in *Zapata*, above n 102, at 389; and is a core argument among the scholars who negate that art 74 encompass legal costs; The proposal of John Felemegas to construe a duty of loyalty to the contract which is breached by a plaintiff who begins court proceedings without proper foundation has been criticised as "result-orientated jurisprudential stretch" and has not gained support: See Felemegas' proposal in John Felemegas "An Interpretation of Article 74 CISG by the U.S. Circuit Court of Appeals" (2003) 15 Pace Intl L Rev 91 at 126; criticised by Flechtner, above n 103, at 152.

¹²² Flechtner, above n 103, at 152; Gotanda, above n 4, at 132.

well ultimately exclude legal fees due to a violation of party equity.¹²³ However, the difference is, those scholars argue with the party equity under the CISG whereas this paper argues that it is the party equity in the procedural relationship, not the contractual relationship that is decisive. Consequently to retain the party equality in the procedural relationship, legal fees were never meant to become part of the substantive law of damages under the CISG, but considered as part of the procedural law.

4 CISG Advisory Council Approach is hiding the qualification as procedural matter

The qualification of legal fees as procedural matter and consequently excluded from the CISG is also the right interpretation of the CISG Advisory Council approach, even if the Advisory Council showed its reluctance to such a distinction.¹²⁴

This argument is based on the following: Once it is accepted that legal fees are part of substantive law, because any distinction between substantive and procedural needs to be avoided, the CISG Advisory Council argues that the principle of party equity apparent in art 45 and 61 hinders an inclusion of legal fees under art 74.

The problem with this argument is that seen correctly, it is not the principle of party equity embodied in the CISG that causes the unequal treatment of defendant and plaintiff. Regarding their contractual relationship, and that is what the CISG is concerned about, the CISG treats the seller and the buyer exactly the same. In case of the breach of contract both have the option to claim damages. What the CISG Advisory Council really means is the principle of party equity in the special relationship created by the beginning of the proceedings. In other words, the CISG Advisory Council first classifies legal fees as a matter of substantive law and hence governed by the CISG, in order to then negate the application of art 74 with a principle that does not lie in the contractual relationship but is one of procedure after the start of proceedings.

In fact, once it is decided that legal fees are part of substantive contract law the solution provided by Zeller would be more consistent. He argues that the recovery of legal fees is simply a gap in the CISG and must be decided according to domestic laws of procedure. The resulting inequality is a matter of disharmony in procedural law and not one of the CISG.¹²⁵

C Summary

It can be concluded that the recovery of legal fees is best considered as a procedural matter not governed at all by the CISG. This is because legal fees are costs that are

¹²³ CISG Advisory Council, above n 6, at 5; Schwenger, above n 6, at [29].

¹²⁴ CISG Advisory Council, above n 6, at [5.2].

¹²⁵ Zeller, above n 105, at 766; with the same arguments to this issue Djordjevic, above 119, at 212.

closely linked to the particular equal treatment of parties in their procedural relationship rather than in their contractual relationship. This solution is not at odds with the fact that certain issues such as the level of proof are considered to be governed by the CISG although they are typical matters regulated in national procedural law. It is true that a simple test on whether a matter is procedural is not satisfying enough to exclude it from the CISG, however, the difference between procedural and substantive law exists and each issue needs to be decided separately. In the case of the level of proof the matter has been transformed in its entirety into the substantive law of the CISG. To include the issue of level of proof into the substantive provisions of the CISG does not affect the equal treatment of the parties in their procedural relationship and the CISG is able to provide consistent results. To the contrary the recovery of legal fees would only be partly shifted into substantive law and hence severely violate the basic principle of equity in court proceedings. It is acknowledged that a uniform approach to the recovery of legal fees would support further harmonisation of international trade and the intent of the drafters would lose its weight with the passing of time since, however, the CISG has reached its limits in that regard and the issue is one of a possible unification of procedural rules. Ultimately even if the CISG does not govern the question of legal fees, the parties are always free to provide for a cost allocation rule in their contract.

V Contractual Changes to Art 74: Agreed Sums Payable Upon Breach

The freedom of parties to shape their contract according to their needs does not only concern matters that the CISG does not govern but also any default provisions in the CISG that the contracting parties want to modify in parts or exclude. Art 6 embodies the essential feature of party autonomy and freedom of contract. This chapter will deal with an important modification of the default rule for damages under art 74: The inclusion of agreed sums payable upon breach of the contract.

A Reasons to Include Agreed Sums

The inclusion of agreed sums payable upon a breach of contract is an often-used practice in international commercial sales contracts.

Firstly, an agreed sum represents a means to secure performance. An example is a particular interest in the timely delivery of goods or adherence to a confidentiality clause.¹²⁶ The promisee assumes that the economic pressure of a fixed sum will represent an incentive for the promisor to perform its obligations. One may say that the agreed sum serves as an insurance against non-performance.

¹²⁶ Pascal Hachem *Agreed Sums Payable upon Breach of an Obligation* (Eleven International Publishing, Den Haag, 2011) at 45.

Secondly, agreed sums serve as a means for compensation, especially when the otherwise applicable damages provision does not allow compensation for the particular type of damages.¹²⁷

Thirdly, even where losses are recoverable under art 74, agreed sums reduce the risk and difficulties associated with proving an exact calculation of loss and facilitate the litigation process. One example for difficulties in calculation represents the breach of a confidentiality clause, where economic loss is suffered, but extremely difficult to prove.¹²⁸

B Agreed Sums Under National Law

Before this paper addresses the question of whether and to what extent the CISG governs agreed sums payable upon breach, a short overview of the treatment in national legal systems needs to be given. The importance of the issue of agreed sums under the CISG cannot be properly understood without knowing the practical consequences for parties of international sales contracts if the matter is governed by the applicable national law.

In fact, the discrepancy existing between common law systems and civil law systems regarding the acceptance of agreed sums in contract constitutes a great legal uncertainty in cross-border contracts.

1 Common law systems

Common law systems divide agreed sums payable upon breach in two categories: liquidated damages clauses and penalty clauses. Liquidated damages clauses are enforceable, whereas penalty clauses are considered to be unenforceable or invalid. This division has its roots in the development of the English law of equity against penal bonds in the 15th century. In this time the practice arose to secure the performance of a primary obligation by obligating the promisor to issue a bond. Under the bond the debtor undertook to pay a fixed amount of money that should cease to have effect when the primary obligation had been fulfilled. This practice opened the way to abuse of the weaker party as the claim was based on debt and the sum under the penal bond was often much higher than the value of the contract. Equity courts granted relief from the penal bond in cases where the bond was intended to serve as a security for monetary damages and the debtor was willing to pay those actual damages plus interest.¹²⁹

¹²⁷ At 47; Under art 74 this may apply to the recovery of litigation costs (to this current issue see above IV).

¹²⁸ At 49.

¹²⁹ An excellent overview of the history of the penalty clauses in English Law is given in *Cavendish Square Holding BV v Talal El Makdessi* [2015] UKSC 67 at [3]–[9].

As a consequence of the decisions in equity common law courts developed the distinction between penalty clauses and liquidated damages clauses in the context of agreed sums payable upon breach of contract. The decisive test is the pre-estimate of loss rule developed in *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd*.¹³⁰ Lord Dunedin stated that a sum amounts to be a penalty clause if the “sum is extravagant and unconscionable in comparison to the greatest loss that could conceivably be proved to have followed from the breach”.¹³¹ The pre-estimate of loss test led to the formula that penalty clauses serve as a punishment in order to compel performance, whereas liquidated damages clauses operate as a means for compensation.¹³²

The application of the pre-estimate of loss test has proven to be difficult and has led to highly unpredictable decisions for parties. The penalty clause rule has been subject to extensive criticism by courts and scholars who argue that the rule is ‘anachronism’, the underlining rationale is not clear and especially not suitable in the commercial context where an interference with freedom of contract should be avoided.¹³³

2 Civil Law systems

Civil law systems consider sums payable upon breach generally enforceable irrespective of their function. The system was influenced by Roman Law where the ‘*stipulatio peneae*’ was seen as an efficient way to encourage performance and to facilitate recovery of losses, particularly to avoid difficulties inherent in the assessment and proof of damages after a breach of contract.¹³⁴ Nevertheless, as Roman Law already acknowledged the need of a certain upper limit to agreed sums, most civil law countries as well as mixed jurisdictions allow the reduction of the sums by the arbitrator or judge in cases where the agreed sum is excessive. However, when determining what constitutes an excessive sum a high threshold has to be met to allow the court to interfere with the parties’ autonomy.¹³⁵

¹³⁰ *Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co Ltd* [1914] UKHL 1: This test is also basis for decisions in Australia, Bhutan, Ireland and New Zealand; In the United States of America an essentially identical test has been established in *Banta v Stamford Motor Co.* Sup Ct Er Conn, 21 December 1914, 92 A 665 (Conn 1914).

¹³¹ At 87.

¹³² See references to this common approach in all common law countries in Hachem, above 126, at 63.

¹³³ At 85, n 218 for an overview of the current criticism in common Law jurisdictions towards the Penalty Rule.

¹³⁴ At 29.

¹³⁵ Some jurisdictions, for example Latvia (Art 1721 CC) and Japan (Art 420 (1) sentence 2 Civil Code), exclude the possibility of reduction for Courts; others do not foresee the possibility of reduction when the agreed sum is included in commercial contracts between merchants (see German Law s 348 Commercial Code which excludes the application of the possibility for reduction stated in s 343 Civil Code).

C Agreed Sums Under the CISG

On an international level the CISG does not deal explicitly with agreed sums in case of a breach of contract. Whereas it is undisputed that the formation of such clauses is governed by the applicable CISG rules, it has recently been discussed whether the validity of such clauses is a matter excluded by the CISG under art 4 (a), and thus the traditional approach prevails; or if art 4 cannot be invoked because the issue of agreed sums is a remedy governed in its entirety by the principle of compensation in combination with the principle of party autonomy.¹³⁶

Having seen the different approaches in national laws, it is obvious, that a uniform approach under the CISG would enhance legal certainty in trade. In cases where the law of conflict follows the common law rule, parties currently risk their agreed sum being declared invalid. This consequence undermines the aim of the parties to facilitate the litigation process and peculiarities of the applicable law of damages.

The following analysis aims at contrasting and evaluating the current positions in the literature and concludes that the agreed sums should be governed in its entirety by the CISG.

1 Question of validity

Art 4 in the CISG states that the CISG is not concerned with the validity of the contract or any of its provisions. Keeping in mind the international character of the CISG and its' aim for a uniform interpretation, the term validity needs to be interpreted autonomously irrespective of the 'label' of the national rule.¹³⁷ Hence, the mere fact that the common law jurisdiction declares penalty clauses invalid or void is not sufficient. Rather the function of the rules governing agreed sums in national law is the decisive factor. Hachem concludes that all rules regarding agreed sums in national jurisdictions share a common function: They are a protection mechanism by reducing the agreed sum or by declaring the provision invalid.¹³⁸ Hachem's view deserves support regarding the qualification as a matter of validity. Both jurisdictions saw the need to set a limit to party autonomy and negate the legal effect of such clauses to a certain degree. However, it is argued the conclusion that Hachem draws from that fact is a step to far, which will be elaborated in the next paragraph.

¹³⁶ Jack Graves "Penalty Clauses and the CISG" (2012) 30 JL & Com 153 where he follows the traditional approach that national law applies to the question of the validity of such a clause; but Bruno Zeller "When is a Fixed Sum Not a Fixed Sum but a Penalty Clause" (2012) 30 JL & Com 173 and Bruno Zeller "Penalty Clauses: Are they governed by the CISG" (2011) 23 Pace Intl L Rev 1 arguing that the CISG governs agreed sums in its entirety.

¹³⁷ Schwenzer and Hachem, above n 107, at [31].

¹³⁸ Hachem, above n 126, at 169.

2 *Equivalent solution within the CISG*

Even if one comes to the result that agreed sums trigger questions of validity, the exception of art 4 (a) does not automatically apply. Resorting to national law is precluded by art 4 (a), the second sentence reads “except as otherwise expressly or provided in this provision”. Agreed sums are not expressly mentioned in the CISG, but this exception has to be understood in a broad matter and includes that the Convention provides implicitly an answer within its four corners. The exception is a gateway for the gap-filling procedure under art 7 (2).

Hachem does not find a solution within the four corner of the CISG. According to him the CISG does not contain any protection mechanisms for the debtor.¹³⁹ Thus he ultimately concludes that agreed sums are excluded from the CISG and national law applies, but – from a systematic point of view not without controversy – the national question of validity needs to be answered against the backdrop of art 7 (1).¹⁴⁰

Whether the CISG does not contain any protection mechanisms will be discussed at a later point, but the primary criticism of Hachem’s approach is that Hachem applies the second step before the first. The first question should be whether, and maybe, to what extent the CISG governs agreed sums. At this stage the question of the protection of the debtor is not relevant yet. Once decided whether the CISG governs the matter of *agreed sums payable upon breach* (not any protection mechanism related to them in national law) the second step must be to examine whether the CISG contains a protection mechanism and eventually when it should apply.

Therefore, irrespective of the national approach to agreed sums payable upon breach of contract, it has to be evaluated whether general principles within the four corners of the CISG govern the matter of agreed sums.

a. Art 74 and Art 6

As an advocate for a solution within the general principles of the CISG Zeller argues that the principle of full compensation in conjunction with the principle of party autonomy provide a ‘functional equivalent’ solution. He concludes that agreed sums should be seen as a “predetermined amount of damages payable in cases of a breach

¹³⁹ At 169.

¹⁴⁰ At 170. Hachem’s solution was adopted by the CISG Advisory Council CISG Advisory Council “Opinion 10: Agreed Sums Payable upon Breach of an Obligation in CISG Contracts” <<http://www.cisg.law.pace.edu>>. See for criticism of this solution: Graves, above n 136, at 159 who argues that Hachem’s solution is doubtful because, once excluded from the CISG, it is not easy to understand why the interpretation of national law needs to follow an international standard under 7 (1). Moreover because 7 (1) usually is applied to internal gaps of the CISG, not to external gaps.

of contract” irrespective of the question if the amount exceeds actual damages. Art 6 replaces the first part of art 74 whereas the rule of foreseeability still applies.¹⁴¹ On the contrary Graves argues that the foreseeability rule does not “provide a fully sufficient independent basis for enforcing anything” and that the parties’ autonomy under art 6 is always subject to the validity check under art 4.¹⁴²

b. How strong is the principle of party autonomy?

The right answer has to be found somewhere in the middle. Art 6 allows parties to modify the effect of any of the provisions under the CISG. The question is; does any exercise of party autonomy become an issue of validity to be analysed under domestic law?¹⁴³

As long as the parties’ derogation stays in the corners of the principle of full compensation there should be no recourse to art 4. However, to stay in the boundaries of the principle of full compensation does not necessarily mean that an amount that exceeds the actual loss otherwise recoverable under art 74 automatically falls out of the principle of full compensation. A clause that is qualified as a penalty clause under Common Law may still fall under art 74.

It is at this point where the analysis of the first part of this paper (above III B) provides useful guidance. The point of reference for any damages claim should be the right to performance under the contract: Compensation as a substitute for the interest in performance. It is exactly the same motivation that drives parties to the inclusion of an agreed sum. They agree on an amount of money in the case of non-performance. Or in other words, they place a value on the interest in performance. That value may exceed the actual monetary loss, but both parties agree prior to the breach that the amount is an appropriate substitute for the non-performance.

Therefore it is the different point of reference that may lead to the fact that an agreed sum that is a penalty clause under common law still falls under the principle of full compensation in art 74. It is not a question of a pre-estimate of actual loss but of the interest in performance. Interestingly the recent decision of the High Court in England *Cavendish Square Holding BV v Talal El Makdessi* argued that the penalty rule in common law is also rooted in the legitimate interest in performance of the obligation in question, but unfortunately, an “over-literal reading” of the *Dunlop* decision,

¹⁴¹ Zeller “When is a Fixed Sum Not a Fixed Sum but a Penalty Clause“, above n 136, at 184.

¹⁴² Graves, above n 136, at 162.

¹⁴³ Phanesh Koneru “The International Interpretation of the UN Convention on Contracts for the International Sale of Goods: An Approach Based on General Principles” (1997) 6 Minn J Global Trade 105 at 145.

caused development towards an “artificial categorization, itself the result of unsatisfactory distinctions: between a penalty and genuine pre-estimate of loss”.¹⁴⁴ Ultimately the Court concludes that

the true test [to decide whether a clause is a penalty clause] is whether the impugned provision is a secondary obligation which imposes a detriment on the contract breaker out of all proportion to any legitimate interest to the innocent party in enforcement of the primary obligation.¹⁴⁵

Furthermore the Court acknowledged that in commercial contracts there is a „strong initial presumption” that “the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of a breach”.¹⁴⁶

Time will show whether this decision is the first step towards an abolishment of the penalty rule. In any case the judgment reveals that the proposed international approach is not at odds with the roots of the penalty clause rule.

c. Agreed sums with a punitive character

The borderline where parties are no longer in the scope of full compensation is reached where the agreed sum has a punitive character. The CISG does not cover punitive damages and therefore a resort to national law, from a dogmatic point of view, is the right answer.¹⁴⁷ Art 6 is at this point subject to the validity check under national law. Zeller also seems to acknowledge this limit of the scope of the CISG in his reply to Graves’ criticism towards his new approach.¹⁴⁸ However, he relies on the “overwhelming” weight of the principle of party autonomy and the aim of uniformity.

This paper agrees with Zeller’s approach, that, although art 6 would trigger art 4 in cases of agreed sums with a punitive character, the preferred answer is that the CISG governs all agreed sums irrespective of their function.¹⁴⁹ Firstly, a punitive character would still need to be evaluated under the principles of the CISG. The mere function of providing an incentive to perform would therefore never be sufficient. Rather the agreed sum has to be examined as to whether it is extensively exceeding any legitimate interest in performance and therefore serves as a punishment. However, in

¹⁴⁴ At [31].

¹⁴⁵ At [32].

¹⁴⁶ At [35].

¹⁴⁷ Taking this approach Michael Bridge *The International Sale of Goods: Law and Practice* (Oxford University Press, 2007) at 11.38 as cited in Pilar Perales Viscasillas “Art 7” in Stefan Kröll, Lukas Mistelis and Pilar Perales Viscasillas *UN Convention on Contracts for the International Sale of Goods (CISG)* (Beck, Munich, 2011) at [55], n 123.

¹⁴⁸ Zeller “When is a Fixed Sum Not a Fixed Sum but a Penalty Clause”, above n 136, at 182.

¹⁴⁹ Perales Viscasillas, above n 147, at [55], n 123.

commercial contracts such clauses will be rare. For example, any agreed sum, irrespective of the amount, will usually find its way into the calculation of the sales price. The fair balance of risks in the contract persists and parties themselves agree on the value of performance.

A real penal character will require an existing unequal bargaining power. In the rare cases where exceptional circumstances hint towards an unequal bargaining situation, it is proposed to solve this issue with a reduction of the sum pursuant to the principle of good faith under art 7. There is a consensus that the principle of good faith, irrespective of the initial intention of the drafters, should not only play a role for the interpretation of the CISG itself, but should also constitute a standard for the relationship of the contracting parties.¹⁵⁰ The question of when an agreed sum is not justified in relation to the contractual duty is after all a question of reasonableness. Even if the parties are businessmen, a fair dealing requires that one party does not abuse its bargaining power excessively without any justification.

The same considerations are reflected in art 7.4.13 (2) of the UNIDROIT Principles, which consider agreed sums valid but provide for the reduction “to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances.” The reference to ‘other circumstances’ demonstrates that actual harm is not the decisive point of reference. Hence, a solution with the help of the principle of good faith would also bring the CISG in line with other international instruments.

D Summary

The analysis of the issue of agreed sums payable upon breach has shown that it is important to resist any qualification of agreed sums under national law. Such pre-categorization always embodies the risk that an international interpretation is influenced by national legal perceptions. Agreed sums payable upon breach are definitely governed by the CISG itself and not by national law as long as they serve a compensatory character and not a punitive character. The compensatory character needs to be evaluated with reference to the performance interest in the contract, which leaves very little scope for a punitive character in business relationships. Ultimately in cases where a court determines a punitive character, the solution should be a reduction pursuant to art 7 CISG, despite the fact that from a dogmatic view, a resort to national law would be the right answer in these cases. A reduction mechanism would preclude

¹⁵⁰ See Perales Viscasillas, above n 147, at [25]–[28] who also points at the development in case law; contrary Schwenger and Hachem, above n 88, at [17] who argue that art 7 “cannot be applied directly to individual contracts” but at least might influence indirectly the relationship via the interpretation of the provisions of the CISG.

an artificial division of agreed sums and would be in line with other existing international commercial law instruments.

VI Final Conclusion

This paper has discussed three current issues related to the law of damages under the CISG. As an overall result the analysis has shown opportunities for further development but has also pointed out limits of the CISG.

In regard to the still little discussed question of disgorgement of profit under the CISG, it is one of the biggest advantages of the law of damages under the CISG that it can be developed through the interpretative provision of art 7. This chance should be taken and the CISG should not hesitate to provide such a solution in order to provide an effective remedy in cases where damages based on economic loss are not appropriate. Certainly, such a development must take place with the appropriate caution but the CISG has the chance to further observe the international trend and elaborate a uniform solution for the availability of disgorgement in contract law.

Likewise, it would be an important step towards the aim of removal of legal barriers if courts deal with agreed sums, regardless of their national classification, exclusively under the Convention. However, the CISG reaches its limits in regard to the recovery of legal fees occurred during litigation. Art 74 is not able to maintain the equity of the parties in their procedural relationship. Hence, the parties are best advised to agree on a cost-allocation rule in their contract.

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