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Full compensation principle in the United Nations Convention on Contracts for the International Sale of Goods

Thesis

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I hereby declare that the thesis *Full compensation principle in the United Nations Convention on Contracts for the International Sale of Goods* is my own work and that I quoted all sources used in this thesis.

Olomouc, 30. 6. 2017

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Vojtěch Vaněk

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List of Abbreviations

art./arts.	Article/Articles
CIETAC	China International Economic and Trade Arbitration Commission
CISG	United Nations Convention on Contracts for the International Sale of Goods of 11 April 1980
CISG AC Op.	CISG Advisory Council Opinion
e.g.	exempli gratia, for example
EU	European Union
GDP	gross domestic product
i.e.	Id est, that is
ibid.	Ibidem, in the same place
ICAC Russia	Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry
ICC	Court of Arbitration of the International Chamber of Commerce
No./Nos.	number/numbers
ULIS	Uniform Law on the International Sale of Goods
UNIDROIT	Institut International pour l´Unification du Droit Privé / International Institute for the Unification of Private Law
UPICC	UNIDROIT Principles of International Commercial Contracts of 2010
US	United States of America
p./pp.	page/pages
para./paras.	paragraph/paragraphs
PECL	Principles of European Contract Law
SCC	Arbitration Institute of the Stockholm Chamber of Commerce

1 Introduction

Each year, our world becomes more and more globalised. With technological advances, cheaper and faster transportation of both goods and persons, it becomes easy for businesses to not only manufacture their goods outside their home country but also to find new markets for their goods. Many countries, including the Czech Republic, are to a great extent dependent on international trade. In 2016, the value of European Union's (the "EU") export was 43,9% of its gross domestic product (the "GDP) and in the Czech Republic, it was 80,3%.[1] That represents an increase of 6,6% in the EU and 17,7% in the Czech Republic in only 10 years.[2] That is by no means an insignificant number.

With increasing globalisation of trade, international trade law is becoming increasingly important as well. One of the international treaties concerning the international trade law is the United Nations Convention on Contracts for the International Sale of Goods (the "CISG"). There are currently 86 contracting States to the CISG,[3] with the economically most important states of the world included.[4] The CISG applies every time when an international contract of sale of goods is concluded between parties whose places of business are in different states or when the rules of private international law lead to the application of the law of a contracting State.[5] This means that unless the parties opt out, most of the international contracts concerning the sale of goods are governed primarily by the CISG, making it one of the most important conventions in private international law.

When a contract is concluded, there is always a risk that it will not be performed in its entirety or that it will not be performed at all. In most cases, non-performance or partial performance of a contract inflicts damages to the other party. Naturally, among other remedies, the CISG provides for the aggrieved party to recover damages incurred as a consequence of the breach. The recovery of damages under the CISG will be the general topic of my thesis.

Since damage recovery is a broad topic, I will only focus on putting the damage recovery into the perspective of the full compensation principle. The full compensation principle is one of the main principles governing the recovery of damages under the CISG. Its

[1] Eurostat. *Exports of goods and services in % of GDP* [online]. ec.europa.eu, 7 October 2016 [cited 27 June 2017]. Available at: <http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=tet00003&plugin=1>.
[2] Ibid.
[3] UNCITRAL. *Status* [online]. uncitral.org, [cited 27 June 2017]. Available at: <http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html>.
[4] Contracting states of the CISG include e.g. The United States of America, Germany, China or the Russian Federation. The most important non-contracting state is without a doubt the United Kingdom.
[5] United Nations Convention on Contracts for the International Sale of Goods, Art. 1.

main intent is to make the injured party whole again. There are, however, many limitations to this principle and also many contradictory court decisions and scholarly opinions.

The main research objective of my thesis will be to verify the main hypothesis: the aggrieved party often will not be put in the exact same position as it would have been in the case of proper contract performance. In order to answer the main hypothesis, I have set out three sub-hypotheses, concerning some of the more problematic types of damages under the CISG. The sub-hypotheses are as follows:

1. Non-pecuniary loss incurred due to the breach of contract will not be recoverable under the CISG.
2. Attorney`s fees cannot be recovered even when incurred as a result of the breach.
3. The full compensation principle can put the aggrieved party in a better position it would have been in cases of disgorgement of profits.

I will mainly use the empirically-analytic research method, but also a comparative method on several places.

The thesis is laid out into four chapters, each of the chapters addressing one of the research questions and together confirming or disproving my hypothesis. Therefore, in the first chapter, I will briefly address the basic definition of the full compensation principle and the applicability of the UNIDROIT Principles of International Commercial Contracts of 2010 (the "UPICC") and Principles of European Contract Law (the "PECL") as interpretative tools to the full compensation principle. In the second chapter, I will show the exact scope of the full compensation principle, addressing the three main types of damages: direct loss, incidental loss, consequential loss and lost profits. In the third chapter, I will examine some of the limitations to the principle, namely foreseeability, duty to mitigate damages and burden of proof. Finally, in the fourth chapter, I will point out the most problematic cases where the full compensation principle may be applicable, particularly non-pecuniary loss, legal costs and disgorgement of profits.

The topic of this thesis is current because of the aforementioned increasing importance of the CISG and the fact that trends in international practice, including damage recovery, never stop developing. There are many court decisions, arbitral awards and academic opinions concerning recovery of damages issued every year. There are numerous electronic sources concerning this topic as well as several bibliographical sources. However, the goal of the thesis is to be as practical as possible and to interpret the full compensation principle with regard paid to the requirement of promoting the international character of the CISG.

Therefore, the main focus will be put on the court decisions and arbitral awards, mainly those where the CISG was applicable as the main contract law. There are no relevant sources written in the Czech language on this topic, hence, I will only use sources written in the English language since that is the language mostly used in international practice.

2 General remarks on the full compensation principle

In this short introductory chapter, I will make some of the more general remarks concerning the full compensation principle. First, I will examine whether the full compensation principle is generally accepted as one of the principles of the CISG. Further, I will elaborate on the applicability of UPICC and PECL as interpretational tools to the CISG.

2.1 General acceptance of the full compensation principle

The main provision of CISG which full compensation principle applies to is the art. 74. This article sets forth general rules for the recovery of damages for breach of contract. The first sentence of this article reads "*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.*" Although the provision for full compensation is not literal, it is clear from the wording of the first sentence that the CISG does provide for full compensation by its wording "*sum equal to the loss, including loss of profit*". Authorities on the CISG generally agree that full compensation principle is one of the general principles governing it.[6]

It is also expressly stated in the CISG Advisory Council Opinion (the "CISG AC Op.") No. 6 that "*Article 74 reflects the general principle of full compensation".*[7] The CISG Advisory Council is an independent body of experts on the CISG from various legal backgrounds.[8] Its main goal is to issue opinions that promote uniform interpretation of the CISG.[9] These opinions are often considered as the most serious authority on the CISG and the closest counterpart to an official commentary.

The principle is also often mentioned and used in various court decisions where CISG was applicable, e.g. in Austria or Italy.[10] As there are no court decisions disputing the principle, it may be concluded that courts do not challenge the applicability of the full compensation principle to the CISG.

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[6] See e.g. SCHWENZER, Ingeborg. *Commentary on the UN Convention on the International Sale of Goods. (CISG).* 4th edition. Oxford: Oxford University Press, 2016. p. 1058 or KRÖLL, Stefan, MISTELIS, Loukas, VISCASILLAS, Pilar P. *UN Convention on Contracts for the International Sale of Goods (CISG).* München: Verlag C. H. Beck oHG, 2011. p. 991.

[7] GOTANDA, John Y. *CISG-AC Opinion No. 6, Calculation of Damages under CISG Article 74* [online]. cisg.law.pace.edu, 8 November 2006 [cited 27 June 2017]. Available at: <http://www.cisg.law.pace.edu/cisg/CISG-AC-op6.html - 2>.

[8] A list of all members of the CISG Advisory Council can be found on <http://www.cisgac.com/council-members/>. The list includes such names as Professor Ingeborg Schwenzer or Professor Harry M. Flechtner, which are both considered as leading authorities on the CISG.

[9] *Scope and Aims* [online]. cisgac.com [cited 27 June 2017]. Available at: <http://www.cisgac.com/home/>.

[10] Judgment of the Oberster Gerichtshof of 14 January 2002, 7 Ob 301/01t. Judgment of the Tribunale di Padova of 25 February 2004, 40552.

The full compensation principle is also laid down in the art. 7.4.2 para. 1 UPICC and in the art. 9:502 PECL. UPICC literally provide for full compensation. The CISG must be interpreted with regard to its international character and to promote uniformity.[11] Furthermore, many legal experts that drafted UPICC and PECL were associated with drafting the CISG as well.[12] Therefore, both of the conventions are relevant for the interpretation of the CISG.

As the full compensation principle is accepted among both relevant authorities on the CISG and court decisions, laid down in UPICC and PECL, it may be concluded that it is one of the general principles governing the CISG.

2.2 Applicability of UPICC and PECL to the full compensation principle

Neither UPICC nor PECL have ever been officially endorsed as an interpretational tool for the CISG. However, as already mentioned, the CISG must be interpreted with regard to its international character, uniformity in application and observance of good faith. Both UPICC and PECL match these goals.

The UPICC is developed in parallel to the CISG and its solutions are largely compatible with it.[13] Although the compatibility between UPICC and the CISG is obvious, it cannot be used in full as a complement to the CISG unless the parties to the contract specifically agree on the application of UPICC. The UPICC cannot be used as general principles, but rather as elaboration on such principles.[14] This is also in line with a decision of the ICC, which refers to UPICC as follows: "*The Convention* (the CISG) *and its general principles, as presently elaborated in the UNIDROIT Principles on International Commercial Contracts, are perfectly suited to the settlement of the present dispute.*"[15] From this, it can be concluded that the art. 7.4.2 UPICC can be used to elaborate on the full compensation principle as the art. 7.4.2 UPICC is a counterpart to the art. 74 CISG.

PECL captures those rules of contract law that are common to most legal systems in the EU. It covers the core rules of contract, formation, authority of agents, validity, interpretation,

[11] CISG, art. 7 para. 1.
[12] FELEMENGAS, John. *An international approach to the interpretation of the United Nations Convention on Contracts for the International Sale of Goods (1980) as uniform sales law*. New York: Cambridge University Press, 2007. p. 30.
[13] BONELL, Michael J. *An International Restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts.* 3rd edition. New York: Transnational Publishers, 2005. p. 305.
[14] VOGENAUER, Stefan, KLEINHEISTERKAMP, Jan. *Commentary on the UNIDROIT Principles of International Commercial Contracts (PICC).* Oxford: Oxford University Press, 2009. p. 61.
[15] ICC case no. 8817 of 1997.

contents, performance, non-performance and remedies.[16] In relation to the CISG, PECL are considered a restatement of the CISG.[17] Restatements can be used to interpret law. Four different types of provisions may be encountered in PECL: 1) provisions completely identical to the CISG, 2) provisions that are substantially the same as the CISG, 3) somewhat similar provisions, 4) provisions substantively different from the CISG.[18] The most relevant provisions for interpretation will be, naturally, those falling into groups 1) and 2).

The PECL counterpart to art. 74 CISG are the arts. 9:501 through 9:510. If the relevant parts of the provisions are compared, the CISG provides for "*a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach*", whereas PECL provides for "*such sum as will put the aggrieved party as nearly as possible into the position in which it would have been if the contract had been duly performed.*" Although the provisions are not literally same, they both provide for the same amount of damages. Therefore, PECL provisions 9:501 through 9:510 fall under the aforementioned group 2) and are relevant when interpreting the full allocation of damages and the full compensation principle connected to it.

[16] The Commission on European Contract Law. *Introduction to the Principles of European Contract Law* [online]. cisg.law.pace.edu, [cited 26 June 2016]. Available at: <https://www.cisg.law.pace.edu/cisg/text/peclcomments.html>.
[17] *Observations on the use of the Principles of European Contract Law as an aid to CISG research* [online]. cisg.law.pace.edu, 22 May 2001 [cited 16 February 2017]. Available at <http://www.cisg.law.pace.edu/cisg/text/peclcomp.html>.
[18] Ibid.

3 Scope of the full compensation principle

In order to assess the scope of the full compensation principle, it must first be determined when does the full compensation apply. An aggrieved party may claim damages under both art. 45 CISG, which provides remedies for breach of contract by the seller, and art. 61 CISG, providing remedies for breach of contract by the buyer. Hence, the full compensation principle will always be applicable whenever a party claims damages, regardless of the position of the party or the type of breach. The breach of contract, however, is a prerequisite that must always occur in order for the full compensation principle to apply.[19] Besides complete non-performance, inadequate performance, as well as a party's explicit refusal to fulfil an obligation not yet due, are sufficient to trigger liability.[20]

art. 74 of the CISG follows the Anglo-American system of strict liability.[21] According to Black's Law Dictionary, strict liability is a "*liability that does not depend on actual negligence or intent to harm, but that is based on the breach of an absolute duty to make something safe".*[22] The Merriam-Webster dictionary provides a similar definition, although somewhat simpler: "*liability imposed without regard to fault".*[23] To put the two definitions into simpler words: the party in breach will be liable for any damages caused by it, regardless of its fault or negligence. The strict liability rule is only subject to limitations under other Arts. of the CISG., as I explain in chapter 3 of this thesis.

The actual meaning of full compensation principle is difficult to determine as it is nowhere clearly explained.[24] By the definition set out by the CISG AC Op., the full compensation principle intends "*to place the aggrieved party in the same pecuniary position it would have been in had the breach not occurred and the contract been properly performed.*"[25] The definition by UPICC is essentially the same, as it "*provides that the general measure of damages is such sum as will put the aggrieved party as nearly as possible into the position in which it would have been if the contract had been duly performed.*"[26] Should these definitions be complied with literally, the full compensation principle would provide for a rather wide range of remedies, that would often cause an unbearable harm to the party in breach. Thus, although all calculations of damages under the CISG should be based

[19] SCHWENZER: *Commentary on the UN…*, p. 1060.
[20] ibid., p. 1061.
[21] ibid., p. 1058.
[22] GARNER, Bryan A. *Black's Law Dictionary*. 8th edition. St. Paul: West, a Thomson business, 2004. p. 934.
[23] *Strict liability* [online]. merriam-webster.com [cited 19 April 2017]. Available at: <https://www.merriam-webster.com/dictionary/strict liability>.
[24] VOGENAUER, KLEINHEISTERKAMP: *Commentary on the UNIDROIT…*, p. 872.
[25] GOTANDA: *CISG-AC Opinion…*
[26] VOGENAUER, KLEINHEISTERKAMP: *Commentary on the UNIDROIT…*, p. 873.

on this definition, there are many exceptions to it either in the CISG itself or inferred by court and arbitral decisions.

The whole CISG is driven by party autonomy, explicitly incorporated into the convention by art. 6. Under this art., parties may derogate from or vary the effect of any of CISG's provisions. This provision therefore allows exclusion of the full compensation principle, if the parties agree to do so. Such exclusion may be done in many ways, e.g. by excluding damages completely, limiting the maximum amount of damages or providing for a fixed amount, regardless of the actual damages the aggrieved party incurred.[27]

It is also possible to exclude the full compensation principle or all CISG provisions on damages without stipulating which law applies. Should such an artificial external gap be created, we must apply national law.[28] Since damages provisions differ from jurisdiction to jurisdiction, it can be anticipated that in such case, plaintiffs would seek damages in a jurisdiction that would, in the end, provide for the largest amount of damages. In a case that it is either uncertain which law applies or the application of national law depends on the forum of the dispute, such provision would therefore lead to forum shopping. With regard to this fact, it advisable to either be certain which national law will apply to damages when CISG provisions on damages are excluded or to not create such external gap at all.

In cases where the full compensation is not excluded, it is necessary to determine the exact types of damages the full compensation principle provides for. According to the *Cooling System Case*, decided by the Austrian Supreme Court, the purpose of the full compensation principle is to protect 3 different interests of the non-breaching party:

1. Not to suffer any loss to his goods due to breach of contract – indemnity interest,
2. Receiving the benefits of proper performance of the contract – expectation interest,
3. Expectation that expenses created by the contract do not become worthless due to breach of contract – reliance interest.[29]

In order to satisfy all of the interests specified in the *Cooling System Case*, the full compensation principle must provide for various types of damages. According to both Kröll`s commentary on the CISG and the CISG Advisory Council, the CISG provides for direct loss,

[27] Different examples may be found in GAMA, Lauro. *CISG Advisory Council Opinion No. 17 Limitation and Exclusion Clauses in CISG Contract* [online]. cisg.law.pace.edu, 16 October 2015 [cited 21 March 2017]. Available at: <http://www.cisg.law.pace.edu/cisg/CISG-AC-op17.pdf>.
[28] ČECH, Ondřej. *Interaction between the CISG and National Law*. Presented at the International Conference on United Nations Convention on Contracts for the International Sale of Goods and Convention on the Limitation Period in the International Sale of Goods on 24 March 2017 in Prague.
[29] Judgment of the Oberster Gerichtshof of 14 January 2002, 7 Ob 301/01t.

incidental damages and consequential damages.[30] The Schlechtriem/Schwenzer commentary uses a different term for the direct loss – non-performance loss – but otherwise agrees with the above-mentioned division of damages under the CISG.[31] Below, I elaborate on the three types of damages recoverable under the full compensation principle.

3.1 Direct loss

Direct loss refers to the loss incurred by the aggrieved party by either not receiving the agreed upon payment or the agreed upon goods. Direct loss may be calculated in two ways. The aggrieved party can recover the difference between the contract price and the price in the substitute transaction plus any further damages connected to the breach, pursuant to art. 75 CISG. If there was no substitute transaction, the art. 76 CISG shall apply, providing for the difference between the market price at the time of the breach and the purchase price for the breach. Both the art. 75 and the art. 76 are *lex specialis* to the art. 74.[32] Although there are two approaches when it comes to the calculation of direct loss, the purpose of both is the same: to allow the aggrieved party to enter into a substitute transaction without incurring any loss due to market price fluctuation.

The rule set out in the art. 75 CISG is primary and must therefore be used before the art. 76. According to the rule, the aggrieved party may recover the difference between the contract price and the price in the substitute transaction as well as any further damages. That means that if the aggrieved party is forced to either sell the goods to another buyer for a lower price or to buy the goods from another seller for a higher price, the breaching party must pay the difference and furthermore, it must bear the costs of the substitute transaction.

The CISG requires the substitute transaction to be conducted "*in a reasonable manner*". It is up to the aggrieved party to prove that the substitute transaction was done in such manner.[33] Since there are no further specifications of reasonable manner in the CISG, it is left to the courts and arbitral tribunals to determine it.

In the *Construction Equipment Case*, after buyer's avoidance of the contract, the seller entered into substitute transaction for 15,000 EUR and claimed the difference of 12,000 EUR (the original contract price was 27,000 EUR). The Austrian Appellate Court stated that

[30] KRÖLL, MISTELIS, VISCASILLAS: *UN Convention on Contracts…*, p. 995. GOTANDA: *CISG-AC Opinion…*
[31] SCHWENZER: *Commentary on the UN…*, p. 1064.
[32] SCHWENZER: *Commentary on the UN…*, p. 1096.
[33] SCHLECHTRIEM, Peter. *Damages, avoidance of the contract and performance interest under the CISG* [online]. cisg.law.pace.edu, 15 September 2008 [cited 19 April 2017]. Available at: <https://www.cisg.law.pace.edu/cisg/biblio/schlechtriem21.html>.

"*according to the factual findings, it must be assumed that [Sellers] could not achieve a price higher than EUR 15,000* [...], *despite having obtained several purchase offers*" and the substitute transaction was therefore executed in a reasonable manner.[34]

This case clearly shows that no matter how large is the difference between the original and substitute transactions – in this case over 44% - it can still be recoverable under the full compensation principle if all the factual findings of the case are considered. In this case, the seller was unable to resell the goods for a larger price, even though it obtained several purchase offers. Therefore, it was objectively impossible to find a better substitute transaction and the transaction was conducted in a reasonable manner.

In the *Printing Machine Case*, parties entered into contract concerning a purchase of a printing machine. After first installation, the printing machine did not work. The seller claimed the reason behind the malfunction was different requirement for electric voltage. The buyer, however, entered into substitute transaction with a third party for a second-hand printer as it was already in delay with its production phase. Later, it turned out that the printing machine provided by the seller did not work with the new electric connection either. The buyer claimed damages for the substitute transaction. The court of first instance denied the claim, stating: "*there did not exist sufficient proof of the causal relation and the necessity of acquiring that machine*". The Spanish appellate court overturned the decision of and awarded the damages for the substitute transaction, even though it was not certain at the time whether the original printing machine was malfunctioning. The reasoning behind the appellate court's decision was that even though the decision to acquire a second-hand printer was a risky one, it turned out to be correct and cannot be considered as capricious.[35]

From this decision, we can draw another conclusion on what can be considered a reasonable manner in a substitute transaction. It is possible to award damages for a substitute transaction even when it was conducted before the actual breach was confirmed. Had the printing machine worked under different voltage, it is clear from the court's decision that it would deny the buyer's claim. However, since it turned out that the printing machine was indeed malfunctioning, the court awarded the damages despite the fact it was not certain at the time of the conclusion of the substitute transaction. Therefore, the aggrieved party may take part in a risky substitute transaction with uncertain result and still recover the difference, as long as it later turns out that the risky decision was correct.

[34] Judgment of the Oberlandesgericht Graz of 29 July 2004, 5 R 93/04t.
[35] Judgment of the Audiencia Provincial de Palencia of 26 September 2005, 227/2005, similar decision may be found in the Chamber of National and International Arbitration of Milan case of 28 September 2001, XXX Ltd v. YYY S.r.l.

Last two cases that need to be mentioned in regard with the reasonableness of the substitute transaction are the *Tannery machines case* and the *Tetracycline case*. In the first case, parties contracted on delivery of tanning machines. The tannery machines had to be later recovered by the seller to adjust parts of the equipment. The seller did not return the tanning machines within the agreed upon period of time. As a result of the delay, the buyer contracted a third party to have its leather goods tanned and claimed damages on the seller. The appellate court in Köln held that the seller's obligation to return the tannery machines on time was fundamental to the contract between the parties as the buyer tanned a certain amount of leather goods daily. It further stated that entering into such substitute transaction does constitute reasonable expenses and awarded buyer the damages.[36]

In the second case, the buyer ordered a product called Tetracycline HCL from the seller, with a specification of "*a micronization below 25 microns*". The buyer needed a swift delivery. The seller was aware that a quick delivery was necessary. After delivery (which was already made in delay), the buyer identified the goods as non-conforming due to the fact the micronization was above the threshold of 25 microns. As a result, the buyer contracted a third party to perform the micronization. The court awarded the costs of the substitute transaction. The reasoning behind the court's decision was that the seller was aware of the buyer's need to commence production as soon as possible and that further delay might no longer be acceptable. Thus, the paid costs for repair were necessary in order to remedy the breach.[37]

These two cases show that the substitute transaction does not have to be contracted for the goods themselves, but also for services that either temporarily substitute the goods or repair the goods. The buyers did not contract for a different tanning machine or Tetracycline HCL but had its leather goods tanned and micronization lowered by a third party instead. They were still able to recover the tanning machine back and to use the Tetracycline. Therefore, the aggrieved party is able to recover the expenses for various services from the party in breach, provided they are reasonable and in connection with the breach. Moreover, in some cases, the aggrieved party will still be able to recover the original goods from the breaching party, in this case the malfunctioning tanning machine.

The second part of the art. 75 obliges the breaching party to bear all the costs that were necessary in connection with the substitute transaction. These include e. g.: payment for the shipment of the substitute goods, extraordinary reinspection and testing of the substitute

[36] Judgment of the Oberlandesgericht Köln of 8 January 1997, 27 U 58/96.
[37] Judgment of the Amtsgericht München of 23 June 1995, 271 C 18968/94

goods,[38] costs for replacement of defective goods,[39] labour costs connected to replacing non-conforming goods or repair costs for faulty goods.[40]

On the other hand, certain costs cannot be recovered as direct damages. The German Supreme court held that "*only adequate expenditures for the assessment of the damage, as well as for its prevention or reduction, are appropriate*" and denied costs for recalibration of a substitute machine that replaced a defective one.[41] The party relying on the breach should therefore always consider whether its expenditure is still adequately connected to the breach and if not, whether it is willing to bear the extra costs itself.

Since the CISG concerns mainly international sale of goods, currency fluctuations are an ever-present issue. Although there will be cases where both parties keep their accounts in the same currency or where one currency is pegged with another (as, for example, Bulgarian lev pegged with euro) in most situations, the currency exchange rate will move one way or the other. Once the currency fluctuates, it must be determined whether the difference is recoverable as direct loss and which point in time will be decisive.

The CISG does not have a single provision concerning the currency exchange rate. Both UPICC and PECL, however, do have specific provisions concerning the exchange rate. In case of breach, UPICC gives the aggrieved party a choice between the exchange rate applicable at the time when the payment was due and the exchange rate at the time of the actual payment,[42] subject to limitation only in the cases where a currency is not freely convertible, which is usually a result of government restrictions that make the currency impossible to be legally converted (e.g. the North Korean won),[43] or if there is an explicit agreement between the parties that the payment should be made in the currency of the contract.[44] Although the wording differs slightly, PECL provides for the same solution to the currency fluctuation, except of the not freely convertible currencies rule.[45] Hence, if the parties wish to exclude any currency fluctuation damages from the contract, they might consider including an explicit provision into the contract.

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[38] Judgment of the U.S. District Court, N. D., New York of 9 September 1994, Delchi Carrier S.p.A. v. Rotorex Corp.
[39] Judgment of the Oberlandesgericht Hamm of 9 June 1995, 11 U 191/94.
[40] Judgment of the Ontario Court, General Division of 16 December 1998, Nova Tool & Mold Inc. v. London Industries Inc.
[41] Judgment of the Bundesgerichtshof of 25 June 1997, VIII ZR 300/96.
[42] UPICC Art. 6.1.9, para. (4).
[43] Investopedia. *Nonconvertible Currency* [online]. investopedia.com [cited 4 June 2017]. Available at: <http://www.investopedia.com/terms/n/nonconvertiblecurrency.asp>.
[44] UPICC Art. 6.1.9, para. (1)
[45] PECL Art: 7:108 paras. 1 and 3.

The question remains, however, what rule applies in a situation when the contract provides for one party to bear the currency fluctuation risk, as it often does. If the party in breach bears the risk, there are no changes to the default rule and it will, without a doubt, bear it even after the payment was due. If the currency risk is, on the other hand, borne by the aggrieved party, we must once again look on the purpose of the full compensation principle. After the payment is due, the aggrieved party cannot be assigned the risk anymore,[46] as it is not a risk that could have been assumed at the time of concluding the contract. Further, in a case where the exchange rate would be steadily on decline, the party in breach would delay the payments for as long as possible since it would pay a lower amount.[47] Because of both of these reasons, the currency rate risk after the payment is due must be borne by the party in breach, as further losses are only incurred as a consequence of the breach. Moreover, if the aggrieved party would bear the risk, it would not be put in the same position as it would have been had the contract been performed without delay. Applying the currency risk otherwise would mean not complying with the principle of full compensation.

This is also confirmed by the Swiss *Sizing machine case*. In this case, and Israeli buyer transferred two advance payments for the sizing machine to the Swiss seller but later on entered into insolvency. It was not able to pay the rest of the purchase price. The seller did not deliver the machine and the buyer sought restitution of its advance payments in United States dollars. The advance payment under the parties' sales contract was paid in United States dollars but immediately converted into Swiss francs as that was the seller's currency. The seller argued that the exchange rate at the time of the original payments must be used as it is the amount it actually received.

The court stated that even though the debt could have been paid in either of the currencies and generally, the seller would have to reimburse the advance payments in United States dollars, in this case, the reimbursement is necessary only due to the buyer's breach. Hence, the seller was able to claim the difference between the exchange rates as damages and did not have to reimburse the buyer for more than it actually received in Swiss francs.[48]

There are two other court decisions concerning the recoverability of the fluctuating exchange rate that need to be addressed. In the *Shoes case Düsseldorf*, an Italian seller wanted to recover devaluation of the Italian lira against the German mark, arguing that it usually conducts its money transfers in German mark and therefore must always convert the lira

[46] MANN, Francis A. The Legal Aspect of Money. 4th edition. Oxford: Oxford University Press, 1982, p. 108.
[47] GOTANDA: *CISG-AC Opinion…*
[48] Judgment of the Handelsgericht St. Gallen of 3 December 2002, HG.1999.82-HGK

immediately. Its accounts were, however, kept in Italian lira. The court declined the seller to recover the difference, stating that usually the creditor's currency is not usually converted into different currency and thus, it usually does not lead to creditor's losses. The seller obtained the foreign currency independently of the buyer's breach and therefore, it would be unreasonable to allow the seller to recover the difference.[49] The currency in which the accounts are kept will therefore always be the decisive factor when assessing the damages incurred by currency fluctuation.

In the *Sunflower oil case*, the buyer sued for the first instalment it paid to the seller as it never received the goods. It also claimed the exchange rate difference between the time when the payment was due and the time it filed the lawsuit. At the time of the court decision, the instalment was yet to be paid back. The Commercial Court in Zürich first stated that the currency fluctuation damages are indeed recoverable under the CISG. It however dismissed the claim for the exchange rate loss, stating that "*the exchange loss between maturity and payment that is to be paid*", which was at the time unknown. Further, it stated that it is impossible to make an estimation of the damages.[50] Although the court certainly was correct not to estimate the currency fluctuation damages, complying with this ruling might lead the parties in breach to wait for the most favourable exchange rate to save money and therefore, delay the actual payment of damages. Furthermore, in case the breaching party would not pay the exchange rate damages voluntarily, there would be need for another ruling issued just for the exchange rate damages. Thus, the aggrieved party would incur even more losses as it would not be able to reinvest the money. Due to these facts, it is advisable to provide for the exchange rate damages immediately and to use the exchange rate at the time of the ruling. Since there is usually small amount of time between the issue of the ruling and possible enforcement, there should be only a slight change in the exchange rate, if any at all.

In cases where there was no substitute transaction, the art. 76 CISG will usually apply to compensate the direct loss. art. 76 generally cannot apply over art. 75.[51] According to the CISG Advisory Council, however, "*article 76 may also be used, instead of Article 75, to calculate damages where the aggrieved party is "continuously in the market" for the particular good of the type in question*" or "*the purchase or resale was not made in a*

[49] Judgment of the Oberlandesgericht Düsseldorf of 14 January 1994, 17 U 146/93
[50] Judgment of the Handelsgericht Zürich of 5 February 1997, HG 95 0347.
[51] SCHWENZER: *Commentary on the UN*..., p. 1097. Judgment of the Oberlandesgericht Graz of 29 July 2004, 5 R 93/04t

reasonable manner".[52] Concerning the first instance, it is noteworthy that despite it is the prevailing academic opinion, there is no accessible court decision confirming it. It would be often rather difficult to determine, but not necessarily impossible. For example, by using the first in, first out method[53], used in accounting, the price for the substitute transaction could be determined. The costs for the calculation could, however, outweigh the price difference. It is therefore advisable to assume the costs before making the actual calculation of the substitute transaction.

art. 76 CISG provides for the difference between the current price for the goods and the price fixed by the contract. To determine the place of the market price, art. 76 para. 2 may be used.[54] Therefore, the price will be the price prevailing at the place where delivery of the goods should have been made or a reasonable substitute place. The time relevant to the calculation will be the time of the avoidance of the contract, pursuant to the first sentence of the art. 76. This rule is, however, limited to the date when the avoidance could have been first declared, since otherwise the aggrieved party would breach its duty to mitigate.[55]

There are cases in which the current loss cannot be determined, e.g. because the goods are no longer sold or because of the specificity of the product. In the *Vacuum cleaners case*, the price could not be determined because the court was not able to find a current price for the "no-name" vacuum cleaners, which were the subject of the dispute. The court did not allow any damages under the art. 76 and based all of the damage calculations on the art. 74.[56] In such cases, resort to the general provision for damages in the art. 74 CISG is the only solution.

3.2 Incidental loss

The second type of damages provided by the full compensation principle are incidental damages. Incidental damages are never explicitly mentioned in the CISG, but in the light of the full compensation principle, they must be recoverable in order to put the aggrieved party into the same position as it would have been in case of proper contract performance. Gotanda describes incidental damages as a "*loss in addition to the loss in value from being deprived of*

[52] GOTANDA, John Y. CISG-AC Opinion No. 8, Calculation of Damages under CISG Articles 75 and 76 [online]. cisg.law.pace.edu, 15 November 2008 [cited 5 June 2017]. Available at: <http://www.cisg.law.pace.edu/cisg/CISG-AC-op8.html>.
[53] First in, first out is a valuation method in which the first assets bought or produced are the ones that are also first sold.
[54] SCHWENZER: *Commentary on the UN*..., p. 1098.
[55] SCHLECHTRIEM, Peter. *Calculation of damages in the event of anticipatory breach under the CISG* [online]. cisg.law.pace.edu, 9 September 2008 [cited 5 June 2017]. Available at: <https://www.cisg.law.pace.edu/cisg/biblio/schlechtriem20.html - iii>.
[56] Judgment of the Oberlandesgericht Celle of 2 September 1998, 3 U 246/97.

performance under the contract".[57] In comparison, the Black's law dictionary states that incidental damages are "*losses reasonably associated with or related to actual damages*".[58] According to both of the definitions, incidental damages can therefore be any costs or other lost value connected to the breach of contract, provided they were incurred in a reasonable manner. Hence, the list of possible incidental damages cannot be considered as exhaustive since different situations require different approaches. Below, I discuss the most common types of incidental damages.

Probably the most common incidental damage that the aggrieved parties ask for is the storage. These may be incurred due to delivery of defective goods by the seller, late acceptance by the buyer,[59] or refusal to accept goods without justification.[60] Often, the storage costs cannot be precisely calculated as the costs consist of several components – e.g. heating, lighting, rent etc. Nevertheless, the aggrieved party should still be able to recover them based on an estimate, provided that the court considers the costs as reasonable.[61] The reasonableness of the estimate or the actual costs, if calculable, may be evaluated by an expert witness.[62]

Another rather common type of incidental damages are the costs for the transport. These may be incurred due to the need of returning defective goods or buyer`s refusal to pay and the need to return the goods back to the seller. In the *DVD machines case*, the seller delivered the goods in five batches instead of one, as was agreed upon in the contract. Because of that, the arbitral tribunal awarded the buyer damages for the increased costs of the transport.[63] Therefore, another reason for transport costs recovery may be not just related to the goods, but also if the transport itself was in conflict with the contract. Furthermore, the aggrieved party will be able to recover also the cost for transport of the substitute goods, in case a substitute transaction was necessary.[64] The transport costs thus do not have to be connected to the original goods. In case of need for expedited delivery of substitute goods, the costs for the expedited delivery will be recoverable as well.[65]

A loan interest may be another cost recoverable under full compensation principle as incidental damages. In case a buyer does not comply with the contract and does not pay the

[57] KRÖLL, MISTELIS, VISCASILLAS: *UN Convention on Contracts…*, p. 996.
[58] GARNER: *Black's law dictionary…*, p. 417.
[59] Judgment of the Oberlandesgericht Karlsruhe of 8 February 2006, 7 U 10/04.
[60] Judgment of the Oberlandesgericht Braunschweig of 28 October 1999, 2 U 27/99.
[61] Judgment of the U.S. District Court, N. D., New York of 9 September 1994, Delchi Carrier S.p.A. v. Rotorex Corp.
[62] Judgment of the Oberlandesgericht Braunschweig of 28 October 1999, 2 U 27/99.
[63] CIETAC case of 9 November 2005, CISG/2005/04.
[64] Judgment of the Landgericht Oldenburg of 9 November 1994, 12 O 674/93
[65] Judgment of the U.S. District Court, N. D., New York of 9 September 1994, Delchi Carrier S.p.A. v. Rotorex Corp.

purchase price on time, the seller may be forced to contract for a financial assistance in order to comply with its existing obligations. Had the contract been performed properly, the seller would pay its existing obligations from the purchase price instead of the loan. Hence, it would not have to pay the interest. In order to put the seller in the same position, the party in breach must pay the interest as incidental damages.

The interest must be reasonable in order to be reimbursable as incidental damages. In a case decided by the Court of Appeal of Eastern Finland, the buyer had to seek a financial assistance by a Lithuanian bank in order to send advance payment to the seller. The goods, however, never arrived and the buyer sued for the advance payment, including a 7% interest per month plus 0,5% interest on arrears per day paid to the bank. The court ruled that the seller could not have been aware of the interest rates in Lithuania as they essentially differ from the interest rates in Western Europe, where the seller was incorporated. Further, the court ruled that the seller could have expected that "*the interest loss resulting from not fulfilling the contractual obligations could be about 10% of the sale price, meaning U.S. $8,000*", and awarded this amount to the buyer.[66] We can draw two conclusions from this decision. First, the buyers are able to recover the interest for a loan that was used to make the payment for the goods before the actual breach. Second, it is advisable to find out the interest rate policy in the seller's country as the seller is not expected to be aware of the interest rates in the buyer's country.

In the *Steel bars case*, the buyer sought damages caused by the non-conformity of the goods. The claim for the damages included two independent expert examinations of the conformity of the goods. Both of the examinations proved the goods as non-conforming. The arbitral tribunal stated that both expert examinations were foreseeable by the seller and therefore recoverable as incidental damages under art. 74 CISG.[67] The expert examinations can therefore be recoverable as incidental damages, provided they are reasonable with regard to the circumstances of the case. Other cases of assessing damage can be recovered under the art. 74 as well.[68]

As already mentioned, incidental damages may consist of any costs incurred in attempt to incur further loss connected to the breach. Other costs may include testing

[66] Judgment of the Court of Appeal of Eastern Finland of 27 March 1997, S 96/605.
[67] SCC case of 1998, 107/1997.
[68] SCHWENZER: *Commentary on the UN…*, p. 1097.

conformity of the goods,[69] fluctuation of the price of the goods,[70] costs connected to averting and mitigating damage,[71] insurance or customs tax.[72]

3.3 Consequential damages

Schwenzer describes consequential damages as "*additional losses beyond those caused by the non-performance as such*".[73] The main difference between consequential and incidental losses is that whereas incidental losses are incurred in attempt to avert or lower the negative effects of the breach, consequential losses represent additional losses caused by the breach itself. The line between the two types can therefore sometimes be very thin, but in light of the full compensation principle, the loss will be recoverable regardless of the type.

Consequential damages can only be recovered in case they are pecuniary in nature.[74] Thus, any damages that cannot be expressed quantified or valued in money, such as pain or suffering, cannot be recovered under the CISG. That does not, however, preclude the aggrieved party for non-pecuniary costs under the national law applicable to the contract.[75]

Since the CISG is driven by the principle of freedom of contract, the parties are free to exclude consequential damages from their obligations. This is also confirmed in the *Cooling system case*, where the parties excluded consequential damages and the court refused to award them to the aggrieved party.[76] While drafting the exclusion clause, it is advisable to list as precisely as possible the categories of loss which is excluded,[77] e.g., loss of opportunity, loss of reputation or third party liability. It is also advisable to use the word "indirect" instead of "consequential" as commercial parties are more likely to understand the clause that way.[78]

The most typical type of consequential loss is liability towards third parties. In business-to-business relationships, it is rather common that the goods are immediately resold to a third party. Therefore, if the delivery is either delayed or non-conforming, the buyer

[69] Judgment of the U.S. District Court, N. D., New York of 9 September 1994, Delchi Carrier S.p.A. v. Rotorex Corp.
[70] Judgment of the Oberlandesgericht Hamm of 23 March 1978, 2 U 30/77. It is necessary to say that in this case, the applicable law was ULIS and not the CISG. Nevertheless, since ULIS is the predecessor of the CISG and the provisions on damages are virtually the same, this court decision has the same relevancy as a CISG court decision.
[71] SCHWENZER: *Commentary on the UN*..., p. 1097.
[72] Arbitration Institute of the Stockholm Chamber of Commerce case of 1998, 107/1997.
[73] SCHWENZER: *Commentary on the UN*..., p. 1070.
[74] Judgment of the Oberster Gerichtshof of 14 January 2002, 7 Ob 301/01t.
[75] For further elaboration on the recoverability of non-pecuniary loss, see below, chapter 4.1.
[76] Judgment of the Oberster Gerichtshof of 14 January 2002, 7 Ob 301/01t.
[77] ELDRIDGE, Tom, RUDD, Michael. Limitation of liability: consequential or indirect loss [online]. lexology.com, 13 August 2009 [cited 7 June 2017]. Available at: <http://www.lexology.com/library/detail.aspx?g=e5c5dd4d-e8df-42d0-ada8-3dfe3a14b508>
[78] ibid.

might be held liable to not complying with the contracts dependent on the delivery. In the *Surface protective film case*, the buyer bought surface-protective film from the seller and resold it to its own customer. As the film turned out to be defective, the buyer had to reimburse its customer for damages caused by the foil non-conformity. The buyer sued the seller for reimbursement. The court stated that such liability to a third party must be considered as consequential damages and awarded it to the buyer.[79] Similarly, in the *Used car case*, a seller sold a used car to a buyer, both being car dealers. After selling the car to a customer, it turned out that the car is two years older and that the mileage of the car is much higher. The buyer voluntarily paid his customer approximately 20% of the purchase price back and sued the seller for the amount. The court held that "*the seller knew that the buyer did not buy the car for his own use, but in his capacity as a car dealer. The seller thus had to reckon that the delivery of non-conforming goods would make the buyer liable towards his customer*" and granted buyer the damages.[80] In case of liability towards third parties, the positions of the parties will therefore be essential. However, since the CISG governs mainly business-to-business contracts, in most cases, the goods will be resold to a final customer after delivery and thus, the seller must anticipate that the buyer can be held liable in the event of non-conformity of the goods.

Another typical consequential loss is loss of reputation or goodwill. This type of damage is rather hard to calculate. Regardless of this fact, many courts refused to reimburse the aggrieved party for the loss of goodwill due to the fact that it was not precisely calculated. In the *Art books case*, the court held that even though loss of goodwill may be compensated under the CISG, it needs to be substantiated and explained concretely. Since the aggrieved party did not explain the connection between the breach and loss of goodwill nor the connection was evident, the court refused to award it.[81] According to the CISG Advisory Council, however, such a requirement often puts an insurmountable burden on the aggrieved party and is in direct conflict with the principle of full compensation.[82]

Regarding the loss of reputation, the court in the *Video recorders case* went even further. It held that "*damaged reputation is completely insignificant as long as it does not lead to a loss of turnover and consequently lost profits*" and that "*as long as it has the necessary turnover, it can be completely indifferent towards its image*".[83] According to this decision, the

[79] Judgment of the Bundesgerichtshof of 25 November 1998, VIII ZR 259/97.
[80] Judgment of the Oberlandesgericht Köln of 21 May 1996, 22 U 4/96.
[81] Judgment of the Handelsgericht Zürich of 10 February 1999, HG 970238.1.
[82] GOTANDA: *CISG-AC Opinion…*
[83] Judgment of the Landgericht Darmstadt of 9 May 2000, 10 O 72/00.

damages for loss of reputation would always be equal to the lost profits. I cannot agree with this decision. First of all, lost profits are almost never precisely calculable. Therefore, it is never certain how much profit would the aggrieved party make in case there would be no loss of reputation. Further, there are many other aspects of business that are influenced by reputation, e.g. business relationships or negotiating power. Hence, even if there is no loss of profit as a consequence of the breach, it can be still harmful to the aggrieved party and recoverable under the principle of full compensation.

There are many other types of losses that are recoverable as consequential damages. The breaching party had to reimburse the aggrieved party for fee payment in case of a dishonoured check.[84] Contractual penalties to third parties that are a result of a breach are also recoverable.[85] In case additional staff needs to be employed to treat the defects on the goods, the salaries may be claimed on the party in breach as well.[86] Lastly, in case the buyer had to take defective goods back from his customers, seller must reimburse the costs connected to it.[87]

3.4 Lost profits

The art. 74 CISG explicitly provides for lost profits, stating "*Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit* […]". It, however, does not go into any further explanation on how to calculate the lost profits. Hence, it is always up to the courts and tribunals to choose the right approach in order to calculate the lost profits.[88] Since full compensation principle plays a major role in lost profits compensation, the tribunals should, while calculating the lost profits, come as close as possible to the amount the aggrieved party would earn had the contract been performed properly.

According to Schwenzer, the lost profits include profit not realized plus losses resulting from the inability to keep the business running due to the breach.[89] In the *Crane case*, the court defined the lost profits even wider, stating that lost profits convey every asset increase that was prevented by the breach.[90] Thus, according to the court decision, the lost profits would include e.g. any increase in company's reputation prevented by a breach or any

[84] Judgment of the Oberlandesgericht München of 28 January 1998, 7 U 3771/97.
[85] ICAC Russia case of 23 December 2004, 97/2004.
[86] Judgment of the Federal Court of Australia of 28 September 2010, Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd.
[87] Judgment of the Oberster Gerichtshof of 6 Februrary 1996, 10 Ob 518/95.
[88] GOTANDA: *CISG-AC Opinion…*
[89] SCHWENZER: *Commentary on the UN…*, p. 1072.
[90] Judgment of the Audiencia Provincial de Murcia of 15 July 2010, 439/10

anticipated increase in the company's intellectual property assets that could not be achieved due to a breach. These rules should apply in all cases governed by the CISG as national law limitations to the lost profits do not apply.[91]

Although the CISG does not specifically state so, besides the profits already lost, future lost profits are recoverable by the aggrieved party as well. This is specifically stated by the CISG Advisory Council.[92] Furthermore, both PECL and UPICC have explicit provisions that provide for future lost profits. PECL, in its art. 9:501 para. 2 states that "*The loss for which damages are recoverable includes:* […] *(b) future loss which is reasonably likely to occur.*" Similarly, PECL states that "*compensation is due only for harm, including future harm […]*".[93]

Often, future profits are not possible to calculate precisely as there are many variables that are unknown and there is no exact way of determining them. Typically, after the breach, it is often impossible to determine the volume of goods that would be sold in case the contract would be performed properly. However, even in those cases the breaching party should not be able to escape liability by claiming the profits are not certain.[94] The aggrieved party only needs to prove its lost profits with reasonable certainty.[95] In this regard, particularly complicated are long term contracts, especially in situations where the breach has destroyed the aggrieved party's business.[96] In such cases, many factors must be taken into account, such as interest rates, energy prices or raw material costs.[97]

There are several limitations to the lost profits. First of all, when the aggrieved party fails to give the party in breach notice that the goods do not conform the contract, it will not be able to recover its lost profits.[98] Secondly, only the lowest possible profit should be taken into account. In the *Frozen meat case*, the seller sued the buyer *inter alia* for lost profits incurred by the buyer's refusal to pay for the goods and deterioration of the goods - frozen meat. Since the seller was unable to provide any actual number in connection to the lost profits, the court relied on expert testimony, which determined the lowest possible level of profit margin. The court awarded the lost profits in the amount of the lowest possible profit

[91] GOTANDA: *CISG-AC Opinion…*
[92] ibid.
[93] PECL Art. 7.4.3.
[94] GOTANDA: *CISG-AC Opinion…*
[95] ibid.
[96] GOTANDA, John Y. Recovering Lost Profits in International Disputes. *Georgetown Journal of International Law*, 2004, Vol. 36, p. 89.
[97] SCHWARTZ, Damon. The Recovery of Lost Profits Under Article 74 of the U.N. Convention on the International Sale of Goods. Nordic Journal of Commercial Law, 2006, Vol. 1.
[98] ICC case no. 9187 of 1999.

margin.[99] Further, lost profits must be reduced by the expenses that would have been incurred when realizing the profit.[100] These will most often be variable costs, such as packaging, credit card fees or shipping costs.

[99] Judgment of the Oberlandesgericht Braunschweig of 28 October 1999, 2 U 27/99.
[100] Judgment of the Handelsgericht Zürich of 22 November 2010, HG070223/U/dz.

4 Limitations to the full compensation principle

As I have shown in the previous chapter, the full compensation principle provides the aggrieved party with a rather wide range of damages that are recoverable. There are, however, many limitations to these damages. Without the limitations, the party in breach would often be put into a position that would be too unfavourable and could completely destroy its business. Furthermore, it would be unjust to put the whole burden on one party. In this chapter, I will examine the three most important limitations to the full compensation principle, 1) foreseeability, 2) duty to mitigate damages and 3) burden of proof.

4.1 Foreseeability

The foreseeability limitation is directly addressed in the art. 74 CISG, which states that "*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* […]". The main purpose of the rule is risk allocation in a fair and reasonable manner.[101] The rule can also be found in UPICC with the exact same wording as the CISG.[102] PECL, in its art. 9:503, contains a different provision: "*The non-performing party is liable only for loss which it foresaw or could reasonably have foreseen at the time of conclusion of the contract as a likely result of its non-performance, unless the non-performance was intentional or grossly negligent.*" As we can notice, PECL does not apply the foreseeability limitation in case of intentional or grossly negligent breach. This exception will however not apply in cases governed by the CISG.[103]

The foreseeability doctrine was firstly developed in Anglo-American judicial practice.[104] The first case formulating the foreseeability rule is the currently 163 years old English case *Hadley v. Baxendale*. In this case, the plaintiff operated a mill. A part of the steam engine broke down. As a result, the plaintiff contracted the defendant, a common carrier company, to deliver the part to a third party, which was to create a new part. Due to a delay in the delivery, the plaintiff's mill had to remain closed for longer than anticipated and the plaintiff sued for damages, including lost profits. The court held that although the breach was the actual cause for the lost profits, the aggrieved party is entitled only to those damages "[…] *that are in the reasonable contemplation of the parties at the time of contracting.*" Since

[101] SAIDOV, Djakhongir. *The Law of Damages in International Sales: The CISG and other International Instruments*. Portland: Hart Publishing, 2008. p. 101.
[102] UPICC Art. 7.4.4.
[103] VÉKÁS: The Foreseeability Doctrine…, p. 159.
[104] ibid., p. 158.

it could not be said in this particular case that lost profits naturally arise from this type of breach, the court refused to award plaintiff the lost profits.[105]

Although the foreseeability doctrine in the CISG does generally follow the Anglo-American rule, regard is to be had only whether the damages were foreseeable to the party in breach.[106] This is different from the *Hadley v. Baxendale* case, where contemplation of both parties was required.

As is clear from the wording of the art. 74 CISG, the decisive moment for foreseeability is the time of conclusion of the contract. It can, however, be argued that in case the parties agree to a change in terms of the contract, a renewed assumption of risk has occurred.[107] Thus, in such case, the time of conclusion of the amendment to the contract will be decisive. Furthermore, the decisive moment may be different in long-term contracts which provide for terms such as price or quantity to be agreed at future points in time and are terminable at will.[108] In such contracts, a party is able to assume the risk at the point when the additional terms are concluded.[109] Therefore, the decisive moment for foreseeability is different for each time the individual terms are negotiated.

The art. 74 CISG provides for both the subjective standard of foreseeability – "*foresaw*" – and the objective standard – "*ought to have foreseen*". As a general rule, the standard of foreseeability will be determined objectively, as is clear from the *Cooling system case*, decided by the Austrian Supreme Court. In this case, the court ruled that "*generally an objective standard is applied* […]" and that the breaching party must reckon with consequences that a reasonable person would have foreseen.[110]

The court also ruled that the subjective standard cannot be completely ignored, typically in cases when the party in breach is aware that the breach would produce unusually high losses.[111] Similarly, a Greek court in the *Bullet-proof vest case* held that subjective factors must be taken into account, such as the breaching party's knowledge of the relative risk that caused damage, specialised skills or knowledge the breaching party has or any information in connection to the existence of risk provided by the aggrieved party.[112] In the end, it is up to the courts to determine whether any subjective standards are applicable and what is the objective standard in each particular case.

[105] Judgment of the Courts of Exchequer of 23 February 1854, Hadley & Anor v. Baxendale & Ors.
[106] SCHWENZER: *Commentary on the UN*..., p. 1078.
[107] SAIDOV: *The Law of Damages*…, p. 119.
[108] ibid.
[109] ibid.
[110] Judgment of the Oberster Gerichtshof of 14 January 2002, 7 Ob 301/01t.
[111] ibid.
[112] Judgment of the Multi-Member Court of First Instance of Athens of 2009, 4505/2009.

The foreseeability limitation does not apply to the breach constituting the loss, it only applies to the extent of the loss.[113] What is left to determine is how precisely foreseeable the extent has to be. In a CIETAC case, the arbitral tribunal refused to award the aggrieved party difference between the contract price and the resale price due to the fact that the difference was not foreseeable at the time of conclusion of the contract.[114] This decision is in conflict with the full compensation principle and should be disregarded. Neither party will usually be able to foresee the precise amount of damages that can be caused by the other party's breach. Moreover, the contract may be breached in various ways, each of which can harm the aggrieved party in a different way.

Another arbitration case pushes the foreseeability of the extent of damages to the other extreme. In an ICAC Russia case, the buyer claimed a contractual penalty it had to pay to a third party due to the seller's breach. The seller argued the contractual penalty was excessive. The tribunal held that "*the amount of the penalty is entirely a matter to be agreed between the contracting parties* […]" and awarded the full extent of the contractual penalty to the buyer.[115] This decision implies that if the damages themselves are foreseeable, the extent is not important.

Both of the arbitral awards are in contrast with the prevailing opinion expressed in a number of court decisions, arbitral awards and scholarly opinions.[116] To mention just two: In the already cited *Cooling system case*, the Austrian Supreme Court provided an example in which a "*buyer of defective goods can foresee an obligation to pay damages to his own customers, as long as the obligation does not exceed the usual extent.*"[117] In another CIETAC case, the arbitral tribunal stated that even though the party in breach was able to foresee that the buyer was going to resell the goods, it could not have foreseen that the profit margin would exceed 100%. Due to the unforeseeable extent of lost profits in this case, the arbitral tribunal only awarded 20% as lost profits.[118] Thus, according to the overwhelming number of authorities, the extent of loss must be foreseeable in order to be recoverable under the full compensation principle.

[113] SCHWENZER: *Commentary on the UN*..., p. 1079., the same opinion expressed in the Judgment of the Oberster Gerichtshof of 14 January 2002, 7 Ob 301/01t.
[114] CIETAC case of 1 February 2000, CISG/2000/01.
[115] ICAC Russia case of 23 December 2004, 97/2004.
[116] For scholarly opinions, see e.g. SAIDOV: *The Law of Damages*…, p. 119 or SCHWENZER: *Commentary on the UN*..., p. 1079.
[117] Judgment of the Oberster Gerichtshof of 14 January 2002, 7 Ob 301/01t.
[118] CIETAC case of 3 June 2003, CISG/2003/01.

In the *Hadley v. Baxendale* case, the court required the damages to be foreseeable as "*probable consequence*" of the breach.[119] In contrast, the art. 74 CISG explicitly requires damages being known by the party in breach as a "*possible consequence*". Unlike Anglo-American law, the aggrieved party does not have to prove substantial probability of the loss, but only the fact that it was a possible result of the breach.[120] Thus, the CISG is more lenient to the aggrieved party when it comes to proving the probability of occurrence of the damages.

4.2 Duty to mitigate damages

The duty to mitigate damages is stipulated in the art. 77 CISG. Pursuant to this article, the aggrieved party is obliged to mitigate its damages. Should the aggrieved party breach this duty, it will not be able to recover any damages that could be avoided. According to the German Supreme Court, the rationale behind this article is that the aggrieved party should not be compensated for avoidable loss.[121] From this purpose, we can also draw a conclusion that the aggrieved party is not just obliged to mitigate its damages, but also avoid them completely, if possible. This is also confirmed by another German Supreme Court decision, which states that a failure to mitigate by the aggrieved party could lead to a total exclusion of liability of the breaching party.[122]

The court decisions are split on the matter whether the duty to mitigate is to be examined *ex officio* or if an objection must be raised by the party in breach. Civil law courts normally examine the duty without the breaching party raising the issue.[123] In contrast, Anglo-American courts usually consider the duty only when the party in breach pleads accordingly.[124] Therefore, it is advisable to consider the forum in regard to the duty to mitigate, or to plead breach of the rule in any case.

The art. 77 CISG requires the aggrieved party to take "*such measures as are reasonable*". It is therefore necessary to determine what can be considered a "*reasonable*" measure. First, it is necessary to pay attention to any usage or practices established between the parties and any international trade usage applicable to their area of business.[125]

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[119] Judgment of the Courts of Exchequer of 23 February 1854, Hadley & Anor v. Baxendale & Ors.
[120] GOTANDA: *Recovering Lost Profits…*, p. 81.
[121] Judgment of the Bundesgerichtshof of 26 September 2012, VIII ZR 100/11.
[122] Judgment of the Bundesgerichtshof of 24 March 1999, VIII ZR 121/98.
[123] e.g. Judgment of the Bundesgerichtshof of 24 March 1999, VIII ZR 121/98 or Judgment of the Audiencia Provincial de Murcia, sección 1 of 25 May 2012, 267/2012.
[124] e.g. Judgment of the Federal Court of Australia of 20 April 2011, Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd or Judgment of the U.S. Court of Appeals (11th Circuit) of 12 September 2006, Treibacher Industrie, A.G. v. Allegheny Technologies, Inc.
[125] CISG Art. 9, paras. 1-2, referred to in SCHWENZER: *Commentary on the UN…*, p. 1107.

In case of absence of usage or practice, the meaning of "*reasonable*" can be interpreted by examining the case law. In the *Excavator case*, the buyer refused to take over the goods and pay the price. As a result, the seller resold the goods for the same amount that it had acquired the goods itself and claimed the difference between the contract price and the substitute transaction on the buyer. The buyer claimed that the seller breached its obligation to mitigate damages. The court ruled that the obligation to mitigate "[…] *is to be interpreted taking into account the competing interests of the parties, as well as commercial customs and the principle of good faith.*" Since there was no evidence that the seller passed on an opportunity to sell the goods for a higher price, the court assumed, in line with the good faith principle, that the seller complied with the obligation to mitigate its damages, and awarded the difference.[126] In the *Propane case*, the Austrian Supreme Court ruled in a similar way, stating that reasonable measures would be those that could have been expected in good faith. Further, it ruled that determining whether a measure is reasonable depends on how a reasonable creditor would have acted in the same situation.[127] From the reasonings behind the court decisions, we can conclude that first of all, good faith of the aggrieved party is presumed. Subsidiarily, an objective standard will apply when determining whether the measures were reasonable.

Besides the objective criteria, it is also necessary to assess each case individually. According to Opie, factors such as perishability of the goods, fluctuation of the market price of availability of the goods on the market should be considered.[128] Furthermore, subjective criteria of the parties, such as experience or financial resources, should also be evaluated.[129]

Parties will often be required to enter into a substitute transaction in order to mitigate their damages. A purchase of substitute goods is often considered a reasonable measure in the circumstances.[130] The number of cases addressing the substitute transaction as a measure to mitigate damages is overwhelming.[131] To address just three: according to the Swiss Supreme Court, if the aggrieved party does not enter into substitute transaction and the court finds that

[126] Judgment of the Oberlandesgericht Graz of 24 January 2002, 4 R 219/01k.
[127] Judgment of the Oberster Gerichtshof of 6 Februrary 1996, 10 Ob 518/95.
[128] OPIE, Elisabeth. *Commentary on the manner in which the UNIDROIT Principles may be used to interpret or supplement Article 77 of the CISG* [online]. cisg.law.pace.edu, January 2005 [cited 15 June 2017]. Available at: <http://www.cisg.law.pace.edu/cisg/biblio/opie.html>.
[129] LOOKOFSKY, Joseph. *Understanding the CISG. A Compact Guide to the 1980 United Nations Convention on Contracts for the International Sale of Goods*. 3rd edition. Kluwer Law International, 2008, 243 pp.
[130] RIZNIK, Peter. Some Aspects of Loss Mitigation in International Sale of Goods. *Vindobona Journal of International Commercial Law and Arbitration*, 2010, Vol. 2, No. 14, p. 273.
[131] For an overview of the most important cases, see ibid. pp. 273-277.

it would have been reasonable to enter into one, the damages will be reduced to the amount that would be due if he had entered into a substitute transaction.[132]

In the case *Secremo v. Helmut Papst*, the seller, after not having received a letter of credit from the buyer, nearly immediately resold the goods to a third party and claimed the difference on the buyer. The Appellate court in Antwerp held that the seller was obliged to enter into a substitute transaction as quickly as possible under the duty to mitigate its damages, and awarded him the difference.[133]

Finally, according to the *Iron molybdenum case,* the aggrieved party is not obliged to refrain from a cover purchase merely because of the high market price if the party in breach is unable to demonstrate a cheaper cover purchase could have been arranged.[134]

From these cases, we can draw three basic rules applicable to the duty to mitigate. First, the aggrieved party is obliged to enter into substitute transaction whenever it is reasonable. Second, the aggrieved party must act as soon as possible. Third, the market price at the time when the substitute transaction occurred will be decisive when determining reasonableness.

Besides substitute transaction, there are other measures the aggrieved party must take in order to mitigate its damages. In the *Clothing case*, the seller delivered the goods only after the season has ended. Due to the seller's delay, the buyer reduced the price to its sub-agents by 10%. The arbitral tribunal held that due to the seasonal nature of the goods, the buyer had to reduce the price in order for it to be acceptable to its sub-agents and therefore complied with the duty to mitigate. Consequently, it awarded the buyer the difference between the price paid and the price obtained as damages.[135] Hence, in case a delay occurs, the aggrieved party must make an attempt to sell seasonal goods even after the season has ended. It may use a discounted price, if necessary.

The last case I will examine in regard to the duty to mitigate is the *Aluminium hydroxide case*. In this case, the buyer received several separate shipments of aluminium hydroxide from the seller. One of the shipments was defective. Since the buyer mixed all the shipments together in one silo, all of its supplies became contaminated and the buyer sued for damages. The court stated that even though all of the shipments came from the same seller, immediate inspections were necessary for each shipment. Since the buyer failed to do so, the court held

[132] Judgment of the Bundesgericht of 17 December 2009, 4A_440/2009.
[133] Judgment of the Hof van Beroep Antwerpen of 22 January 2007, 2004/AR/1382.
[134] Judgment of the Oberlandesgericht Hamburg of 28 February 1997, 1 U 167/95.
[135] ICC case no. 8786 of 1997.

that the duty to mitigate damages was breached did not award damages.[136] Therefore, it is always necessary to examine each separate shipment in order to mitigate potential damages.

4.3 Burden of proof

The CISG does not have a specific provision on who bears the burden of proof in regard to the damages. Currently, however, it is clear from the case law that the Convention does indeed govern the burden of proof. To provide with just two examples: the German Supreme Court ruled in a case governed by the CISG that "[…] *the CISG regulates the burden of proof* […] *so that consequently, recourse to the national law is blocked* […]".[137] The Higher Cantonal Court in Valais ruled in the same way, stating that "*There is no direct provision in the CISG concerning the burden of proof. Yet, the judge must not refer to domestic law because the CISG indirectly provides for the allocation of the burden of proof, by way of the effect of its terms or by establishing a relationship between a rule and its exception.*"[138]

Now that it has been established that the CISG does govern the burden of proof, it is necessary to examine what has to be proved and which party bears the burden. According to the Appellate Court Zweibrücken, the party claiming damages must, as a general principle of the convention, prove the other party's breach of contract, the particular case of damage and the quantity of the suffered loss.[139] Further, the district court in Vigevano argued that because of the explicit provision in the art. 79 CISG, according to which the party in breach bears the burden to prove existence of circumstances exempting it from liability for its failure to perform, it is also implicitly confirmed that the other party – the aggrieved party – bears the burden to prove the existence of a lack of conformity and the damage ensuing from it.[140] Therefore, the aggrieved party must prove 1) the other party's breach of contract, 2) the extent of its loss and 3) the causation between the breach and the damages. Should the aggrieved party be unable to prove the three facts, it will not be able to recover all of its damages, even though it would mean that it will not be put into the same position it would have been in case of proper contract performance.

It is also necessary to determine which party bears the burden of proof in regard to the above-addressed foreseeability limitation. Consensus is absent among national legal

[136] Judgment of the Oberlandesgericht Köln of 21 August 1997, 18 U 121/97.
[137] Judgment of the Bundesgerichtshof of 9 January 2002, VIII ZR 304/00.
[138] Judgment of the Tribunal cantonal du Valais of 28 January 2009, C1 08 45.
[139] Judgment of the Oberlandesgericht Zweibrücken of 31 March 1998, 8 U 46/97.
[140] Judgment of the Tribunale di Vivegano of 12 July 2000, n. 405.

systems.[141] The CISG case law, however, is quite straightforward. In the *Dye for clothes case*, the court ruled that the buyer – which was the aggrieved party – failed, *inter alia,* to prove that the seller could have known about the buyer's potential losses, and rejected the buyer's claim for damages.[142] In the *Fabric case*, the court explicitly stated that "*The burden of proof for the foreseeability of the loss is on the damaged party*".[143] Since there are presently no court decisions opposing the opinion, the aggrieved party must prove that the damages were foreseeable by the breaching party.

Unlike the foreseeability limitation, the party in breach bears the burden of proof for the claim that the aggrieved party violated its duty to mitigate, as is clear from the case law. The Federal Court of Australia ruled that since the manufacturer, who was the party in breach in the case, did not prove its claim for a reduction of the damages payable by it, the damages cannot be reduced.[144] Similarly, a German court in the *Tetracycline case* referred to the party in breach as to the party that bears the burden of proof in regard to the duty to mitigate damages.[145]

With the allocation of the burden of proof determined, we can now move to the standard of proof. In *Delchi v. Rotorex*, the court cited the law of New York, which was the *lex fori* of the case, as the law applicable to the standard of proof.[146] In another case, a Swiss district court ruled that since the CISG does not contain rules for the burden of proof, the private international law rules of the *lex fori* must be applied, pointing to domestic rules on the standard of proof.[147] There are even more recent court decisions pointing to the law of the forum.[148] The court decisions are in conflict with the prevailing academic opinion. According to both Schlechtriem and the CISG Advisory Council, this approach would undermine one of the main goals of the CISG – to promote uniform interpretation of the convention.[149] It would also be contrary to the principle of full compensation.[150] Furthermore, I believe that such

[141] VÉKÁS, Lajos. The Foreseeability Doctrine in Contractual Damage Cases. Acta Juridica Hungarica, 2002, Vol. 43, Nos. 1-2, p. 168.
[142] Judgment of the Audiencia Provincial de Barcelona, sección 16ª of 20 June 1997, 755/95-C.
[143] Judgment of the Oberlandesgericht Bamberg of 13 January 1999, 3 U 83/98.
[144] Judgment of the Federal Court of Australia of 20 April 2011, Castel Electronics Pty Ltd v Toshiba Singapore Pte Ltd.
[145] Judgment of the Amtsgericht München of 23 June 1995, 271 C 18968/94.
[146] Judgment of the U.S. District Court, N. D., New York of 9 September 1994, Delchi Carrier S.p.A. v. Rotorex Corp.
[147] Judgment of the Bezirksgericht der Saane of 20 February 1997, T 171/95.
[148] e.g. Judgment of the Handelsgericht Zürich of 22 November 2010, HG070223/U/dz or Judgment of the Kantonsgericht Zug of 14 December 2009, A2 2001 105.
[149] GOTANDA: *CISG-AC Opinion…*, SCHWENZER: *Commentary on the UN…*, p. 1085.
[150] GOTANDA: *CISG-AC Opinion…*

approach would lead to forum shopping as one case could result in a different outcome at different forums due to the different standards of proof applicable.

The standard of proof that is to be used instead of the *lex fori* rules can be found in both UPICC and PECL. According to UPICC, a party must prove its claim for compensation "*with a reasonable degree of certainty*".[151] In comparison, PECL provides for "*loss which is reasonably likely to occur*".[152] The imposition of a "reasonable" standard should not be viewed as radical as it is consistent with the CISG as a whole.[153] Moreover, the CISG itself often refers to the parties as "reasonable persons".[154] Therefore, the damages must be proved with a reasonable degree of certainty when CISG is the applicable contract law.

[151] UPICC Art. 7.4.3 para. 1.
[152] PECL Art. 9:501 para. 2 (b).
[153] GOTANDA: *CISG-AC Opinion…*
[154] e.g. Arts. 8, 25, 35, 75, 79.

5 Problematic types of damages

Now that both the scope of the full compensation principle and the limitations to it were established, I will address the most problematic types of damages where both the judicial decisions and scholarly opinions are divided. I will also present my legal opinion on whether each of the types of damages should be recoverable under the full compensation principle or to what extent should it be recoverable. The three types of damages I will address are non-pecuniary loss, attorney's fees and disgorgement of profits.

5.1 Non-pecuniary loss

Black's law dictionary defines non-pecuniary damages as damages that cannot be easily ascertained because there is no fixed pecuniary standard of measurement.[155] These may include e.g. emotional distress, personal injury or moral harm. Some authors consider loss of reputation or goodwill as non-pecuniary damages, but as I have addressed this type of damage already,[156] for the purpose of this chapter, I will not consider it as non-pecuniary damages.

Death and personal injury is clearly out of the scope of the CISG, which in its article 5 explicitly states it does not apply "[…] *to the liability of the seller for death or personal injury caused by the goods to any person.*"[157] However, in case of the buyer's liability towards third parties for death or bodily harm, the legal situation is different. In the *Veneer cutting machine case*, the buyer demanded damages for personal injury and death caused by a defective machine delivered by the seller. The court held that the buyer's liability is an economic (pecuniary) loss and does not fall under the scope of art. 5 CISG, and awarded the damages to the buyer.[158] An opinion exists that damages for death or personal injury are not recoverable regardless of the situation as the CISG only knows compensation in money.[159] However, the liability of a buyer for death or personal injury to third persons will be expressed in money. this opinion can therefore be disregarded. Thus, the buyer's liability for death or personal injury is recoverable as consequential damages.

Besides death and personal injury, there is no explicit provision in the CISG pointing in favour of recoverability of non-pecuniary loss or against it. Schwenzer states that purely non-pecuniary damages may be recoverable where the intangible purpose became part of the

[155] GARNER: *Black's law dictionary…*, p. 417-418.
[156] *Supra*, p. 25.
[157] Art. 5 CISG.
[158] Judgment of the Oberlandesgericht Düsseldorf of 2 July 1993, 17 U 73/93.
[159] LIU, Chengwei. *Remedies for Non-performance: Perspectives from CISG, UNIDROIT Principles & PECL* [online]. cisg.law.pace.edu, September 2003 [cited 17 June 2017]. Available at: <http://www.cisg.law.pace.edu/cisg/biblio/chengwei.html>.

contract and the loss is a typical consequence of non-performance, but generally claims that non-pecuniary loss is not recoverable.[160] The CISG Advisory Council also agrees with this opinion.[161] It is noteworthy that case law concerning non-pecuniary damage is practically non-existent. The only accessible case is an ICAC Russia case, which states that the CISG contains no provisions for the compensation of "moral harm".[162] Although it is clearly a prevailing opinion, neither the authorities nor the cited case provide any further argumentation on why the non-pecuniary damages should not be recoverable.

Presently, there are opinions advocating that the breach of contract cannot be adequately addressed if only economic losses could be claimed as damages.[163] I agree with these opinions. The entire purpose of the full compensation principle is to make a party whole again. In a case where the aggrieved party incurs non-pecuniary harm due to the breach of contract, it must be put into the position before the breach. I see no reason why it should not include the non-pecuniary harm.

Since the CISG does not have a specific provision, we may take recourse to UPICC and PECL as interpretation tools. UPICC provides that "[…] *harm may be non-pecuniary and includes, for instance, physical suffering or emotional distress.*"[164] Physical suffering is out of the scope of the CISG as is clear from the art. 5 CISG. However, UNIDROIT in its commentary explicitly states that "[…] *non-material harm may assume different forms and it is for the court to decide which of them, whether taken alone or together, best assures full compensation.*[165] Therefore, other forms of non-pecuniary harm may be recoverable under the CISG. PECL has a somewhat simplified provision, stating that recoverable loss includes "*non-pecuniary loss*" with no examples or explanation.[166] Since both of the conventions provide for recoverability of the non-pecuniary loss, we may consider interpreting the CISG in line with the conventions. This would certainly promote uniformity of international private law as is required by the art. 7 CISG.

Furthermore, Schlechtriem argues that satisfaction could be one of the cases where non-pecuniary loss should be allowed.[167] There may be cases in which for procedural reasons,

[160] SCHWENZER: *Commentary on the UN…*, p. 1073-1074.
[161] GOTANDA: *CISG-AC Opinion…*
[162] ICAC Russia case of 3 March 1995, 304/1993.
[163] SCHLECHTRIEM, Peter. Non-Material Damages -- Recovery Under the CISG? *Pace International Law Review*, 2007, Vol. 1, No. 19, p. 90.
[164] UPICC Art. 7.4.2 para. 2.
[165] UNIDROIT. *UNIDROIT principles of international commercial contracts*. 2010 edition. Rome: UNIDROIT, 2010. p. 269.
[166] PECL Art. 9:501 para. 2 (a)
[167] SCHLECHTRIEM: *Non-Material Damages…*, p. 92.

declaratory judgment is unavailable. If there would be no pecuniary loss in such circumstances, there would not be any part of the decision declaring the behaviour of the party in breach was wrong. In such cases, a judgment awarding the aggrieved party non-pecuniary loss for satisfaction could function as a declaration of the breaching party's wrongdoing.[168]

5.2 Attorney's fees

Pursuing one's rights usually comes with a significant amount of costs. These usually include attorney's fees as well as extra-judicial costs, such as travel expenses. First of all, it is up to the parties to address the allocation in the contract. Schwenzer recommends to either make a specific provision in the contract or provide for such a rule by a forum selection clause.[169]

In cases where specific provision does not exist, it is questionable whether attorney's fees can be recovered as damages under the CISG. On the first glance, it seems only reasonable in line with the full compensation principle to award attorney's fees to the prevailing party. The only way to make the aggrieved party whole again is to reimburse it for all the costs it incurred in connection with the breach. That would certainly include legal costs. However, there are several arguments pointing to the contrary. A summary of these arguments can be found in one of the most important cases in this matter, the well-known *Zapata Hermanos v. Hearthside Baking* case (hereinafter the "*Zapata case*"). In this case, the US Federal Appellate Court overturned a decision of a district court, declining to award attorney's fees as damages to the prevailing party. The court made following arguments in its ruling:

1. The question of litigation costs is a matter of procedural law and therefore not covered by the CISG.
2. Allowing attorney's fees as damages under the CISG would only allow successful claimant to recover them as the CISG requires breach of contract in order for art. 74 to apply. Therefore, the position it would create would be anomalous.
3. There was no evidence in the drafting history of the CISG that would consider attorney's fees as damages.[170]

[168] ibid. 93.
[169] SCHWENZER: *Commentary on the UN…*, p. 1068.
[170] Judgment of the U.S. Circuit Court of Appeals (7th Circuit) of 19 November 2002, Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Company, Inc. d/b/a Maurice Lenell Cooky Company.

There are further court decisions denying awarding attorney's fees under the CISG. Another US court stated that the CISG is silent on the matter of attorney's fees and denied awarding them under US procedural law.[171] Similarly, an Italian court also disregarded the CISG and applied only procedural law to the matter of attorney's fees.[172] Some authorities agree that recovery of attorney's fees is indeed a procedural matter.[173] Furthermore, the CISG Advisory Council expresses the same opinion as stated in the second argument of the *Zapata case* and further adding that due to the anomaly, the principle of equality would be breached.[174]

All of the arguments stated in the *Zapata case*, however, can be challenged. Firstly, there is case law pointing to recoverability of attorney's fees. In the *Shoes case Düsseldorf*, the court ruled that "*It is true that art. 74 CISG encompasses compensation for the cost of a reasonable pursuit of one's legal rights.*"[175] Further, an ICC arbitral tribunal considered legal costs as foreseeable and awarded them as damages under the CISG as well.[176] Hence, the courts and arbitral tribunals are not consistent in their decisions whether the art. 74 applies to attorney's fees.

Concerning the procedural matter of attorney's fees, many authorities believe this argument should not be followed. The distinction whether a matter is substantive or procedural varies from jurisdiction to jurisdiction and in international law, such a distinction may be even considered harmful.[177] Furthermore, the efforts on harmonising the law would go in vain and it could lead to application of domestic rules and standards.[178] The CISG Advisory Council agrees, stating that "*relying upon such a distinction in this context is outdated and unproductive.*"[179] Therefore, we may conclude that the first argument made in

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[171] Judgment of the U.S. District Court New Jersey of 15 April 2009, San Lucio, S.r.l. et al. v. Import & Storage Services, LLC et al.
[172] Judgment of the Tribunale di Vivegano of 12 July 2000, n. 405.
[173] FLECHTNER, Harry, Lookofsky, Joseph. Viva Zapata! American Procedure and CISG Substance in a U.S. Circuit Court of Appeal. *Vindobona Journal of International Commercial Law and Arbitration*, 2003, Vol. 7, p. 94.
[174] GOTANDA: *CISG-AC Opinion…*
[175] Judgment of the Oberlandesgericht Düsseldorf of 14 January 1994, 17 U 146/93.
[176] ICC case no. 7585 of 1992.
[177] ORLANDI, Chiara G. Procedural law issues and law Conventions. *Uniform Law Review*, 2000, Vol. V, No. 1, p. 24.
[178] ĐORĐEVIĆ, Milena. *'Mexican Revolution' In CISG Jurisprudence And Case-Law: Attorneys' Fees As (Non)Recoverable Loss For Breach Of Contract* [online]. harmonius.org, 2010 [cited 20 June 2017]. Available at: <http://www.harmonius.org/sr/publikacije/clanci/milena_djordjevic/Private_Law_Reform_in_South_East_Europe.pdf>, p. 207-208.
[179] GOTANDA: *CISG-AC Opinion…*

the *Zapata case* is in conflict with the CISG's requirement to promote uniformity and should not be followed.

In regard to the second argument, some authors do not consider principle of equality to be necessarily in conflict with the principle of full compensation in case of attorney's fees. Đorđević argues that it is too far-fetched to claim that the CISG provides for an absolutely equivalent system of remedies for both buyers and sellers due to the different modalities of parties' obligations.[180] Although I agree with this opinion in general, in regard to the attorney's fees, I see no reason for such remedy to be provided to only one party, especially in case of attorney's fees, which are usually paid by both parties. Further, it can be argued that the requirement for breach may be overcome by ruling that the claimant breached his duty of loyalty to the contract.[181] Such a ruling would provide both parties with the possibility of recovering attorney's fees in case they prevail in a dispute. It is, however, a German, not international, interpretation method and one should not respond to this argument in such way.[182] Thus, such a rule cannot be applied in international disputes either. Đorđević further argues that the principle of equality is not in conflict due to the fact that both parties, regardless of the fact whether they are buyer or seller, are able to recover the attorney's fees in the position of claimant.[183] That is certainly true, it however does not change anything about the fact the parties would be treated unequally once a dispute arises, especially since the party who did not initiate the proceedings would be the one that could not recover their attorney's fees. Hence, in my opinion, this argument raised in the *Zapata case* prevails.

Concerning the last argument, it is certainly true that attorney's fees were never mentioned in the drafting history of the CISG.[184] However, the drafting history does not suggest that the attorney's fees are not recoverable under the CISG either. Although it is not certain what the reason behind not discussing the matter is, the fact that it was not discussed should not itself preclude the recovery of attorney's fees under the CISG.[185]

To summarise, I believe that even though the *Zapata case* is widely criticised and all of its arguments may be disputed, the argument that allowing awarding attorney's fees would

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[180] ĐORĐEVIĆ: *'Mexican Revolution' In CISG…*, p. 211.
[181] FELEMEGAS, John. An Interpretation of Article 74 CISG by the U.S. Circuit Court of Appeals. *Pace International Law Review*, 2003, Vol. 15, No. 91, p. 126.
[182] SCHLECHTRIEM, Peter. Legal Costs as Damages in the Application of UN Sales Law. *Journal of Law and Commerce*, 2006-2007, Vol. 26, p. 76.
[183] ĐORĐEVIĆ: *'Mexican Revolution' In CISG…*, p. 212.
[184] For drafting history of the CISG, see HONNOLD, John O. *Documentary history of the uniform law for international sales : the studies, deliberations and decisions that led to the 1980 United Nations convention with introductions and explanations*. Deventer: Kluwer law and taxation, 1989. 881 pp.
[185] ĐORĐEVIĆ: *'Mexican Revolution' In CISG…*, p. 210.

create anomalous situation and therefore breach the principle of equality between the parties prevails. Therefore, attorney's fees should not be recoverable under the CISG, but rather under procedural law of the forum. Under procedural law of the forum, either prevailing party will usually be able to recover its attorney's fees under the "loser pays" rule. In forums where the "loser pays" rule does not apply, both of the parties will be aware of the fact before the dispute and can therefore prepare themselves for the costs connected with it.

5.3 Disgorgement of profits

Disgorgement may be classified as an "*act of giving up something on demand or by legal compulsion*".[186] Therefore, disgorgement of profits means that illegally obtained profits, usually by selling the goods second time after the breach, are taken from the party in breach and awarded to the aggrieved party. The CISG does not address the issue of disgorgement of profits and neither do UPICC or PECL. There is a running dispute between authorities whether profits may be disgorged.

There are several arguments that may be raised in favour of awarding disgorgement under the CISG. First, there are currently increasing tendencies in domestic legal systems that allow for disgorgement of profits.[187] Since there is such development in domestic legal systems, we may argue that it could influence the CISG as well. The CISG's main goal is to promote uniformity. With this goal in mind, the CISG must not only be interpreted, but also developed uniformly.[188] Therefore, in cases where certain tendencies appear in various legal systems to the extent that they may be considered as new development in international legal practice. Disgorgement of profits might be considered one of the tendencies. Although this is certainly a valid theory that may be used as a support, it cannot itself mean that profits can be disgorged, especially since at this point, case law is completely lacking.

Another argument that can be made is that disgorgement of profits is in line with the principles of the CISG – namely the principle of good faith and *pacta sunt servanda*. The principle of good faith is explicitly mentioned in the convention[189] and cited in court decisions as one of the main principles of the CISG.[190] The principle of good faith obliges the parties to

[186] GARNER: *Black's law dictionary…*, p. 501.
[187] ISRAEL, Ronald, O'NEILL, Brian. Disgorgement as a viable theory of restitution damages. *Commercial Damages Reporter*, 2014, Vol. January, p. 6. Also, SCHWENZER: *Commentary on the UN…*, p. 1076.
[188] FELEMEGAS, John. *The United Nations Convention on Contracts for the International Sale of Goods: Article 7 and Uniform Interpretation* [online]. cisg.law.pace.edu, 2000 [cited 22 June 2017]. Available at: <http://www.cisg.law.pace.edu/cisg/biblio/felemegas.html#ch3>.
[189] Art. 7 para. 1 CISG.
[190] e.g. Judgment of the Cour d'appel Grenoble of 22 February 1995, 93/3275.

act honestly and fairly in the performance of one's contractual duties.[191] If the party in breach realises profit by contracting a third party, it may be argued that it breached the principle of good faith and in would be highly unfair to allow it to keep the profit. It is also in line with Schwenzer's opinion, who states that "[…] *targeting profits of the promisor is possible and necessary in the following constellations: the seller sells the goods a second time and realizes a higher profit than agreed to under the contract with the first buyer* […]".[192]

The *pacta sunt servanda* principle is known to most if not all legal systems. The principle is one of the cornerstones of the CISG and requires the parties to a contract to keep their contractual promises.[193] According to one opinion, in order to satisfy the purpose of the *pacta sunt servanda* principle, the party in breach must be forced to disgorge its profits if it enters into a second sale after the breach.[194] Therefore, according to the arguments presented, one may argue that by entering into a second contract after the breach of contract, the party breached both of the principles and should be disgorged of any profits it made as it should not benefit from its own breach.

Although the ideas behind the arguments are valid, I believe they are in conflict with the full compensation principle. The purpose of the full compensation principle is to make the party whole again, to compensate it fully, but not to overcompensate. By awarding the profits made by the party in breach to the aggrieved party, the aggrieved party would in some cases receive more than it would have actually received had the contract been performed. Therefore, it would not be put into the same position, but into a better position. I believe that is out of the scope of the full compensation principle and consequently, the CISG.

Moreover, disgorgement should be considered punitive damages as it aims to punish the party in breach for making a profit after the breach. Punitive damages are however not permitted under the CISG, including in cases where domestic law allows them for breach of contract.[195] Therefore, disgorgement cannot be allowed under the CISG due to its punitive nature.

To conclude, I believe that even though recent national development often allows disgorgement under national law and in most cases, the party in breach will be in conflict with both the principle of good faith and *pacta sunt servanda*, the aggrieved party should still not

[191] POWERS, Paul J. Defining the Undefinable: Good Faith and the United Nations Convention on Contracts for the International Sale of Goods. *Journal of Law and Commerce*, 1999, Vol. 18, p. 351.
[192] SCHWENZER: *Commentary on the UN…*, p. 1076.
[193] LIU, Chengwei. *Changed Contract Circumstances* [online]. cisg.law.pace.edu, 2nd edition, April 2005 [cited 22 June 2017]. Available at: <http://www.cisg.law.pace.edu/cisg/biblio/liu5.html>.
[194] BARNETT, Katy. *Accounting for profit for breach of contract, Theory and Practice*. Oxford: Hart Publishing Ltd, 2012, p. 107.
[195] GOTANDA: *CISG-AC Opinion…*

be allowed to disgorge all the breaching party`s profits. Awarding them would not be in line with the full compensation principle as it would overcompensate the aggrieved party rather than putting it in the same position it would have been but for the breach. Furthermore, the disgorgement has punitive nature, which is not allowed under the CISG. Thus, the party in breach may be disgorged, but only in the amount that will make the aggrieved party whole again.

6 Conclusion

The main purpose of this thesis was to determine whether or not the full compensation principle will put the aggrieved party in the exact same position as it would have been in case of proper contract performance. In order to answer this question, it was necessary to first determine whether is the full compensation principle generally accepted as a principle of the CISG, the scope of the damages recoverable under the principle and the limitations of the principle.

In the first chapter, I have determined that the principle of full compensation is generally accepted among various authorities, including the CISG Advisory Council. Furthermore, both UPICC and PECL are applicable as interpretational tools to the CISG under the requirement to interpret the CISG with regard to its international character and uniformity. Therefore, the full compensation principle is accepted as one of the principles governing the CISG.

It is possible for the parties to contractually derogate from the full compensation principle and to take recourse to national law. If the parties will choose not to do so, the full compensation principle provides for various types of damages. Direct loss is recoverable as a difference between the substitute transaction and the contract price, or between the market price and contract price. The CISG requires the aggrieved party to conduct the substitute transaction in a reasonable manner. Otherwise, it will not be recoverable, as is clear from a number of court decisions and arbitral awards. Furthermore, costs connected to the substitute transaction and currency fluctuations may not always be recoverable. Therefore, direct loss award will not always recover all the costs connected to the breach and the aggrieved party will not be in the same position it would have been.

Incidental damages provide for any losses associated with the breach, such as transport or storage costs. They are also limited by the requirement of reasonableness and will not always be recoverable. Consequential damages, such as liability towards third parties, will usually be recoverable without larger issues. Courts sometimes refuse to award loss of reputation as a consequential damage as it cannot be calculated precisely, but according to my opinion, the inability to precisely calculate loss cannot lead to such result, especially due to the fact that the breach is the reason why the loss cannot be calculated.

Lost profits, including future lost profits, are also recoverable under the principle. It is however often not possible to calculate the lost profits precisely. Furthermore, there are

several limitations, such as notice of the non-conforming goods that limit the recoverability of the lost profits.

The full compensation principle is further limited by foreseeability of the damages, usually at the time of the breach. Both the objective and subjective standards are applicable to the foreseeability. The extent of damages foreseeable does not have to be precise, it must be foreseeable as a "possible consequence" of the breach. Although this rule is rather lenient in comparison with national laws, there still may be instances where the aggrieved party will not be made whole again due to unforeseeability of the damages.

The aggrieved party is also required to mitigate its losses and to bear the burden of proof in regard to its losses. In cases where the aggrieved will not mitigate its damages or will be unable to prove its loss, it will not be able to recover it to its full extent.

Death and personal injury are out of the scope of the full compensation principle, although they are recoverable in case of liability of the aggrieved party towards third parties. Opinions on recoverability of other types of non-pecuniary loss differ, but I believe it should be allowed, especially due to the fact that both UPICC and PECL provide for such recoverability. Therefore, my first sub-hypothesis is only partially confirmed as certain non-pecuniary losses may be recoverable under the full compensation principle.

Concerning the of attorney`s fees, there are numerous arguments claiming that they are not recoverable under the CISG, all of which are challenged. However, if the CISG would provide for attorney`s fees, only a successful claimant would be able to recover them due to the requirement of breach is in conflict with the principle of equality between the parties. Thus, attorney`s fees cannot be recovered under the CISG, confirming my second sub-hypothesis.

Despite increasing tendencies in domestic legal systems allowing disgorgement of profits, there is no such practice apparent in the CISG. Further, although many argue disgorgement of profits should be allowed in line with the principles of good faith and *pacta sunt servanda*, such approach would go against the principle of full compensation, which aims to put the aggrieved party to the same position, not a better position. Moreover, disgorgement is a type of punitive damages, which are clearly forbidden under the CISG. For these reasons, the breaching party can only be disgorged of the profits that will fully compensate the aggrieved party, but not overcompensate it, which disproves my last sub-hypothesis.

The main hypothesis is, for the most part, confirmed. Due to numerous limitations, such as reasonableness of the substitute transaction, non-recoverability of the attorney`s fees or

certain non-pecuniary losses, the aggrieved party will often not be put in the same position as it would have been in case of proper contract performance. It will not, however, ever be put into a better position.

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Abstract

The thesis with the title “Full compensation principle in the United Nations Convention on Contracts for the International Sale of Goods” examines the full compensation and its applicability to the United Nations Convention on Contracts for the International Sale of Goods (the CISG). The thesis first focuses on the scope of the full compensation principle, followed by the limitations of it. In the last part, the thesis examines some of the more problematic types of damages. The author uses foreign sources written in English only, with emphasis put on the court decisions and arbitral awards where the CISG was the applicable substantive law.

Abstrakt

Diplomová práce s názvem „Princip úplné kompenzace v Úmluvě OSN o smlouvách o mezinárodní koupi zboží“ pojednává o principu úplné kompenzace a jeho aplikaci na Úmluvu OSN o smlouvách a mezinárodní koupi zboží (CISG). Diplomová práce se nejprve soustředí na rozsah principu úplné kompenzace a následně jeho limity. V poslední části diplomová práce zkoumá některé z více problematických typů náhrady škody. Autor práce užívá výhradně zahraniční literaturu psanou v anglickém jazyce, s důrazem kladeným na soudní rozhodnutí a rozhodčí nálezy, ve kterých byla CISG aplikovatelným hmotným právem.

Key words

full compensation principle, CISG, damages, foreseeability, duty to mitigate, non-pecuniary loss, attorney`s fees, disgorgement of profits

Klíčová slova

princip úplné kompenzace, CISG, náhrada škody, předvídatelnost škody, přiměřená opatření ke zmenšení ztráty, náklady právního zastoupení, odnětí zisku