THE LAW OF DAMAGES IN THE INTERNATIONAL SALE OF GOODS

The CISG and other International Instruments

Djakhongir Saidov

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PUBLISHING

THE LAW OF DAMAGES IN INTERNATIONAL SALES

This book aims to explore the remedy of damages in international sales transactions. Its focus is on the international contract law instruments such as the Convention on Contracts for the International Sale of Goods (CISG), the UNIDROIT Principles of International Commercial Contracts, and the Principles of European Contract Law. The issues addressed in the book include: the basis for the right to claim damages; definition and purpose of damages; the idea of limiting damages; principles underlying the award of damages; classification of losses and heads of recoverable losses; causation; foreseeability; mitigation; standards of proving losses; and methods of calculating and determining the amount of damages. The book draws on the experience of some major legal systems in dealing with contract damages as well as on the body of cases and scholarly writings on the international instruments. In doing so, the book attempts to provide a justification for the existing rules on damages, highlights the problems in their interpretation and application, and proposes solutions to the existing problems in the light of relevant policies and goals pursued by the international instruments. The work will be of interest to practitioners involved in international commercial transactions, scholars and students interested in international commercial and comparative contract law.

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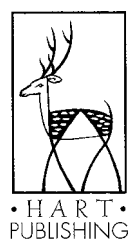

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To my parents and the memory of Oijon

Preface

Recent decades have witnessed an increasing scholarly interest in the law of contract damages in the context of various legal systems. This book seeks to contribute to the existing body of scholarship on this subject by exploring the remedy of damages under the UN Convention on Contracts for the International Sale of Goods (CISG) and, to a somewhat lesser extent, under the UNIDROIT Principles of International Commercial Contracts (UPICC) and the Principles of European Contract Law (PECL). In writing it, I aimed to provide a comprehensive treatment of these instruments' provisions on damages for breach of contract taking into account cases that have thus far been decided under the instruments in various domestic jurisdictions and arbitration tribunals. Having been written against the background of the experience of some major legal systems, the book engages with the issues and problems raised in domestic systems to the extent relevant to the international instruments' remedy of damages. I hope that the book will be of use not only to scholars, practitioners and students interested in the law of the international instruments but also to those interested in contract damages.

This book is a product of several years of research. During that period, I have benefited greatly from the help, comments and criticism of many people. I would like to thank Alastair Mullis, Michael Bridge, Ralph Cunnington, Albert Kritzer, Nelson Enonchong, Sarah Green, TT Arvind, Kyriaki Noussia, and Frank Meisel—all of whom, at various points in time, have kindly read earlier chapters of this book. I am very grateful to Tanya Corrigan for her immense help in preparing the book for publication. I also wish to thank the Birmingham Law School, University of Birmingham, for generously granting me the study leave which enabled me to complete this project. I owe much to Richard Hart for his encouragement, support and patience. Above all, I would like to thank my parents and parents-in-law, my wife, Sanam, daughter, Malika, and sister, Anora, without whom none of this would have been possible.

The book is based on the materials that were available to me up to 31 January 2008.

Djakhongir Saidov
Birmingham, 31 January 2008

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Introduction

1. GENERAL

RECENT DECADES HAVE seen a steady growth in international trade and, with it, increasing efforts to harmonise and unify commercial law. For a number of reasons, harmonisation of law is often seen as important and even necessary in the conditions of the globalisation of commerce and markets. Some of these reasons are based on a belief that it would: facilitate commerce and trade by lifting legal barriers and reducing transaction costs; produce legal regimes which are neutral and specifically tailored for particular types of transactions; dispense with a need to resort to conflict of law rules and reduce the opportunities for forum shopping; fill a legal vacuum by creating legal regimes in a field not covered by domestic legal systems; increase certainty, security and predictability in international transactions; trigger law reforms in some domestic legal systems[1]; and contribute to world peace and security by encouraging the settlement of disputes by amicable and peaceful means.[2] Although this view of harmonisation of law is not shared by all,[3] the process of gradual 'transnationalisation' of commercial law[4] seems to be well on its way. That said, international commercial law remains fragmentary[5] and in contrast with domestic legal systems, international instruments do not exist within a 'common legal environment'.[6] However, it is probably true that in the area of contract law this problem has been considerably alleviated by the adoption of three instruments: the UN Convention on Contracts for the International Sale of Goods (CISG) and the UNIDROIT Principles of International Commercial

[1] See L Mistelis, 'Is Harmonisation a Necessary Evil? The Future of Harmonisation and New Sources of International Trade Law' in I Fletcher, L Mistelis and M Cremona (eds), *Foundations and Perspectives of International Trade Law* (London, Sweet & Maxwell, 2001) 3, 20–1.

[2] See R Goode, H Kronke and E McKendrick, *Transnational Commercial Law: Text, Cases, and* Materials (Oxford, OUP, 2007) 192–3. See also ch 2.

[3] For a well-known example, see JS Hobhouse, 'International Conventions and Commercial Law: The Pursuit of Uniformity' (1990) 106 LQR 530; and for a helpful summary of arguments, see Mistelis (n 1) 22.

[4] See, eg, KP Berger, 'Transnational Commercial Law in the Age of Globalization' <http://w3.uniroma1.it/idc/centro/publications/42berger.pdf> accessed 18 December 2007.

[5] MJ Bonell, *An International Restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts*, 3rd edn (Ardsley, NY, Transnational Publishers Inc, 2005) 16.

[6] O Lando, 'European Contract Law' (1983) 31 AJCL 654.

Contracts (UPICC) at an international level and the Principles of European Contract Law (PECL) at a regional level. Some commentators regard these instruments with an even greater enthusiasm by treating them as 'an emerging jus commune, the gospels for the future world law of contract'.[7] Whatever a true characterisation of the instruments may be, it is beyond doubt that each of instruments has marked an important step in the development of commercial and contract law at the international and regional levels. They are now firmly entrenched in the commercial and contract law world by being regularly applied by judges and arbitrators and used as models for legal reform in a number of states as well as for drafting international contracts.[8] There is now an immense amount of literature discussing these instruments[9] and only a brief overview of their historical background, nature, aims and structure will be presented here.

2. THE CISG

The CISG[10] is a product of lengthy attempts to unify the law of international sales. Its general aims are set out in the Preamble, which states that in the adoption of the Convention the following considerations were taken into account:

> the broad objectives in the resolutions adopted by the sixth special session of the General Assembly of the United Nations on the establishment of a New International Economic Order, . . . the development of international trade on the basis of equality and mutual benefit is an important element in promoting friendly relations among States, . . . that the adoption of uniform rules which govern contracts for the international sale of goods and take into account the different social, economic and legal systems would contribute to the removal of legal barriers in international trade and promote the development of international trade.

The CISG is not the first international instrument purporting to govern international sales. In 1964, two instruments—a Uniform Law on the International Sale of Goods (ULIS) and a Uniform Law on the Formation of Contracts for the International Sale of Goods (ULFS)—were adopted. These instruments, however, failed to achieve a worldwide unification and were ratified only by a very

[7] O Lando, 'Comparative Law and Lawmaking' (2000–2001) 75 Tulane L Rev 1015, 1016.

[8] See, eg, MJ Bonell, 'UNIDROIT Principles 2004—The New Edition of the Principles of International Commercial Contracts Adopted by the International Institute for the Unification of Private Law' (2004) 45 Uniform L Rev 5, 6–17.

[9] For an extensive and regularly updated list of relevant sources, see, eg, <http://www.cisg.law.pace.edu/cisg/biblio/full-biblio.html>.

[10] The Convention on Contracts for the International Sale of Goods was signed in Vienna on 11 April 1980. It entered into force on 1 January 1988. The Convention consists of 101 Articles and is organised into four parts: Part I outlines the Convention's sphere of application and its general provisions; Part II deals with formation of the sales contract; Part III provides for the substantive rules of the sales contract itself; Part IV contains the Final Provisions on the Obligations of the Contracting States.

limited number of states.[11] In this respect, the CISG is far more successful having been ratified, as at the time of writing, by 70 states.[12] As noted, the CISG is routinely applied by courts and arbitration tribunals as the source of law for international sales contracts.[13] The CISG represents a piece of 'international legislation' being an 'international treaty' within the meaning of art 2 of the Vienna Convention on the Law of Treaties 1969.[14] If the conditions for its applicability are met[15] and the parties have not excluded its application to their contract,[16] the CISG will govern the sales contract in question. It is often pointed out that the Convention is fraught with a number of compromises that had to be made in order to enable the representatives of various political, legal, economic and social systems to agree on a unified sales law. This has had an impact on the CISG in at least two respects: first, a number of its provisions are based on general, and some would say vague standards and rules such as reasonableness or fundamental breach[17]; and second, the CISG is what might be called a skeleton or a minimalist instrument[18] which emphasises a general structure and spirit of its legal regime rather than various situational settings that may arise in international sales. A key feature of many international private law conventions has been the requirement that their international character be respected and that uniformity in their application be promoted.[19] This means that like other Conventions, the CISG must be interpreted 'autonomously', that is, by reference *only* to its own concepts and terms. In other words, the Convention must not be interpreted by reference to concepts and meanings in domestic legal systems.[20] This requirement is expressed in the important art 7(1) CISG, which provides that:

[11] Belgium, Federal Republic of Germany, Italy, Luxembourg, Netherlands, San Marino, UK, Gambia, and Israel.

[12] See Status 1980 United Nations Convention on Contracts for the International Sale of Goods <http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html> accessed 18 October 2007.

[13] For a constantly growing collection of cases refer to the following websites: <http://www.cisg.law.pace.edu>; <http://www.uncitral.org>; <www.unilex.info>; <http://www.cisg-online.ch/cisg/cases.html>.

[14] ' "[T]reaty" means an international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation' (art 2(1)(a) of the Vienna Convention on the Law of Treaties 1969).

[15] Article 1(1) CISG provides that the 'Convention applies to contracts of sale of goods between parties whose places of business are in different States: (a) when the States are Contracting States; or (b) when the rules of private international law lead to the application of the law of a Contracting State'.

[16] See art 6 CISG.

[17] See, eg, CP Gillette and RE Scott, 'The Political Economy of International Sales Law' (2005) 25 Int'l Rev L Economics 446, 473–5.

[18] See, eg, AH Kritzer, 'Observations on the Use of the Principles of European Contract Law as an Aid to CISG Research' <http://cisgw3.law.pace.edu/cisg/text/peclcomp.html>.

[19] See, eg, art 6 Convention on International Financial Leasing (1988); art 4 of the Convention on International Factoring (1988); art 5 of the Convention on International Interests in Mobile Equipment (2001).

[20] See, eg, M Gebauer, 'Uniform Law, General Principles and Autonomous Interpretation' (2000) 5 Uniform L Rev 683, 686–7.

> In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

The following paragraph of the same article is no less important as it provides guidance on what needs to be done if a particular matter is not expressly addressed by the Convention:

> Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.[21]

Thus, if a particular matter is not expressly dealt with by the CISG, the first thing to do is to determine whether the matter is *governed* by the Convention (ie, if it is within the Convention's scope) and when it comes to specific issues, it may be very difficult to resolve them. The Convention's general guidance in this respect is that it 'governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract'.[22] Considering the multiplicity of issues that may potentially arise, it is not of much use to attempt to discuss in abstract what issues do or do not fall within the Convention's scope. Several such issues will arise in the course of this book and each of them will be addressed in the relevant chapters. If the matter is found to be governed by the CISG, the next step is to identify a relevant general principle and some uncertainty still exists as to what can be considered a general principle underlying the Convention. Nevertheless, it is probably safe to say that party autonomy, equality of the parties' legal status, reasonableness and full compensation for the loss suffered are some of the Convention's general principles.[23] Much controversy has surrounded the question of whether good faith, mentioned in art 7(1) only as a method of interpreting the CISG, can be regarded as a general principle. There are valid objections to treating good faith as a general principle: one is that doing so would contravene the compromise made by the drafters prior to the adoption of the Convention whereby good faith was intended to be nothing more than a method of interpreting the Convention; another is that, owing to the difficulty of discerning a coherent content from the concept of good faith, recognising it as a general principle would undermine the Convention's objective of promoting certainty and predictability in international trade. Despite these objections, this book will adopt the view that good faith *is* a general principle of the CISG. The reason is twofold. First, although the Convention's drafters did, admittedly, strike a compromise to the contrary, it is difficult to deny the fact that the idea of good faith emanates from numerous provisions of the CISG.[24] Second, as has been correctly suggested, in

[21] Article 7(2) CISG.
[22] Article 4 CISG.
[23] The main text mentions only those principles which are relevant to the subject of the book.
[24] See arts 16(2)(b), 21(2), 29(2), 37, 40, 44, 46, 64(2), 77, 82, 85–88 CISG.

practice there is little to distinguish between the supplementation of the CISG on the one hand and its interpretation on the other.[25] Finally, if there is no relevant general principle to govern the matter or if the matter is outside the Convention's scope, it is to be resolved by reference to the law applicable by virtue of private international law.

3. THE UPICC

In contrast with the CISG, the UPICC[26] are an instrument of a different nature which represents a 'totally new product of international trade law'.[27] The Principles do not constitute either an act of 'international legislation' adopted by the states or a model law which becomes effective by means of its implementation into national legislation. The UPICC were intended to become a non-binding instrument, a source of 'soft law'[28] of international commercial contracts.[29] They are regarded as a kind of restatement of world contract law,[30] playing a role in the international arena similar to that of the Restatement of Contracts in the United States.[31] It has been suggested that this non-binding

[25] '[I]t is not possible in practice to distinguish a problem of interpretation from one of supplementation. It is not reasonable that a question of interpretation of a rule in the Convention is, and the interpretation of a term in the sales contract is not to be governed by the principle of good faith' (O Lando, 'CISG and Its Followers: A Proposal to Adopt Some International Principles of Contract Law' (2005) 53 AJCL 379, 391).

[26] The first edition of the UPICC was adopted in 1994 within the framework of the International Institute for the Unification of Private Law (UNIDROIT). The second edition was adopted in 2004. It consists of a Preamble and 185 Articles which are divided into the following chapters: ch 1—'General Provisions'; ch 2—'Formation' (Section 1) and 'Authority of Agents' (Section 2); ch 3—'Validity'; ch 4—'Interpretation'; ch 5—'Content' (Section 1) and 'Third Party Rights' (Section 2); ch 6—'Performance in General' (Section 1) and 'Hardship' (Section 2); ch 7—'Non-performance in General' (Section 1), 'Right to Performance' (Section 2), 'Termination' (Section 3), and 'Damages (Section 4); ch 8—'Set-Off'; ch 9—'Assignment of Rights' (Section 1), 'Transfer of Obligations' (Section 2), and 'Assignment of Contracts' (Section 3); ch 10—'Limitation Periods'. For an overview of the 2004 edition, see Bonell (n 8).

[27] KP Berger, 'The Lex Mercatoria Doctrine and the UNIDROIT Principles of International Commercial Contracts' (1997) 28 L and Policy Int'l Business 943, 945 (with further reference).

[28] R Goode, 'International Restatements of Contract and English Contract Law' in EZ Lomnicka and CGJ Morse (eds), *Contemporary Issues in Commercial Law—Essays in Honour of Professor AG Guest* (London, Sweet & Maxwell, 1997) 65.

[29] For a description of history of preparation of the UPICC, see Bonell (n 5) 9–56.

[30] 'However, to the extent that [the UPICC] do not follow the common-core but the best-solution approach the even more felicitous characterisation is pre-statement: the drafters take on the role of an enlightened legislature to enact the most functional, modern and internationally acceptable rule' (H Kronke, 'The UN Sales Convention, The UNIDROIT Contract Principles and the Way Beyond' (2005–2006) 25 J L Commerce 451, 457–8).

[31] See EA Farnsworth, 'An International Restatement: the UNIDROIT Principles of International Commercial Contracts' (1996–1997) 26 U Baltimore L Rev 1, 2–3; JM Perillo, 'UNIDROIT Principles of International Commercial Contracts: The Black Letter Text and a Review' (1994) 63 Fordham L Rev 281, 283; A Rosett, 'The UNIDROIT Principles of International Commercial Contracts: A New Approach to International Commercial Contracts, Part I' (1998) 46 AJCL 348. For a different view, see R Hyland, 'On Setting Forth the Law of Contract: A Foreword' (1992) 40 AJCL 541, 542 ('[The UPICC] are . . . not a restatement—either of the oft-mentioned

nature of the UPICC is a better way to achieve harmonisation of international commercial and contract law than to attempt to do so by means of international 'legislative' instruments.[32] The scope of the UPICC is much broader than that of the CISG because they are not confined to any one type of commercial contract. The objectives of the UPICC are set out in their Preamble:

—[The] Principles set forth general rules for international commercial contracts.
—They shall be applied when the parties have agreed that their contract be governed by them.
—They may be applied when the parties have agreed that their contract be governed by general principles of law, the lex mercatoria or the like.
—They may be applied when the parties have not chosen any law to govern their contract.
—They may be used to interpret or supplement international uniform law instruments.
—They may be used to interpret or supplement domestic law.
—They may serve as a model for national and international legislators.

By assigning these functions to the UPICC[33] the drafters intended, among other things, for this instrument to help remedy the fragmentary orientation of many international conventions[34] by creating an 'international legal environment'. They are based not only on the principles and rules found in most major legal systems but also on some other solutions which were perceived to be most suitable to the needs of international commerce.[35] The UPICC may also help bring some clarity and conceptual order to the vague concept of *lex mercatoria*, although at present there seems to be no agreement as to the interrelationship between the UPICC and *lex mercatoria*.[36] Similar to the CISG, the UPICC provide that in their interpretation 'regard is to be had to their international character and to their purposes including the need to promote uniformity in their

common core of existing legal systems or of the lex mercatoria. Certain of the rules formulated in the Principles doubtlessly reflect ideas that are generally accepted in modern systems of contract law. Other rules reflect the standard practice in international trade. Yet neither the common core—if in fact one exists—nor the lex mercatoria has been sufficiently elaborated to provide a basis either for restatement or for codification').

[32] See Rosett (n 31) 349; Goode (n 28) 65–6.

[33] For the discussion of some other cases where the UPICC could perhaps be used see, eg, AM Garro, 'The Contribution of the UNIDROIT Principles to the Advancement of International Commercial Arbitration' (1994) 3 Tulane J Int'l Comparative L 93, 114–25; H van Houtte, 'The UNIDROIT Principles of International Commercial Contracts' (1995) 11 Arbitration Int'l 373, 380–1.

[34] Bonell (n 5) 16.

[35] See Introduction to the 1994 edition in *UNIDROIT Principles of International Commercial Contracts 2004* (UNIDROIT, Rome 2004) xv.

[36] See, eg, Berger (n 27) 952; G Baron, 'Do the UNIDROIT Principles of International Commercial Contracts form a New Lex Mercatoria?' <http://www.cisg.law.pace.edu/cisg/biblio/baron.html>; H Veytia, 'The Requirement of Justice and Equity in Contracts' (1994–1995) 69 Tulane L Rev 1191; MPP Viscasillas, 'UNIDROIT Principles of International Commercial Contracts: Sphere of Application and General Provisions' (1996) 13 Arizona J Int'l and Comparative L 381; O Lando, 'Assessing the Role of the UNIDROIT Principles in the Harmonization of Arbitration Law' (1994) 3 Tulane J Int'l Comparative L 129.

application'.[37] If a particular matter is not expressly settled in the UPICC but is nevertheless within their scope, it is 'as far as possible to be settled in accordance with their underlying general principles'.[38] In contrast with the CISG, the UPICC expressly impose a duty to act 'in accordance with good faith and fair dealing in international trade'.[39]

4. THE PECL

The PECL[40] have much in common with the UPICC. Similar to the UPICC, the PECL were intended to be a non-binding instrument[41] and, indeed, the two instruments largely cover the same issues.[42] There are also similarities in the style and presentation since the two groups of drafters have influenced each other's work.[43] However, there are some differences between the two sets of Principles. The essential difference lies in their purpose and orientation: while the UPICC are intended to be applied worldwide, the PECL only target the countries of the European Community. In accordance with art 1:101, the PECL are to be applied as general rules of contract law in the Communities.[44] The purpose behind the adoption of the PECL was to launch the process of harmonisation of the law of contract within the European Communities. This aspiration was based upon the idea that a variety of laws stands in the way of European Economic Integration.[45] Quite naturally, the PECL have been designed as 'European law' because 'European communities [had] to be offered principles of contract law which [met] their requirements and those of the communities, and which [did] not have to pay heed to the traditions and views of nations with a political social and economic background widely different from that of the EEC countries'.[46] The purposes of the PECL have been formulated thus:

[37] Article 1.6(1) UPICC.
[38] Article 1.6(2) UPICC.
[39] Article 7.1(1) UPICC. The parties cannot limit or exclude this duty (art 7.1(2)).
[40] The Principles of European Contract Law (PECL) were prepared by the self-appointed Commission on European Contract Law (CECL), also referred to as the 'Lando Commission' in honour of its founder and chairman Professor Ole Lando. The Commission, which, in essence, represented a body of scholars, was set up and started its work in 1982. At present, the PECL consists of the following chapters: ch 1—'General Provisions'; ch 2—'Formation'; ch 3—'Authority of Agents'; ch 4—'Validity'; ch 5—'Interpretation'; ch 6—'Contents and Effects'; ch 7—'Performance'; ch 8—'Non-Performance and Remedies in General'; ch 9—'Particular Remedies for Non-Performance'; ch 10—'Plurality of Parties'; ch 11—'Assignment of Claims'; ch 12—'Substitution of New Debtor: Transfer of Contract'; ch 13—'Set-Off'; ch 14—'Prescription'; ch 15—'Illegality'; ch 16—'Conditions'; ch 17—'Capitalisation of Interest'.
[41] See Lando (n 6) 656.
[42] See Lando (n 7) 1019.
[43] See Bonell (n 5) 338.
[44] See art 1:101 PECL.
[45] See Lando (n 6) 658.
[46] *Ibid*, 656.

—to facilitate cross-border transactions with Europe;
—to strengthen the Single European Market;
—to create an infrastructure for Community laws governing contracts;
—to provide guidelines for national courts and legislatures and fill gaps in national laws;
—to construct a linkage between the Civil and the Common law;
—to provide a modern formulation of 'general principles of law' or *lex mercatoria* relating to contracts.[47]

Besides some differences in policy and purposes, there are a number of other differences between the PECL and the UPICC. Although the PECL are narrower in geographical scope, they are wider in some other respects. By contrast with the UPICC, which are concerned with 'international commercial contracts', the PECL apply to contracts in general, whether domestic or international, commercial or non-commercial.[48] There are also some differences in the way the rules of the applicability are formulated.[49] Article 1:101 PECL provides that:

(2) These Principles will apply when the parties have agreed to incorporate them into their contract or that their contract is to be governed by them.
(3) These Principles may be applied when the parties:
  (a) have agreed that their contract is to be governed by 'general principles of law', the 'lex mercatoria' or the like; or
  (b) have not chosen any system or rules of law to govern their contract.
(4) These Principles may provide a solution to the issue raised where the system or rules of law applicable do not do so.

The rules of interpretation and gap filling do not differ greatly from those in the UPICC. Article 1:106 PECL provides as follows:

(1) These Principles should be interpreted and developed in accordance with their purposes. In particular, regard should be had to the need to promote good faith and fair dealing, certainty in contractual relationships and uniformity of application.
(2) Issues within the scope of these Principles but not expressly settled by them are so far as possible to be settled in accordance with the ideas underlying the Principles. Failing this, the legal system applicable by virtue of the rules of private international law is to be applied.

Finally, just like the UPICC, the PECL impose duties of good faith and fair dealing on the parties.[50]

[47] Goode (n 28) 67.
[48] See Bonell (n 5) 348–9; Goode (n 28) 67.
[49] For a detailed comparison of contents of the UPICC and PECL, see Bonell (n 5) 339–52.
[50] Article 1:201 PECL.

5. PURPOSES, SCOPE, AND STRUCTURE OF THE BOOK

The focus of this book is on the remedy of damages for breach of contract under the CISG and, to a somewhat lesser extent, under the UPICC and PECL (hereafter referred to as the 'international instruments' or the 'instruments'). This focus also explains why the scope of the book is confined to international sales contracts. The purpose of the book is twofold. It aims, first of all, to provide a comprehensive examination of the remedy of damages taking into account the peculiarities stemming from the instruments' nature, purposes, underlying values and policies, principles and rules. At the same time, the book is as much about damages as it is about the life that the instruments thus far have had. The examination of the specific remedy of damages will undoubtedly shed some light on whether the instruments have been successful in meeting their drafters' expectations and, more importantly, in achieving their underlying purposes. There is little doubt that damages continue to be one of the main remedies for breach of contract as demonstrated by an increasing interest of lawyers throughout the civil and common law world.[51] Much of the interest stems from the reciprocal relationship between the law of damages and the wider policies and purposes pursued by the law. The examination of the law of damages helps identify the law's underlying purposes and values. As one commentator has noted, '[n]o aspect of a system of contract law is more revealing of its underlying assumptions than is the law that prescribes the relief available for breach'.[52] At the same time, however, it is our understanding of the law's values and policies that will often influence our judgements about how a particular problem on damages should be resolved. Lawyers' fascination with contract damages also emanates from their realisation of the important practical role that damages play. There can be little doubt that remedies, and damages in particular, are vital for the effective operation of contract law, for without them the law of contract would lose much of its force and value[53] and the market economy and trade, which the law of contract aims to support and facilitate,[54] would be substantially undermined.[55] Damages are also the most commonly claimed remedy for the simple reason that business persons are predominantly concerned with pecuniary matters and therefore aim to achieve the end results in monetary terms.[56]

[51] See D Saidov and R Cunnington, 'Current Themes in the Law of Contract Damages: Introductory Remarks' in D Saidov and R Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (Oxford, Hart Publishing, 2008) 1.

[52] EA Farnsworth, 'Damages and Specific Relief' (1979) 27 AJCL 247.

[53] See, eg, AL Corbin, *Corbin on Contracts: A Comprehensive Treatise on the Working Rules of Contract Law*, vol 5 (St Paul, Minn, West Publishing Co, 2002) 2.

[54] H Collins, *The Law of Contract*, 4th edn (London, Butterworths, 2003) 9; J Jackson, 'Global Economics and International Economic Law' (1998) 1 JIEL 1, 5; A Rosett, 'Unification, Harmonization, Restatement, Codification, and Reform in International Commercial Law' (1992) 40 AJCL 683.

[55] See ch 2 for further discussion of these ideas.

[56] See Saidov and Cunnington (n 51) 2.

While the book takes a largely practical perspective on damages, it is also based on the view that an understanding of the law's underlying considerations is vital for its proper application and in the case of the international instruments, for the goal of uniformity to be feasible. For this reason, besides analysing the ways in which the instruments have thus far been applied in various situational settings, this book develops the rationale for the instruments' provisions on damages and shows how an understanding of the underpinnings of a particular rule can be relevant to resolving specific and oftentimes technical questions on damages. While the problems arising under the instruments will often be similar to those addressed by domestic legal systems, international sales transactions do raise a number of legal issues which stem from the peculiarities of such transactions. For example, losses arising as a result of changes in the values of currencies are likely to arise much more frequently in international than in domestic transactions. Some types of loss, such as the injured seller's payment of penalty to state authorities for its non-return (or untimely return) of foreign currency due to the buyer's failure to pay, are altogether unlikely to arise from domestic sales contracts. Where damages are awarded to an injured party in a purely domestic transaction, the question of the currency in which damages are to be awarded is also unlikely to be relevant whereas this issue often arises in international transactions. A greater diversity of markets in the international arena, with the consequent idiosyncrasies emanating from the needs of different trade sectors, is an important consideration to be taken into account in calculating damages (eg, in terms of the definition of what constitutes a 'market', the questions of whether there is a relevant 'market' or 'current' price or what constitutes a reasonable time for making a substitute transaction).[57] Some domestic sales and contract regimes, such as English sales law, already have an immensely rich experience of dealing with international sales and in recent years there has been much discussion about whether the CISG is as well suited to governing the so-called 'trade in commodities' as is English law. It has been argued that while the CISG may be better suited to those trade sectors involving goods bought for commercial consumption, English law is a better law for commodity sales involving highly volatile markets where traders often enter into contracts for the purpose of speculation.[58] This debate touches upon a broad question potentially covering all aspects of sales law and engaging with it fully would lie outside the book's scope. Nevertheless, the debate was taken into account in the course of writing this book and some chapters (such as those dealing with

[57] See ch 8.

[58] See, eg, MG Bridge, 'A Law for International Sales' (2007) 37 Hong Kong L J 17; MG Bridge, 'Uniformity and Diversity in the Law of International Sale' (2003) 15 Pace Int'l L Rev 55; A Mullis, 'Avoidance for Breach under the Vienna Convention; A Critical Analysis of Some of the Early Cases' in M Andenas and N Jareborg (eds), *Anglo-Swedish Studies in Law* (Uppsala, Iustus Förlag, 1999) 326; cf P Schlechtriem, 'Interpretation, Gap-Filling and Further Development of the UN Sales Convention' <http://cisgw3.law.pace.edu/cisg/biblio/schlechtriem6.html>; I Schwenzer, 'Avoidance of the Contract in Case of Non-Conforming Goods (Article 49(1)(a) CISG)' (2005–2006) 25 J L Commerce 437.

the calculation of damages)[59] touch, to some extent, upon the question of how the CISG should be applied to certain situations arising in commodities trade. More generally, a detailed examination of the international instruments' remedy of damages will certainly contribute to the debate by demonstrating whether the way in which this remedy operates under the instruments is in line with the expectations, needs, and interests of traders in a particular sector.

The Convention's journey to uniformity has been anything but smooth and when it comes to damages there are many interrelated reasons for such a state of affairs. One is that the provisions lack specificity and it is not surprising that the interpretation of these general provisions by numerous fora worldwide has generated many inconsistent and conflicting results. Another reason relates to the quality and style of many of the reported decisions. In the absence of a centralised body responsible for giving authoritative interpretations, and considering the diversity of judicial styles and cultures,[60] it is quite often difficult to understand the rationale underlying a particular decision under the CISG,[61] not to mention those cases where the decisions do not even explain the facts with sufficient clarity and detail. This, coupled with the question of what value should be accorded to prior decisions of courts in other countries and various arbitration tribunals, has naturally hampered the emergence of a coherent and reasoned body of cases on damages which would send a clear signal to the commercial community as to what they could expect if they were to claim damages under the CISG. Despite these serious problems, this book's message is not that of despair and disappointment but, on the contrary, that of optimism and the recognition of the Convention's success as a major *truly international* commercial law instrument,[62] together with the realisation that much work needs to be done by *all* in the relevant legal community to help alleviate the existing difficulties. For one thing, as has been correctly pointed out by one commentator, the CISG does not mandate an 'absolutist approach to uniformity' but rather 'a process and a mind set'—a 'regard' for 'the need to promote uniformity'.[63] The

[59] See ch 8.

[60] See, eg, MG Bridge, 'Issues Arising under Articles 64, 72 and 73 of the United Nations Convention on Contracts for the International Sale of Goods' (2005–2006) 25 J L Commerce 405, 406.

[61] 'How can I write intelligently about case law from different national legal traditions when so many of those cases give sparse reasons for their decisions and often assert propositions in a conclusive, rather than a reasoned, way? . . . The fate of . . . laconic case law is to be banished from the main text of commentaries and consigned to an obscure place in the footnotes. If a more discursive style of judgment were to emerge, the case law would be enriched and the weight of the legal culture surrounding the Convention increased. It would no longer be possible, if it ever was, to classify cases as right or wrong. A more nuanced, relative reading would be required' (*ibid*, 406).

[62] See, eg, Goode, Kronke and McKendrick (n 2) 309 ('The CISG must be considered to be a considerable success. It has been ratified by most of the major trading nations of the world; it has been tested in thousands of cases and arbitral hearings in many of the world's jurisdictions and it has been the subject of exhaustive academic commentary . . . In general it can be said that the CISG has proved to be a workable instrument in practice which produces sensible results in the vast majority of cases'); R Goode, *Commercial Law in the Next Millennium* (London, Sweet & Maxwell, 1998) 95.

[63] HM Flechtner, 'The Several Texts of the CISG in a Decentralized System: Observations on Translations, Reservations and Other Challenges to the Uniformity Principle in Article 7(1)' (1998) 17 J L Commerce 187, 217, also at <http://www.cisg.law.pace.edu/cisg/biblio/flecht1.html>.

former approach would 'undermine the flexibility required to allow the CISG to deal with the vast diversity of trading conditions around the world . . . and . . . sacrifice the sometimes slow development of well-conceived and just principles to the false god of absolute uniformity'.[64] A true achievement of the CISG is its marking the first step towards spreading what has been called 'an international law methodology', that is:

> a methodology that, by mandating knowledge of and respect for (but not necessarily submission to) the perspectives of legal systems beyond one's national boundaries, clears the way for more ambitious ventures in international law. As Professor Honnold has written, 'international acceptance of the same rules gives us a common medium for communication—a *lingua franca*—for the international exchange of experience and ideas. It is not too much to expect that this dialogue will contribute to a more cosmopolitan and enlightened approach to law'.[65]

The skeleton structure of the Convention's provisions makes it necessary that the discussion on damages concentrates not on what is by now a superficial exercise of examining what the Convention says, for it is impossible to find 'the law on damages in the text of statutory rules',[66] but on testing how the CISG would apply to various factual settings.[67] To do so, this book relies not only on cases decided under the international instruments, but also on the 'rich storehouse of experience'[68] of major domestic legal systems. This comparative method is essential in at least two ways: first, the experience of domestic legal systems helps identify the kind of problems which need to be addressed; and secondly, it provides a range of possible solutions that can be used to resolve these problems. This comparative exercise may also be of use to those primarily interested in domestic regimes because a comprehensive analysis of the instruments' experience may equally reveal problems, questions, and solutions earlier unknown to a particular domestic system.[69]

The consideration of three international instruments will naturally involve the comparison among them and, particularly in relation to the CISG and UPICC, this exercise may have to go beyond a mere comparison. The reason is that, as noted above, the preamble to the UPICC provides that the Principles can be used to supplement uniform law instruments such as the CISG and the question arises as to the extent to which it is permissible to do so. The question

[64] *Ibid*. For a recent analysis of how flexible the CISG has been thus far, see S Eiselen, 'Adopting the Vienna Sales Convention: Reflections Eight Years down the Line' (2007) 19 SA Mercantile L J 14–17.

[65] *Ibid*.

[66] MG Bridge, 'The Market Rule of Damages Assessment' in Saidov and Cunnington (n 51) 435.

[67] '[A] true knowledge of this area of law can only derive from a clear understanding of the complexity and variety of problems surrounding modern commercial transactions' (Saidov and Cunnington (n 51) 4).

[68] The phrase is used in JS Ziegel, 'The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives' in Galston and Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (NY, Matthew Bender, 1984) 9-1, 9-2.

[69] See Saidov and Cunnington (n 51) 6.

is of great practical importance, particularly when it comes to damages for breach of contract. Since the UPICC contain, in most cases, more detailed provisions, allowing them to supplement the CISG would mean that the scope and coverage of the CISG would be considerably extended and the provisions which the Convention itself does not contain would, in effect, be read into it. The legitimacy of such an approach can be questioned on the following basis:

> The UNIDROIT Principles were, after all, drawn up subsequent to the coming into effect of the CISG and it is not altogether easy to see the basis on which it can be said that the interpretation of one Convention can be influenced by a document drawn up at a later point in time which does not itself have the force of law.[70]

It is suggested that simply because the UPICC state that they can be used to supplement uniform law instruments is not a sufficient and satisfactory basis for doing so. Nevertheless, the possibility of the supplementation cannot be ruled out altogether and it is submitted that in addressing the relationship between the two instruments, the first step is to consider whether the CISG is capable, by its own means of interpretation and gap filling, of resolving the issue *within its own framework*. Where this is possible, there is simply no need to supplement the CISG with the UPICC. It is only where no such possibility exists that the question of the supplementation is truly relevant. At this point, it may be convenient to distinguish between the situation where the instruments' provisions contain the same concepts but where the provisions of the UPICC are more detailed by setting out additional criteria and clarifying the meaning of a particular concept,[71] and the situation where the issue is a 'gap' under the CISG but which is addressed in the UPICC. Although in the former case the admissibility of supplementing the CISG with the provisions of the UPICC may be more appropriate, the issue in both cases is ultimately to be resolved on a case-by-case basis. The critical question should always be whether the provisions of the UPICC reflect or are based on the same general principles, ideas, legal structures, values and policies as those underlying the CISG. If so, then the supplementation would seem to be admissible. It has been argued that both instruments are based on the same ideas because the UPICC are 'a component part of the "general principles" underlying the Convention'[72] and this, with respect, is surely a step too far for it cannot be assumed that the UPICC as a whole reflect the

[70] See Goode, Kronke and McKendrick (n 2) 289–90; see also JY Gotanda, 'Using the UNIDROIT Principles to Fill Gaps in the CISG' in Saidov and Cunnington (n 51) 166 ('it goes too far to apply the UNIDROIT Principles as the primary source of authority for filling a gap in the CISG').

[71] One example relates to the instruments' provisions on fundamental breach (see arts 25 CISG, 7.3.1 UPICC). For the relevant discussion, see MJ Bonell, 'The UNIDROIT Principles of International Commercial Contracts and CISG—Alternatives or Complementary Instruments?' <http://www.cisg.law.pace.edu/cisg/biblio/ulr96.html>; cf R Koch, 'Commentary on Whether the UNIDROIT Principles of International Commercial Contracts May Be Used to Interpret or Supplement Article 25 CISG' <http://www.cisg.law.pace.edu/cisg/biblio/koch1.html#rki>.

[72] AM Garro, 'The Gap-Filling Role of the UNIDROIT Principles in International Sales Law: Some Comments on the Interplay between the Principles and the CISG' (1994–1995) 69 Tulane L Rev 1156.

Convention's general principles.[73] When it comes to damages for breach of contract, the UPICC potentially provide a lot of opportunities for supplementing the CISG. The analysis in this book, however, demonstrates that most unresolved problems on damages under the CISG (which are 'gaps' under the Convention but which are addressed by the UPICC) are perfectly capable of being resolved by the Convention itself. This relates to such issues as the problems of the recoverability of loss of a chance, future losses, damage to reputation and goodwill, standard of proof, the possibility of the exercise of judicial discretion and the currency in which damages are to be awarded. Therefore, it is submitted that in this context, there is not much room for supplementing the CISG with the UPICC. This does not, however, mean that there is no relationship between the CISG and the UPICC because the latter can still be of help by informing the meaning of, and helping add precision into, the formulation of the newly developed principles and rules under the CISG.[74]

The instruments' provisions on damages offer, by and large, only general guidance as to how the remedy of damages operates and it has been argued that such general rules (many of which have their roots in domestic regimes formed a long time ago) may no longer be adequate against the background of modern commercial practices, sophisticated transactions and the 'complex mathematical formulae used by economists in providing their calculation of damages'.[75] With this consideration in mind, this book takes account of some developments made in the area of the calculation of damages and generally places a substantial emphasis on this aspect of the law of damages.

So far as structure is concerned, the book begins by discussing the general aspects of the law of damages, which include a discussion of the definition and purposes of damages, the basis for the right to claim damages, basic principles underlying the award of damages and the idea of limiting damages.[76] The chapter on categories of loss[77] addresses the problem of the recoverability of different heads of loss and at the same time gives examples of various losses that can arise in international sales contracts. The following chapters examine the methods of limiting damages such as causation,[78] foreseeability[79] and mitigation.[80] The book concludes by exploring the problems of proving losses[81] and calculating damages.[82]

[73] See Gotanda (n 70); see also F Ferrari, 'General Principles and International Uniform Commercial Law Conventions: A Study of the 1980 Vienna Sales Convention and the 1988 UNIDROIT Conventions on International Factoring and Leasing' (1997) 2 Uniform L Rev 451, 459–60.

[74] For a similar view, see Gotanda (n 70).

[75] See A Komarov, 'The Limitation of Contract Damages in Domestic Legal Systems and International Instruments' in Saidov and Cunnington (n 51) 246.

[76] See ch 2.

[77] See ch 3.

[78] See ch 4.

[79] See ch 5.

[80] See ch 6.

[81] See ch 7.

[82] See chs 8 and 9.

Part I
General Part

2

General Part of the Law of Damages

1. DEFINITION AND PURPOSE OF DAMAGES

DAMAGES FOR BREACH of contract under the international instruments can be defined as a *monetary compensation for the loss suffered* by the injured party.[1] While it is easy to formulate the main purpose of damages in terms of compensation, it is much more difficult to implement this purpose. The difficulty stems from the problem of defining a loss and it is advocated that this problem must be addressed at different levels.[2] One level is that of different heads of loss and the question here is whether a particular type of loss is sufficiently real and important to qualify for legal protection. Another level is that of the dilemma, faced by every legal system, between the so-called 'concrete' and 'abstract' approaches to calculating damages. This dilemma also poses, in an acute form, questions about the role to be played by some of the methods of limiting damages such as mitigation or causation. The next level, which is interlinked with the previous two, relates to the nature and role of the 'performance interest' of the contract. Yet another level, which is again related to some of those already mentioned, centres on the extent to which the law should take into account any gains made by the breaching party as a result of the breach in calculating the loss suffered by the injured party. Each of the levels will be addressed in various parts of this book.

While compensation is undoubtedly the central purpose of damages under the instruments, from a policy perspective damages can also be said to pursue a number of other purposes. First, remedies in general, and damages in particular, have been said to serve the goal of keeping peace through the prevention of private wars. It has been suggested that if there were no remedies available, the injured parties could 'seek justice' by starting private wars against the parties in breach.[3]

[1] See arts 74 CISG, 7.4.2 UPICC and 9:502 PECL. For a discussion of the increasing difficulty of defining contract damages in some domestic legal systems, see H McGregor, *McGregor on Damages*, 17th edn (London, Sweet & Maxwell, 2003) 3 [1-001]; also D Saidov and R Cunnington, 'Current Themes in the Law of Contract Damages: Introductory Remarks' in D Saidov and R Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (Oxford, Hart Publishing, 2008) 9–12.

[2] This point has been made earlier in Saidov and Cunnington (n 1) 17.

[3] See AL Corbin, *Corbin on Contracts: A Comprehensive Treatise on the Working Rules of Contract Law*, vol 5 (St Paul, Minn, West Publishing Co, 2002) 29; AI Ogus, *The Law of Damages* (London, Butterworths, 1973) 5.

While preventing private wars may not be a serious concern in the context of international commercial transactions, this goal should not be dismissed as altogether irrelevant considering that commercial law plays an important role in terms of facilitating and supporting international trade which, in turn, is still often regarded as an important means of maintaining world peace and friendly relations amongst countries. By requiring '[i]nternational collaboration in the cause of uniformity', the international instruments can also be said to 'assist . . . mutual understanding and encourage . . . neighbourliness'.[4] Second, it seems clear that the existence of remedies, and in particular damages, is vital for the effective operation of contract law[5] and if no legal remedies were available, the market economy and international trade which the contract law aims to support[6] would be substantially undermined. Third, in the light of a general need for security in commercial transactions and the instruments' values of *pacta sunt servanda* (contract must be performed)[7] and *favour contractus* (keeping the contract in existence as long as possible)[8] the goal of deterring the parties from breaching their contracts is undoubtedly a valuable one. Although the extent to which damages have an effect of deterring the parties from breaching the contract is disputed,[9] damages, being in a sense a legal sanction for breach, may

[4] MG Bridge, 'Uniformity and Diversity in the Law of International Sale' (2003) 15 Pace Int'l L Rev 55, 56.

[5] '[W]here no remedy is provided, there is neither right nor duty . . . [The recognition of rights and duties] is made effective by providing and enforcing a remedy for breach. Until this has been done, there is no sufficient reason for saying that rights and duties exist as a part of any legal system' (Corbin (n 3) 2); B Coote, 'Contractual Damages, *Ruxley*, and the Performance Interest' (1997) 56 Cambridge LJ 537, 541.

[6] H Collins, *The Law of Contract*, 4th edn (London, Butterworths, 2003) 9; J Jackson, 'Global Economics and International Economic Law' (1998) 1 JIEL 1, 5; A Rosett, 'Unification, Harmonization, Restatement, Codification, and Reform in International Commercial Law' (1992) 40 AJCL 683.

[7] See art 1.3 UPICC and comment thereon; although the rule is not expressly mentioned in the CISG and PECL, there is no doubt that it is implicit in these instruments (see, eg, arts 30, 53, 79 CISG and 6:111 PECL; see also U Magnus, 'General Principles of UN-Sales Law' <http://www.cisg.law.pace.edu/cisg/text/magnus.html>; P Huber, 'CISG—The Structure of Remedies' (2007) 71 Rabels Zeitschrift für ausländisches und internationales Privatrecht 13, 17–20; O Lando, 'Salient Features of the Principles of European Contract Law: A Comparison with the UCC' (2001) 13 Pace Int'l L Rev 339, 343–4, 360–1).

[8] MJ Bonell, 'Art. 7 CISG' in CM Bianca and MJ Bonell, *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Milan, Giuffrè, 1987) 80; MJ Bonell, *An International Restatement of Contract Law: The UNIDROIT Principles of International Commercial Contracts*, 3rd edn (Ardsley, NY, Transnational PublishersInc, 2005) 102–26; JM Perillo, 'UNIDROIT Principles of International Commercial Contracts: The Black Letter Text and a Review' (1994) 63 Fordham L Rev 281, 303; Lando (n 7) 360–1.

[9] The ability of damages to deter a breach and to induce performance has been doubted for many reasons. One argument is that it is not a formal legal sanction that deters a breach but various non-legal sanctions (eg, reputational loss) that have a true deterrent effect (see H Collins, *Regulating Contracts* (Oxford, OUP, 1999) 97–126; CP Gillette, 'Reputation and Intermediaries in Electronic Commerce' (2001–2002) 62 La L Rev 1165; L Bernstein, 'Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry' (1992) 21 JLS 115; L Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms, and Institutions' (2000–2001) 99 Mich L Rev 1724). Another argument is that a need to establish the preconditions for an award of damages and uncertainties involved in proving losses may in fact create

nevertheless have a deterrent effect.[10] Fourth, it is submitted that economic considerations of wealth maximisation and economic efficiency are not irrelevant to the international instruments and arguably constitute an important part of a set of values that the instruments aim to promote.[11] The value of free trade, which the international instruments are intended to facilitate, is often justified from the standpoint of efficient allocation of resources.[12] In addition, the goals of uniformity and harmonisation pursued by the instruments are believed to encourage trade by means of reducing transaction costs.[13] Specific principles and rules underlying the law of damages such as the protection of the expectation/performance interest, foreseeability and mitigation are also said to be in line with the goal of efficient allocation of resources.[14] Therefore, there is little doubt that, at least to some extent, the remedy of damages can be justified from the law and economics perspective. It would seem, however, that not all components of the traditional law and economics analysis would be acceptable to the ethos of the international instruments. This relates to the doctrine of 'efficient breach', which refers to a situation where it is *efficient* for a party to breach its contract because by doing so it will be able to fully compensate the injured party for the loss suffered and still be left with a benefit greater than that which it would have received had it performed the contract.[15] This doctrine, it is suggested, does not sit easily with the already-mentioned values, underlying the instruments, of *pacta sunt servanda* and *favour contractus*. Finally, it needs to be remembered that sales contracts are not only concerned with the passage of property in the goods but they also perform an important function of allocating market risks[16] and the

incentives to break a contract (see D Harris, 'Incentives to Perform, or Break Contracts' (1992) 45 Current Legal Problems 29). From the law and economics perspective, it has been argued that the 'expectation' measure often encourages a party to breach the contract where, by doing so, it will be able to fully compensate the other party for the loss suffered *and* to be left with a greater gain than it would have received had it performed the contract ('efficient breach' doctrine) (for recent descriptions of this perspective, see AI Ogus, 'The Economic Basis of Damages for Breach of Contract: Inducement and Expectation' in Saidov and Cunnington (n 1) 126–9; D Harris, D Campbell and R Halson, *Remedies in Contract and Tort*, 2nd edn (Cambridge, CUP, 2002) 77).

[10] See R Demogue, 'Validity of the Theory of Compensatory Damages' (1917–1918) 27 Yale L J 591; for a similar view, see Corbin (n 3) 29.

[11] 'Ultimately, it is economics that drives the demand for international trade, and international trade that drives the demand for transnational contract law. International legal institutions should accordingly attend to the economic underpinnings of the transactions they govern, in order to facilitate their underlying purposes' (AW Katz, 'Remedies for Breach of Contract under the CISG' (2006) 25 Int'l Rev L Economics 378, 394).

[12] See, eg, JH Jackson, WJ Davey and AO Sykes, Jr, *Legal Problems of International Economic Relations: Cases, Materials and International Regulation of Transnational Economic Relations*, 3rd edn (St Paul, Minn, West Publishing Co, 1995) 7–14.

[13] For a recent critical analysis, see G Cuniberti, 'Is the CISG Benefiting Anybody?' (2006) 39 Vanderbilt J Transnational L 1511.

[14] See the respective parts of the book where each of these rules is discussed.

[15] For a recent overview, see Ogus (n 9).

[16] 'The function of contract has shifted: instead of simply being the method of transferring title to specific property, a contract promising future delivery became a means of ensuring an expected future market return. Executory contracts became important as instruments for futures agreements, designed to transfer risk from those wishing to insure against market fluctuations in supply and price

remedy of damages plays an important role in ensuring that such risks are allocated in accordance with policies and values pursued by the instruments.

2. BASIS FOR THE RIGHT TO CLAIM DAMAGES

2.1 General

A claim for damages can arise in several types of case which include situations involving a breach of contract, problems of validity of the contract,[17] and pre-contractual relationships.[18] This work is only concerned with claims arising from a breach of contract. To have the right to claim damages for breach of contract, the injured party must prove that: the other party has committed a *breach* of contract; it has suffered *loss*, recognised by the instruments as recoverable; and the alleged loss has occurred *as a consequence of the breach*. The loss will be recovered only to the extent to which it was foreseeable by the breaching party at the time of the conclusion of the contract and the burden of proving foreseeability lies with the injured party.[19] The injured party is also required to take all reasonable steps to mitigate its loss and this requirement is a further limitation on the award of damages. In contrast with the foreseeability requirement, it is the breaching party who bears the initial burden of proving the injured party's failure to mitigate.[20] The issues of recoverable heads of loss, causation, foreseeability, mitigation and proof will be considered in later chapters of the book. This section only aims to make a few remarks in relation to the breach of contract as a basis for the right to claim damages.

to those wishing to speculate' (D Simon and GA Novack, 'Limiting the Buyer's Market Damages to Lost Profits: Challenge to the Enforceability of Market Contracts' (1978–1979) 92 Harvard L Rev 1395, 1399). See also MR Cohen, 'The Basis of Contract' (1932–1933) 46 Harvard L R 584–5.

[17] The issues of validity are outside the scope of the CISG (see art 4); see ch 3 UPICC (on the measure of damages, see art 3.18); see ch 4 PECL (on the measure of damages see art 4:117).

[18] See arts 2.1.15, 2.1.16 UPICC and 2:301, 2:302 PECL. For the discussion of legal issues which may arise in the course of pre-contractual dealings, see J Dietrich, 'Classifying Precontractual Liability: A Comparative Analysis' (2001) 21 LS 156; EA Farnsworth, 'Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations' (1987) 87 Columbia L Rev 217; F Kessler and E Fine, 'Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study' (1963–1964) 77 Harvard L Rev 401; NE Nedzel, 'A Comparative Study of Good Faith, Fair Dealing, and Precontractual Liability' (1997) 12 Tulane European Civil L Forum 97. The prevailing view is that the issue of pre-contractual liability is outside the scope of the CISG (see, eg, H Stoll and G Gruber, 'Arts. 74–77 CISG' in P Schlechtriem and I Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods*, 2nd English edn (Oxford, OUP, 2005) 751–2 with further references; *cf* DM Goderre, 'International Negotiations Gone Sour: Precontractual Liability under the United Nations Sales Convention' (1997) 66 U Cincinnati L Rev 257, 274–80; J Klein and C Bachechi, 'Precontractual Liability and the Duty of Good Faith Negotiation in International Transactions' (1994–1995) 17 Houston J Int'l L 1, 19–26).

[19] See ch 5.

[20] See ch 6.

In contrast with some civil law systems,[21] the international instruments rely upon a comprehensive and uniform concept of breach (or non-performance) of contract: *any* breach or non-performance[22] gives an aggrieved party the right to claim damages. According to the CISG, '[i]f the seller fails to perform any of his obligations under the contract or this Convention, the buyer may . . . claim damages as provided for in articles 74 to 77'.[23] Similarly, '[i]f the buyer fails to perform any of his obligations under the contract or this Convention, the seller may . . . claim damages as provided in articles 74 to 77'.[24] The UPICC provide that '[a]ny non-performance gives the aggrieved party a right to damages either exclusively or in conjunction with any other remedies'[25] and likewise, the PECL state that '[t]he aggrieved party is entitled to damages for loss caused by the other party's non-performance'.[26] The character and gravity of the breach or its consequences are of no legal significance so far as the right to claim damages is concerned.

2.2 The role of fault

In contrast with some civil law systems,[27] the party's right to damages under the instruments does not depend on whether the breaching party was at fault when

[21] See GH Treitel, *Remedies for Breach of Contract: A Comparative Account* (Oxford, Clarendon Press, 1988) 129; J Basedow, 'Towards a Universal Doctrine of Breach of Contract: The Impact of the CISG' (2005) 25 Int'l Rev L Economics 487, 489–91.

[22] The CISG uses term 'breach' or 'failure to perform' and the UPICC and the PECL use the term 'non-performance'.

[23] Article 45(1)(b) CISG; see also Case No 10 Ob 518/95 Supreme Court (Austria) 6 February 1996 (Propane case) <http://cisgw3.law.pace.edu/cases/960206a3.html>; Case No 8 U 46/97 Appellate Court Zweibrücken (Germany) 31 March 1998 (Vine wax case) <http://cisgw3.law.pace.edu/cases/980331g1.html>; Case No 4 O 113/90 District Court Baden-Baden (Germany) 14 August 1991 (Wall tiles case) <http://cisgw3.law.pace.edu/cases/910814g1.html>.

[24] Article 61(1)(b) CISG; see also Case No 2 U 27/99 Appellate Court Braunschweig (Germany) 28 October 1999 (Frozen meat case) <http://cisgw3.law.pace.edu/cases/991028g1.html>; Case No 43 O 136/92 District Court Aachen (Germany) 14 May 1993 (Electronic hearing aid case) <http://cisgw3.law.pace.edu/cases/930514g1.html>.

[25] Article 7.4.1 UPICC.

[26] Article 9:501 PECL; see also art 8:101 providing that '[w]henever a party does not perform an obligation under the contract and the non-performance is not excused under Art 8.108, the aggrieved party may resort to any of the remedies.'

[27] '[T]he contract in the civil law world primarily is a mutual promise of a certain behaviour whereas the common law would consider the contract rather as a guarantee made by each party of the result achieved by the performance of its undertaking. What the party owes under common law is a certain state of affairs, while the obligation is directed towards a certain behaviour in civil law jurisdictions. Consequently, the breach of contract under common law consists in the divergence between the result promised under the contract and the real state of affairs, it is a matter of objective assessment. In itself, this divergence is not sufficient to qualify as a breach in the perspective of civil law jurisdictions; since the obligation is focused on the debtor's behaviour a breach can only be assessed if the debtor could reasonably have been expected to behave in a different way. Therefore, the fault principle is often considered to be an indispensable part of the law of obligations in civil law countries' (Basedow (n 21) 495 with further reference).

committing a breach.[28] Nevertheless, it is worth pointing out that some of the elements, of which the notion of fault is said to consist, may play a role in determining whether a breach of contract has occurred. In those legal systems which utilise the concept of fault, two forms of fault are identified: actual fault and negligence.[29] The former is fault in the subjective sense because it refers to the breaching party acting intentionally or deliberately.[30] The latter, which in different systems can have different degrees,[31] is regarded as fault in the objective sense: it denotes a failure to exercise the required degree of care or skill.[32] Actual fault (in the subjective sense) looks at the actual intent of the party while negligence (fault in the objective sense) requires the compliance with a certain standard of conduct and this means that 'a defendant may . . . be liable even though he was not guilty of any actual (or subjective) fault'.[33] With regard to the question of whether a breach, to form the basis for the right to claim damages, must be accompanied by fault, it is the notion of fault in the objective sense that may be a relevant consideration. To see why this is the case, it needs to be pointed out that the UPICC distinguish between a duty 'to achieve a specific result' and a duty 'to exert best efforts': 'To the extent that an obligation of a party involves a duty to achieve a specific result, that party is bound to achieve that result'[34] and '[t]o the extent that an obligation of a party involves a duty of best efforts in the performance of an activity, that party is bound to make such efforts as would be made by a reasonable person of the same kind in the same circumstances'.[35] This distinction has its roots in French law,[36] where a failure to comply with the duty of best efforts (*obligation de moyen*)—that is, to show 'the degree of care to be expected of a reasonable person'[37]—is regarded as fault in the objective sense.[38] Clearly, the same line of reasoning is applicable to the

[28] See, eg, Stoll and Gruber (n 18) 750.

[29] Treitel (n 21) 8, 11–13; MI Braginskiy and VV Vitryanskiy, *Contract Law*: *General Provisions* (*Dogovornoye pravo: Obshiye polozheniya*) (Moscow, Statut, 1998) 595–97, 613.

[30] Treitel (n 21) 12; Braginskiy and Vitryanskiy (n 29) 595, 613. For example, in the Russian doctrine of civil law 'wilful fault' is defined as 'intentional acts or failure to act with a view not to perform an obligation or not to perform an obligation properly' (*ibid*, 613) (translation of the author).

[31] 'Civil law systems . . . distinguish between ordinary (or 'slight') and gross negligence' (Treitel (n 21) 11); also Braginskiy and Vitryanskiy (n 29) 595, 613.

[32] Treitel (n 21) 11–12; Braginskiy and Vitryanskiy (n 29) 595, 613.

[33] Treitel (n 21) 12.

[34] Article 5.1.4(1) UPICC.

[35] Article 5.1.4(2) UPICC.

[36] See M Fontaine, 'Content and Performance' (1992) 40 AJCL 648. For the discussion of the classification in French law, see B Nicholas, *The French Law of Contract*, 2nd edn (Oxford, Clarendon Press, 1992) 50–56; B Nicholas, 'Rules and Terms—Civil and Common Law' (1973–1974) 48 Tulane L R 946, 952–5; Treitel (n 21) 9–10. This distinction is also used in a number of other legal systems (see note 2 in Comment to art 8:101 in O Lando and H Beale (eds), *Principles of European Contract Law: Parts I and II* (prepared by the Commission on European Contract Law (The Hague, Kluwer Law International, 2000) 361).

[37] Treitel (n 21) 11.

[38] See Treitel (n 21) 9 ('A party claiming damages for breach of [*obligation de moyens*] must prove that the other party was guilty of fault'); Nicholas (n 36) 52; ICC Arbitration Case No 7006 of 1992 (decided on the basis of French law) (in *Collection of ICC Arbitral Awards: 1991–1995: Recueil des Sentences Arbitrales de la CCI 1991–1995*, compiled by JJ Arnaldez Y Derains and

UPICC: to prove a breach of duty of 'best efforts' it must be demonstrated that the other party's conduct was not in compliance with the standard fixed in the UPICC, namely 'such efforts as would be made by a reasonable person of the same kind in the same circumstances'.[39] Therefore, in essence, proving a breach of duty of 'best efforts' under the UPICC will be similar to what French law would refer to as proving the other party's *fault* in the objective sense. Contracts governed by the CISG[40] and PECL[41] may also contain obligations of 'best efforts' and, where this is the case, establishing a breach of such an obligation will also involve demonstrating what some legal systems would regard as objective fault.

There may also be cases, governed by the instruments, where fault becomes relevant by virtue of the parties' agreement: because parties are free to derogate from the instruments' provisions,[42] they can include, in their contract, some additional preconditions for the right to claim damages such as fault. In one case under the CISG,[43] the seller's warranty terms, which were a part of the contract, provided that the buyer could not have the right to claim damages for non-conformity in the goods, unless 'the damage resulted from or . . . the defect resulted from *wilful or harshly negligent* action on [the seller]'s side'. Notwithstanding the Convention's principle of strict liability, the court had to treat fault as a necessary prerequisite for the right to claim damages by stating that 'the parties are free to agree on the content of the warranty and its effect on the liability for non-conformity'.[44]

2.3 Anticipatory breach

The instruments recognise not only the breach which has *actually* occurred but also 'anticipatory breach'[45] or 'anticipatory non-performance'.[46] This refers to a situation where *before* the due date the innocent party has grounds to expect that the other party's performance *at* the due date will not be forthcoming. The

D Hascher (The Hague, Kluwer Academic Law Publishers, 1997) 203); F Werro and EM Belser, 'Switzerland' in MJ Bonell (eds), *A New Approach to International Commercial Contracts: The UNIDROIT Principles of International Commercial Contract* (The Netherlands, Kluwer Law International, 1999) 368 ('When . . . the obligor merely owes her best efforts, proof of non-performance overlaps with the proof of the obligor's fault').

[39] Article 5.1.4(2) UPICC.

[40] See also B Nicholas, 'Fault and Breach of Contract' in J Beatson and D Friedmann (eds), *Good Faith and Fault in Contract Law* (Oxford, Clarendon Press, 1995) 352 (interpreting art 60 CISG as containing an obligation of best efforts).

[41] See Comment on Article 5:101 PECL in Lando and Beale (n 36) 286.

[42] See art 6 CISG, art 1.1 UPICC and art 1:102 PECL.

[43] Turku Court of Appeal (Finland) 12 April 2002 (Forestry equipment case) <http://cisgw3.law.pace.edu/cases/020412f5.html>.

[44] See also Arbitration proceeding Case No 48 of 2005 (Ukraine) <http://cisgw3.law.pace.edu/cases/050000u5.html>.

[45] The term used in the CISG.

[46] The term used in the UPICC and in the PECL.

recognition of 'anticipatory breach' makes it possible for a party to be held liable even before the date when the performance of this obligation is due.[47] The concept of anticipatory breach forms the basis of several provisions in the CISG. First, according to art 71, 'if after the conclusion of the contract, it becomes apparent that the other party will not perform a substantial part of his obligations',[48] the innocent party is entitled to suspend its obligations.[49] Article 71(2) also provides for a remedy, specifically designed for the seller, of preventing the handing over of the goods to the buyer if the seller had dispatched the goods before it knew of the grounds indicating danger of a future 'substantial non-performance'. The party suspending performance also has an obligation to 'immediately give notice of the suspension to the other party and [to] continue with performance if the other party provides adequate assurance of his performance'.[50] Second, according to art 72(1), '[i]f prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach of contract, the other party may declare the contract avoided'.[51] The article further provides that '[i]f time allows, the party intending to declare the contract avoided must give reasonable notice to the other party in order to permit him to provide adequate assurance of his performance'.[52] This requirement, however, will not apply 'if the other party has declared that he will not perform his obligations'.[53] It is submitted that anticipatory breach can constitute a basis for claiming damages in cases where the innocent party *avoids* the contract under art 72(1).[54] Where, however, the contract is not or cannot be avoided under art 72(1), no right to claim damages should be available for two reasons. First, it is only the avoidance of the contract that crystallises the parties' legal positions in the sense that neither party can change its mind: if the contract remains in existence there is still a possibility that the party under suspicion will be able to perform and claiming damages at a stage where the parties' legal positions have not yet crystallised may be unjustified. Allowing a claim for damages *only* where

[47] For the discussion of the concept of anticipatory breach, see JC Gulotta, Jr, 'Anticipatory Breach—A Comparative Analysis' (1976) 50 Tulane L Rev 927; MG Strub, 'The Convention on the International Sale of Goods: Anticipatory Repudiation Provisions and Developing Countries' (1989) 38 ICLQ 475; D Saidov, 'Anticipatory Non-Performance and Underlying Values of the UNIDROIT Principles' (2006) 11 Uniform L Rev 795.

[48] The criteria for determining whether there is a danger of a future 'substantial non-performance' are 'a serious deficiency in [the other party's] ability to perform or [this party's] creditworthiness; [the other party's] conduct in preparing to perform or performing the contract' (art 71(1)(a) and (b)).

[49] See art 71(1); suspension must be understood as meaning not only actual performance, but also preparation to perform (see P Schlechtriem, *Uniform Sales Law: The UN-Convention on Contracts for the International Sale of Goods* (Vienna, Manz Verlag, 1986) 93).

[50] Article 71(3).

[51] Article 72(1).

[52] Article 72(2) CISG.

[53] Article 72(3) CISG.

[54] See also art 73 CISG. The arguments are based on those developed in the context of the common law in Q Liu, 'Claiming Damages upon an Anticipatory Breach: Why Should an Acceptance Be Necessary?' (2005) 25 LS 559, 566.

the contract has been avoided helps achieve finality and certainty in resolving disputes. Second, as has been argued in the common law, the innocent party cannot be allowed to claim damages for loss of a bargain while maintaining that the other party must still perform the contract. It is also important to reiterate that while the innocent party has the right to suspend its performance of the contract, it must immediately give notice of suspension to enable the other party to provide adequate assurance of performance. Failure to do so is a sufficient basis for that other party to claim damages.[55] The same can be said about the notification requirement in art 72(2) CISG.[56]

The UPICC and PECL also enable an innocent party to suspend performance[57] or terminate the contract[58] in cases of anticipatory non-performance. Insofar as the right to damages is concerned, it is submitted, for the reasons given above, that damages can only be claimed where the contract has been terminated.

3. BASIC MEASURE OF DAMAGES

3.1 General

The basic measure of damages establishes the principle(s) by reference to which the amount of compensation is to be determined. The measure expressly provided for by the instruments is that the injured party is entitled to damages for the loss suffered including loss of profit (or gains prevented).[59] In addition, the PECL also state that '[t]he 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'.[60] The former principle, known as the principle of 'full compensation',[61] has its roots in Roman law, where recoverable damages were classified as both *damnum emergens* (actual loss) and

[55] See Netherlands Arbitration Institute Case No 2319, decision dated 15 October 2002 (Condensate crude oil mix case) <http://cisgw3.law.pace.edu/cases/021015n1.html>.

[56] See Strub (n 47) 498.

[57] Article 7.3.4 UPICC (first sentence): 'A party who reasonably believes that there will be a fundamental non-performance by the other party may demand adequate assurance of due performance and may meanwhile withhold its own performance'; art 9:201(2) PECL: 'A party may similarly withhold performance for as long as it is clear that there will be a non-performance by the other party when the other party's performance becomes due.'

[58] Article 7.3.3 UPICC: 'Where prior to the date for performance by one of the parties it is clear that there will be a fundamental non-performance by that party, the other party may terminate the contract' (see also art 7.3.4 UPICC second sentence); art 9:304: 'Where prior to the time for performance by a party it is clear that there will be a fundamental non-performance by it the other party may terminate the contract.'

[59] See arts 74 CISG, 7.4.2 UPICC, 9:502 PECL.

[60] Article 9:502 PECL.

[61] See, eg, arts 14 of the Civil Code of Uzbekistan and 15 of the Civil Code of the Russian Federation; see also Braginskiy and Vitryanskiy (n 29) 516; AP Sergeyev and YK Tolstoy, *Civil Law* (*Grazhdanskoye pravo*) Part 1 (Moscow, Prospect Publishing House, 1998) 554.

lucrum cessans (lost profit),[62] and is widely used by many civil law systems.[63] The principle is relatively simple—an injured party is entitled to claim *full* compensation for the losses it has suffered and gains of which it was deprived as a result of the breach. This simplicity probably explains why such little attention has been paid to the discussion of this principle in civil law.[64] The latter principle, known as the protection of the 'expectation',[65] 'performance',[66] or 'positive'[67] interest, derives from those legal systems (mainly those of the common law)[68] which view 'the remedies for breach of contract through the "interests" that the remedies serve to protect'.[69] The protection of the expectation/performance interest compensates the injured party for loss of the bargain.[70] Suppose that A contracts with B to manufacture and sell a piece of machinery for £100,000. The cost of manufacture is £80,000, but before A incurs any costs B refuses to perform. The 'net' profit that A expected to gain from the contract was £20,000 and the protection of the expectation/performance interest would lead to the award of £20,000 because this is the amount A would have been left with had B performed the contract. Despite different formulations of the basic measure of damages, there is no doubt that both the principle of full compensation and the protection of the expectation/performance interest are based on the very same idea:[71] it is only by being *fully* compensated for its loss (including loss of profit) that the party is placed in the position in which it would have been had the contract been performed.[72] This explains why art 74 CISG, for example, has

[62] See IS Peretyorskiy and IB Novitskiy, *Roman Private Law* (*Rimskoye Chastnoye Pravo*) (Moscow, Yurist, 1999).

[63] See Lando and Beale (n 36) 439. See also art 14 of the Civil Code of the Republic of Uzbekistan and art 15 of the Civil Code of the Russian Federation.

[64] See, eg, Nicholas (n 36) 226 (stating that French writers make nothing of the distinction between *damnum emergens* and *lucrum cessans*).

[65] See LL Fuller and WR Perdue, Jr, 'The Reliance Interest in Contract Damages' (1936) 46 Yale L J 53. The term 'expectation interest' has been heavily criticised: 'The expectation interest is simply an inappropriate term describing the performance interest . . . If we understand 'interest' to reflect the purpose or the reason for entering the contract, then performance is the only genuine contractual interest.' 'Expectancy' is often used to describe a prospect or a probability of receiving a benefit in the future, *when this possibility is not supported by a legal right*' (D Friedmann, 'The Performance Interest in Contract Damages' (1995) 111 LQR 628, 632, 634).

[66] See Friedmann (n 65).

[67] See Lando and Beale (n 63) 439.

[68] See *Robinson v Harman* (1848) 1 Exch 850; s 1-106 UCC; s 344(a) Restatement the Second of Contracts.

[69] A Burrows, 'Contract, Tort and Restitution—A Satisfactory Division or Not?' (1983) 99 LQR 218. In the English common law, the principle of putting the injured party in the position in which it would have been had the contract been properly performed had existed before it was labelled as the protection of the 'expectation' or 'performance' interest (see *Robinson v Harman* (n 68)).

[70] See Treitel (n 21) 82.

[71] '[Art 9:502] combines the widely accepted "expectation interest" basis of damages and the traditional rule of "*damnum emergens*" and "*lucrum cessans*" of Roman law' (Lando and Beale (n 36) 437).

[72] This statement finds support in Roman law where the formula, based on the distinction between *damnum emergens* and *lucrum cessans* ('interesse') meant the 'difference' between the position of the creditor in which it would have been had the obligation been performed and the actual position in which it found itself as a result of the breach (see Peretyorskiy and Novitskiy (n 62)). The

been interpreted as being based on both the principle of full compensation[73] and the protection of the expectation/performance interest.[74] A convenient way of conceptualising the relationship between the two principles is to view the protection of the expectation/performance interests as the *aim* that the remedy of damages seeks to achieve whilst treating the principle of full compensation as the *means* of achieving that aim.[75]

The aim of protecting the expectation/performance interest has been justified by reference to a number of reasons. First, the binding nature of the contract suggests that the party has a *legal right* to the other party's performance of an obligation. If the obligation is not performed, it arguably flows from the innocent party's legal right to the performance that damages must be measured with reference to the value of that obligation. There is little doubt that 'the very recognition of a legal right entails some consequences regarding the remedy, one of which relates to the initial point of inquiry. This initial point relates to the value of legal right.'[76] It is suggested that this reason in itself is sufficiently strong to justify the goal of protecting the expectation/performance interest.[77] Second, this goal has been justified from the standpoint of the morality of promise keeping. It has been said, for example, that 'promises are sacred *per se*, that there is something inherently despicable about not keeping a promise, and a properly organized society should not tolerate this . . . [C]ommon sense does generally find something revolting about the breaking of a promise, and this, if a fact, must be taken into account by the law.'[78] It follows from this view that because

basic measure under the CISG is sometimes interpreted in the same way (see Stoll and Gruber (n 18) 746 with further references).

[73] See, eg, V Knapp, 'Arts. 74–77 CISG' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Giuffrè, Milan 1987) 543; Stoll and Gruber (n 18); E Visser, 'Gaps in the CISG: In General and with Specific Emphasis on the Interpretation of the Remedial Provisions of the Convention in the Light of the General Principles of the CISG' <http://www.cisg.law.pace.edu/cisg/biblio/visser.html>; Vienna Arbitration proceeding SCH–4318, decision dated 15 June 1994 (Rolled metal sheets case) <http://cisgw3.law.pace.edu/cases/940615a4.html>; Vienna Arbitration proceeding SCH–4366, decision dated 15 June 1994 (Rolled metal sheets case) <http://cisgw3.law.pace.edu/cases/940615a3.html>; ICC Arbitration Case No 7585 of 1992 (*Foamed board machinery*) <http://cisgw3.law.pace.edu/cases/927585i1.html>.

[74] Commentary to art 70 of the 1978 Draft, para 3; Knapp (n 73) 543; JO Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention*, 3rd edn (Deventer, Kluwer Law International, 1999) 445; JS Sutton, 'Measuring Damages under the United Nations Convention on the International Sale of Goods' (1989) 50 Ohio State L J 737, also at: <http://www.cisg.law.pace.edu/cisg/biblio/sutton.html>; EC Schneider, 'Measuring Damages under the CISG' <http://www.cisg.law.pace.edu/cisg/text/cross/cross-74.html>.

[75] For further discussion of the relationship between the two principles, see Nicholas (n 64) 226 and D Tallon, 'French Report' in D Harris and D Tallon (eds), *Contract Law Today: Anglo-French Comparisons* (Oxford, Clarendon Press, 1991) 274.

[76] See Friedmann (n 66) 637.

[77] For a similar position, see A Von Mehren, 'General View of Contract' in *International Encyclopedia of Comparative Law* (vol VII, 1981) 92.

[78] Cohen (n 16) 571–2. See also C Fried, *Contract as a Promise: A Theory of Contractual Obligation* (Cambridge, Mass, Harvard University Press, 1981).

a promise and the innocent party's expectations are important, the law should provide the party with the value of the broken promise. The third justification which places an emphasis not on the morality of a promise, but on the psychological expectation of the innocent party, has been described thus: 'The breach of a promise arouses in the promise a sense of injury . . . [T]he promise has formed an attitude of expectancy such that a breach of the promise causes him to feel that he has been "deprived" of something which was "his".'[79] However, as the proponents of this view recognise, this argument cannot fully justify the protection of the expectation/performance interest because no legal system protects every kind of promise and every kind of expectation.[80] Another justification is that since 'expectation damages' provide the injured party with the benefit of the bargain, the remedy of damages based on the protection of the expectation/performance interest increases security in commercial transactions by reducing the risks associated with the breach of contract and encourages contracting and exchange.[81] This, in turn, provides the necessary support for the workings of the market economy by making it possible for goods and services to end up where they are valued most.[82] In a similar vein, it can be argued that the protection of the expectation/performance interest is essential for maintaining the system of credit which has become such an important part of the economic system in the modern world:

> The essence of a credit economy lies in the fact that it tends to eliminate the distinction between present and future (promised) goods. Expectations of future values become, for purposes of trade, present values. In a society in which credit has become a significant and pervasive institution, it is inevitable that the expectancy created by an enforceable promise should be regarded as a kind of property, and breach of the promise as an injury to that property. In such a society the breach of a promise works an 'actual' diminution of the promisee's assets—'actual' in the sense that it would be so appraised according to modes of thought which enter into the very fiber of our economic system.[83]

Protecting the party's expectation/performance interest has also been encouraged from the law and economics perspective. One reason is that the economic goal of wealth maximisation requires that resources be put to their most valuable use and, as noted, 'expectation' damages aim to do just that. In other words, because a voluntary exchange is usually thought to lead to an efficient allocation of resources, 'expectation damages' play an important role in achieving such an allocation by providing incentives for the parties to enter into

[79] Fuller and Perdue (n 65) 57.

[80] See *ibid*, 57–8.

[81] See, eg, DW Barnes, 'The Net Expectation Interest in Contractual Damages (1999) 48 Emory L J 1159–60.

[82] See A Burrows, *Remedies for Torts and Breach of Contract*, 3rd edn (Oxford, OUP, 2004) 36; Fuller and Perdue (n 65) 60–62.

[83] Fuller and Perdue (n 65) 59.

transactions.[84] A further reason relates to the doctrine of 'efficient breach', an important part of the economic analysis of contract law. For a breach to be efficient, not only must the breaching party be made better off but also no one must be made worse off (Pareto efficiency) and the 'expectation damages' generally meet these criteria as in the efficient breach situation, the injured party by being awarded a full value of the promised performance is not, as a rule, worse off as a result of the breach while the breaching party is better off.[85] While, as noted above, the latter perspective of the law and economics revolving around the 'efficient breach' doctrine does not sit easily with the instruments' values of *pacta sunt servanda* and *favour contractus*, the former perspective (ie, that focusing on the incentives for the parties to enter into a voluntary exchange) is certainly in line with the instruments' policy of promoting international commerce and trade.[86]

3.2 'Gains made' and 'costs saved' as a result of the breach

By providing the basic measure of compensation, the principles of full compensation and the protection of the party's expectation/performance interest also set a limit on how much the injured party can recover. In other words, these principles dictate that the party cannot be awarded damages which exceed the amount of its loss and thereby be put in a better position than the one in which it would have been had the contract been performed. This means that to prevent over-compensation, all gains made and costs saved as a consequence of the breach need to be taken into account when calculating damages.[87] Suppose that after the buyer's failure to pay £2,000 for the manufacture of jewellery the manufacturer uses the resources, initially allocated to performing the contract with the buyer, to fulfil another order which would not have been accepted had the buyer performed the contract. If the seller expected to receive a 'net' profit margin of £500 (£1,500 being the cost of manufacture) from its contract with the buyer and if the seller's 'net' profit from a substitute order was £300, the seller would be entitled to an award of £200 because £300 would represent gains made as a result of the breach. 'Costs saved' as a result of the breach are relevant

[84] 'Say, for example, A contracts to sell to B for £100,000 a machine that is worth £110,000 to B (ie that would yield him a profit of £10,000). Before delivery C comes to A and offers him £109,000 for that machine. A would be encouraged to breach the contract with B were he not liable to pay B £10,000 expectation damages. Given that damages do protect the expectation rather than the reliance interest, C will not be able to induce a breach of A's contract with B unless he offers A more than £110,000 thereby indicating that the machine really is worth more to him than to B. The expectation rule thus ensures that the machine ends up where it is most valuable' (Burrows (n 82) 36).

[85] For a very recent overview, see Ogus (n 9).

[86] See the discussion above.

[87] See, eg, art 7.4.2(1) UPICC and comment 3 thereon; CISG Advisory Council (CISG–AC) Opinion No 6 'Calculation of Damages under CISG Article 74' <http://www.cisg.law.pace.edu/cisg/CISG-AC-op6.html>; Comment C on Article 9:502 PECL (see Lando and Beale (n 63) 438–9).

where it is 'gross' profit, as opposed to 'net' profit, that is the starting point for calculating damages.[88] To return to the previous example, suppose that all that is known at the beginning of the calculation process is the seller's contract price of £2,000 (gross profit). To award proper compensation, all the costs the seller would have incurred to deliver the jewellery will have to be identified. Suppose that it is found that the seller has actually spent £800 on procuring precious stones and that, had the buyer performed, it would also have had to spend £500 to employ a specialist and £200 to pay for other necessary materials and the delivery. Clearly, the seller's profit from the contract with the buyer cannot just be the difference between the contract price and the cost actually incurred (£1,200 (2,000 – 800)) because had the buyer performed, the seller would also have had to spend another £700 (500 + 200) to earn the contract price. Although expenses of £700 have not been actually incurred, they are nevertheless a 'cost saved' by the breach, which needs to be deducted from the amount of gross profit to determine the amount of 'net' profit the seller would have made but for the breach, that is, £500 (2,000 – 800 – 700).[89]

3.3 The role of the 'reliance interest'

Besides protecting the expectation/performance interest, some legal systems also protect the so-called 'reliance'[90] or 'negative' interest by placing the innocent party in the position in which it would have been had there been no contract.[91] This is done by means of compensating the party for expenses incurred in reliance on the contract. These expenses primarily include those which are necessary for preparing to perform or in performing the contract. Simply put, these costs, known as 'essential reliance',[92] are the 'price' the injured party pays in order to obtain the other party's performance and benefits flowing from it. 'Essential reliance' is contrasted with 'incidental reliance', which does not,

[88] See CISG–AC (n 87); Comment C on art 9:502 PECL (see Lando and Beale (n 63) 438–9). See also Case No 11 O 4261/94 District Court Kassel (Germany) 21 September 1995 (Wooden poles case) <http://cisgw3.law.pace.edu/cases/950921g1.html> ('[the Buyer's inability to perform its sub-sale contract] caused in the first place a loss of revenue of US $608,879.77 which however must not be considered as the profit subject to compensation. Experience [shows] that the execution of a transaction of the [same] kind as the present [transaction] causes additional expenses which lead to a lower profit and which have been saved in the case at hand. For example, it is undisputed that [the Buyer] was to bear the costs of the owed examination of poles by inspectors of company E, which would have cost it US$1,000 in each case. Furthermore, [the Buyer] had to have a number of letters of credit opened which in turn generally leads to considerable bank fees that have now been saved as well. Finally, [the Buyer] itself at least temporarily had to pre-fund the amounts due to payment, which generally causes expenses. If these savings are taken into account . . . it appears justifiable to award [the Buyer] damages in the amount of US$580,000').

[89] For further discussion, see ch 3.

[90] See Fuller and Perdue (n 65) 54.

[91] See *ibid*; Treitel (n 21) 83; s 344 Restatement the Second of Contracts.

[92] Fuller and Perdue (n 65) 78.

strictly speaking, involve costs necessary for the performance of the contract[93] but which nevertheless aims to advance benefits expected to flow from using the subject-matter of the contract.[94] For example, incidental reliance includes costs the buyer incurs in making any necessary modifications to the contract goods or to advertise them in order to either increase the goods' ability to generate profits or to increase the buyer's ability to sell them.[95] Another type of loss which is said to be a part of the reliance interest is the loss the injured party suffers by foregoing other opportunities. When the injured party is placed in the position in which it would have been had there been no contract, it can be argued that at that point in time, it had an *opportunity* to enter into other similar transactions and it has been argued that because the breach deprives the injured party of that opportunity, the protection of the reliance interest would require that the injured party be compensated for the lost opportunity.[96]

There is certainly a degree of overlap between the expectation/performance interest on the one hand, and the reliance interest on the other: for the former interest to be protected, the party will need to be compensated for 'net' loss of profit *and* for losses the party has incurred in relying on the contract. Suppose that A contracts with B to manufacture and sell a piece of machinery for £100,000 with the expectation that it will incur £80,000 in costs in performing the contract. If A had incurred, say, £50,000 in costs towards performing the contract (and assuming that the result of this expenditure is worthless), A would have to be awarded £70,000 to be placed in the position in which it would have been had B performed the contract (£20,000 (being 'net' lost profit) + £50,000 (being essential reliance loss actually incurred)). It has also been said that the two interests approach one another at the point where the loss of foregone opportunities is awarded as part of the reliance interest.[97] It has been suggested that if in a competitive market the injured party had entered into alternative contracts with third parties, it would have made the same profit as that which it expected to gain from the contract with the breaching party.[98] Two points need to be made here. First, this assertion equates loss of foregone opportunities with 'loss of profit', and this does not seem to be entirely accurate as 'loss of foregone opportunities' is probably best described as loss of a 'chance' to profit on another transaction. The difference is that damages for the latter are likely to be lower than damages for lost profit, since compensation is awarded for a *chance* to profit and not for the profit itself. Second, even if loss of foregone opportunities does mean loss of profit, rarely will alternative lost profits be the same as

[93] *Ibid*.
[94] See RE Hudec, 'Restating the "Reliance Interest"' (1982) 67 Cornell L Rev 724.
[95] For a more detailed discussion, see ch 3.
[96] Fuller and Perdue (n 65) 74.
[97] *Ibid*.
[98] SA Smith, *Contract Theory* (Oxford, OUP, 2004) 415 ('For example, in reliance on a supplier's promise to provide a purchaser with widgets, the purchaser will not attempt to obtain widgets from other suppliers. Assuming the market for widgets is reasonably competitive, the economic value of the buyer's lost opportunity is equivalent to the economic value of the original contract').

profits lost under the contract with the breaching party: 'unless there is a perfect market, one cannot say that by entering into the contract with the defendant, the plaintiff has foregone the opportunity to make exactly the same gain in a contract with somebody else'.[99]

Despite these points of overlap and similarity, the expectation/performance interest and reliance interest are nevertheless distinct and take different perspectives on the measure of damages: the former is a forward-looking measure while the latter is backward-looking. The question arises, then, as to whether the expectation/performance and the reliance measures constitute alternatives bases for the recovery of damages under the instruments.[100] The measure of damages provided for by the instruments for breach of contract is that of protecting the party's expectation/performance interest. However, as is well known, this does not prevent the reliance interest from constituting a separate basis for recovery where the injured party cannot prove its loss of profit and does not have any choice but to claim its reliance losses.[101] In this case, an award of reliance damages is not in conflict with the general protection of the expectation/performance. The conflict will arise, however, if damages are awarded for 'foregone opportunities' because this award will require making an assumption that the *contract had not come into existence*. This is not in line with the assumption, which needs to be drawn under the instruments' damages provisions, that the *contract had been performed*.[102] In one case under the CISG,[103] the buyer claimed damages for *loss of profit*, arguing that it could have deposited the money used to open the letter of credit under the contract with the bank under the deposit rate. The tribunal allowed the claim because the buyer had proved the calculation of that alleged profit. It seems, however, that although the claim was formulated in terms of *loss of profit*, it was in essence a claim for 'foregone opportunities': the buyer could have earned profit from the money it had spent on performing the contract *only* if it had not entered into the contract with the seller. For the reasons just given, it is respectfully submitted that the approach taken in this case is inconsistent with the measure provided for in art 74 CISG.

Finally, it needs to be pointed out that where reliance losses are claimed and where the claim is consistent with the instruments' 'expectation/performance interest' measure, reliance damages cannot be awarded if it is evident that had

[99] Burrows (n 69) 223.

[100] See JS Ziegel, 'The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives' in NM Galston and H Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (NY, Matthew Bender, 1984) 9-38 note 104 (raising this question in the context of the CISG). There is no uniformity amongst legal systems in this respect (see Treitel (n 21) 89–98). English law generally gives the injured party a choice between the two measures (see *CCC Films (London) Ltd v Impact Quadrant Films Ltd* [1985] QB 16).

[101] For a well-known example in English law, see *Anglia Television v Reed* [1972] 1 QB 60.

[102] *Cf* P Koneru, 'The International Interpretation of the UN Convention on Contracts for the International Sale of Goods: An Approach Based on General Principles' (1997) 6 Minnesota J Global Trade 105, also at <http://www.cisg.law.pace.edu/cisg/biblio/koneru.html>.

[103] ICAC Case No 238/1998, decision dated 7 June 1999 <http://cisgw3.law.pace.edu/cases/990607r1.html>.

the contract been performed, the innocent party would have made a loss.[104] To return to an earlier example, suppose that although A planned to make a £20,000 profit by manufacturing and selling machinery to B for £100,000, A realised, after the contract had been made, that it would have to spend £110,000 (and not £80,000 as it had originally planned) to perform the contract. If, by the time of B's breach, A has incurred £50,000 in costs, A should not be allowed to claim £50,000 since such an award would put A in a better position than the one in which it would have been had B performed the contract.

3.4 The role of gain-based damages

Because the purpose of the instruments' remedy of damages for breach of contract is to compensate the injured party for the loss, benefits received or gains made by the breaching party as a result of the breach are generally irrelevant for measuring damages. It is therefore safe to say that the so-called 'restitution interest',[105] which focuses not on the injured party's loss but on the breaching party's gain in order to prevent that party from being unjustly enriched,[106] is not protected by the instruments.[107] Nevertheless, it is tentatively submitted that the benefits received by the breaching party as a result of its breach cannot be dismissed outright as entirely irrelevant for calculating *compensatory* damages because, in some cases, damages reflecting gains made by the breaching party may be an appropriate way of implementing the compensatory purpose of damages.[108] More crucially, however, the instruments cannot ignore the issue of gain-based damages because otherwise courts may apply concurrent domestic remedies to those types of case with which the instruments were designed to deal.[109] If this happens, not only will the instruments be 'undermined in one of [their] core areas'[110] but also the goal of uniformity will be significantly impaired.[111]

[104] See Fuller and Perdue (n 65) 76.

[105] See *ibid*, 53.

[106] Gains can be of two kinds: the value of what has been received under the contract (goods or purchase price) and the value derived from putting the subject-matter of the performance into a profitable use. The instruments contain provisions relating to the return of what has been received under the contract in cases where the contract has been avoided (see arts 81, 82 CISG; art 7.3.6 UPICC; and arts 9:307, 9:308 PECL).

[107] For a recent critical analysis of the common law position with respect to gain-based damages for breach of contract, see R Cunnington, 'The Measure and Availability of Gain-Based Damages for Breach of Contract' in Saidov and Cunnington (n 1).

[108] A similar point has been recently made in I Schwenzer and P Hachem, 'The Scope of the CISG Provisions on Damages' in Saidov and Cunnington (n 1) 100–102.

[109] *Ibid*.

[110] *Ibid*.

[111] It also needs to be stressed that because the instruments are explicit about the compensatory purpose of damages, recognising the possibility of the 'restitution interest' being a separate measure of recovery (ie, it being an alternative to the 'expectation/performance' interest) under the instruments is a step too far. This leads to the need to accommodate gains made by the breaching party within the framework of compensatory damages with the almost inevitable and unfortunate result that some of the proposed conditions (such as the deliberate and cynical nature of the breach), set out below in the

Cases where it may be appropriate to rely on gains made by the breaching party to implement the compensatory purpose of damages are those where a mere focus on the party's loss is *not adequate* to compensate the party where, for example, it is not in the position to prove its loss. This condition in itself is, of course, far from sufficient to justify an award based on gains made by the breaching party and therefore, a number of other conditions must be met. One such condition is that the injured party must have a legitimate interest in preventing the breaching party from benefiting from its breach.[112] An additional condition, which would often accompany cases where the injured party has such a legitimate interest, is that the breach must be intentional, cynical,[113] or be committed in bad faith. While the latter two conditions are, admittedly, vague, there are examples demonstrating the types of case justifying an award based on gains made by the breaching party. In a recent case under the CISG,[114] the seller agreed to supply pressure sensors to the buyer and to license the use and integration of these pressure sensors with the buyer's other products. Since the performance of the contract involved the buyer's exposure to significant amounts of the seller's confidential and proprietary information, the contract contained a confidentiality clause whereby the parties agreed that neither party would obtain rights to the confidential and proprietary information of the other party and undertook not to disclose such information to third parties. The seller argued that the buyer committed a breach of both those obligations and, in fact, alleged that the buyer 'never had the genuine intention to perform its obligations [and] entered into the Agreement as a tactical step to obtain access [to the Seller]'s confidential and proprietary technology in order to develop, manufacture and sell the pressure sensors which will directly compete with those manufactured and sold by [the Seller]'.[115] The arbitrator found that the buyer did indeed copy the seller's information and awarded damages based on the profits the buyer earned by using the seller's technology. In a different case under the CISG,[116] the seller agreed to sell jeans to a US buyer on the condition that they would not be resold on the European market and it was agreed that the goods would only be resold in South America and Africa. During the pre-contractual negotiations as well as after the conclusion of the contract, the seller repeatedly demanded that the buyer provide proof of the destination of the goods. The

main text, for identifying cases where taking into account the breaching party's gains is justified arguably have little to do with the compensatory purpose of damages.

[112] This guideline has been put forward in English law to help identify cases where 'gain-based' damages are available as an independent measure (and alternative to the expectation damages) for breach of contract (see *Attorney-General v Blake* [2001] AC 268, 285).

[113] For a similar argument in the context of English law (albeit in favour of an independent restitutionary damages remedy), see Burrows (n 82) 406–7.

[114] Stockholm Chamber of Commerce Arbitration Award of 5 April 2007 (Pressure sensors case) <http://cisgw3.law.pace.edu/cases/070405s5.html>.

[115] *Ibid*.

[116] See *SARL BRI Production 'Bonaventure' v Société Pan African Export* Appellate Court Grenoble (France) 22 February 1995 <http://cisgw3.law.pace.edu/cases/950222f1.html>. This case has also been used for the same purposes as it is used here in Schwenzer and Hachem (n 108).

buyer breached the contract by selling the goods in Spain. The rationale for the seller's interest in the destination of the goods was described thus:

> [The seller] is bound by contracts with many foreign distributors and, more specifically in the case of Spain where the brand name 'Jeans Bonaventure' is sought after, it has an interest in not allowing a parallel network of sale [parallel imports]. [The seller] adds that it has received numerous complaints by its Spanish distributors who complain that Bonaventure Jeans have flooded the market and that it has encountered counterfeiting problems. It adds that, with respect to the USA, it is not the owner of the trade mark 'Bonaventure' and that it risks having its products seized.[117]

Although damages were awarded on an unclear ground of 'abuse of process', the court held that the buyer did not act in good faith. It can be argued that profits made by the buyer by reselling the goods in Spain would constitute an appropriate measure of recovery of compensatory damages particularly considering that they would most likely be reflective of profits the seller lost as a result of the breach.[118] Another example is where the buyer, conscious of human rights, agrees to buy goods from a seller on the condition that no child labour would be used in the production of the goods and pays a price higher than the current price for these type of goods, to ensure compliance with this condition.[119] It has been correctly argued that, considering the difficulty of placing a value on the buyer's interest in performance, the savings made by the seller as a result of its breach can constitute a helpful way of measuring the buyer's loss.[120] In short, it is submitted that in all these types of case, an award of damages based on gains made by the breaching party could be justified as long as the injured party is not in the position to prove the amount of its loss. First, in all three cases the injured party can be said to have had a legitimate interest in the performance. Second, by being very well aware of the importance the injured party placed on the performance and nevertheless breaching the contract solely to make a gain, the other party's breach can certainly be described as 'deliberate, cynical' and arguably, as having been committed in 'bad faith'.[121]

4. THE IDEA OF LIMITING DAMAGES

Just like most domestic legal systems,[122] the instruments are not relentless in pursuing the goals of full compensation and the protection of the injured party's

[117] *Ibid*.

[118] See Schwenzer and Hachem (n 108).

[119] The example has been given *ibid*. The example is also discussed in several other parts of the book (see chs 3 and 9).

[120] See Schwenzer and Hachem (n 108).

[121] For another good example in the context of sale of goods, see the English case *Esso Petroleum Co Ltd v Niad Ltd* [2001] All ER (324) (Nov).

[122] For a recent comparative overview, see A Komarov, 'The Limitation of Contract Damages in Domestic Legal Systems and International Instruments' in Saidov and Cunnington (n 1).

expectation/performance interest. The party's claim is subject to several other requirements which have the effect of limiting damages. These requirements, usually referred to as the 'methods of limiting damages', include causation, foreseeability, mitigation and to some extent, the standard of proof. Existing literature on the law of damages may create an impression that all these methods derive from one single idea of the necessity of limiting damages. It is suggested, however, that this is true only to some extent and to understand why, it is necessary in the first instance to explore the reasons which have been advanced to explain why damages need to be limited.

First, it has been argued that it is necessary to limit damages because in some cases, losses can be unexpectedly high and it is not fair for the breaching party to be held liable for such losses. The argument runs as follows. Relentless adherence to the principle of full compensation may result in a breaching party's liability for all losses resulting from the breach, 'however improbable, however unpredictable'.[123] The risk of 'unusual' and 'unpredictable' liability is all the more real in commercial transactions where 'the provision of opportunities for gain may have a snowball effect: opportunities breed further opportunities'.[124] Saddling the breaching party with such losses would be unjust.[125] This argument is particularly relevant where the party has not assumed the risk of such losses under the contract. Second, the idea of limiting damages has been put forward in the context of losses which are disproportionate to the amount of the benefit received by the breaching party under the contract.[126] In this case, the necessity of limiting damages can be explained by 'an impulse to preserve some proportion between the liability imposed on the defendant and the compensation which was paid him under the contract'.[127] Finally, it has been argued that unqualified adherence to the principle of full compensation would 'operate as too strong a disincentive to the assumption of contractual obligations, or to an undue raising of charges to cover such unlimited liability'.[128]

It is evident that the justification of the idea of limiting damages has not been uniform. Even if we accept that all these aforementioned reasons are an integral part of a single idea of limiting damages, they are insufficient to justify the existence of *all* methods of limiting damages because each of the methods is based, to a significant extent, on the considerations and policies which are peculiar to itself. Nevertheless, it is also true that the notions of fairness[129] and reasonable-

[123] *Victoria Laundry (Windsor) Ltd v Newman Industries Ltd Coulson and Co Ltd (Third Parties)* [1949] 2 KB 528, 539.

[124] HLA Hart and T Honore, *Causation in the Law*, 2nd edn (Oxford, Clarendon Press, 1985) 312.

[125] CT McCormick, *Handbook on the Law of Damages* (St Paul, Minn, West Publishing Co, 1935) 565.

[126] Fuller and Perdue (n 65) 87; A Von Mehren and JR Gordley, *The Civil Law System: An Introduction to the Comparative Study of Law*, 2nd edn (Boston, Little, Brown & Co, 1977) 1114.

[127] Fuller and Perdue (n 65) 88.

[128] Treitel (n 21) 143; Comment, 'Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery' (1955–1956) 65 Yale L J 992, 995–6.

[129] For a somewhat similar view see Corbin (n 3) 16 (seemingly explaining the necessity of limiting damages by the idea of 'justice').

ness[130] inevitably permeate both the justification and the application of each of the methods and perhaps, to this extent, all methods can be said to find unity within the same spirit and ideas.

[130] See Ogus (n 3) 290 (justifying the existence of methods of limiting damages from the standpoint of both justice and reasonableness).

3

Categories of Loss

1. GENERAL

THE PROBLEMS OF meaning and definition of loss lie at the very heart of the law of damages and this chapter explores only *one* set of issues relating to how the notion of 'loss' should be interpreted under the international instruments—that is, what losses are, as a matter of law, recoverable? In other words, what types of loss are considered to be sufficiently 'real' and serious to qualify for legal protection? These questions are important because by considering them we inevitably enter the debate about the values and policies underlying the instruments. To answer these questions, losses are considered, for the sake of convenience, under several broad headings and an attempt is made not to rely on any of the classifications of losses which can be found in legal literature.[1] The only classification worth recognising is that adopted by the instruments themselves: that is the distinction, dating back to the Roman law and widely used by many civil law systems,[2] between 'loss suffered' and 'gains prevented (loss of profit)'[3] (or, to use a well-known Latin terminology, the

[1] See H Stoll and G Gruber, 'Arts. 74–77 CISG' in P Schlechtriem and I Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods*, 2nd English edn (Oxford, OUP, 2005) 753, stating that '[possible] forms of damages as a result of breach of contract are *non-performance* damages, *incidental* damages, and *consequential* damages'. It is respectfully submitted that this classification is not helpful. First, such concepts as 'incidental' and 'consequential' damages are widely used in some domestic legal systems (see, eg, §§ 2-710 and 2-715 UCC). In addition, the term 'consequential damages' has been used in a number of different senses (see, eg, GH Treitel, *Remedies for Breach of Contract: A Comparative Account* (Oxford, Clarendon Press, 1988) 87). Therefore, relying on these terms in the context of the CISG would be neither in line with the need to respect the Convention's international character nor with the need to promote uniformity in its application. Second, by introducing the concept of 'consequential loss', in the sense used by the authors, they take an approach which is different from that of the Convention. 'Consequential loss' is often treated as a type of loss which comprises several different heads of loss and loss of profit is only one of them (see, eg, RR Anderson, 'Incidental and Consequential Damages' (1987) 7 J L Commerce 330; U Draetta, 'The Notion of Consequential Damages in the International Trade Practice: A Merger of Common Law and Civil Law Concepts' (1991) 4 Int'l Business L J 491–2). Stoll and Gruber (767) treat 'consequential loss' in a similar way and this approach would seem to be inconsistent with that taken by the CISG which treats losses as consisting of loss suffered and loss of profit and does not contain, so to speak, an 'intermediate' category which would comprise *both* some losses falling under the 'loss suffered' category *and* 'loss of profit'.

[2] See, eg, Treitel (n 1) 84; B Nicholas, *The French Law of Contract*, 2nd edn (Oxford, Clarendon Press, 1992) 226–7.

[3] See art 74 CISG, art 7.4.2 UPICC and art 9:502 PECL.

distinction between *damnum emergens* and *lucrum cessans*). 'Loss suffered' is generally regarded as the reduction in the already existing assets, property, or financial situation[4] and here, the reference is made to what the innocent party has actually lost or will lose. 'Loss of profit', in contrast, refers to what the party has never had but would have had if the contract had been performed. What is the purpose of this distinction? One answer is that, in the case of the CISG at least, there are instances where loss of profit cannot be claimed and they concern the provision in art 44 which allows a disregard of the provisions in arts 39[5] and 43[6] if the buyer has a reasonable excuse for the failure to give the required notice. Where this is the case and the buyer claims damages, loss of profit cannot be claimed.[7] Another answer, applicable to all international instruments, is that considering that not all legal systems allow damages for loss of profit (gains prevented),[8] this type of loss is specifically mentioned with a view to indicate its recoverability.[9]

2. EXPENDITURE WASTED AS A RESULT OF THE BREACH

A party to the contract often incurs expenses which constitute part of its performance of (or preparation to perform) the contract in the expectation that they will be recouped from the value received from the other party's performance. If, however, that other party fails to do so, these expenses may, wholly or in part, turn out to be wasted, thereby causing loss. What items can be regarded as 'as expenses wasted as a result of the breach' depends on the nature of the injured party's performance. The seller may have incurred costs relating to the manufacture of the goods, such as the costs of labour and materials,

[4] See, eg, Comment 2 to Article 7.4.2 UPICC; OS Ioffe, *Otvetstvennost' po Sovetskomu Grazhdanskomu Pravu* (Leningrad, LGU, 1955) 205–6.

[5] Article 39(1) CISG: 'The buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it.'

[6] Article 43(1) CISG: 'The buyer loses the right to rely on the provisions of article 41 or article 42 if he does not give notice to the seller specifying the nature of the right or claim of the third party within a reasonable time after he has become aware or ought to have become aware of the right or claim.'

[7] Article 44 CISG: 'Notwithstanding the provisions of paragraph (1) of article 39 and paragraph (1) of article 43, the buyer may reduce the price in accordance with article 50 or claim damages, except for loss of profit, if he has a reasonable excuse for his failure to give the required notice.'

[8] It has been reported that such legal systems include, eg, those of Jordan and United Arab Emirates (see JY Gotanda, 'Damages in Lieu of Performance because of Breach of Contract' (Villanova University School of Law Working Paper Series, 2006, Paper 53) <http://law.bepress.com/cgi/viewcontent.cgi?article=1053&context=villanovalwps>).

[9] See para 3 on art 70 of the Secretariat Commentary of the 1978 Draft of the Convention; V Knapp, 'Arts. 74–77 CISG' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Milan, Giuffrè, 1987) 543; Comment 2 on Article 7.4.2 UPICC. But see JY Gotanda, 'Recovering Lost Profits in International Disputes' (2004) 36 Georgetown J Int'l L 61, 86 (stating that the 'principle of recovery [of lost profit] is so well settled that it can be said it has become a general rule of private international law').

which it intended to deliver to the buyer.[10] The injured buyer may have incurred a variety of other costs in performing the contract arising from importing the goods,[11] and, more specifically, paying import duties, clearing customs, transporting the goods,[12] paying insurance fees,[13] as well as from paying fees for the opening of the letter of credit.[14] The question of whether a particular cost is regarded as an essential part of performing the contract (known as 'essential reliance') is important for the purposes of calculating damages for, if it is, it has to be taken into account. Crucially, double compensation needs to be avoided at this point: if the cost has *actually* been incurred it can only be compensated together with the amount of '*net profit*', as opposed to 'gross profit', for the latter already comprises the entire cost of the performance. By the same token, if a claim refers to the amount of 'gross profit' where a particular cost of 'essential reliance' has *not* been incurred, that cost (being, this time, a 'cost saved' as a result of the breach) will need to be deducted from the amount of 'gross profit'. For example, where, as a result of the buyer's failure to accept the goods, the seller resells the goods and thereby avoids paying a commission to a broker which it would have had to pay had the buyer accepted the goods, then the amount of the commission, being a 'saved cost', needs to be deducted from the difference between the contract price and the resale price.[15]

Attempting to avoid double compensation in cases involving the injured buyer can be more difficult. Where the seller fails to deliver the goods and the buyer is awarded damages under the instruments' 'concrete' or 'abstract' formula,[16] the costs of 'essential reliance' should not be recoverable because the buyer either has the goods on hand[17] or has the monetary value enabling it to purchase substitute goods.[18] In both cases the buyer is put in the position that

[10] See Case No 2 U 30/77 Appellate Court Hamm (Germany) 23 March 1978 (Brass poles case) <http://cisgw3.law.pace.edu/cases/780323g1.html>.

[11] See *China Xhanghai Dongda Import & Export Corp v Germany Laubholz-Meyer Corp* Shanghai Yangpu District People's Court 2002 (China) <http://cisgw3.law.pace.edu/cases/020000c1.html>.

[12] See CIETAC Arbitration proceeding 26 October 1996 (Cotton bath towel case) <http://cisgw3.law.pace.edu/cases/961026c1.html>.

[13] CIETAC Arbitration proceeding 30 October 1991 (Roll aluminium and aluminium parts case) <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/911030c1.html>.

[14] See, eg, CIETAC Arbitration proceeding 14 March 1996 (Dried sweet potatoes case) <http://cisgw3.law.pace.edu/cases/960314c1.html>.

[15] See *Downs Investments Pty Ltd v Perwaja Steel SDN BHD* [2000] QSC 421.

[16] See arts 75 and 76 CISG; arts 7.4.5 and 7.4.6 UPICC; and arts 9:506 and 9:507 PECL.

[17] For cases where the buyer procured substitute goods and where the fees it had paid to open (and/or modify) a letter of credit were denied, see CIETAC Arbitration proceeding 14 March 1996 (n 14); CIETAC Arbitration proceeding 7 May 1997 (Horsebean case) <http://cisgw3.law.pace.edu/cases/970507c1.html>. However, if as a result of the breach, the buyer had to pay that fee twice, then it should, no doubt, be recoverable (see CIETAC Arbitration proceeding 4 September 1996 (Natural rubber case) <http://cisgw3.law.pace.edu/cases/960904c1.html> ('[The] Buyer signed Contract . . . to purchase substitute goods and paid a security deposit and issuing fee for the L/C [and this] caused the L/Cs to be issued twice for buying the goods . . . The expense of the first L/C is additional expense to buy the goods . . .')).

[18] CIETAC Arbitration proceeding 25 December 1998 (Basic pig iron case) <http://cisgw3.law.pace.edu/cases/981225c2.html>.

enables it to carry on with its plans (resale or manufacture). The same should be the case where the buyer who resells non-conforming goods at a reduced price is awarded the loss in its profit margin (that is, the difference between the reduced price at the actual resale and the price at which it would have sold the goods had they been conforming).[19] It is clear that in such cases, the costs of 'essential reliance' are not wasted. The same applies to cases where the seller delays the delivery of the goods and the buyer is awarded the cost of hiring an immediate replacement for the period of delay. In this case, even if the buyer has incurred certain costs of 'essential reliance', such costs are not 'wasted' because the buyer is still able to execute its plans. It is in cases where it is not possible for the buyer to procure a replacement (cases where no market exists, where goods are unique, or where the buyer suffers loss of volume) that 'essential reliance' costs can be recoverable. Even then, however, it must be proved that had the seller performed the contract the buyer would have been able to put the goods to profitable use, thereby recouping such costs.[20]

It is evident that to be relevant to the calculation of damages, a cost needs to be 'essential' to the performance of the contract, that is, a cost without which performance would not be possible. There are, however, expenses which do not constitute an essential part of the performance of the contract, but which are nevertheless incurred in the expectation that they will bring benefit relating to the subject-matter of the contract. For example, it may be the case that before the goods were found to be defective, the buyer had spent money on advertising the goods,[21] preparing to take part in an exhibition,[22] or on making certain modifications to the goods (such as painting a machine).[23] It is suggested that, subject to two requirements, such costs can, in principle, be recoverable. First, they must be shown to be reasonably connected with a further use of the subject-matter of the contract. If, for instance, it is found that an advertisement or an exhibition had little to do with the contract goods and were aimed at promoting some other product(s), then it is appropriate to deny compensation for these costs.[24] Second, such costs must be reasonable or expedient in the circumstances. If a car dealer repainted a car, which turned out to be defective, and

[19] CIETAC Arbitration proceeding 11 April 1997 (Silicon metal case) <http://cisgw3.law.pace.edu/cases/970411c1.html> ('The first SGS inspection cost, the cost of establishing the L/C and the cost of packing the goods are normal costs in international trade; since the profit losses and damages suffered by [the] Buyer are confirmed and to be compensated, the requests for the above costs claimed by [the] Buyer cannot be granted').

[20] For similar views in the context of the common law, on avoiding double compensation in cases involving 'essential reliance' costs, see S Waddams, *The Law of Damages*, 4th edn (Toronto, Canada Law Book Inc, 2004) 103–4.

[21] See Case No 10 O 72/00 District Court Darmstadt (Germany) 9 May 2000 (Video recorders case) <http://cisgw3.law.pace.edu/cases/000509g1.html>.

[22] See CIETAC Arbitration proceeding 21 May 1999 (Excavator case) <http://cisgw3.law.pace.edu/cases/990521c1.html>.

[23] See the English case *Cullinane v British 'Rema' Manufacturing Co Ltd* [1954] 1 QB 292.

[24] '[The] Buyer's claim for the exhibition expenses, RMB 18,000 is not related to this case and cannot be upheld' (CIETAC Arbitration proceeding 21 May 1999 (n 22)).

where there were no reasonable grounds to expect that the re-painting work would increase the chances of selling the car or selling it at a higher price, then clearly the cost of doing so should not be recoverable.[25] It goes without saying that if the injured party has received benefits as a result of incurring such costs, then these benefits must be taken into account in calculating damages. Thus, in one case under the CISG[26] where the seller failed to deliver a pipe extrusion production line, the buyer claimed compensation for numerous items of accessory equipment bought for the purpose of enhancing the use of the production line. The tribunal awarded damages for such costs only in part on the ground that those items of accessory equipment did not wholly 'lose their use value'.

Another question to be addressed here relates to the so-called 'overhead' or 'fixed' costs, as opposed to 'variable' costs. While the latter are 'costs which may be identified as belonging to a specific contract or product of sale'[27] the former are costs which do not directly relate to any particular contract and are necessary to the maintenance of the business as a whole—they can include, for example, insurance protection, power, lighting, rental payments and work time of employees. The question is whether such 'fixed' costs should be treated as costs which are sufficiently connected with the breached contract so as to be taken into account in calculating damages. If so, this can have the following consequences. Because fixed costs are, as a rule, incurred *regardless of* the breach of contract, they can rarely become a 'saved cost' which would reduce the amount of lost profits. It would seem that it is only in rare cases where a breach of contract prevents the very possibility of incurring certain fixed costs (eg, where a breach of contract causes the destruction of the factory or the suspension of the production making it unnecessary for the party to incur utility costs) that the amount of lost profits would need to be reduced by the amount of fixed costs thus 'saved'.[28] Another consequence is that recognising a part of the overall

[25] See AS Komarov, *Otvetstvennost' v kommercheskom oborote* (Moscow, Juridical Literature, 1991) 202 (discussing the case, decided by the USSR Foreign Trading Commission, where the costs incurred by the injured party were denied on the ground that, when incurring those costs, the party did not have sufficient confidence that benefits would result from such an investment; the tribunal held that the party had acted at its own risk).

[26] CIETAC Arbitration proceeding 6 November 2002 (Pipe extrusion case) <http://cisgw3.law.pace.edu/cases/021106c1.html>.

[27] R Childress and R Burgess, 'Seller's Remedies: The Primacy of UCC 2-708(2)' (1973) 48 New York University L Rev 833, 840.

[28] For this reason, it is difficult to understand the view (see Secretariat Commentary on article 70 of the 1978 Draft, Example 70A; *Delchi Carrier SpA v Rotorex Corp* 71 F.3d 1024-1031 [2d Cir. 1995]) that if fixed costs *are not* recoverable, then they must *not* reduce the amount of lost profits. It is submitted that the same result would be reached even if fixed costs *are* recognised as recoverable because they are, almost by definition, *incurred* and not 'saved' and should not therefore reduce lost profits (see Case No 1 U 31/99 Appellate Court Hamburg 26 November 1999 (Germany) (Jeans case) <http://cisgw3.law.pace.edu/cases/991126g1.html>). In other words, once a particular cost is recognised as relevant for calculating damages, it will only be taken to reduce damages where it is a 'saved' cost because once it has been incurred, it would require that damages be awarded for it. Because fixed costs are usually incurred, that part of lost profits which bears a pro rata relation to the overall fixed costs needs to be compensated.

fixed costs as having a sufficient connection with a particular contract leads to the possibility of claiming compensation for such costs[29] as 'reliance damages'. This would clearly not be possible if fixed costs were treated as irrelevant for calculating damages. There is no agreement as to whether fixed (overhead) costs need to be taken into account under the international instruments[30] and it is suggested that they should be regarded as costs sufficiently related to a particular contract since by enabling a business to run, they thereby enable each particular contract to be performed. In principle, therefore, fixed costs need to be allocated to a particular contract 'in the same proportion which the contract price bears to the total revenues'.[31] In practical terms, however, it is far from easy to implement this principle as 'the calculation of overheads is not an exact science'[32] and, consequently, there is no agreement amongst accountants as to what constitutes overhead costs.[33] To make matters worse, what is an overhead to one manufacturer may be a variable cost to another and it may be the case that the same item of cost may be both a variable and a fixed cost to the same manufacturer depending on its volume of manufacture and sales.[34] For these reasons, the amount of overheads attributable to a particular contract will ultimately depend 'on more or less arbitrary management accounting decisions'.[35]

3. ADDITIONAL EXPENDITURE INCURRED AS A RESULT OF THE BREACH

Losses under this heading include expenses which are not part of the performance of the contract but are *additional* losses incurred by the injured party as a consequence of the breach. Numerous examples can be given. It is often the case that the injured party incurs costs in attempting to mitigate its losses.[36] For instance, where the buyer rejects the goods, the seller may have to incur additional storage and/or maintenance charges and costs of modifying the goods for

[29] More precisely, a part of the overall fixed costs to which profits under a particular contract would have contributed on a pro rata basis.

[30] For those seemingly in favour in the context of the CISG, see Appellate Court Hamburg (Germany) 26 November 1999 (n 28); JO Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention*, 3rd edn (Deventer, Kluwer Law International, 1999) 453; Stoll and Gruber (n 1) 759. For the contrary position, see Federal Appellate Court (2nd Circuit) 6 December 1995 (n 28); *TeeVee Tunes Inc et al v Gerhard Schubert GmbH* not reported in F.Supp.2d 2006, WL 2463537 (SDNY) (No. 00 Civ 5189 (RCC)).

[31] Childress and Burgess (n 27) 843.

[32] R Goode, *Commercial Law*, 3rd edn (London, Penguin, 2004) 406.

[33] JJ White and RS Summers, *Uniform Commercial Code*, 5th edn (St Paul, Minn, West Publishing Co, 2000) 289.

[34] Childress and Burgess (n 27) 841.

[35] Goode (n 32) 406; for a similar view, see also R Speidel and K Clay, 'Seller's Recovery of Overhead Under UCC Section 2-708 (2): Economic Cost Theory and Contract Remedial Policy' (1972) 57 Cornell L Rev 689.

[36] For a more extensive discussion, see ch 6.

the needs of a new buyer[37] or, where there is no need to do so, it may have to incur additional transportation, broker's and sales promotion fees.[38] Where the seller fails to deliver, the injured buyer may similarly incur costs in attempting to find and conclude a replacement transaction.[39] If the buyer receives non-conforming goods which it does not reject, it may be reasonable for the buyer to attempt to cure the non-conformity, and the costs of doing so, subject to their being reasonable, have been held to be recoverable.[40] If there is a delay in delivery, it may be reasonable for the buyer to hire a replacement for the period of delay[41] and the cost of doing so should also be recoverable.

It is clear that expenses arising from attempts to mitigate losses are recoverable as long as they are reasonable and it is certainly true that the same requirement applies to expenses other than those arising from mitigation. However, in addition to the requirement of reasonableness, a new criterion has emerged in cases under the CISG according to which costs incurred after the breach must be *necessary* or *unavoidable* to be recoverable.[42] In this regard, it is suggested that not only can this criterion be considered a part of the broader reasonableness requirement (for if the cost is truly necessary or unavoidable, it is certainly reasonable), but it also clarifies, to some extent, what costs will be regarded as reasonable and therefore recoverable. Both the considerations of reasonableness and necessity have been relied upon to deal with the question of whether the amount of the injured party's liability to third parties should be recoverable as damages. For example, as a result of the seller's non-delivery the buyer may have to reach a settlement with its sub-buyer and, in one case under the CISG,[43] the amount of such a settlement was held recoverable as it was 'reasonable and legally binding'. In another case of non-delivery,[44] the buyer was awarded damages for its liability to its sub-buyer on the ground that paying damages to the sub-buyer was 'inevitable'. Paying damages to a sub-buyer can certainly be

[37] See ICC Arbitration Case No 7585 of 1992 (Foamed board machinery) <http://cisgw3.law.pace.edu/cases/927585i1.html>; ICAC Case 142/94, decision dated 25 September 1995 <http://cisgw3.law.pace.edu/cases/950425r2.html>; Vienna Arbitration proceeding SCH-4366, decision dated 15 June 1994 (Rolled metal sheets case) <http://cisgw3.law.pace.edu/cases/940615a3.html>; *Vital Berry Marketing NV v Dira-Frost NV* District Court Hasselt (Belgium) 2 May 1995 <http://cisgw3.law.pace.edu/cases/950502b1.html>.

[38] See *China Yituo Group Company v Germany Gerhard Freyso Ltd GmbH and Co* Second Intermediate People's Court (District Court) of Shanghai (China) 22 June 1998 <http://cisgw3.law.pace.edu/cases/980622c1.html>; see also Case No OR.96.0-0013 Commercial Court Aargau (Switzerland) 26 September 1997 (transportation costs apparently incurred after and as a result of the breach) (Cutlery case) <http://cisgw3.law.pace.edu/cases/970926s1.html>.

[39] See, eg, Case No 27 U 58/96 Appellate Court Köln (Germany) 8 January 1997 (Tannery machines case) <http://cisgw3.law.pace.edu/cases/970108g1.html>.

[40] See ICC Arbitration Case No 8740 of October 1996 (Russian coal case) <http://cisgw3.law.pace.edu/cases/968740i1.html>. For a more extensive discussion, see ch 8.

[41] See Case No 7 Ob 301/01t Supreme Court (Austria) 14 January 2002 (Cooling system case) <http://cisgw3.law.pace.edu/cases/020114a3.html>.

[42] For references and further discussion, see ch 4.

[43] See CIETAC Arbitration proceeding 17 October 1996 (Tinplate case) <http://cisgw3.law.pace.edu/cases/961017c1.htm>.

[44] CIETAC Arbitration proceeding 14 March 1996 (n 14).

regarded as 'inevitable' or 'unavoidable' where the buyer is required to do so by a legally binding settlement or a court or arbitration decision.[45] It goes without saying, however, that the settlement itself must be reasonable or, where a claim is brought against the buyer, the buyer needs to take reasonable steps to defend it. This flows either from the mitigation rule or, more broadly, from the instruments' general principle of reasonableness. It is noteworthy that, in one case,[46] reasonableness has been taken as far as to deny the recovery of the injured buyer's costs incurred prior to the litigation with its sub-buyer because the buyer had failed to engage the breaching seller in the pre-litigation process which, in the court's opinion, could have helped the buyer deal with the sub-buyer's claim.

It should also be mentioned that it will not always be the case that a mere fact of reaching a reasonable settlement with a sub-buyer will make the seller liable for the full amount of the settlement as it may have been the parties' intention to share liability for this loss. In one case under the CISG,[47] the seller had stated, subsequent to the conclusion of the contract, that it would be willing to bear a part of the buyer's responsibility to its customer subject to certain conditions and although no definite agreement at that point had been reached, the tribunal inferred from such a statement that it was the parties' intention to bear joint responsibility for settlements the buyer would reach with its sub-buyers. A difficult situation may arise where there is a chain of buyers following the buyer's sub-sale and where, as a result of the seller's breach, each buyer claims damages against its preceding buyer. The question is whether the first buyer can claim damages against the seller for the entire amount of these accumulated items of liability.[48] It is submitted that although in principle the seller can be held for such damages, methods of limiting damages, such as causation, foreseeability and mitigation have a special role to play in such circumstances: the chain of liability may be broken by unreasonable actions of one of the buyers in the chain;[49] or the seller may not have been in the position to foresee either the chain itself or its extent;[50] the buyer may have been in the position to prevent such a snowball accumulation of liability.[51]

[45] See CIETAC Arbitration proceeding 25 October 1994 (High tensile steel bar case) <http://cisgw3.law.pace.edu/cases/941025c1.html> (where the buyer's liability to its sub-buyer was based on both the court decision and the settlement with the sub-buyer).

[46] See Case No P 1997/482 Civil Court Basel (Switzerland) 1 March 2002 (Soyprotein products case) <http://cisgw3.law.pace.edu/cases/020301s1.html>. This case is also discussed in ch 4.

[47] CIETAC Arbitration proceeding 29 March 1999 (Flanges case) <http://cisgw3.law.pace.edu/cases/990329c1.html>.

[48] For the discussion of the position taken by English law on this issue, see MG Bridge, *The Sale of Goods* (Oxford, OUP, 1997) 572–3.

[49] See *ibid*; for general considerations applicable in such situations, see ch 4.

[50] See the argument made by the breaching seller in CIETAC Arbitration proceeding 5 August 1997 (Cold-rolled coils case) <http://cisgw3.law.pace.edu/cases/970805c1.html>.

[51] This was the basis for the tribunal's curious division of responsibility in *ibid* ('The Tribunal . . . notes [that] as the market price then was in downward trend, and the [Buyer's] principal . . . had already sold the goods to downstream customers, [the Buyer] should have taken steps for substitute goods within a reasonable time, in order to avoid further damages. Although [the Buyer] claims that

A breach of contract may lead not only to the injured party's liability to its customers but also to liability vis-a-vis various state authorities. The unpaid seller may have to pay a penalty to state authorities for its failure to sell foreign currency on time[52] or the buyer may have to pay a penalty to customs authorities if the seller fails to deliver the goods.[53] There have been suggestions that in the former type of case, damages for the seller's liability to state authorities are not recoverable because the seller had incurred liability not as a subject of private contractual relations but as a taxpayer, ie as a subject of administrative public relations.[54] It is argued, however, that there is no reason in principle why such damages cannot be recoverable so long as the requirements of limiting damages are met and this position has been taken in the majority of cases under the CISG.[55] These losses seem to be peculiar to international sales transactions and some other examples of losses which are unlikely to occur in domestic sales can be given.

For instance, because of the seller's delay, the buyer may have to pay a higher import tariff than the one it would have paid had there been a timely delivery and damages for the difference between the two rates have been awarded in a case under the CISG.[56] In a similar vein, where the seller commits a breach of its obligation to deliver the goods of a specified place of origin thereby causing the buyer to pay a higher import duty, the amount of such a duty can be recovered as damages.[57] One case under the CISG[58] involved the sale of agricultural tools which were, according the applicable regulations in the United States, treated as 'dumped products'. To avoid the imposition of an import anti-dumping duty by the US authorities, the so-called 'reconsideration application' ought to have

the contract goods of cold-rolled steel of 0.5 mm x 1250 mm x COIL are a special product, the Tribunal has determined that this [was] not the case. Therefore, [the Buyer] should bear some responsibility for the losses because it did not take reasonable measures to find substitute goods. Therefore . . . [the Seller] should be responsible for 70% . . . of the sum [the Buyer] has paid to its downstream customer as liquidated damages and relevant legal fees; the rest, or the 30%, . . . should be borne by [Buyer] itself.').

[52] See, eg, Arbitration proceeding 9 July 1999 (Ukraine) (Metal production goods case) <http://cisgw3.law.pace.edu/cases/990709u5.html>; Arbitration proceeding 27 October 2004 (Ukraine) (Lavatory paper case) <http://cisgw3.law.pace.edu/cases/041027u5.html>; Arbitration proceeding 10 May 1999 (Ukraine) (Sunflower seeds meal case) <http://cisgw3.law.pace.edu/cases/990510u5.html>.

[53] ICAC Case 85/2002, decision dated 26 June 2003 <http://cisgw3.law.pace.edu/cases/030626r1.html>. This case, and cases referred to in note 52, are also discussed in ch 6.

[54] *Gildia Ltd v Gaiski GOK* Federal Arbitration Court for the Moscow Circuit (Resolution of the cassation instance on whether the decisions of arbitration courts are legal and substantiated), No KG-A40/5498-00 (Russia) 6 December 2000 <http://cisgw3.law.pace.edu/cases/001206r1.html>.

[55] See cases referred to in D Saidov, 'Cases on the Sales Convention and the UNIDROIT Principles Decided in the Russian Federation: An Update' (2005) 9 Vindobona J Int'l Commercial L Arbitration 1, note 30.

[56] See ICAC Case 437/1992, decision dated 6 May 1994 (see MG Rozenberg, *Kontrakt mezhdunarodnoy kupli-prodazhi* (Moscow 1998) 53).

[57] See Case No 8 O 118/02 District Court Saarbrücken (Germany) 1 June 2004 (Pallets case) <http://cisgw3.law.pace.edu/cases/040601g1.html>.

[58] See CIETAC Arbitration proceeding 10 December 2003 (Agricultural tools case) <http://cisgw3.law.pace.edu/cases/031210c1.html>.

been filed with the authorities. The tribunal held that it was an obligation of the Chinese seller to file such an application and because its failure to do so had caused the US buyer to pay an import anti-dumping duty, the buyer was awarded damages for the amount of that duty. In a further case under the CISG, the US buyer had breached the contract by not providing the Russian seller, within the fixed time limit, with documents which would have enabled the seller to claim exemption from the payment of value added tax (VAT) and the tribunal granted damages for the amount of the VAT.[59] In yet another case under the CISG,[60] the buyer's non-payment resulted in the Chinese seller losing the 'duty drawback', which seemed to refer to a refund of an import duty where the goods initially imported into China (or finished products manufactured from them) were to be subsequently exported from China. The seller was awarded damages for this loss.

Some other costs incurred as a result of the breach that (subject to the requirement of reasonableness discussed above) may be recoverable as damages include the seller's cost of taking out a loan in cases of non-payment or late payment by the buyer[61] or the seller's loss of use of money.[62] A controversial question is whether the seller's cost of employing a debt collection agency constitutes a recoverable cost. It is suggested that the standards of reasonableness and expediency point in the direction of these costs not being generally recoverable under the instruments: since debt collection agencies do not have any special powers of enforcing the seller's claim to the price[63] and the legal means available to such agencies are not generally superior to those available to the seller,[64] it cannot be assumed that employing such services is a normal (and certainly not necessary or unavoidable, to use a guideline discussed earlier) way of enforcing the seller's rights.[65] However, given that some courts have been prepared to recognise the recoverability of such costs,[66] a more appropriate position is to establish a

[59] See ICAC Case 91/1997, decision dated 29 May 1998 in MG Rozenberg, *Arbitrazhnaya praktika mezhdunarodnogo kommercheskogo arbitrazhnogo suda pri TPP RF za 1998 g* (Moscow, Statut, 1999).

[60] CIETAC Arbitration proceeding 18 April 2003 (Desulfurization reagent case) <http://cisgw3.law.pace.edu/cases/030418c1.html>.

[61] CIETAC Arbitration proceeding 21 July 1997 (Yam-dyed fabric case) <http://cisgw3.law.pace.edu/cases/970721c1.html>; CIETAC Arbitration proceeding 7 November 1996 (Stone products case) <http://cisgw3.law.pace.edu/cases/961107c1.html>.

[62] Although claiming interest for the sum in arrears may be a more appropriate and in fact convenient way of compensation for this loss, there have been cases under the CISG where the seller specifically claimed damages for this loss and where the arbitrators recognised it as a compensable head of loss (see ICAC Case 107/2002, decision dated 16 February 2004 <http://cisgw3.law.pace.edu/cases/040216r1.html>).

[63] See Stoll and Gruber (n 1) 757–8.

[64] See Case No 3/11 O 3/91 District Court Frankfurt (Germany) 16 September 1991 (Shoes case) <http://cisgw3.law.pace.edu/cases/910916g1.html>.

[65] For an extensive list of references to relevant cases, see Stoll and Gruber (n 1) 758; Article 74 in *UNCITRAL Digest of Case Law on the United Nations Convention on the International Sale of Goods* (2004) <http://www.uncitral.org/uncitral/en/case_law/digests/cisg.html>.

[66] For a recent example, see *Gaba BV v Direct NV* District Court Hasselt (Belgium) 12 January 2005 <http://cisgw3.law.pace.edu/cases/050112b1.html>.

rebuttable presumption that such costs are unreasonable, unnecessary and, for that reason, irrecoverable and it should be up to the injured party to prove otherwise.

The buyer's use of defective goods delivered by the seller may cause damage to the buyer's property and although the CISG expressly excludes liability for death and personal injuries,[67] there is little doubt that damage to property is recoverable under the Convention.[68] Because there is nothing in the UPICC and the PECL to exclude this loss, it seems safe to assume that it is also recoverable under the two sets of Principles.[69]

Another issue that has arisen under the CISG is that of the relationship between agreed damages clauses (liquidated damages/penalty clauses)[70] and the right to claim damages under the instruments. The difficulty arises where the injured party claims that the amount of liquidated damages is lower than its actual loss and the question is whether the injured party is entitled to claim damages under the CISG in the amount not covered by liquidated damages. The first issue to be addressed is whether the question of the relationship between liquidated damages and the Convention's remedy of damages is a matter governed by the CISG. While the prevailing view is that the validity of such clauses is a matter to be resolved by the applicable domestic law,[71] it is suggested that the issue of the relationship between agreed damages clauses and the right to damages under the CISG is, contrary to several cases under the CISG,[72] a matter within the Convention's scope. Admittedly, if this position is taken a conflict may, in some cases, be inevitable between the Convention's right to damages and the policy of some legal systems of not allowing ordinary compensatory damages *in addition* to the amount flowing from an agreed damages clause where the latter does not fully compensate the party for its actual loss.[73] Where possible,[74] however, this conflict can be avoided if it is possible to infer from interpreting the clause that it was the parties' intention[75] that the issue of

[67] See art 5 CISG.

[68] See Case No HG 920670 Commercial Court Zürich (Switzerland) 26 April 1995 (Saltwater isolation tank case) <http://cisgw3.law.pace.edu/cases/950426s1.html>; Stoll and Gruber (n 1) 769; W Khoo, 'Arts. 2–5 CISG' in Bianca and Bonell (n 9) 49; Honnold (n 30) 74–5.

[69] See O Lando and H Beale (eds), *Principles of European Contract Law: Parts I and II* prepared by the Commission on European Contract Law (The Hague, Kluwer Law International, 2000) 439.

[70] For a recent overview on this subject, see A Komarov, 'The Limitation of Contract Damages in Domestic Legal Systems and International Instruments' in D Saidov and R Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (Oxford, Hart Publishing, 2008) 257–9, 262–4; see also Treitel (n 1) 208–44; P Benjamin, 'Penalties, Liquidated Damages and Penal Clauses in Commercial Contract: A Comparative Study of English and Continental Law' (1960) 9 ICLQ 600.

[71] See, eg, Stoll and Gruber (n 1) 769–70 (with further references).

[72] See ICAC Case 95/2004 decision dated 27 May 2005 <http://cisgw3.law.pace.edu/cases/050527r1.html> and cases referred to and discussed in Saidov (n 55) 6.

[73] See *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79.

[74] See CIETAC Arbitration proceeding 1 April 1993 (Steel products case) <http://cisgw3.law.pace.edu/cases/930401c1.html>.

[75] See art 6 CISG.

compensation should be governed solely by the agreed damages clause.[76] It is only where no intention can be derived that the conflict between the Convention's right to damages and the applicable domestic law may arise. The former should prevail over the latter[77] because the applicable domestic law should not be allowed to prevail over a right provided for by an international treaty, particularly if the country in question has ratified the Convention.[78] Furthermore, this should be the case because of the need to respect the Convention's requirement[79] that regard be had to its international character and the need to promote uniformity in its application.[80]

Much controversy has surrounded the question of whether the costs of legal proceedings and attorney's fees incurred as a result of the breach are recoverable as damages under the CISG. There is no uniformity, either amongst domestic legal systems or in international commercial arbitration, regarding the treatment of such costs[81] and the Convention itself is silent on the matter. Against this background, it is not surprising that opinions have been divided. On the one hand, it has been argued that costs of litigation (arbitration) and the resulting attorney's fees constitute a 'loss' within the meaning of art 74 CISG because such an interpretation follows from a plain reading of this article: because such costs are incurred as 'a consequence of the breach', the principles of full compensation and the protection of the party's expectation/performance interest dictate that these costs be recoverable.[82] This argument has been further supported on the grounds of policy by suggesting that such an interpretation is dictated by the need to achieve uniformity in the application of the Convention.[83] On the other hand, it has been suggested that the issue of the recoverability of

[76] Presumably, the reverse is also true—that is, that the parties are allowed to specify their intention to allow the injured party to claim damages under the CISG where agreed damages do not fully compensate the party for the loss.

[77] See Saidov (n 55) 6–8. *Cf* Stoll and Gruber (n 1) 769–70.

[78] See arts 26, 27 of the Vienna Convention on the Law of Treaties.

[79] See art 7(1) CISG.

[80] See also CIETAC Arbitration proceeding 13 June 1989 (Sesame/urea case) <http://cisgw3.law.pace.edu/cases/890613c1.html> (the decision is somewhat unfortunate because in awarding damages in addition to the amount fixed by the agreed damages clause the tribunal relied not only on the CISG but also on the applicable domestic statute).

[81] See, eg, JY Gotanda, 'Awarding Costs and Attorney's Fees in International Commercial Arbitrations' (1999) 21 Mich J Int'l L 1.

[82] J Felemegas, 'The award of counsel's fees under Article 74 CISG, in *Zapata Hermanos Sucesores v Hearthside Baking Co* (2001)' (2002) 6 Vindobona J Int'l Commercial L Arbitration 30, 32, 37–8. For cases where legal fees were held to be recoverable under art 74 CISG, see, eg, Case No 1 C 419/01 Lower Court Viechtach (Germany) 11 April 2002 (Pallets case) <http://cisgw3.law.pace.edu/cases/020411g1.html>; Case No 99 O 123/92 District Court Berlin (Germany) 30 September 1992 (Shoes case) <http://cisgw3.law.pace.edu/cases/920930g1.html>; Appellate Court Düsseldorf (Germany) 14 January 1994 (Shoes case) <http://cisgw3.law.pace.edu/cases/940114g1.html>.

[83] See B Zeller, 'Interpretation of Article 74—*Zapata Hermanos Sucesores v Hearthside Baking*—Where Next?' (2004) 1 Nordic J Commercial L <http://www.njcl.fi/1_2004/commentary1.pdf >.

such costs is outside the Convention's scope and should be left to the applicable law.[84] Various reasons have been put forward to support this suggestion. One such reason is that the matter is a procedural issue and should, for that reason, be outside the CISG because the Convention is only concerned with the matters of substantive law.[85] The view has been strongly expressed in a much-discussed case under the CISG:

> The Convention is about contracts, not about procedure. The principles for determining when a losing party must reimburse the winner for the latter's expense of litigation are usually not a part of a substantive body of law, such as contract law, but a part of procedural law.[86]

Another reason is that treating such costs and fees as damages under the CISG will give rise to an anomaly where damages will be awarded to the *winning claimant* but where no damages will be due to the *prevailing respondent party* who successfully defends a breach of contract claim because damages are only awarded for breach of contract. This result undermines the equality of the parties[87] and it is this argument that best explains why the recoverability of costs of legal proceedings and attorney's fees should lie outside the Convention's scope. It has been suggested that the anomaly can be resolved by awarding damages to the prevailing respondent party on the basis that the claimant breached its 'duty of loyalty to the contract' by 'filing a suit for a breach of contract where a court later holds that party's suit to be lacking a proper foundation'.[88] This suggestion, however, lacks support in the CISG[89] and, in any event, is too far fetched to constitute a solid foundation on which to base an award of damages to the prevailing respondent.[90] To return briefly to the first reason in favour of the

[84] This position has been taken in numerous cases. See, eg, *Zapata Hermanos Sucesores v Hearthside Baking Co* 13 F.3d 385; Case No C1 04 162 Appellate Court Valais/Wallis (Switzerland) 21 February 2005 (CNC machine case) <http://cisgw3.law.pace.edu/cases/050221s1.html>; ICAC Case 97/2004, decision dated 23 December 2004 <http://cisgw3.law.pace.edu/cases/041223r1.html>; Case No 12 HKO 4174/99 District Court München (Germany) 6 April 2000 (Furniture case) <http://cisgw3.law.pace.edu/cases/000406g1.html>. For further references to cases both in favour and against the recoverability of legal fees, see, eg, *UNCITRAL Digest* (n 65).

[85] See H Flechtner and J Lookofsky, 'Viva Zapata! American Procedure and CISG Substance in a US Circuit Court of Appeal' (2003) 7 Vindobona J Int'l Commercial L Arbitration 93, 94.

[86] *Zapata Hermanos Sucesores v Hearthside Baking Co* (n 84) 388.

[87] The principle of equality can be derived from the Convention's preamble and from its generally symmetrical structure in relation to the rights, obligations, and remedies of the seller and the buyer.

[88] J Felemegas, 'An Interpretation of Article 74 CISG by the US Circuit Court of Appeals' (2003) 15 Pace Int'l L Rev 91, also <http://www.cisg.law.pace.edu/cisg/biblio/felemegas4.html>.

[89] See A Mullis, 'Twenty-Five Years On—The United Kingdom, Damages and the Vienna Sales Convention' (2007) 71 Rabels Zeitschrift für ausländisches und internationales Privatrecht 35, 44.

[90] 'An approach that requires such a result-oriented jurisprudential stretch . . . in order to avoid egregious partiality, however, does not recommend itself' (HM Flechtner, 'Recovering Attorneys' Fees as Damages under the UN Sales Convention: A Case Study on the New International Commercial Practice and the Role of Case Law in CISG Jurisprudence, with Comments on *Zapata Hermanos Sucesores SA v Hearthside Baking Co*' (2002) 22 Northwestern J Int'l L Business 121, 151).

position that legal costs and fees should be outside the Convention's scope, it is now increasingly recognised that resolving issues under the CISG merely by reference to the distinction between procedural and substantive law is unhelpful: whether a particular matter is classified as a substantive or procedural issue varies from one legal system to another.[91] Consequently, this distinction is not an appropriate framework for dealing with the issue of legal costs and fees. Therefore, the question of whether costs of legal proceedings and attorney's fees can be recovered in a particular case lies outside the CISG because it undermines the equality between the parties and should be resolved by reference to the applicable law.[92]

The same, however, does not necessarily apply to legal costs incurred *prior* to litigation (arbitration). Some such types of legal expenditure, such as costs incurred in mitigating losses, are certainly recoverable under the CISG.[93] There may, however, be certain types of pre-litigation costs which cannot be neatly separated from costs of litigation such as 'the legal costs for the provisional assessment of the legal situation, of the possible outcome of any litigation and settlement negotiations'.[94] It has been correctly suggested that such costs can be very similar to costs arising from litigation and where this is the case the considerations of equality of the parties would again seem to require that they should not be recoverable.[95] In other words, the pre-litigation costs incurred in order to prepare for litigation (or reach a settlement)[96] will, if recoverable under the CISG, be recovered as damages by the winning claimant but will not be recovered as damages by the respondent who successfully defended the claim.

4. DAMAGE TO THE 'PERFORMANCE INTEREST'

It can be argued that where one party does not perform its obligation in accordance with the contract, then the other party's interest in performance ('performance interest') can be said to be damaged because the party does not get what it is entitled to receive under the contract. It would follow from this that nearly every breach can be said to damage the innocent party's interest in and right to performance, and a striking consequence of such a description of the party's loss

[91] See generally, CG Orlandi, 'Procedural Law Issues and Law Conventions' (2000) 5 Uniform L Rev 23, also at: <http://www.cisg.law.pace.edu/cisg/biblio/orlandi.html>.

[92] See also T Kelly, 'How Does the Cookie Crumble? Legal Costs under a Uniform Interpretation of the United Nations Convention on Contracts for the International Sale of Goods' (2003) 1 Nordic J Commercial L at <http://www.njcl.fi/1_2003/commentary2.pdf >; J Vanto, 'Attorney's Fees as Damages in International Commercial Litigation' (2003) 15 Pace Int'l L Rev 203 (also at <http://www.cisg.law.pace.edu/cisg/biblio/vanto1.html>).

[93] *Zapata Hermanos Sucesores v Hearthside Baking Co* (n 86).

[94] I Schwenzer and P Hachem, 'The Scope of the CISG Provisions on Damages' in Saidov and Cunnington (n 70) 105.

[95] *Ibid.*

[96] *Ibid.*

is that whenever there is a breach there is necessarily a loss.[97] This would surely be a step too far.[98] Nevertheless, it is submitted that relying upon the concept of the performance interest in describing losses cannot be abandoned altogether as there are cases where it has special relevance. These are the cases where the innocent party places some kind of subjective or non-economic value on the performance[99] and, in such cases, the well-known 'concrete' and 'abstract' approaches to calculation provide an inadequate and inappropriate analytical framework.[100] Suppose that:[101] a builder fails to build a swimming pool of the required depth but this has no impact on its market value[102]; the seller supplies a wedding ring of greater market value than that agreed upon in the contract but which comes as a great disappointment to the buyer because of an emotional attachment to a cheaper ring; a ring cheaper than that contracted for is delivered but the injured party's wife actually prefers the delivered ring to the one provided for by the contract. If the 'abstract' measure is applied to these examples it will produce inconsistent results; the market formula will lead to damages only in the last case for it is only there that there is a difference between the contract price and the value of the delivered product. While the 'concrete' approach, which looks at the party's *actual* circumstances, may lead to the conclusion that the injured party has suffered some kind of loss, this approach *in itself* is unable to explain and rationalise what that loss is. Eventually the question of whether the party can be considered to have suffered any loss depends on whether the law is prepared to compensate the party for damage to the 'subjective' value (non-economic interest) it has placed on the performance. Therefore, damage to the performance interest is a separate issue requiring special treatment and should, it is submitted, be viewed as an independent head of loss but only, as noted, where the injured party places a subjective or non-economic value on the performance.

Although the above examples were outside the commercial context, the problem of damage to the performance interest may be equally relevant to commercial transactions.[103] While the problems of calculating this loss will be addressed in a later chapter,[104] it may be helpful to give a relevant example at this stage. Suppose that a company, conscious of human rights, orders goods

[97] See A Burrows, 'Are 'Damages on the *Wrotham Park* Basis Compensatory, Restitutionary, or Neither?' in Saidov and Cunnington (n 70) 173.

[98] See *ibid* (stating, in the context of the common law, that if this approach is logically followed through 'one would end up with the infringement of every type of right leading to substantial compensation for the value of the "lost right". That is not our present law and acceptance of it would shatter our conventional approach to damages'.)

[99] For a well-known article on this subject, see D Harris, A Ogus, and J Phillips, 'Contract Remedies and the Consumer Surplus' (1979) 95 LQR 581.

[100] See D Saidov and R Cunnington, 'Current Themes in the Law of Contract Damages: Introductory Remarks' in Saidov and Cunnington (n 70) 25.

[101] All examples are based on those discussed in *ibid*.

[102] See *Ruxley Electronics and Construction Ltd v Forsyth* [1996] AC 344 (HL).

[103] See Schwenzer and Hachem (n 94).

[104] See ch 8.

under a condition that no child labour will be used in the production of the goods and agrees to pay an additional price to ensure compliance with this condition.[105] Suppose further that child labour has been used in manufacturing the goods but that this fact does not change the tangible properties of the product. A strong case can be made in such circumstances that even if the use of child labour has not affected the market value of the product, the buyer has suffered loss. The difficult question, of course, is how to identify those cases where the innocent party has in fact placed some subjective or non-economic value on the performance. It is suggested that one important factor is whether the party, such as the buyer in our example, has paid an additional price precisely with a view to ensure compliance. There may also be some other clear evidence such as a contractual clause imposing a strict obligation concerning the use of child labour reinforced by specific and strong statements to this effect made during the negotiations between the parties prior or subsequent to the conclusion of the contract, or a relevant trade usage. Another way of both identifying and calculating such losses could be for the court to 'ask itself, hypothetically, if the parties had agreed on a liquidated damages clause, whether . . . it would have included compensation for non-pecuniary benefits'.[106] In the light of the possible difficulties of both identifying cases where a subjective value has been placed on the performance and calculating damage to that value, the parties are certainly advised to make their intentions clear and, even more importantly, to provide their assessment of the value they place on the performance (eg, by including a liquidated damages clause).

5. LOSS CAUSED BY THE CHANGE IN THE VALUE OF CURRENCY

In international transactions, delay in performance may give rise to losses brought about by a change in the value of the currency(ies) in question. To identify cases where such losses can occur, it is necessary to distinguish between two situations. First, there are situations where losses can be caused by a change in the so-called 'internal' or 'real' value of a currency. A change in the internal value of currency is usually part of inflationary or deflationary processes[107] and

[105] The example is given in Schwenzer and Hachem (n 94). There has been much evidence recently demonstrating that many companies are concerned about and are unwilling to purchase products involving the violation of human rights generally and the use of child labour in particular (see, eg, 'Gap acts over Indian child labour' <http://news.bbc.co.uk/2/hi/business/7098975.stm> accessed on 29 November 2007).

[106] A Ogus, 'The Economic Basis of Damages for Breach of Contract: Inducement and Expectation' in Saidov and Cunnington (n 70) 135.

[107] 'Inflation and its opposite, deflation, describe changes in a nation's . . . currency's domestic purchasing power' (K Rosenn, *Law and Inflation* (University of Pennsylvania Press, Philadelphia 1982) 3). Although there is no universally accepted definition of the term 'inflation', it has been said to refer either to 'a sustained rise in an economy's general level of prices or to a corresponding fall in the domestic purchasing power of an economy's currency' (*ibid*, 3); also RG Hammond, 'Compensation for the Lost Value of Money: A Canadian Proposal' (1983) 99 LQR 71–2 (defining inflation in descriptive and causal senses).

represents a change in the domestic purchasing power of a currency.[108] A change in its purchasing power can, in turn, be defined as a change in the value of a currency 'against the value of goods and services which can be acquired with it'.[109] Second, losses can also arise from a change in the 'external' or 'international' value of a currency and these terms refer to the value of one currency in relation to the value of another currency. This relationship influences and is reflected in the 'rate of exchange', ie 'the price of one currency in terms of another'.[110] The distinction between the two situations is important because a change in one value will not necessarily entail a change in the other type of value,[111] although in the long term it may be the case that a change in the internal value will result in a change in the external value.[112] Since, at least in the short term, the two types of value are distinct from one another, a change in those values can be said to give rise to two different types of loss: loss arising from a change in the purchasing power (internal value) of a currency and loss caused by a change in the external value of a currency. The former may occur where, for example, the buyer makes a late payment and the currency has depreciated between the due date and the date of actual payment and as a result, the seller receives less than it would have received had the payment been made on time. The loss flowing from changes in the external value of currencies may arise in different situations. One example is where the buyer makes a late payment in a currency which the seller then intends to exchange for its domestic currency. If the domestic currency has strengthened against the currency of payment or if the latter has devalued against the former between the due date of payment and the date of actual payment, the seller can be said to have received less than it would have received had the contract been properly performed.[113]

Should these losses be recoverable under the international instruments? An argument in favour of their recoverability is that they are *real* financial losses and so long as the requirements of limiting damages are met, they should be recoverable. It can also be argued that this result is dictated by the purpose of putting the party in the position in which it would have been had the contract

[108] Rosenn (n 107) 3.

[109] A Hudson, 'Money as Property in Financial Transactions' (1999) 14 J Int'l Banking L 171.

[110] C Proctor, *Mann on the Legal Aspect of Money*, 6th edn (Oxford, OUP, 2005) 74; Rosenn (n 107) 3.

[111] 'It seems that there is no necessary or direct connection between the domestic and the international values of the unit of account; in the late 1970s and the early 1980s, significant rates of inflation eroded the domestic value of the pound, yet its value in terms of the US dollar remained broadly stable' (Proctor (n 110) 75). Therefore, we cannot be as categorical as one court was by stating that 'inflationary value of the money . . . affects the flexible exchange rates which, as opposed to fixed exchange rates, are determined on the basis of the laws of supply and demand. The flexible exchange rates mirror the respective purchase power of the currency' (Case No O 116/81 District Court Heidelberg (Germany) 27 January 1981 <http://cisgw3.law.pace.edu/cases/810127g1.html>).

[112] 'In the long run, countries experiencing inflation rates higher than those of customary trading partners, will be forced to devalue; however, in the short run, it is frequently possible for countries to maintain the same exchange rate despite substantial inflation, or to devalue by less than the inflation rate differential' (Rosenn (n 107) 3).

[113] For other examples and a more extensive discussion, see ch 9.

been performed. So far as the case of the 'external' value of currencies is concerned,[114] there are no obstacles to this line of argument.[115] The same cannot be said of the 'internal' value of currency where the principal objection to the recoverability of currency depreciation losses is the principle of nominalism.[116] According to this principle, nominalism means that any change in the purchasing power of currency should not be taken into account and it is its face value which should be relied upon.[117] Nominalism has been said to be an 'essential part of every stable monetary system'[118] and this idea has already been supported in a case governed by the ULIS, where the court stated the following:

> [The] financial nominalism is derived from considerations of the stability of currency and also the promotion of good faith and legal certainty. If the value of the currency had to be considered in connection with every purchase price debt, this would lead to an accelerated depreciation of the currency and would present the contracting party . . . with an incalculable risk . . . Recognition of a loss of value of a currency as a compensable loss on grounds of a delayed payment would accelerate the drop of the value of a currency and would intervene in the monetary policies of the Contracting States.[119]

Therefore, relying on this principle, the buyer who made a late payment can argue that any decrease in the currency's purchasing power must simply be ignored as the seller still received nominally the same amount as it would have received had the payment been made on time.

It is submitted that despite the principle of nominalism being widely recognised and well entrenched in some legal systems,[120] it should not prevent the currency depreciation loss from being recoverable under the international instruments.

First of all, this principle has been said to rest on and to have resulted from the presumed intentions of the parties:[121] by agreeing on a particular currency the parties are presumed to have intended for their obligations to be discharged

[114] See also arts 6.1.9(4) UPICC and 7:108(3) PECL (which contain a specific remedy designed to deal with the problem of exchange rate losses) and the discussion in ch 9.

[115] It has been suggested in one case under the CISG that '[a] currency devaluation can only be compensated if it leads to damages on the part of the creditor, for instance, if the creditor usually conducts his money transfers in a third currency and therefore always converts other currencies immediately after their receipt. In such a case, the currency devaluation has an unfavorable effect' (Appellate Court Düsseldorf (Germany) 14 January 1994 (n 82). It is suggested, however, that this statement cannot be taken as a general position on the recoverability of this loss as its true relevance lies with the issue of whether exchange rate losses, when a creditor exchanges the currency of payment into another currency, are foreseeable (for further discussion, see ch 9).

[116] For reasons why nominalism is not relevant to cases involving exchange rate losses, see RA Brand, 'Exchange Loss Damages and the Uniform-Money Claims Act: The Emperor Hasn't All His Clothes' (1991/1992) 23 L Policy Int'l Business 1, 44–5.

[117] See TA Downes, 'Nominalism, Indexation, Excuse and Revalorisation: A Comparative Survey' (1985) 101 LQR 98–9.

[118] Waddams (n 20) 383.

[119] Landgericht Heidelberg (n 111).

[120] See Brand (n 116) 43.

[121] Proctor (n 110) 242.

on 'a unit for unit basis'.[122] In addition, it has also been argued that because the declining value of currency as well as contractual devices for protecting against inflation[123] are widely known in modern times, it can be presumed that a failure to include such devices in the contract should serve as evidence that the creditor has assumed the risk of a decline in the value of money.[124]

In response to these points, it has been correctly argued that while drawing presumptions regarding the parties' intentions may be appropriate in cases involving claims for the payment of the price or similar claims for the payment of a pre-determined sum of money, drawing such presumptions is not relevant in cases where damages are claimed as the 'innocent party had not intended that the contract should be broken'.[125] It is further submitted that a failure to stipulate a device for protecting against inflation may, *in some cases*, be a sufficient reason to presume that the risk of currency depreciation has been assumed by the creditor. For instance, if the evidence shows that, before making the contract, the creditor had considered and discussed with the other party the risk of inflationary losses, it may well be justifiable to conclude that the creditor intended to assume such a risk. However, it would seem that in international transactions involving business persons of different backgrounds and varying levels of commercial sophistication, drawing the suggested general presumption is a step too far. A more appropriate and balanced position is to consider each case *on its own facts* with a view to determining whether the parties intended to derogate from the instruments' general provisions on damages by allocating the risk of the currency depreciation loss to the creditor.[126] A failure to include an inflation protection device should merely be a factor to be taken into account when interpreting a particular contract. Thus, the reasons set out in this paragraph together with the need to protect the party's 'expectation/performance' interest and the fact the currency depreciation loss is a real financial loss dictate that this loss be recoverable under the international instruments.[127]

[122] C Proctor, 'Changes in Monetary Value and the Assessment of Damages' in D Saidov and R Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (Oxford, Hart Publishing, 2008) 464.

[123] These devices include linking payments to an agreed index, escalation clauses and short repayment periods for loans (Waddams (n 20) 384).

[124] *Ibid*.

[125] Proctor (n 122).

[126] Article 6 CISG, art 1.5 UPICC and art 1:102(2) PECL.

[127] The Comments to the PECL seem to indicate that currency losses represent recoverable losses under the PECL: '[T]he aggrieved party's remedy for non-payment or delay in payment is not limited to interest. It extends to additional and other loss recoverable within the limits laid down by the general provisions on damages . . . This might include, for example, . . . a fall in the internal value of the money, through inflation, between the due date and the actual date of payment, so far as this fall is not compensated by interest under paragraph (1); and, where the money of payment is not the money of account, loss on exchange' (Comment C to Article 9:508 in Lando and Beale (n 69) 450). For a seemingly different position on this issue, see CISG Advisory Council (CISG-AC) No. 6 'Calculation of Damages under CISG Article 74' <http://www.cisg.law.pace.edu/cisg/CISG-AC-op6.html>. For cases where currency losses were held recoverable, see ch 9. See also *Gruppo IMARS SpA v Protech Horst* District Court Roermond (Netherlands) 6 May 1993 where the position of the court was not clear when it stated that 'although under the CISG a devaluation of the currency of

6. DAMAGE TO REPUTATION AND GOODWILL[128]

In contrast with the UPICC and PECL, which expressly recognise the recoverability of non-pecuniary losses,[129] the CISG provides no indication as to the recoverability of such losses. However, most of such losses are unlikely to be relevant to commercial transactions because such transactions usually give rise only to pecuniary or economic considerations and because most commercial players are legal entities which are incapable of suffering most types of non-pecuniary loss (such as emotional harm or mental distress).[130] Nevertheless, business reputation and goodwill are those intangible phenomena which may be relevant to commercial transactions and, therefore, damage to these intangibles cannot be easily dismissed as being irrecoverable under the CISG. It has been suggested that only pecuniary losses flowing from damage to intangibles are recoverable,[131] and a similar attitude has been expressed in some cases decided under the CISG. For example, in one case, the court stated that '[t]he [buyer] cannot claim a loss of turnover, on the one hand—which could be reimbursed in the form of lost profits—and then, on the other hand, try to get additional compensation for a loss in reputation. A damaged reputation is completely insignificant as long as it does not lead to a loss of turnover and consequently lost profits. A businessperson runs his business from a commercial point of view. As long as he has the necessary turnover, he can be completely indifferent towards his image'.[132] Likewise, another court has stated that 'deterioration of commercial image [reputation] is not compensable damages in itself, if it did not entail proved pecuniary damages'.[133] These cases seem to reflect the view that damage to reputation and/or goodwill is somehow not a 'real loss' in itself and that it only becomes such where adverse pecuniary consequences follow.[134]

the price is in principle at the risk of the seller, in this case, the buyer had to pay damages for devaluation since the seller would not have incurred this loss if the buyer had paid in due time' <http://cisgw3.law.pace.edu/cases/930506n1.html>.

[128] This section is based on D Saidov, 'Damage to Business Reputation and Goodwill under the Vienna Sales Convention' in Saidov and Cunnington (n 70).

[129] Article 7.4.2(2) UPICC and art 9:501(2)(a) PECL.

[130] See National and International Arbitral Tribunal of Milan (Italy) Award No A-1795/51 of 1 December 1996 <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13618&x=1> (where the tribunal, applying the UPICC, excluded compensation for emotional harm and distress because the injured party was a corporate entity).

[131] See Stoll and Gruber (n 1) 753; CISG-AC (n 127).

[132] Case No 10 O 72/00 District Court Darmstadt (Germany) 9 May 2000 (Video recorders case) <http://cisgw3.law.pace.edu/cases/000509g1.html>.

[133] See *Calzados Magnanni v Shoes General International* Court of Appeal Grenoble (France) 21 October 1999 <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/991021f1.html>. This decision overruled the decision in the first instance where compensation for loss of reputation had been awarded.

[134] This is the position that is sometimes taken in the context of English law (see N Enonchong, 'Contract Damages for Injury to Reputation' (1996) 59 MLR 592, 597).

The question is whether this is a proper approach to take under the CISG. The procedure that the CISG adopts to deal with issues which it does not expressly address is, first of all, to determine whether the issue in question is governed by the CISG.[135] If so, the matter needs to be resolved on the basis of the Convention's general principles.[136] To deal with the first part of this procedure, it is submitted that the issue of the recoverability of losses is certainly within the Convention's scope. The Convention expressly aims to deal with the issue of damages and, therefore, the answer to this question needs to be found within the Convention itself. Is there a relevant general principle which would help resolve the matter? It is often suggested that the principle of 'full compensation' can be regarded as a general principle[137] and it is sometimes argued that it is this principle that dictates that loss of reputation and goodwill be recoverable.[138] But this is probably too easy an answer[139] because full compensation would dictate the recovery of damage to intangibles only if such damage is regarded as a (recoverable) 'loss' within the meaning of art 74 in the first place.

It would appear then that the issue is one of the interpretation of art 74 and the question is whether damage to reputation and goodwill is 'a loss' under the CISG. It is suggested that the answer depends on the policies of the Convention which are, in turn, informed by its underlying values.[140] For present purposes, it will suffice to state that the CISG aims to support international trade and commerce and that it represents an attempt to provide a balanced set of rules which would be acceptable to international traders. It is often argued that to be able to facilitate commercial development legal rules need to meet the legitimate needs, expectations, and practices of commercial men.[141] This line of thinking leads to the question whether business people would view reputation and goodwill as something that is important for them. Are reputation and goodwill something into which they will invest money, time, and effort? Are they things on which they rely in conducting their affairs? In short, is it reasonable to expect that they would generally regard reputation and goodwill as important assets? It is the

[135] The Convention defines its scope in very general terms by referring to the issues of formation and rights and obligations of the parties flowing from the contract (see art 4).

[136] See art 7(2) CISG.

[137] See Comment 3 to Article 70 of the 1978 Draft Convention; see also cases decided by the Vienna Arbitration proceeding SCH-4318, decision dated 15 June 1994 (Rolled metal sheets case) <http://cisgw3.law.pace.edu/cases/940615a4.html> and SCH-4366 15 June 1994 (n 37).

[138] See A Burrows, *Remedies for Torts and Breach of Contract*, 3rd edn (Oxford, OUP, 2004) 317.

[139] The same can be said about the argument that art 7.4.2 UPICC could supplement the CISG in this respect.

[140] The connection between what constitutes loss, on the one hand, and underlying values of a legal system and of society as a whole has been highlighted on a number of occasions (see, eg, E McKendrick and K Worthington, 'Damages for Non-Pecuniary Loss' in N Cohen and E McKendrick (eds), *Comparative Remedies for Breach of Contract* (Oxford, Hart Publishing, 2005) 322; MG Bridge, 'Contractual Damages for Intangible Loss: A Comprehensive Analysis' (1984) 62 Can Bar Rev 323, 326–7).

[141] See, eg, Goode (n 30) 1203–4.

answers to these questions that should be decisive in resolving the question of whether damage to reputation and goodwill is recoverable under the CISG.

It does not seem possible to make generalisations in answering these questions.[142] It is certainly true that in some industries or trade sectors reputation or goodwill may be regarded as important assets whereas in others this may not be the case.[143] It may also be the case that companies with bad reputations would be very profitable.[144] Nonetheless, there is a substantial body of evidence, both in law and outside it, which demonstrates that it is *often* the case that reputation and goodwill are viewed by business persons as important commercial assets. Although the reasons are many, they all revolve around the benefits flowing from having a good reputation or goodwill. These benefits include: a company's ability to charge premium prices for their products/services[145]; pay lower prices to its suppliers; incur lower marketing costs; attract top recruits; experience greater loyalty from customers and employees; have more stable profits; face fewer risks in times of crisis; obtain credit more easily; and, more generally, have greater freedom in decision making.[146] Because of these potential benefits, good reputation has been viewed as a strategic resource enabling a company to have a competitive advantage over its rivals.[147] Legal research[148] has also demonstrated that in certain trade sectors, reputation is an important factor in selecting a transactional partner and a non-legal sanction[149] the threat of which may deter a breach or help enforce an arbitral decision. There can be little doubt, therefore, that reputation and goodwill play a significant *multi-functional* role in commercial affairs and it is not surprising to discover that some companies would make significant investments in terms of money, time and effort in developing and sustaining their reputations.[150] The importance of reputation and

[142] See R Chun, 'Corporate Reputation: Meaning and Measurement' (2005) 7 Int'l J Management Reviews 91, 100 ('A good image/reputation is probably better than a bad image, but the results in the literature have in fact been inconsistent').

[143] See NA Gardberg, 'Reputatie, Reputation, Réputation, Reputazione, Ruf: A Cross-Cultural Qualitative Analysis of Construct and Instrument Equivalence' (2006) 9 Corporate Reputation Rev 39, 51.

[144] *Ibid*, 52.

[145] See L Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Cooperation through Rules, Norms, and Institutions' (2000–2001) 99 Mich L Rev 1724, 1748–9 nn 104 and 107.

[146] There are numerous sources outlining these benefits (see, eg, C Fombrun, *Reputation: Realizing Value from the Corporate Image* (Boston MA, Harvard Business School Press, 1996) 11, 73, 75).

[147] *Ibid*, 11 and 28.

[148] See, eg, the following sources with further references: H Collins, *Regulating Contracts* (Oxford, OUP, 1999) 97–126; CP Gillette, 'Reputation and Intermediaries in Electronic Commerce' (2001–2002) 62 La L Rev 1165; L Bernstein, 'Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry' (1992) 21 JLS 115; Bernstein (n 145).

[149] See Case No 32 O 508/04 District Court Bayreuth (Germany) 10 December 2004 (Tiles case) <http://cisgw3.law.pace.edu/cases/041210g1.html> (where the buyer alleged that its customer had warned other customers not to purchase tiles from the buyer).

[150] See EL Black and TA Carnes, 'The Market Valuation of Corporate Reputation' (2000) 3 Corporate Reputation Rev 31; Collins (n 148) 112. Cases provide a number of examples showing that building a solid reputation may require years to develop and expand business and establish good relations with other companies (such as, eg, suppliers and retailers) as well as much effort in

goodwill is further reaffirmed by evidence and suggestions that companies would sometimes prefer to pay damages or fines than to take the risk of damaging their reputations.[151] For these reasons, damage to these intangibles can be potentially quite significant for a company's business standing, even if it does not immediately result in substantial financial losses.

This discussion demonstrates that reputation and goodwill can be significant business assets and it is reasonable to assume that business people often treat them as such. It also seems fair to suggest that if damage to these intangibles is not recoverable, incentives for commercial men to invest in reputation and goodwill will be reduced.[152] All this appears to point in favour of such damage being, in principle, recoverable.

It is important to examine the existing objections to this position. One objection is that the question of the recoverability of this type of damage cannot be properly dealt with unless reputation and goodwill are defined precisely.[153] The intangible nature of reputation and goodwill makes it impossible to develop a precise and workable definition of what constitutes damage to these phenomena. This also makes it impossible to identify a specific property to which damage has been done; such damages are too speculative, difficult to prove and not capable of a rational assessment.[154] For these reasons, it can be further argued that making a breaching party pay damages for this alleged loss is simply unfair. According to some courts, this unfair treatment becomes more acute because of the difficulty of setting limits to the recovery of such damages.[155] Another objection is that such losses are never foreseeable as required by art 74 and, for that reason, are not recoverable.[156] Finally, the so-called 'floodgate' argument is

ensuring high quality of goods/services and proper contractual performance and much financial investment in hiring new employees, promotion and advertising (see decision by Tampere Court of First Instance (Finland) 17 January 1997 (Canned food case) <http://cisgw3.law.pace.edu/cases/970117f5.html> (decided under the CISG); *Barrett Co v Panther Rubber Mfg Co* 24 F.2d 329, 331 (C.A.1 1928); *Reo D Stott v Thomas Johnston* (1951) 36 Cal.2d 864, 872–3 (the latter two cases were decided under US law)).

[151] Fombrun (n 146) 84; TW Waelde, 'Contract and Enforceability in International Business: What Works?' <http://www.dundee.ac.uk/cepmlp/journal/html/vol5/vol5-8.html>.

[152] It can also be argued that the recoverability of damage to reputation may, in some cases, create a disincentive for parties to breach their contracts and this would be in line with the idea of *favor contractus* which is often said to underlie the CISG (see, eg, U Magnus, 'General Principles of UN-Sales Law' <http://www.cisg.law.pace.edu/cisg/biblio/magnus.html>).

[153] See D Saidov, 'Damages: The Need for Uniformity' (2005–2006) 25 J L Commerce 393, 395. It can also be argued that since the ideal is for the Convention to be applied uniformly around the world, reaching an agreement on a uniform definition is important to achieve a uniform treatment of claims for damage to reputation and goodwill.

[154] See, eg, *Kassab v Central Soya* 246 A.2d 848, 858 (Pa. 1968). Similar points have been made in the context of other disciplines. See SL Wartick, 'Measuring Corporate Reputation: Definition and Data' (2002) 41 Business & Society 371, 372 '[A]ny discussion of measurement must necessarily start with a look at definition. The following thought may be grossly oversimplified, but it seems to me that one cannot talk about measuring something until one knows what that something is').

[155] See *Armstrong Rubber Co Inc v Griffith* 43 F.2d 689, 691 (C.A.2 1930).

[156] For cases under the CISG, see CIETAC 26 October 1996 (n 12) (it is not clear, however, whether, loss of reputation was simply not foreseeable on the facts of this case or whether the tribunal took the view that this type of loss could never be foreseeable). This argument has also been

often put forward, according to which courts will be swamped with various claims which can be described as loss of reputation/goodwill.[157] Each of these objections will be addressed in turn.

The 'definitional' objection requires taking a closer look at the attempts made to define business reputation and goodwill.[158] So far as the former is concerned, no uniform definition exists for the purpose of dealing with claims for damage to reputation either in the Convention or in domestic jurisdictions. It seems possible, however, to highlight the essential characteristics of business reputation. First, there seems to be an agreement that *perceptions or impressions* are central to the idea of reputation. Reputation is developed by means of the processing of information about the company's past actions and making judgements about its future prospects by an individual, group, or community (whichever is relevant). Therefore, reputation is 'purely perceptual'.[159] The second element relates to relevant observers *making judgements about or assessing* a company's business standing. Third, who should be regarded as the relevant 'stakeholders' whose perceptions and judgements we need to examine?

Clearly, there are potentially a large number of individuals and groups who might be considered stakeholders as they may include customers, other companies whose business activities are connected with the company in question, employees, investors and a broader community. It is probably true that in the majority of cases, it is damage to reputation amongst customers that is alleged. Nevertheless, examples can be found where courts deemed it possible to define concepts not dissimilar to reputation on the basis that customers were not the only relevant stakeholders. In one US case involving a claim for loss of goodwill, the court stated that although goodwill is primarily viewed as 'a function of customer response and ongoing allegiance to a company',[160] the measure of goodwill can also take into consideration 'a firm's relationship with creditors, including relationship with its bank'. The court also alluded to the possibility of taking into account not only the relationship with the company's creditors and banks but also the existence of goodwill in the 'labour market'.[161] This broad approach to defining reputation has also been taken in many writings in business and business-related disciplines where reputation has been defined as 'a collective representation of a firm's past behaviour and outcomes that depicts the firm's ability to render valued results to multiple stakeholders'.[162] According to

raised in the context of other legal systems (for the discussion and further references in English law, see Enonchong (n 134) 600; in the context of US law, see RP Barbarowicz, 'Loss of Goodwill and Business Reputation' (1970–1971) 75 Dickinson L Rev 63, 75; RR Anderson, 'Incidental and Consequential Damages' (1987) 7 J L Commerce 327, 421).

[157] See, eg, Enonchong (n 134) 602 and Barbarowicz (n 156) 68.

[158] Since most players in international trade are companies as opposed to natural persons, the focus is on 'corporate' reputation and goodwill.

[159] Wartick (n 154) 374.

[160] *Toltec Fabrics v August Inc* WL 339280 1, 2 (SDNY 1993).

[161] *Ibid*, 2.

[162] *Ibid*, 243.

another similar definition, business reputation is 'a perceptual representation of a company's past actions and future prospects that describes the firm's overall appeal to all of its key constituents when compared with other leading rivals'.[163]

There are, however, serious doubts about the workability of such a broad definition and a better approach is to refrain from a comprehensive definition and to admit that *there is no one reputation*. Instead, the relevant questions are: Reputation to whom, for what, and for what purpose?[164] Taking this position would mean that there are many aspects to the definition of reputation. A claimant may, for example, claim damages only for loss of reputation amongst a very specific group of stakeholders such as customers or potential investors, and the question 'reputation for what?' would have to be answered depending on what a particular group is interested in. A company's customers would presumably focus on the quality of goods and services as well as on other aspects of contractual performance such as timely delivery, for example. So far as investors are concerned, reputation would relate to a company's ability to maintain a financially healthy and stable business. In sum, it is possible to define business reputation in very general terms by referring to its essential characteristics of being based on people's perceptions and judgements. However, it will have to be left to a claimant to answer the questions 'reputation to whom, for what, and for what purpose?' in the context of its particular case. So far as the definition of goodwill is concerned, recent research has shown that despite a multiplicity of definitions of goodwill, for the purposes of breach of contract claims it should be treated synonymously with business reputation.[165]

The objection that there are serious difficulties of proving and assessing damage to reputation/goodwill is addressed later in the work, where it is shown that there *are* reliable means of calculating this type of loss.[166] The next argument asserting the difficulty of setting the limits to the recovery does not seem to be a strong one as the Convention contains mechanisms such as the rules on foreseeability, causation, mitigation[167] and the standard of proof (if it exists under the Convention)[168] which are capable of setting appropriate limits. The argument that such losses are never foreseeable also cannot prevent them from being

[163] Fombrun (n 146) 72. Although these definitions of reputation have not been free from criticism, it would appear that they have been used more widely than other existing definitions (See, eg, Wartick (n 154) 374–80).

[164] See PG Lewellyn, 'Corporate Reputation: Focusing on Zeitgeist' (2002) 41 Business & Society 446, 451.

[165] See Saidov (n 128).

[166] See ch 9.

[167] See *NV Maes Roger v NV Kapa Reynolds* Appellate Court Gent (Belgium) 10 May 2004 <http://cisgw3.law.pace.edu/cases/040510b1.html> (where the claim for damage to reputation was dismissed on the grounds of causation and mitigation).

[168] See ch 7.

recoverable. As has been pointed out on numerous occasions,[169] it is perfectly possible, for example, for a seller to be in the position to foresee, at the time when the contract is made, that its delivery of a large quantity of defective goods is likely to damage a buyer's reputation. Just like with any other loss, the question whether it was foreseeable is to be decided in the context of the particular facts. Finally, there also seems to be a general agreement that the 'floodgate' argument is not a valid reason to prevent the recoverability of damages to reputation/goodwill. As has been said in a well-known English case, 'it will not be right to allow "floodgates" arguments . . . to stand in the way of claims which, as a matter of ordinary legal principle, are well founded'.[170] Thus, there is no good reason why damage to reputation/goodwill should not be recoverable and it is submitted that the line of cases recognising this loss as recoverable under the CISG should be followed.[171]

7. LOSS OF PROFIT

7.1 General

Loss of profit, which is specifically indicated by the instruments as being recoverable, can arise in a variety of circumstances. If the seller fails to deliver the goods, the buyer may be prevented from earning a profit by reselling the goods. If the buyer intended to use the goods in manufacture, non-delivery may cause an interruption in the manufacturing process or, in more extreme cases, wholly deprive the buyer of an opportunity of carrying out the manufacturing activity. In both cases, the buyer may suffer lost profits as a result of either its inability to sell the final product during the period of the interruption or by not being able to sell anything at all. The buyer may also suffer loss of volume through not being able to supply all the customers whom it would have supplied had there been no breach.[172] Similarly, the seller's delivery of defective goods or late

[169] See *EK, L and A v F* Supreme Court (Switzerland) 28 October 1998 <http://cisgw3.law.pace.edu/cases/981028s1.html> ('it is not possible to establish a general rule which says that certain damages are only foreseeable if they have been expressly dealt with in the contractual negotiations. This is also true for goodwill disadvantages and for damages that are caused because a buyer loses a client due to a deficient delivery. Such damages can be foreseeable by the seller if the buyer is obviously an intermediary in a sensitive market and in addition has no possibility to otherwise supply its clients with complying goods within the time limit due to its own precautions') Anderson (n 156) 421; *Reo D Stott v Thomas Johnston* (n 150) 353; Enonchong (n 133) 75; McKendrick and Worthington (n 140) 315 (in the context of non-pecuniary losses generally).

[170] *Malik v Bank Credit and Commerce International SA* [1998] AC 20, 42.

[171] See ICC Arbitration Case No 11849 of 2003 (Fashion products case) <http://cisgw3.law.pace.edu/cases/031849i1.html>; Case No HG 970238.1 Commercial Court of Zürich (Switzerland) 10 February 1999 (Art books case) <http://cisgw3.law.pace.edu/cases/990210s1.html>; Case No S 00/82 Helsinki Court of Appeals (Finland) 26 October 2000 (Plastic carpets case) <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/001026f5.html>; Appellate Court Gent (n 167).

[172] *Delchi Carrier SpA v Rotorex Corp* (n 28) (the case involved the delivery of defective goods but because they were rejected, the case is tantamount to a case of non-delivery).

delivery may result in the buyer being prevented from earning the planned profit by reselling the goods because its sub-buyers either reject the goods[173] or buy them at reduced prices.[174] Just like in the case of non-delivery, the delivery of defective goods (or delay in delivery) may result in the buyer losing profits because the production line of finished goods had remained idle due to the defects in the goods.[175] If, in turn, the buyer fails to pay, the seller, being either a middleman or a manufacturer, will (if the bargain was not a losing one) lose the profit margin it planned to receive by selling the contract goods. As a result of not getting the price on time, the seller may also lose profit by being deprived of an opportunity to invest in a lucrative venture. All these types of lost profits may be recoverable as damages subject to the methods of limiting damages (causation,[176] foreseeability[177] and mitigation[178]), the applicable standards of proof,[179] and their calculation will depend on the applicable methods of calculation.[180]

Loss of profit often occurs where, as a result of the breach, the injured party loses its customers.[181] A typical case is where the buyer argues[182] that as a result of defective delivery, its sub-buyers have cancelled the existing orders and/or decided not to do business with the buyer in the future. In such circumstances, damages have been awarded for loss of clientele, orders, or trade.[183] It is submitted, however, that it is misleading to treat loss of custom as *a loss in itself* for which damages may be given. It is suggested that loss of custom essentially describes a *situation* that has resulted from the breach and that situation, in turn, may give rise to specific losses for which damages may be awarded. Such specific losses are usually lost profits but may include other types of loss as

[173] See, eg, Case No VIII ZR 210/78 Supreme Court (Germany) 24 October 1979 (Cheese case) <http://cisgw3.law.pace.edu/cases/791024g1.html> (decided under the ULIS).

[174] ICAC Case 054/1999, decision dated 24 January 2000 <http://cisgw3.law.pace.edu/cases/000124r1.html>.

[175] ICAC Case 310/1996, decision dated 26 September 1997 in MG Rozenberg, *Mezhdunarodnaya kuplya-prodazha tovarov: Kommentariy k zakonodatel'stvu i praktike razresheniya sporov* (Moscow, Statut, 2001) 249.

[176] See ch 4.

[177] See ch 5.

[178] See ch 6.

[179] See ch 7.

[180] For a detailed discussion, see chs 8 and 9.

[181] This paragraph is based on the discussion in Saidov (n 128).

[182] For such claims brought under the CISG, see CIETAC Arbitration proceeding 31 January 2000 (Clothes case) <http://cisgw3.law.pace.edu/cases/000131c1.html> (where this loss was not held to be foreseeable and not sufficiently proved); *Société TCE Diffusion Sarl v Société Elettrotecnica Ricci* Appellate Court Orléans (France) 29 March 2001 <http://cisgw3.law.pace.edu/cases/010329f1.html>.

[183] See Swiss Supreme Court (Switzerland) 28 October 1998 (n 169) (the abstract of the case refers to loss of clientele, while the translation of the case refers to loss of profit flowing from loss of clientele). Such damages have been awarded in English law (see *Cointat v Myham & Son* [1913] 2 KB 220; *GKN Centrax Gears Ltd v Matbro Ltd* [1976] 2 Lloyds Rep 555).

well.[184] Clearly, lost profits arising from loss of custom are recoverable (subject to the usual requirements of limiting damages and proof).[185]

7.2 Loss of volume

An injured party may suffer lost profit as a result of losing 'volume' of sales and there has been some uncertainty regarding whether or not this type of loss should be recoverable. In a 'lost volume'[186] situation, the seller has fewer customers than it can supply[187] or, in other words, its ability to supply exceeds the demand for its goods. In such conditions, the buyer's refusal to accept and pay for the goods costs the seller 'one sale' or one unit of profit even if it manages to resell the goods. In a true lost volume situation, the seller's resale is not a replacement for the original contract because even if the original contract had been performed, the second buyer would have bought these goods from the seller anyway and the seller has lost volume by having sold only one item instead of two. Lost volume situations may arise simply because the amount of supply the seller is able to provide exceeds the existing demand for the goods in question. They may also arise where the goods are highly specialised and/or have been manufactured for the needs of a particular buyer[188] or where the goods have to bear the buyer's signet,[189] thereby eliminating any demand for the seller's goods.

Although it is the seller who is usually prone to experiencing loss of volume, the party who acts as the buyer in the contract with the breaching seller can also find itself in this situation. This can be the case where, for example, the buyer, whether a middleman or a manufacturer, purchases the goods with a view to either reselling them or using them to manufacture the final product destined for further sale. If the demand for the contract goods exceeds their supply,[190] the buyer may be unable, as a result of the seller's breach, to supply its sub-buyer or

[184] For instance, in one case, the injured party claimed that 'as a result of losing business relations with one customer he lost a group delivery arrangement which would increase the buyer's future transportation costs' (Supreme Court (Germany) 24 October 1979 (n 173)) .

[185] See *ibid* (where the injured buyer claimed that as a result of a delivery of defective goods, its customers had discontinued business relations with it which had caused lost profits over four years).

[186] The term has been coined by RJ Harris (see RJ Harris 'A General Theory for Measuring Seller's Damages for Total Breach of Contract' (1961–1962) 60 Michigan L Rev 599–605). Loss of volume is recoverable in a number of legal systems: see the English case *Thompson (WL) LD v Robinson (Gunmakers) LD* [1955] Ch 177; EA Farnsworth, *Contracts*, 4th edn (New York, Aspen Publishers, 2004) 773.

[187] RR Anderson, 'Damages for Sellers under the Code's Profit Formula' (1986–1987) 40 Southwestern L J 1023.

[188] See Case No 1 Ob 292/99v Supreme Court (Austria) 28 April 2000 (Jewellery case) <http://cisgw3.law.pace.edu/cases/000428a3.html>.

[189] See Commercial Court Aargau (Switzerland) 26 September 1997 (n 38) (the situation related only to the sale of knives).

[190] See EA Farnsworth, 'Legal Remedies for Breach of Contract' (1970) 70 Columbia L Rev 1196, n 210.

manufacture the final product and sell it in the expected volumes. If the buyer makes what may seem to be a cover purchase and resells these goods to its sub-buyer, it can argue that it has lost volume of one sale if it can prove that had the seller performed, it would have bought these goods anyway and resold them to *another* sub-buyer who would also have bought the goods. Clearly, however, such situations cannot be properly described as lost volume situations involving a buyer *exclusively* because although the injured party acts as the buyer in the first transaction (with the breaching party), it would not have suffered loss of volume had it not acted as the seller in a subsequent transaction. The reason it loses volume is because of its lack of supply in its capacity as a seller. At the same time, the difference with a lost volume seller, discussed in the previous paragraph, is that in that case the seller's *supply exceeded demand* whereas in the present case loss of volume arises because *demand exceeds supply*. Therefore, it seems more appropriate to refer to the latter situation as involving a lost volume 'buyer-seller'.

The next question is whether loss of volume is recoverable under the instruments and it should be mentioned that several objections to its recoverability have been advanced. First, it has been argued that a legal recognition of a lost volume seller would not correspond to the realities of commercial life. No seller, the arguments runs, can either prove with certainty the specific number of customers it will have in the future, or that it will have an unlimited capacity to supply because there will invariably be periods when the seller will not be able to handle new customers and this may be 'due to such things as temporary shortages of goods, limitation on or breakdowns of productive capacity, shortage of warehousing facilities, temporary unavailability of personnel'.[191] The second related objection is based on the economic law of diminishing returns according to which it is inevitable that, as the seller's volume increases, a point will be reached where the marginal cost of producing and selling an additional item will diminish and eventually nullify the seller's return, thereby rendering the production of such an additional item unprofitable.[192] Another objection is based on the argument that the buyer's breach in fact expands the seller's market because the seller is put in a position to sell the goods to those who otherwise would have been the buyer's customers. In other words, the buyer's breach removes the threat of the buyer's competition and the volume initially lost as a result of the buyer's breach can be re-captured by selling to the buyer's customers.[193] Finally, because the problem of lost volume is too complex[194] and

[191] MG Shanker, 'The Case for a Literal Reading of UCC Section 2-708(2) (One Profit for the Reseller)' (1973) 24 Case Western Reserve L Rev 697, 705.

[192] This argument has been made on numerous occasions: see, eg, *RE Davis Chemical Corp v Diasonics, Inc*, 826 F.2d 678 (1987) ('Diasonics I'); Shanker (n 191); White and Summers (n 33) 292; Goode (n 32) 406.

[193] See RE Scott, 'The Case for Market Damages: Revisiting the Lost Profits Puzzle' (1990) 57 University Chicago L Rev 1155, 1165.

[194] 'Do we really want to develop rules of law that require . . . prescience from our courts? After all, our courts are administered by human beings, not prophets' (Shanker (n 191) 708).

revolves around economics, it has been argued that judges and arbitrators are not sufficiently equipped to deal with it.[195]

It is suggested that while these arguments improve and refine our understanding of the problem of lost volume, they should not lead to the conclusion that this loss should be irrecoverable as a matter of law. The concerns raised by these arguments can, and indeed must, be sufficiently addressed at the stage of proving the loss. But once it has been shown that the innocent party has found itself in a true lost volume situation, there is no reason why this loss should not be recoverable. After all, what the injured party suffers is 'loss of profit' and this loss is expressly recognised by the instruments as recoverable. At the risk of sounding trite, it is nevertheless worth stating that if this loss is not compensated in appropriate cases, the injured party will not be placed in the position where it would have been had the contract been performed.[196] The recoverability of lost profits, arising from loss of volume, is gaining recognition in cases under the CISG. In one case, damages for lost profit were awarded to the seller who had agreed to manufacture and sell jewellery to the buyer. The delivery was not made as a result of the buyer's failure to pay and the court stated that the seller's loss would arise 'regardless of a possible resale of the goods ordered to a subsequent buyer, as the later contract would have been formed independently of the [buyer's] order'.[197] In another case,[198] involving a lost volume 'buyer-seller', as a result of the seller's delivery of defective compressors which the buyer intended to use in its manufacture of air conditioners, the buyer was unable to obtain substitute compressors from other sources thereby producing and selling fewer air conditioners in the respective selling season than it would otherwise have sold. The court stated that the CISG permitted the 'recovery of lost profit resulting from a diminished volume of sales'.

What remains to be said relates to the requirements that must be met for a party to be found to be in a lost volume situation and it is appropriate to begin with a lost volume seller who argues that it would have sold the goods to the second buyer even if the first buyer had not breached the contract. To prove this claim, it must be established, first of all, that the seller would have successfully solicited the second buyer[199] and several factors may need to be taken into account in this regard. The fact that the seller has made some *special* efforts to

[195] See White and Summers (n 33) 292.

[196] The suggestion that loss of volume is recoverable is now widely accepted by commentators. See CISG-AC (n 127); J Ziegel, 'The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives' in NM Galston and H Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (NY, Matthew Bender, 1984) 9–41; Honnold (n 30) 454; EA Farnsworth, 'Damages and Specific Relief' (1979) 27 AJCL 252; also (seemingly in favour) Stoll and Gruber (n 1) 779.

[197] Supreme Court (Austria) 28 April 2000 (n 188).

[198] Federal District Court (New York) 9 September 1994 (United States) <http://cisgw3.law.pace.edu/cases/940909u1.html> (that part of the decision was later upheld by the court of higher instance (see *Delchi Carrier SpA v Rotorex Corp* (n 28)).

[199] RJ Harris, 'A Radical Restatement of the Law of Seller's Damages: Sales Act and Commercial Code Results Compared' (1965–1966) 18 Stanford L Rev 82.

carry out the second sale may serve as an indication that, but for the breach, this sale would not have been made. Such special efforts may include, for example, advertising of the contract goods or using the services of a broker. If it is established that these efforts are not usually taken by the seller to sell the goods and that the second buyer bought the goods as a result of such special efforts, this may serve as evidence that the seller did not intend to sell the goods to this particular buyer and that this buyer bought the goods only because the first buyer did not perform its contract. The characteristics of the goods and the needs of a particular resale buyer may also need to be taken into consideration. If the seller had resold the goods only because the original buyer had rejected them, the resale to the second buyer would not have been made if the first buyer had performed. Suppose that the seller is a car dealer who has many cars to sell. The original buyer ordered one car of a rare colour and the seller made sure that one of its cars was painted as ordered. The original buyer then refused to perform the contract and shortly afterwards the second buyer, attracted by the unusual colour of the car, bought it. Although the seller had many cars to sell, it may be the case that the second buyer bought the car *only* because it saw the unusual colour.[200] Second, it must be shown that the seller would have had the capacity to perform an additional contract and it may have to be demonstrated that the seller had, for example, excessive capacity to manufacture the goods or ready access to additional stock.[201] If it cannot do that, then it may need to present evidence that it 'would, in fact, have expanded [its] manufacturing operations, or sought and found replacement stock outside [its] regular supply channels'.[202] Third, bearing in mind the concerns reflected in the objections to the recoverability of lost volume, it is submitted that it must also be proved that such an additional sale would have been profitable.[203] It also seems appropriate to place the initial burden of demonstrating that these requirements are met on the injured party. This suggestion follows from a basic prerequisite (for the right to claim damages) that the injured party must demonstrate that it has suffered loss. This allocation of the burden of proof is also appropriate considering that the injured party is obviously in a better position than the breaching party to provide information regarding what *it* would have done had there been no breach.

In a similar vein, the 'buyer-seller' must, first of all, prove that it would have bought the goods which were sold to the first buyer with a view to selling more of these goods to yet another buyer had there been no breach, and a number of factors may be relevant here. Similar to a lost volume seller, it may be important to establish whether the 'buyer-seller' has made special efforts to find another

[200] See JB Holisky, 'Finding the "Lost Volume Seller": Two Independent Sales Deserve Two Profits under Illinois Law' (1988) 22 John Marshall L Rev 375, 384–5; see also JA Sebert, Jr, 'Remedies under Article Two of the Uniform Commercial Code: An Agenda for Review' (1981–1982) 130 U Pennsylvania L Rev 388.

[201] See Holisky (n 200) 380–1.

[202] *Ibid*, 381.

[203] For a similar approach in some US cases, see *E Davis Chemical Corp v Diasonics, Inc* (n 192).

supplier.[204] If such special efforts were taken, this fact might indicate that had the first supplier not breached the contract, the 'buyer-seller' would *not* have bought the goods from the second supplier and, therefore, would not have been able to sell more goods to yet another buyer if the first supplier had not breached. Evidence showing that there had already been arrangements between the 'buyer-seller' and the second supplier prior to breach may point in favour of the 'buyer-seller' being in a lost volume situation.[205] Previous relations and practices between the parties may also be relevant. If, for example, there were no past business relations between the parties, some strong evidence may be needed to support the claim that the goods would have been bought from the second supplier regardless of the seller's breach. Conversely, the existence of ongoing business relations between the parties may increase the likelihood that the 'buyer-seller' is in a lost volume situation. The second question is whether another buyer would have bought the goods had there been no breach and, again, several factors are likely to be relevant. First, some earlier arrangements or past dealings and practices between the 'buyer-seller' and that additional buyer, their past dealings and practices may establish that the goods would have been sold to the additional buyer. In some cases, the time at which the transaction with the second supplier was made may be important. If there is an indication that another buyer only wanted the goods at the date earlier than the date when the goods were bought from the second supplier, this may indicate that the 'buyer-seller' is not in a lost volume situation. Finally, it may be that, even if it is proved that another buyer intended to buy the goods, the type of goods actually bought from the second supplier was not that which that buyer would have purchased.

8. LOSS OF A CHANCE

Some legal systems allow the recovery of damages for loss of a chance[206] which aim to compensate the party not for loss of profit but for loss of a chance to profit that would have been available but for the breach. The UPICC take a similar approach by providing that '[c]ompensation may be due for the loss of a chance in proportion to the probability of its occurrence'.[207] Although no express provision recognising the recoverability of this loss is contained in the CISG or PECL, it will be argued that this loss should be recoverable under these instru-

[204] Such as hiring a broker or posting an announcement in an attempt to find a supplier.

[205] Such arrangements may include contracts for future delivery and some other evidence confirming the parties' intentions to make such a transaction in future.

[206] Damages for loss of a chance are allowed in a number of legal systems (for the position of French law, see, eg, Komarov (n 25) 202); *Chaplin v Hicks* [1911] 2 KB 786 (for the position taken by English law); for the discussion of the position in US law, see MA Eisenberg, 'Probability and Chance in Contract Law' (1998) 45 U California L Rev 1005, 1049–52; see also s 346(3) of the Restatement the 2nd of Contracts).

[207] Article 7.4.3(2).

ments as well. Before this argument is put forward, it is necessary to explore the reasons that can justify damages for loss of a chance. In doing so, it is important to bear in mind that loss of a chance is a peculiar concept as it can be considered from the standpoint of the issue of the recoverability of losses as well as a standard of proving losses. Both standpoints need to be borne in mind when dealing with the question of whether loss of a chance should be recoverable.

If loss of a chance is looked at from the standpoint of the recoverability of losses, the crucial question is whether loss of a chance can be regarded as an 'asset' recognised by the instruments. A striking example where this is the case can usually be found in contract cases where the subject-matter of the contract is *a chance*.[208] However, this situation is unlikely to arise in ordinary sales transactions where the subject-matter is the supply of goods. Nevertheless, there can be numerous sales contracts of which a chance is an integral part, such as those involving exhibitions and bidding.[209] For example, as a result of the seller's breach, the buyer may be unable to take part in a large-scale exhibition and thereby loses an opportunity to make lucrative contracts, to be ever considered as a potential supplier by important business players,[210] or to take part in a competition for the best exhibition carrying a substantial monetary prize.[211] The seller's breach may also cause the buyer to lose an opportunity to make a bid on a large-scale project[212] or to make a supply contract with a construction company which, in turn, intended to bid on a project. In such cases, it can certainly be argued that a chance should be regarded by law as an 'asset'.[213] First, taking chances is important in business because taking risks and the involvement in speculative ventures are often the primary vehicles of commercial activity. Second, the innocent buyer in our examples, despite the uncertainty of the outcome of taking part either in exhibitions or bidding, may have made substantial investments of time, effort and money in taking a chance and, if so, this would demonstrate that business persons would regard chance as an asset on which they place a value, despite the assertions that it is 'not something in the real world' or is 'merely a causal likelihood'.[214]

It is also possible to regard loss of a chance as a standard of proving losses. It is well known that it is often difficult to prove loss of profit with absolute certainty because of the need to enquire into hypothetical future or past events.

[208] See *Chaplin v Hicks* (n 206).

[209] See Bridge (n 48) 540 arguing that to be recoverable 'the lost chance must constitute the subject-matter of the transaction or at least an integral part of it'.

[210] See Commercial Court Zürich (Switzerland) 10 February 1999 (n 171), where the buyer argued that owing to the seller's late delivery of art books and catalogues to several presentations, an art exhibition and a press conference, it had never again been considered by sponsors of these events as a potential supplier.

[211] See an example given in S Eiselen 'Unresolved Damages Issues of the CISG: A Comparative Analysis' (2005) 38 Comparative Int'l L J Southern Africa 32, 38.

[212] See an example given in Schwenzer and Hachem (n 94).

[213] The discussion below is partly based on D Saidov, 'Damages: The Need for Uniformity' (2005–2006) 25 J L Commerce 393, 400–02.

[214] See M Hogg, 'Lost Chances in Contract and Delict—Golden Opportunities for Litigation' [1997] SLT 71.

There may be cases, therefore, where although lost profit cannot be proved with the required degree of certainty, the court/tribunal is satisfied that some loss has nevertheless been suffered. The question then is whether the injured party should be left with no, rather than some, compensation. It can be argued that, in such cases, while it is unfair to require the breaching part to pay the full amount of the alleged lost profit, it is equally unfair to leave the innocent party with no compensation. If we accept this argument, loss of a chance can be viewed simultaneously as a tool of implementing a liberal approach to damages by disfavouring the 'all-or-nothing' result and, arguably, of striking a fair balance between the interests of both parties, as a mechanism of dealing with uncertainty of losses[215] and 'a pragmatic response to the uneconomic pursuit of truth in the definition of the plaintiff's true expectation loss'.[216]

Returning now to the question of whether loss of a chance is recoverable under the CISG and PECL, it is argued that, first of all, the issue of the recoverability of losses is within the scope of the instruments and this question needs to be resolved by interpreting the instruments themselves. One way of doing this is to regard the matter as governed, but not expressly addressed by the instruments.[217] The relevant general principle (idea) would appear to be that of full compensation for loss suffered. However, this principle does not provide us with an answer as to whether a particular loss is recoverable in the first place. The answer is to be found in the interpretation of the notion of loss as used in the instruments' provision on damages, and this interpretation rests ultimately on what we think are the policies and values underlying the instruments. If this is correct, then, as explained, there are sufficiently strong policy reasons pointing in favour of the recoverability of the loss of a chance under both the CISG[218] and PECL.[219]

The next question is whether loss of *any* chance to profit, no matter how speculative and uncertain, should be recoverable or whether loss of only those chances which can be considered as 'real' or 'substantial' can be claimed. The express wording of the UPICC does not preclude the former position as it simply refers to valuing a chance by reference to the probability of its occurrence.

[215] S Waddams, 'Damages: Assessment of Uncertainties' (1998) 13 J Contract Law 55.

[216] MG Bridge, 'Expectation Damages and Uncertain Future' in J Beatson and D Friedmann (eds), *Good Faith and Fault in Contract Law* (Oxford, OUP, 1995) 438.

[217] See arts 7(2) CISG and 1:106 PECL.

[218] Since there is a fine line between loss of a chance and lost profits, the only difference being the degree of uncertainty involved, some commentators argue that the recoverability of loss of a chance is expressly allowed by art 74 CISG, which stresses the recoverability of loss of profit. It is important to note that thus far there has been no agreement, either in cases or amongst commentators, as to whether loss of a chance is recoverable under the CISG. For those in favour of the recoverability of this loss, see *Mansonville Plastics (BC) Ltd v Kurtz GmbH* 2003 BCSC 1298; Schwenzer and Hachem (n 94); Saidov (n 213). For the view arguing against its recoverability, see Commercial Court Zürich 10 (Switzerland) February 1999 (n 171); Stoll and Gruber (n 1) 759. For the view that loss of a chance is recoverable only in cases where a chance is a subject-matter of the contract see CISG-AC (n 127). However, this view will essentially lead to this loss not being recoverable because, as noted, these cases are unlikely to arise in sales transactions.

[219] 'Future loss often takes the form of the loss of a chance' (Comment F to Article 9:501 PECL, see Lando and Beale (n 127) 435).

On this view, even very unlikely events (say, a 2 per cent chance of getting an alleged profit) may provide a basis for awarding damages for loss of chance. It is suggested, however, that this cannot be the correct approach. First, taking this approach would mean that virtually every breach, unless there was no likelihood whatsoever of earning profit, would result in *some* award of damages. Second, it is arguable that this approach does not sit particularly well with the rationale of a chance being an 'asset': if a chance of success is not 'real' or 'substantial', it is not reasonable to expect business persons to take risks arising from, and make investments in, taking such a chance. There are signs that this is how tribunals have interpreted some of the instruments. In one case, where the tribunal referred to the UPICC, it was stated that the claimant had to demonstrate 'a very high probability' of a chance being successful.[220] In another case governed by the CISG,[221] the court rejected the buyer's claim for damages for loss of an opportunity to conclude, and profit from, a supply contract with a construction company which in turn intended to bid on a large-scale construction project by stating that it was 'entirely speculative to conclude that [the buyer] sustained a *substantial* loss with respect to this project'.[222]

How is it to be determined what constitutes a 'real' or 'substantial' chance? It has been argued that such a determination should not be a matter of quantifying probabilities or ascertaining percentages as the latter are only relevant for the purpose of *calculating* loss of a chance; the problem of determining whether a chance is 'real' or 'substantial' is only relevant for fixing liability in damages.[223] Once a lost chance is found to be 'real' and liability is thereby fixed, the issue of percentages (of the likelihood of the occurrence of the loss) becomes relevant for the purposes of quantum.[224] In short, it has been argued that whether or not a chance is real is a matter of 'gut instinct' and not mathematics.[225] It would seem, however, that although this position may well be appropriate in some cases, it will often be difficult, if not impossible, to avoid an inquiry into the likelihood (percentage) of the occurrence of a particular event in order to determine whether a chance of profit was 'real' and 'substantial'.[226]

[220] ICC Arbitration Case No 9078 of October 2001 <http://www.unilex.info>. See also ICC Arbitration Case No 10346 of December 2000 <http://www.unilex.info>.

[221] *Mansonville Plastics (BC) Ltd v Kurtz GmbH* (n 218) (italics added).

[222] The court further accepted the view expressed in a case decided under Canadian law that the facts precluded 'any real and substantial chance of benefit'. Although the reliance upon domestic law with respect to the issue governed by the CISG is incorrect, the decision demonstrates that courts have not been prepared to compensate for chances which could not be viewed as 'real' or 'substantial'.

[223] J Poole, 'Loss of Chance and the Evaluation of Hypotheticals in Contractual Claims' [2007] LMCLQ 63, 74–76, 81–82.

[224] *Ibid*.

[225] *Ibid*, 74.

[226] See *Mansonville Plastics (BC) Ltd v Kurtz GmbH* (n 218) ('[The buyer] may have lost an opportunity to enter into a supply arrangement with [the construction company] but the opportunity would have led to nothing unless [the latter] was the successful bidder. There is no evidence with which I can properly assess the *possibility or likelihood* of winning the contract'); ICC Case No 9078 of October 2001 (n 220).

Nevertheless, this does not mean that a particular threshold (eg, 50 per cent chance) should be set to indicate whether a chance is sufficiently 'real' to establish liability in damages.[227] The likelihood of a chance of success should be merely a factor, albeit an important one, in deciding whether a chance is 'real', but, ultimately, it should be left to judges and arbitrators to fix liability in the light of all circumstances of a particular case.

Finally, in some legal systems, loss of a chance cannot be claimed where a relevant hypothetical depends on the actions of the innocent party.[228] The distinction between the actions of the innocent party and those of third parties primarily rests on the idea that the innocent party can be expected to produce the best evidence possible of what *its* conduct would have been whereas the same cannot be said of a third party not least because it is unlikely to take part in the proceedings.[229] Not allowing a claim for damages for loss of a chance where a relevant hypothetical depends on the actions of the innocent party has also been justified on the ground that if the position of the law were otherwise, the innocent party would have incentive to lie.[230] Both considerations seem sufficiently convincing to justify taking the same approach under the international instruments and cases thus far decided under the instruments appear to have awarded damages for loss of a chance or, at least, acknowledged the recoverability of this loss only where the relevant hypothetical questions depended on the actions of third parties.

For instance, in one case,[231] a party breached its obligation to re-transfer to the other party all know-how relating to the equipment in question and not to manufacture and sell the equipment to third parties.[232] The injured party argued that as a result of the breaching party selling the equipment to third parties, it was deprived of a chance to sell the equipment to third parties. It seems that the tribunal's award of damages for loss of a chance centred on the likelihood of whether *third parties* would have bought the equipment from the injured party.[233] Another case[234] may, at first sight, appear to provide evidence to the contrary. In that case, involving the supply of industrial equipment and transfer of know-how, the supplier failed to provide the buyer with the necessary

[227] For example, in the English case *Mohammed Hanif v Middleweeks (A Firm)* [2000] Lloyd's Rep PN 151, a 20% chance was not regarded as insignificant (see para 44 of the judgment).

[228] For the discussion of this position in English law, see, eg, Poole (n 223) 67–69; Burrows (n 138) 60–61.

[229] Burrows (n 138) 60.

[230] M Chen-Wishart, *Contract* Law, 2nd edn (Oxford, OUP, 2008) 561.

[231] ICC Case No 9078 of October 2001 (n 220).

[232] See also Supreme Court of British Columbia 21 August 2003 (n 218); Commercial Court Zürich 10 February 1999 (n 210).

[233] '[I]n most cases, it would be impossible to prove that the potential customer would have concluded a supply contract with the claiming party, and, further, it would be impossible in most cases to prove at what conditions, respectively prices, such contract might have been concluded. The sole fact that the claiming party has submitted an offer is, by itself, obviously no evidence for the fact that it would have been able to conclude a final contract and no evidence for the conditions at which the contract would have been concluded'.

[234] ICC Arbitration Case No 8264 of April 1997 <www.unilex.info>.

information relating to the equipment and the buyer claimed that this failure had deprived it of an opportunity to 'develop and adapt its industrial production to the demands of the market'. Although it would seem that the inquiry would have to focus on the *buyer's* hypothetical actions (ie, whether the buyer would have carried out the alleged development and adaptation), a lost opportunity of the development and adaptation is not *in itself* the ultimate purpose of the inquiry and it is a lost opportunity of making profits from these works that is relevant so far as damages for loss of a chance are concerned. This ultimate purpose of the inquiry was most likely dependent on the actions of third parties rather than on the actions of the injured party.[235] For this reason, it is suggested that this decision should not be regarded as evidencing an approach contrary to the one advanced here.

9. FUTURE LOSSES

It is often the case that the injured party claims damages not only for loss which it has already suffered, but also for those which it will suffer in the future. Future losses are not confined to any one type. For example, the buyer may claim compensation for the amount of liability it will incur to its sub-buyer as a result of the seller's breach or for costs of cure it will incur to remedy the non-conformity, which, in turn, was caused by the seller's breach. The injured party will also often claim damages for its loss of future profits: the seller's breach of a forward delivery contract soon after its conclusion will often cause the buyer the loss of future profits it intended to receive from the resale or use of the goods, as the case may be. Provided that the requirements of proof and limiting damages are met, future losses are expressly recoverable under the UPICC and the PECL.[236]

In contrast, the CISG does not contain a similar provision and, in several cases, it has been interpreted as allowing the recovery of only those losses which have *actually* been suffered.[237] This interpretation of the CISG seems to be based on two reasons. First, the arbitrators may have been driven by the concern of preventing compensation for uncertain and speculative losses. The second reason seems to relate to the legal background of some of the arbitrators. Two out of the three cases have been tried by the Russian ICAC and it seems to have

[235] Unfortunately, only an abstract of the case in the English language was available at the time of writing and this prevented the author from exploring the text of the decision.

[236] Art 7.4.3(1) UPICC and art 9:502(2)(b) PECL.

[237] See ICAC Case 131/1996, decision dated 14 September 1998 in MG Rozenberg, *Praktika Mezhdunarodnogo Kommercheskogo Arbitrazhnogo Suda: Nauchno-Prakticheskiy Kommentariy* (Moscow, Izd. mezhd. tsentra finansovo-economicheskogo razvitiya, 1997) 165; ICAC Case No 345/1996, decision dated 14 September 1998 (see MP Bardina in MG Rozenberg (eds), *Venskaya Konventsiya OON 1980 g. o dogovorah mezhdunarodnoy kupli-prodazhi tovarov. K 10-letiyu yeyo primeneniya Rossiyei* (Moscow, Statut, 2001) 39; also ICC Case No 7660 of 23 August 1994 (*Battery machinery case*) where damages within the meaning of art 74 were interpreted as covering only those losses which were actually suffered (abstract of the case and editorial remarks by AH Kritzer <http://cisgw3.law.pace.edu/cases/947660i1.html>).

been the case that the arbitrators were influenced by both the Russian text of the Convention, which uses past tense for the word 'suffered' ('*ponesyon*') and the comparison of art 74 CISG with art 15 of the Russian Civil Code, which specifically states that recoverable losses include those which have been incurred or *will have to be incurred*.[238] The absence of an express reference to future losses in art 74 CISG may have led the ICAC arbitrators to conclude that future losses were not intended to be recoverable under the Convention. So far as the first reason is concerned, it is argued that although the concern of preventing speculative awards is undoubtedly valid, it should be addressed not by means of disallowing the recoverability of future losses but by ensuring a due application of the standard of proof. The second reason is more difficult. First, although, admittedly, the Convention's Russian text uses the past tense for the word 'suffered', excluding future losses would still seem to be based, for reasons set out below, on an unduly restrictive reading of art 74. Second, interpreting the CISG from the standpoint of the Russian Civil Code is, with respect, most unhelpful and entirely unjustified. This approach clearly contravenes the Convention's international character and the need to promote uniformity in its application.[239]

It is submitted that future losses must be interpreted as recoverable under the CISG.[240] If the Convention is interpreted otherwise, the injured party will either have to wait until the time when future losses become 'actual' losses or may be compelled to bring more than one claim for breach of the same contract at different points in time and this may not be allowed by the procedural rules of the forum.[241] Such a result is unfair to the injured parties because claiming damages under the CISG is likely to become an unduly time-consuming and expensive affair and may encourage the parties to exclude the CISG. Undoubtedly, all of this is not in line with the Convention's aspiration of becoming a uniform instrument. It can also be argued that because future losses will often include lost profit and because art 74 expressly refers to the recoverability of lost profits, this provision can be interpreted as indicating that future losses are recoverable.[242]

[238] According to art 15(2) of the Civil Code of the Russian Federation 'real loss' is defined as 'expenses, which a person whose right has been infringed, has incurred or will have to incur in order to redress the infringed right, loss or damage to its property'.

[239] See art 7 CISG.

[240] For a recent work where the same view is taken, see Mullis (n 89).

[241] For example, this would not be possible under English law: see Chitty on Contracts, 28th edn, vol 1 (London, Sweet & Maxwell, 1999) 1275.

[242] For a similar view, see Eiselen (n 211) 37.

Part II
Methods of Limiting Damages

4

Causation[1]

1. GENERAL

THE INTERNATIONAL INSTRUMENTS provide that damages are due only for losses which were caused by the breach of contract. According to art 74 CISG damages 'consist of a sum equal to the loss . . . suffered . . . *as a consequence of the breach*'. Similar provisions are contained in the UPICC and PECL.[2] This requirement can be regarded both as a precondition for liability in damages and as a method of limiting damages.[3] The party in breach cannot be liable for the loss which its breach has not caused and, in this sense, the presence of a causal connection is a necessary prerequisite for the existence of liability in damages. At the same time, causation is a limitation on damages since compensation for losses can be claimed only to the extent that they were caused by the breach.

The reasons for the existence of the causation requirement appear to be deeply rooted in our thinking. The notion of causation is arguably a necessity of human thought.[4] One reason is that it is only through this notion that a human being acquires and maintains the sense of him/herself as a separate person. It is also causation which enables a person to think of him/herself as an author of his/her actions capable of making changes in the world.[5] It has been further suggested, in relation to the law of remedies, that the 'whole law of remedies . . . is based upon the belief that there is uniformity in the sequence of events, in the conduct of men as well as in that of atoms and planets, and that it is possible for

[1] This chapter is a substantially revised and updated version of D Saidov, 'Causation in Damages: The Convention on Contracts for the International Sale of Goods, the UNIDROIT Principles of International Commercial Contracts, the Principles of European Contract Law' in *Review of the Convention on Contracts for the International Sale of Goods (CISG) 2004–2005* (Munich, Sellier European Law Publishers, 2006) 225.

[2] Article 7.4.2(1) UPICC: 'The aggrieved party is entitled to full compensation for harm sustained *as a result* of the non-performance.' Article 9:501(1) PECL: 'The aggrieved party is entitled to damages for loss *caused* by the other party's non-performance.'

[3] See CT McCormick, *Handbook on the Law of Damages* (St Paul, Minn, West Publishing Co, 1935) 260.

[4] See Lord Wright, 'Notes on Causation and Responsibility in English Law' [1955] Cambridge L J 163.

[5] HLA Hart and T Honore, *Causation in the Law*, 2nd edn (Oxford, Clarendon Press, 1985) lxxx–lxxxi.

men to influence and control the future as well as to predict it'.[6] It could also be argued that, for many of us, it would seem fair to hold people liable *only* for the consequences flowing from their own actions[7] (individual, as opposed, to collective responsibility).

Causation is a complex area of law and legal systems differ greatly when it comes to their treatment of causation. These differences are evidenced by the existence of a variety of 'theories' of causation.[8] Causal problems are most acute in tort (delict) or criminal law because the difficult cases on causation mostly concern physical injury or damage. Although the problems of causation arise more rarely in the law of contracts,[9] they may nevertheless pose serious challenges and therefore need to be explored. The purpose of this chapter is to identify such problems insofar as they are relevant to international sales contracts, and to explore ways of resolving them.

2. FACTUAL AND LEGAL CAUSATION

Although legal systems differ as to whether the existence of causal connection is a question of fact or of law,[10] drawing a distinction between factual causation and legal causation seems virtually inevitable.[11] The factual causation inquiry focuses on the history leading to the loss (that is, the chain of events which resulted in the loss) and on the determination of whether the breach was an event in the chain. This inquiry is non-legal and its sole purpose is to provide factual evidence. The legal causation inquiry aims at establishing what legal consequences should be attached to the breach and other events in the chain. This inquiry is not concerned with a history of the loss and is based on value and policy which are questions of law.[12] It determines whether the breach, despite its being one of the conditions of the occurrence of the loss, should be regarded as a 'legal cause'. The legal causation inquiry can only be launched once the facts are established.[13]

To determine whether the breach was an event in the chain leading to the loss (factual causation), the so-called *conditio sine qua non* or 'but for' test is applied

[6] AL Corbin, *Corbin on Contracts* vol 5 (St Paul, Minn, West Publishing Co, 2002) 60.

[7] See Hart and Honore (n 5) 1.

[8] For an excellent analysis of different theories of causation (albeit in the context of tort), see AM Honore, 'Causation and Remoteness of Damage' in K Zweigert and K Drobnig (eds), *International Encyclopedia of Comparative Law*, vol 11, ch 7 (Martinus Nijhoff Publishers, 1971).

[9] Hart and Honore (n 5) 308; MI Braginskiy and VV Vitryanskiy, *Contract Law: General Provisions* (*Dogovornoye pravo: Obshiye polozheniya*) (Statut, Moscow, 1998) 576.

[10] See Honore (n 8) 20–1.

[11] '[It is a] generally accepted notion that, to be a cause of harm in law, the conduct or defined event must at least be a condition . . . of it' (Honore (n 8) 67).

[12] See Honore (n 8) 21.

[13] The distinction between factual and legal causation has been emphasised and relied upon by many commentators (see, eg, C Morris, 'On the Teaching of Legal Cause' (1939) 39 Columbia L Rev 1087, 1088–9; EJ Weinrib, 'A Step Forward in Factual Causation' (1975) 38 MLR 518).

in most cases.[14] According to this test, a factual cause (condition) of an event is the one without which the event would not have occurred. There is much less agreement as to the proper ways of determining which factual causes (conditions) should be treated as legal causes and this is the stage where different theories of causation come into play.

The question arises as to whether the distinction between factual and legal causes should be the basis for dealing with the issues of causation under the instruments. In relation to the CISG, it has been suggested that '[i]t suffices that the breach was a condition of the occurrence of the harmful event (*conditio sine qua non*, 'but for rule') [and that] [i]t is irrelevant whether the damage was caused directly or indirectly by the breach'.[15] One way to interpret this view is to state that the only causal issues that can arise under the instruments are those relating to factual causation and that there should be no room for legal causation. Another way to interpret it is to suggest that the 'but for' test should be regarded as comprising both factual and legal tests of causation at the same time. Whatever approach to interpreting this view is taken, it follows therefrom that a cause of the loss is the one without which the loss would not have occurred and that no other type of causal inquiry is necessary. This view represents, in essence, the so-called 'equivalence' theory advocated in some legal systems.[16] It has a number of apparent advantages: it relies on the 'but for' test, which is most often treated as the main test of factual causation; the 'but for' test prevents events which make no difference to the course of events leading up to the loss from being regarded as the cause; the test is relatively simple.[17]

Those commenting on this theory have pointed out that its application may lead to excessive liability and that some additional limitations are needed.[18] Its advocates, however, would probably meet this criticism by stating that the instruments leave 'no room for legal theories of causation which limit liability for damage to probable or not entirely remote causal sequences of events, since [they employ] the foreseeability rule . . . in order to exclude liability for damage

[14] This test is not the only test of factual causation. A number of commentators pointing out the drawbacks of the test have suggested alternative tests of factual causation. The 'but for' test, however, has enjoyed a wide acceptance (see Honore (n 8) 67; G Williams, 'Causation in the Law' [1961] Cambridge L J 62, 63).

[15] H Stoll, 'Damages: Article 74' in P Schlechtriem (ed), *Commentary on the UN Convention on the International Sale of Goods (CISG)*, 2nd edn (Oxford, OUP, 1998) 558. Some other commentators seem to suggest a similar approach to causation: 'the Convention seeks to place the injured party in the position she would have enjoyed "but for" the breach' (H Bernstein and J Lookofsky, *Understanding the CISG in Europe: a compact guide to the 1980 United Nations Convention on Contracts for the International Sale of* Goods, 2nd edn (The Hague, Kluwer Law International, 2003) 139).

[16] 'The equivalence theory is also called the theory of equivalent conditions, the condition theory . . . and the *conditio sine qua non* theory. According to it every condition in the absence of which the harm would not have occurred in the way in which it did occur (*in concreto*) is a cause of the harm' (Honore (n 8) 33).

[17] *Ibid.*

[18] *Ibid.*

which is so remote as to lie outside the scope of a party's responsibility'.[19] The following discussion will examine whether it is proper to confine all causal issues to the 'but for' test and whether the foreseeability rule will be capable of dealing with the problems that may be unresolved by the 'but for' test.

3. MULTIPLE SUFFICIENT CAUSATION

On numerous occasions, it has been pointed out that the 'but for' test has its limitations as a test of factual causation in the case of multiple sufficient causation or causal over-determination ('over-determination'). This is a situation where *two or more* events or acts independently result in the consequence in question and where each of these events or acts is sufficient *in itself* to bring about this consequence. Because the same consequence would have taken place even if one of the events or acts had not occurred, the 'but for' test would not lead to liability in such cases.

One US case provides a useful illustration.[20] A manufacturer of leggings concluded a contract with the War Department. The contract provided for liquidated damages for delay in delivery. The manufacturer placed an order with a seller for the supply of webbing necessary for the manufacture of leggings. The seller was late in delivering the webbing and the manufacturer had to pay liquidated damages to the War Department. The manufacturer claimed compensation for this loss and one of the objections raised by the seller was that delay in delivering webbing was not the sole cause of the manufacturer's loss. It claimed that there had been other contributing causes such as 'a landlord's distress and eviction at the buyer's factory, a removal by the [manufacturer] of its plant, a shortage of eyelets necessary to the manufacture of the leggings'.[21] Suppose that those other causes were sufficient in themselves to cause the delay and the loss suffered by the manufacturer. The application of the 'but for' test would lead to the finding that even if the seller had delivered webbing on time, the manufacturer would have suffered the same loss anyway and consequently the seller's breach cannot be said to be the cause of the loss.

The foreseeability rule will not resolve the problem because the presence of a causal link is a separate requirement that needs to be met for the seller to be liable. It is also noteworthy that, in the original decision, the foreseeability requirement was held to have been met as the seller had known about the liquidated damages clause in the contract between the manufacturer and the War Department.

Thus, if we take the view that the 'but for' test is all that is needed for dealing with causal over-determination, the seller would not be held liable. Is this a satisfactory result? Before this question is answered, it may be helpful to explore

[19] Stoll (n 15) 558. This statement related only to art 74 CISG.
[20] See *Krauss v Greenbarg* 137 F.2d 569 (1943).
[21] *Ibid*.

the results that would be achieved if other theories of causation were relied upon. Thus, according to one theory, the breach is the cause of the loss if it is a necessary element of a set of conditions sufficient to bring about the loss (the so-called 'NESS' test).[22] The difference between the NESS test and the 'but for' test is that the former is a test of sufficiency and the latter is that of necessity.[23] If the NESS test were applied to our example, both the seller's breach and other events would be regarded as causes because each of them was sufficient to bring about the same loss. Another alternative is to regard the breach as a cause if it was a 'substantial factor' in producing the loss.[24] This test requires that the breaching party be responsible only if its contribution 'was not quantitatively negligible'[25] and it is this test that was applied in the case on which our example was based. The court stated that '[if] a number of factors [were] operating one may so predominate in bringing about the harm as to make the effect produced by others so negligible that they [could not] be considered substantial factors and hence legal causes of the harm produced. In that event liability attache[d], the requisites of legal cause being shown, only to the one responsible for the predominating, or substantial, factor bringing the harm.'[26] What constitutes a substantial factor was defined as the conduct which 'ha[d] such effect in producing the harm as to lead reasonable men to regard it as a cause'.[27] If this theory were applied to our example, the seller's breach would most likely be regarded as a substantial factor and the causal connection between the seller's breach and the loss would probably be established. However, the main drawback of the 'substantial factor' theory is its irrelevance in the context of causal overdetermination. If two or more events and acts are sufficient to produce the same loss, it is difficult to see how each of these acts or events *cannot* be a substantial factor in bringing about the loss.[28]

Returning now to the question posed in the previous paragraph, it is submitted that the breaching party should be held liable in cases of causal overdetermination. Suppose that two independent suppliers failed to deliver two different but essential materials to the manufacturer who, just like the manufacturer in the example above, had to pay liquidated damages to its customer as result. If the 'but for' test is relied upon, the manufacturer will find itself in the situation where, having suffered loss as a consequence of the two suppliers breaching their contracts it is unable to claim damages against either of them.

[22] See T Honore, 'Causation in the Law' <http://plato.stanford.edu/entries/causation-law/>; D Hamer, '"Chance Would Be a Fine Thing": Proof of Causation and Quantum in an Unpredictable World' (1999) 23 Melbourne U L R 557, 571–2.

[23] Hamer (n 22) 572.

[24] Honore (n 8) 68–9; Honore (n 22).

[25] Honore (n 8) 69.

[26] *Krauss v Greenbarg* (n 20) 572.

[27] *Ibid*.

[28] Hart and Honore (n 5) 236, seem to take the same view ('Neither the terminology of "contributory causes" nor that of "substantial factor" is really appropriate in . . . situations when one of the causes is sufficient without the other, which is also sufficient, to produce the loss complained of').

This result would be grossly unfair to the injured party and clearly the 'but for' test has to be rejected. Instead, it is suggested that the NESS theory is most appropriate here as it achieves a fair result by enabling the manufacturer to bring a damages claim against the breaching suppliers.[29]

4. HYPOTHETICAL ALTERNATIVE CAUSATION

Another situation where the 'but for' test will not lead to liability is that involving hypothetical alternative causation ('alternative causation'), that is, where the breach produces the loss, but the same loss would have occurred even if there had been no breach.[30] The difference between alternative causation and causal over-determination is that an alternative *cause* is *hypothetical* while in the case of over-determination all sufficient causes do *in fact* occur.[31] The reason why the 'but for' test does not lead to liability is that it cannot be said that but for the defaulting party's breach the loss would not have had occurred.

Suppose that two independent suppliers are to deliver two different, but essential, materials for the manufacture of the final product. Suppose further that the second supplier has an obligation to deliver the materials within 20 days after the receipt of the manufacturer's notice of delivery by the first supplier. The first supplier fails to deliver and the manufacturer claims damages for non-delivery. The first supplier, however, presents evidence that even if it had delivered the materials, the second supplier would have failed to deliver and the manufacturer would have suffered the same loss anyway. If it is only the 'but for' test that is relied upon, the manufacturer will not be able to claim damages against the first supplier and will be left uncompensated. To avoid this result, the 'but for' test will once again have to be rejected and the first supplier's breach

[29] The question arises here as to how damages should be allocated between the two breaching suppliers. It would seem appropriate for the injured party to be allowed to claim damages for the full amount of the loss from either of the suppliers. Suppose that the transaction with one supplier is governed by one of the international instruments and the transaction with the second supplier is governed by some other law which uses the 'but for' test. The issue of liability of each supplier is likely to be dealt with separately. The second supplier will be exempt from liability in damages by virtue of the 'but for' test. If the first supplier is then held liable only for a part of the loss, the injured party will not be fully compensated and this result seems unfair to the injured party. Thus, it is submitted that the injured party who claims damages against one supplier for its breach of the contract governed by one of the international instruments should be able to recover the full amount of the loss. If so, the injured party cannot claim damages against the other supplier since it has now been fully compensated for the loss (and presumably most legal systems would disallow double recovery). Similarly, if it is shown that the injured party has already recovered damages for the full amount of its loss caused by one supplier's breach of the contract governed by some domestic law, no damages can be claimed against the other supplier for breach of the contract governed by one of the international instruments.

[30] Honore (n 8) 79–81; Hart and Honore (n 5) 249.

[31] Hart and Honore (n 5) 249.

will need to be recognised as the cause of the loss, both in fact and in law,[32] and a hypothetical alternative cause should be causally irrelevant.[33]

A different approach may have to be taken where a hypothetical alternative cause is not an unlawful act (such as a breach by the second supplier in the previous example), but a natural event. Suppose that the seller's obligation to deliver the goods consisted in placing the goods on board the ship X. The seller breached the contract by placing the goods on board the ship Y which sank during the voyage. Responding to the buyer's claim for damages for non-delivery, the seller, while recognising its breach, presents evidence that the ship X also sank during the voyage. Therefore, even if it had placed the goods on board the ship X, the buyer would have suffered the same loss anyway.[34] In such cases it seems more appropriate not to hold the seller liable because had it performed the contract, the buyer would not have been able to attribute the blame for its loss to anybody's wrongful actions.[35]

5. INTERVENING CAUSE

5.1 General

Problems of causation also arise where some event or act occurs after the breach but before the loss.[36] In such situations, the question is whether the breach or the subsequent event/act should be treated as the cause of the loss. If the subsequent event/act is regarded as such, it is usually referred to as an 'intervening cause' which 'breaks' or 'interrupts' the chain of causation between the breach and the loss. 'Breaking the chain of causation' is a metaphor as 'the sequence of physical events is not interrupted, nor does a mysterious psychological discontinuity take

[32] In some cases it may be unnecessary to reject the 'but for' test as the breaching party may still be held liable on the basis of this test. This may be possible by formulating the consequence of the breach in greater detail (thereby distinguishing it from a consequence which would have flown from a hypothetical alternative cause in terms of time, place, or some other detail of occurrence). In some cases, however, real and hypothetical losses can be indistinguishable (see Honore (n 8) 80).

[33] 'A more satisfactory way of explaining how the right conclusion is to be reached is to say that the imaginary subtraction of the alleged causal fact must not be accompanied by the invention of any other imaginary facts in its place, however likely it may be that such a replacement would have occurred in reality' (Williams (n 14) 72).

[34] This simple example is given merely for the purposes of illustration.

[35] This view seems implicit in Hart and Honore's statement: '[i]f defendant has wrongfully deprived the plaintiff of an economic opportunity of which, in the alternative, another would *wrongfully* have deprived him he should be liable to pay compensation, because . . . plaintiff has a right to any economic advantage which he would enjoy apart from wrongful acts on the part of anyone . . .' (Hart and Honore (n 5) 251).

[36] See, eg, *Chitty on Contracts*, 28th edn, vol 1 (London, Sweet & Maxwell, 1999) 1282, pointing out this problem in contracts.

place. The interruption is man-made.'[37] We do so for the purposes of explanation, prediction, and imposition of liability.[38] One way of explaining this treatment of causation is that where an intervening event/act is considered 'much more responsible' for the loss than the breach, it is considered unfair to hold the breaching party liable.[39] An intervening cause can be an event, an act of a third party, or an act of the injured party. Before each of these situations is addressed, it may be helpful to make a few general remarks.

It has been suggested that our common sense regards as a cause something which interferes in or departs from the *normal or ordinary* course of events. In other words, a cause is something which is of abnormal nature. An abnormal factor makes 'a difference' between the loss and the things occurring as usual.[40] If this is true, a subsequent abnormal event will 'break the chain of causation' between the breach and the loss. What is abnormal is relative to the context of the inquiry and the interests and the purposes of the inquirer.[41] Another condition that needs to be met for an event to be regarded as an intervening event is that it must be independent of the breach. If the event would not have occurred but for the breach, it will not break the causal connection.[42]

5.2 Intervening event and an act of a third party

> Example 1: S agrees to sell to B machinery which S knows is required by B to manufacture goods in its factory. The machinery is due to be delivered on 1 June but S fails to make the delivery. B is losing profit at the rate of £1,000 for each week's delay. This is a normal level of profit for a business of this kind. On 29 June a fire breaks out in B's factory, which is burnt to the ground. On 16 July S delivers the machinery. B would not have been able to put the machinery to use elsewhere during this period.[43]

This example raises the question of whether profit lost between 29 June and 16 July was caused by the breach. The answer, it is suggested, should be 'no'. It is clear that even if S had properly performed the contract, B would not have made a profit between 29 June and 16 July. For this reason, it does not seem appropriate to regard S's delay in delivering the machinery as causing loss of profit during the said period and the 'but for' test *can* be used here to achieve this result.[44]

[37] Honore (n 8) 47.
[38] *Ibid*.
[39] A Burrows, *Remedies for Torts and Breach of Contract*, 3rd edn (Oxford, OUP, 2004) 97.
[40] Hart and Honore (n 5) 29, 34–5.
[41] *Ibid*, 35–6.
[42] *Ibid*, 176.
[43] O Lando and H Beale (eds), *Principles of European Contract Law: Parts I and II* prepared by the Commission on European Contract Law (The Hague, Kluwer Law International, 2000) 434.
[44] For a similar view, see *ibid*.

> Example 2: S failed to load the goods on board a ship on time and the ship left the port later than planned. The ship was caught in a storm and the goods were destroyed. B claims damages for loss suffered as a result of non-delivery. S argues that the loss was not caused by S's failure to deliver on time because the storm broke the chain of causation between S's breach and the loss.

If the loss would have occurred even if there had been no breach, the situation becomes similar to alternative hypothetical causation and, as discussed above, the preferable solution is not to hold S liable. This result can again be achieved by means of the 'but for' test. Should the position be the same if the ship would not have been caught in a storm had S delivered on time? Before answering this question it should be noted that this type of situation has arisen in one English case[45] where, as a result of the defendant's (the shipowner's) breach of an obligation to provide a seaworthy ship, the cargo was delayed. Meanwhile, the war between Great Britain and Germany broke out and the British Admiralty prohibited the vessel from proceeding to the destination and ordered her to discharge at Glasgow. As a result, the innocent party had to incur the costs of transshipping the cargo. One of the issues to be decided by the court was whether those expenses were caused by the defendant's breach. In doing so, the court used the foreseeability test, viz whether it was foreseeable to the defendant that the war would break out. It was held that 'the diversion to Glasgow, brought about through the delay in carrying out the contract of carriage . . ., is attributable to the default of the owners of the ship, because . . . they ought to have foreseen that war might shortly break out and that any prolongation of the voyage might cause the loss of or diversion of the ship'.[46] Thus, the foreseeability test was used in addition to the 'but for' test. In other words, the 'but for' test, as a test of factual causation, was deemed insufficient and was supplemented by an additional criterion of legal causation. This approach seems correct. A mere reliance on the 'but for' test in cases where the breaching party's 'conduct . . . merely changes . . . the time at which some . . . thing arrives at a given place'[47] may lead to liability where a natural intervening event may, in fact, be much more responsible for the loss. To prevent this result, an additional requirement seems essential[48] and the foreseeability test provides an appropriate and a relevant solution because foreseeability is arguably a feature of our ordinary thought affecting our judgements about causation.[49] Applying this test to our Example 2, it can be argued that if the seller knows (on the basis of the weather forecast, for example) that if the shipment of cargo is delayed, the vessel is likely to be caught in a storm and nevertheless takes the risk and delays the shipment,

[45] *Monarch Steamship Co Ltd v Karlshamns Oljefabriker (A/B)* [1949] AC 196.
[46] *Ibid*, 216.
[47] Hart and Honore (n 5) 168.
[48] A similar view seems implicit in *ibid*.
[49] P Lipton, 'Causation Outside the Law' in H Gross and R Harrison (eds), *Jurisprudence: Cambridge Essays* (Oxford, OUP, 1992) 140.

we are more inclined to state that its breach was the cause of the loss and more reluctant to regard the storm as breaking the chain of causation.

> Example 3: In June S in Paris contracts to sell a Seurat painting to B in Hamburg for FF1 million, the painting to be shipped to B in Hamburg by the end of August. Because of delays on the part of its staff S is unable to arrange shipment earlier than 1 October. On 5 September the French government imposes a ban on the exportation of works of art without a licence, and despite using its best endeavours S is unable to obtain a licence to export the Seurat painting. The value of the painting at the end of August is considered by experts to be FF2 millions.[50]

This is an example involving an intervening act of a third party. The question is whether the ban imposed by the French government should be treated as breaking the chain of causation between delay in delivery and the loss suffered. While relying solely on the 'but for' test would, no doubt, make it easier to deal with this kind of situation, it would seem that a more complex treatment is necessary[51]: it cannot be assumed that the mere fact that the loss would not have occurred but for S's delay should necessarily make it liable; nor can it be assumed that the fact that an act of a third party (such as the governmental ban in this example) was a necessary condition of the occurrence of the loss is in itself sufficient to break the chain of causation between the breach and the loss. A more balanced and arguably fair approach is to apply the 'but for' test in conjunction with some additional requirement and, as argued in relation to Example 2, the foreseeability test (being a fair and workable method for dealing with this type of situation) is a suitable candidate for this role. Thus, if, in Example 3, the chances of an embargo, as determined by the breaching party's foreseeability, were not increased by delay, the breaching party should not be liable. Conversely, if before breaching the contract S foresaw or was in the position to reasonably foresee a possibility of an embargo in case of delay, S should be held liable.

One final remark needs to be made. As has just been argued, situations such as those in Examples 2 and 3 need to be resolved on the basis of the 'but for' test together with the likelihood/foreseeability test. It would seem, however, that the desired result can, in principle, be achieved by means of other theories of causation. It is true that theories of causation 'mostly have little empirical content'[52] and that is why they can be used as a disguise for achieving the desired result.[53] One example is a theory of 'direct/indirect causation' according to which a party is liable only where the loss is a *direct* consequence of the breach.[54] What constitutes an 'indirect consequence' is capable of many interpretations[55] and there

[50] The example is taken from Lando and Beale (n 43) 435–6.

[51] This approach is taken in *ibid* ('since but for S's delay in shipping the painting its export would not have been affected by the ban').

[52] Honore (n 8) 66.

[53] For a similar view, see Hart and Honore (n 5) 4.

[54] Honore (n 8) 40.

[55] *Ibid*, 41–2.

seems little in the basic statement of the theory to prevent a judge or an arbitrator who believes that in Examples 2 or 3 the seller should not be liable from ruling that the loss was an indirect consequence of the breach. The same applies to the 'adequate causation' theory according to which a contingency is a legal cause if it: (1) is a *condition sine qua non* of the loss, and (2) has significantly increased an objective probability of the occurrence of the loss.[56] Whether or not the breach has significantly increased an objective probability of the loss must be judged from the standpoint of an experienced observer. Knowledge of all the circumstances of which a person of that kind ought to have as well as any special knowledge possessed by the breaching party will be imputed to such an observer.[57] If, from the standpoint of such an experienced observer, it was likely that the vessel would be caught in a storm or the shipment would be prevented by a government ban in the case of delay, the breaching party would be held liable. The approach therefore is very similar to the suggested 'likelihood'/foreseeability test.[58] It needs to be stressed, however, that it is not argued that *all* theories of causation will *always* lead to the same result. The point is, rather, that in cases such as those in Examples 2 and 3 more than one theory of causation is potentially able to achieve the desired result.[59]

5.3 Injured party's contribution to the loss

The question of how the issues of liability and causation should be resolved where, after the breach, the injured party's act or omission contributes to the loss is a difficult one: should such an act be regarded as breaking the chain of causation between the breach and the loss or should the risk be rather allocated in accordance with each party's contribution to the loss? There is no doubt that the injured party's acts or omissions are capable of wholly breaking the causal link.[60]

[56] See, eg, Hart and Honore (n 5) 469; GH Treitel, *Remedies for Breach of Contract: A Comparative Account* (Oxford, Clarendon Press, 1988) 163.

[57] Treitel (n 56) 163.

[58] However, methods used by the two tests are different. For instance, as has been seen, in Hart and Honore's analysis, foreseeability relates to the occurrence of an intervening event. The adequate causation theory refers to the increased probability of the occurrence of the *loss* (not of the intervening event). However, as Hart and Honore point out, the probability of the occurrence of an intervening event can sometimes be made relevant by incorporating the event into the description of the loss (see Hart and Honore (n 5) 479).

[59] The focus in this section has been on the problem of whether an event or an act of a third party should break the causal link between the breach and the loss. It can hardly be denied that there may be cases where an event or a third party's act is insufficient to break the chain of causation but has nevertheless contributed to the loss. It is argued, therefore, that a possibility of allocating the loss between the breach and an event/third party's act in accordance with their respective contributions cannot be ruled out. The factors to be relied upon in determining the extent of each contribution are set out below.

[60] 'a voluntary human action . . . has a special place in causal inquiries . . . because, when the question is how far back a cause shall be traced through a number of intervening causes, such a voluntary action is often regarded both as a limit and also as still the cause even though other later abnormal occurrences have provisionally been recognized as causes' (Hart and Honore (n 5) 42).

For example, in one case under the CISG,[61] a glass manufacturer received a delivery of defective aluminium hydroxide from the seller and, without a prior examination, mixed it with another material. As a result, defective glass was produced. It was established that 'the defect would have been revealed even by means of simple tests'. Although damages were denied on the ground of the manufacturer's failure to mitigate, the same decision could clearly have been reached on the ground of causation by holding that the manufacturer caused its own loss.[62] The crucial factor in deciding whether the injured party's actions broke the chain of causation is whether they were reasonable in the circumstances.[63] In the CISG case just mentioned, it was clearly unreasonable for the manufacturer not to inspect the goods considering that the defects would have been revealed by simple tests and that the buyer had a duty to examine the goods.[64]

Approaching the injured party's act or omission solely from the standpoint of the question of whether it breaks the chain of causation is based on an 'all-or-nothing' view of liability in damages: the breaching party is either fully liable for the loss or not liable at all. It can, however, be argued that there may be cases where it is more appropriate to apportion the loss between the parties and this possibility is recognised in the UPICC and the PECL. The UPICC provide that '[w]here the harm is due in part to an act or omission of the aggrieved party or to another event as to which that party bears the risk, the amount of damages shall be reduced to *the extent that these factors have contributed to the harm*, having regard to the conduct of each of the parties'.[65] Similarly, according to the PECL, '[t]he non-performing party is not liable for loss suffered by the aggrieved party to the *extent* that the aggrieved party *contributed to . . . [the] effects [of non-performance]*'.[66] Although the CISG does not contain a similar provision, it contains mechanisms enabling it to recognise the possibility of apportionment. First, it is arguably a logical inference from the causation requirement in art 74 that the part of the loss to which the injured party has contributed cannot be regarded as being caused by the breaching party. Second, the mitigation rule can also be interpreted as denying damages which the injured party could have avoided. Finally, art 80 recognises the need for determining the *extent* of the injured party's contribution to the other party's breach, and, because the nature of the problem under art 80 is the same as the one here,[67] an 'all-or-nothing' approach is arguably against the spirit of the CISG.

[61] Case No 18 U 121/97 Appellate Court Köln (Germany) 21 August 1997 (Aluminium hydroxide case) <http://cisgw3.law.pace.edu/cases/970821g1.html>.

[62] See, for example, English cases *Quinn v Burch Bros (Builders) Ltd* [1966] 2 QB 370 and *Beoco Ltd v Alfa Co Ltd* [1995] QB 137.

[63] Hart and Honore (n 5) 144–5, 230.

[64] See art 38 CISG.

[65] Article 7.4.7 UPICC (emphasis added).

[66] Article 9:504 PECL (emphasis added).

[67] Article 80 refers to the injured party's contribution to the *breach* and the case under consideration is that of the injured party's contribution to its loss.

Adopting this position gives rise to two inter-related difficulties. One relates to the question of how to distinguish between cases where the injured party's actions or omissions break the chain of causation and where they merely contribute to the occurrence of the loss. The second is the question of how the injured party's contribution to the loss can be determined. In some cases, it may be relatively easy to see why and how the loss should be apportioned. Suppose that the seller supplied a farmer with a substance designed to be sprayed over the land. The contract contains a clause requiring that several blocks of the land are to be sprayed by the seller and other blocks by the farmer himself. The parties also have a *strict* obligation to test the substance before using it because if it does not comply with the specified standards, it may adversely affect the soil. The seller delivered defective substance and, surprisingly, none of the parties had taken the trouble to examine it before it was used. The farmer suffered losses as a result of the soil having been affected by the defective substance. In this case, it would seem sensible to make each party liable for the losses flowing from the blocks for which each party was responsible.

Unfortunately, many cases are likely to be much less straightforward. Consider an example given in the Comments on the PECL:

> A leases[68] a computer which under the terms of the contract is to be ready for use in England where the voltage is 240v. The computer supplied is capable of operating on various voltages and, in breach of contract, is actually set for 110v. A prominent sign pasted on the screen warns the user to check the voltage setting before use. A ignores this and switches on without checking. The computer is extensively damaged and repairs will cost A £1,500.[69]

The Comments' answer to the above questions is to split the loss between the parties on a 50/50 basis.[70] Although this (50/50) allocation seems to be based on the Comments' reliance on the notion of fault (discussed below), it is far from clear *why* and *how* fault has led to an equal apportionment of liability. It would seem that in many cases of this kind, decisions will depend on courts and tribunals balancing various factors which are deemed relevant in the circumstances and this is why it is very difficult to rationalise such cases. The most that can be done is to identify criteria which can be used to apportion losses between the parties and to provide examples of the possible interplay between them. The relevant criteria include: (1) causal criteria[71]; (2) gravity of each party's conduct[72]; (3) each party's fault; (4) justice and equity; and (5) the judge's or arbitrator's discretion.[73]

So far as the first criterion is concerned, there are several potentially relevant causal criteria. The theory of adequate causation leads to the determination

[68] Since this work focuses on sales transactions, we can assume that it was a sales contract.
[69] Lando and Beale (n 43) 444.
[70] See *ibid*.
[71] Honore (n 8) 121.
[72] Comment 3 on art 7.4.7 UPICC.
[73] Honore (n 8) 121.

based on the extent to which each party's contribution increased the probability of the loss.[74] Another criterion could flow from a flexible version of the 'efficiency' theory, according to which 'the degree in which a particular condition causes an event may be quantified according to its energetic or efficient quality'.[75] Under this approach, determining each party's contribution will be based on 'a quantity of energy' attached to each of the party's actions or omissions.[76] Another causal criterion which has emerged in cases under the instruments is that of *necessity* of costs incurred by the injured party after the breach. In one case under the CISG,[77] the seller, who had resold the contract goods after the buyer's failure to pay, claimed, amongst other things, damages for the inspection fee it had incurred before reselling the goods. The court dismissed that part of the claim on the ground that the inspection fee was not necessary (presumably, for the purpose of reselling the goods). In another case, the seller's claim for the recovery of costs of sending a person to collect the goods, after the goods had already been shipped back to the seller, was denied on the ground there was no need for the collection.[78] In yet another case,[79] the buyer's costs incurred prior to the litigation with its sub-buyer were denied on the ground that the costs had not arisen 'unavoidably in the sense of sufficient causality' because, by not engaging the breaching seller in the pre-litigation process, the buyer had 'failed to avail itself of any possible support for its case'. These cases reflect the view that for the costs incurred by the injured party after the breach to be regarded as being caused by the breach they must be, in a sense, unavoidable or necessary for dealing with the consequences of the breach. One major consequence of the breach is that the injured party has a 'duty' to avoid or reduce its actual or possible loss and this duty needs to be exercised in a reasonable

[74] Honore (n 8) 122.

[75] Honore (n 8) 38. According to a less flexible version, 'the cause is a condition to which the highest energy attaches'. This version cannot be relied upon because it will run counter to the provisions of the UPICC and PECL (and the CISG if it is interpreted in the way suggested in this work) which require that the extent of the injured party's contribution to the loss be determined. Even a flexible version of the theory cannot be fully relied upon because, according to Honore, under the flexible version, '[a]ll those whose contributions come above a certain percentage are causes of the harm'. This again implies that if a contribution is below a certain level, it will not be regarded as the cause. This result is not what was intended under the instruments, which recognise the possibility of determining the injured party's contribution to the loss.

[76] For an analysis of the efficiency theory, see *ibid*, 38–40. The 'equivalence theory' (essentially the 'but for' test) could not be used here because it would allocate each party's contribution on the basis of a 50/50 split, thereby disregarding the possibility of an allocation other than the one based on a 50/50 split.

[77] See *China Yituo Group Company v Germany Gerhard Freyso Ltd GmbH and Co KG*, Second Intermediate People's Court (District Court) of Shanghai (China) 22 June 1998 <http://cisgw3.law.pace.edu/cases/980622c1.html>.

[78] '[T]he Seller sent [a] person for the collection in late August . . . not long after the fifth group of goods [had been] sent out on 21 August, at a time when there seemed no special necessity [for the] collection. The collection fee sought by the Seller is only a general business fee, and [is] not to be compensated'. (CIETAC Arbitration proceeding 7 November 1996 (Stone products case) <http://cisgw3.law.pace.edu/cases/961107c1.html>).

[79] See Case No P 1997/482 Civil Court Basel (Switzerland) 1 March 2002 (Soyprotein products case) <http://cisgw3.law.pace.edu/cases/020301s1.html>.

manner.[80] That is why there will often be a close connection between what these decisions termed as 'necessity' or 'unavoidability' of costs and the notion of reasonableness. In fact, it would seem that all these cases could just as well have been analysed from the standpoint of whether the injured party's actions were reasonable. On this basis, it is suggested that the question of whether a particular cost incurred by the injured party was caused by the breach is to be answered by reference to whether the cost was reasonable or expedient in the circumstances. Nevertheless, the criterion of 'necessity' and 'unavoidability' can introduce further guidance as to what costs can be regarded as being caused by the breach.

The second criterion leads to the allocation of losses based on the seriousness of each party's conduct: 'The more serious a party's failing, the greater will be its contribution to the harm.'[81] The third criterion is based on allocating losses according to each party's fault and, in some legal systems, this criterion has been used precisely because of the difficulty of allocating losses on the basis of causal criteria.[82] There are, however, doubts as to whether it is appropriate to use this criterion under the instruments since they are generally based on 'strict liability'. If fault is not a precondition for liability in damages, why should it be relevant for determining each party's contribution to the loss? However, one element which characterises the notion of fault may have a role to play. The gravity of breach, as suggested above, is likely to be an important criterion of apportioning losses and it is this element which is closely interlinked with the notion of fault.[83] The fourth criterion of apportionment is based on the notions of justice and equity and while it may seem attractive, it is certainly not conducive to certainty and consistency in this area of causation. The fifth criterion is even broader than the previous one because it does not enunciate any value to be protected and simply leaves the matter at the court's or tribunal's discretion.

Interplay between some of these criteria is illustrated by one case under the CISG[84] where the buyer suffered loss as a result of a breakdown of the machinery delivered by the seller. The contract contained a procedure for determining causes of a breakdown by requiring that first, a bilateral commission between the parties be established to come to an agreement on this matter and if no agreement was reached, each party ought to conduct its own examination of what caused the breakdown. Neither the commission nor the parties themselves

[80] See ch 6.

[81] Comment 3 on art 7.4.7 UPICC.

[82] See OS Ioffe, *Law of Obligations* (*Obyazatelstvennoye pravo*) (Leningrad 1975) 140; AP Sergeyev and YK Tolstoy (eds), *Civil Law* (*Grazhdanskoye Pravo*) (Moscow, Part 1 Prospect Publishing House, 1998) 577.

[83] It has been said that '[c]ivil law systems . . . distinguish between ordinary (or 'slight') and 'gross' negligence' (Treitel (n 56) 11) and this distinction shows that the two types of fault in those systems depend, to a certain extent, on the seriousness of the party's conduct (see D Tallon in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Giuffrè, Milan 1987) 598).

[84] ICAC Case No 189/2003, decision dated 29 December 2004 <http://cisgw3.law.pace.edu/cases/041229r1.html>.

managed to identify whether it was the seller's breach or the buyer's failure to follow the instructions that was responsible for the loss. The tribunal stated that:

> due to the fact that the parties [had] failed to determine the cause of the breakdown of the equipment, both of them [had to] suffer a financial burden resulting from that. The greater share of the liability [was] imposed on the Seller since it, as the supplier, had to take into account the specificity of the equipment and should have been more punctilious and demanding in following the provisions stipulated in the contract, in determining the cause of the breakdown of the equipment and in preventing further violations.[85]

Relying on the principles of 'justice and fairness', the tribunal held the seller liable for three-quarters of the loss suffered. The decision is clearly based on the tribunal's perception of what was just and fair in the circumstances and that, in turn, was intertwined with the considerations running along the lines of each party's *fault*. Thus, one quarter of the loss was ultimately borne by the buyer because, just like the seller, it was not entirely diligent in following the contractual procedure of establishing the cause of the breakdown.

6. CAUSATION AND CALCULATION

The role and prominence of the causation requirement in a particular legal system are dependent on whether that legal system prefers the 'concrete' or the 'abstract' method of calculation. The former aims to calculate loss by reference to the claimant's *actual* circumstances while the latter calculates damages 'in abstract' by reference to some fixed formula which usually presumes that an injured party has acted in a way that is deemed reasonable. A typical example is the formula, used in cases of non-delivery or non-acceptance, which is based on the difference between the contract price and the current price at a particular time. This formula does not look at the injured party's *actual* conduct and loss and instead *presumes* that it is possible for this party to make a cover transaction at the current price and that its loss amounts to the difference between the contract price and the current price.[86] In its pure form, the 'abstract' approach to calculation would therefore prevent taking into account events subsequent to the time fixed in the 'abstract' formula.[87] If the injured seller, wishing to speculate, waits beyond a reasonable time and only then resells the goods at a price higher than both the contract and the current price, it will, under the 'abstract'

[85] ICAC Case No 189/2003, decision dated 29 December 2004 <http://cisgw3.law.pace.edu/cases/041229r1.html>.

[86] For a more detailed discussion, see ch 8.

[87] That is, generally the time of avoidance in the case of international instruments (CISG also provides that where the contract has been avoided after taking over the goods, the current price shall be determined by reference to the time of such taking over (art 76(1) second sentence)) and the time of breach in the case of some common law systems.

approach, be awarded damages for the difference between the contract price and the current price, despite not suffering any actual loss (in fact, by making such a resale, the seller is already better off than it would have been had the buyer performed).[88] Thus, benefits made after the time specified in the applicable 'abstract' formula will be ignored in calculating damages.[89]

If, however, the 'concrete' approach is taken, it can be argued that the seller was only able to gain benefit by reselling the goods *because* the buyer had not performed the contract: because it is a corollary of the compensatory principle that any benefits the injured party obtains *as a result* of the breach must offset losses, the 'concrete' approach would dictate that the seller's resale be taken into account in calculating damages. The advocates of the 'abstract' approach would, no doubt, object to such a description of the causal relationship between the breach and the seller's benefits by arguing that the benefits were received not as a result of the breach but as a result of the seller's own speculation and risk which must be considered as breaking the chain of causation between the breach and the benefits. This position is based on the policy of encouraging market speculation by maintaining symmetry: the injured party is to bear fruits of the benefits and risks of losses occurring after the time specified in a particular 'abstract' formula. No such symmetry is likely to be possible under the 'concrete' approach for while the benefits will be taken to offset losses, losses suffered as a result of, for example, the seller reselling after a reasonable period of time (such as storage costs or losses suffered as a result of reselling at a price lower than it would have been had it sold within a reasonable time), will most probably be denied on the ground of the seller's failure to mitigate. This can, of course, also be put in terms of causation: by waiting beyond a reasonable time, the seller broke the chain of causation between the buyer's breach and its loss.[90]

The international instruments generally prefer the 'concrete' approach to calculating damages, although they do allow that the 'abstract' approach be taken in certain cases.[91] It would follow that those benefits which would not have been received but for the breach must generally be taken to offset losses, even if benefits resulted from the party's speculation on the market.[92]

[88] See, eg, *AKAS Jamal v Moolla Dawood, Sons & Co* [1916] 1 AC 175; *Campbell Mostyn (Provisions), Ltd v Barnett Trading Company* [1954] 1 Lloyd's Rep 65.

[89] For a similar view, see MG Bridge, 'The Market Rule of Damages Assessment' in D Saidov and R Cunnington (eds), *Contract Damages: Domestic and International Perspectives*, (Oxford, Hart Publishing, 2008) 433 ('In its purest, abstract application, the market damages rule pays no regard to the question of factual causation in the award of damages').

[90] See also ch 6.

[91] For a detailed discussion, see ch 8.

[92] For the discussion of cases where the injured buyer procures goods superior to the contract goods, see ch 6.

7. INJURED PARTY'S CONTRIBUTION TO THE OTHER PARTY'S FAILURE TO PERFORM

The injured party's acts or omissions may, in some cases, contribute to the other party's *failure to perform*. All three instruments contain a specific provision designed to deal with this type of situation. The CISG provides that '[a] party may not rely on a failure of the other party to perform, to the extent that such failure was caused by the first party's act or omission'[93] and similar rules can be found in the UPICC and PECL.[94] This position is usually justified on the basis that it would be contrary to fairness and good faith to hold the breaching party fully responsible for the actions to which the injured party has contributed.[95] The consequence of this provision is that a party's failure to perform will not be regarded as a breach (non-performance) to the extent that it has been caused by the injured party.[96]

The problems of apportionment here are very similar to those of apportioning losses where the injured party has contributed to the loss, with the only difference being that in the latter situation the injured party contributes to the *loss* whereas in the former case it contributes to the defaulting party's *failure to perform*. For this reason, the considerations set out above in relation to cases where the injured party contributes to its own loss are also relevant here. The discussion in this section will focus on two lines of cases that have thus far emerged in the context of the CISG.

The first line of cases concerns the situation where the actions of one party *complicate* the other party's position but do not prevent that party from performing the contract. These are cases where a party has to exercise its judgement and to make a choice as to what course it should take. Suppose that the buyer had given incorrect instructions to the manufacturer and the manufacturer produced defective equipment. Suppose further that the manufacturer was in the position to discover the incorrectness of the instructions and to ask the buyer to issue the proper ones. Should the buyer be regarded as *having caused* the manufacturer's failure to produce equipment in conformity with the contract? The answer depends, most probably, on whether the manufacturer's

[93] Article 80 CISG.

[94] Article 7.1.2 UPICC: 'A party may not rely on the non-performance of the other party to the extent that such non-performance was caused by the first party's act or omission or by another event as to which the first party bears the risk'. Article 8:101 PECL: 'A party may not resort to any of the remedies set out in Chapter 9 to the extent that its own act caused the other party's non-performance'. Article 9:504 PECL: 'The non-performing party is not liable for loss suffered by the aggrieved party to the extent that the aggrieved party contributed to the non-performance . . .'

[95] Lando and Beale (n 43) 359; Comment 1 to art 1.7 UPICC. See also Case No 1 U 280/96 Appellate Court Karlsruhe (Germany) 25 June 1997 (Surface protective film case) <http://cisgw3.law.pace.edu/cases/970625g1.html>; Case No 7 U 1720/94 Appellate Court München (Germany) 8 February 1995 (Automobiles case) <http://cisgw3.law.pace.edu/cases/950208g1.html>.

[96] See Comment 1 to art 7.1.2 UPICC ('[w]hen the article applies, the relevant conduct . . . loses the quality of non-performance altogether').

conduct was reasonable in the circumstances. If it is reasonable to expect someone in the manufacturer's position to check the instructions,[97] then arguably the buyer should not be regarded as having caused the manufacturer's breach. However, as demonstrated by cases under the CISG, the surrounding legal framework and, more specifically, legal rights, obligations of and remedies available to the parties can also be relevant.

In one case,[98] as a result of the buyer's failure to pay for several deliveries, the seller, claiming the payment of outstanding sums, refrained from making further deliveries. In principle, however, the seller was willing and able to deliver. The buyer claimed damages for non-delivery but the court held that the buyer could not rely on the seller's failure to deliver because the buyer itself had caused the seller's failure to perform. In another case,[99] it was held that the seller could not rely on the buyer's failure to open a letter of credit because the seller had failed to perform its obligation to nominate the port of loading. Although it was established that the letter of credit *could* be opened without a port of loading being nominated, the court nevertheless interpreted the contract as if nominating the port of loading was a condition for the buyer's obligation to open a letter of credit and then ruled, by reference to art 80 CISG, that it was the seller's breach that had caused the buyer's failure to open a letter of credit:

> It is irrelevant whether the opening of a letter of credit would have been possible even without information about the place of loading, because the parties expressly agreed upon the naming of the place of loading by the sellers. Due to this agreement, the sellers had the primary duty to name the place of loading. Only after this act on the part of the sellers did the buyer have the obligation to issue the letter of credit. The non-issuance of the letter of credit, therefore, was caused by an omission of the sellers, and—following Art 80 CISG—the latter cannot rely on the buyer's failure to open the letter of credit.[100]

There are doubts as to whether, in the first case, the buyer's failure to pay could be regarded as the cause of the seller's failure to deliver the goods in the sense of art 80 CISG. The CISG protects the parties like the seller in that case by making available a number of remedies. The seller could, for instance, claim specific performance or, if relevant,[101] avoid the contract (if the breach were fundamental) and claim damages; if the buyer's failure to pay for the previous delivery gave sufficient grounds to conclude that an anticipatory breach would occur, it

[97] Some of the relevant factors include the level of expertise of both parties, previous relationships, negotiations and practices between the parties, and relevant trade usages (see arts 8 and 9 CISG).

[98] Case No 10 O 5423/01 District Court München (Germany) 20 February 2002 (Shoes case) <http://cisgw3.law.pace.edu/cases/020220g1.html>; the decision was affirmed in Case 10 O 5423/01 Appellate Court München (Germany) 1 July 2002 (Shoes case) <http://cisgw3.law.pace.edu/cases/020701g1.html>.

[99] Case No 10 Ob 518/95 Supreme Court (Austria) 6 February 1996 (Propane case) <http://cisgw3.law.pace.edu/cases/960206a3.html>.

[100] *Ibid*.

[101] See n 104.

could suspend performance and/or terminate the contract. But because the seller still had an existing legal obligation, it could not, unless a general right to withhold performance is recognised, simply stop its own performance just because the other party failed to perform and argue that the buyer's failure to perform caused its own non-performance.[102] So far as the express provisions of the CISG are concerned, a breach by one party does not automatically justify the suspension of performance by the other party unless such a suspension falls within the scope of art 71[103] or art 58.[104]

The second case also demonstrates that the parties' rights and obligations under both the contract and the Convention are relevant for determining whether the seller's omission was the cause of the buyer's failure to perform. If the decision is correct in interpreting the contract as making the seller's nomination of the port of loading a condition for the buyer's obligation to open a letter of credit, it demonstrates that the causal relationship referred to in art 80 CISG will sometimes depend on the preconditions, set forth in the contract, for the performance of a particular obligation. Indeed, if it were the term (whether express or implied) of the contract that the buyer's obligation to open the letter of credit could *only* be performed after the port was nominated, the seller's failure to nominate can be said to cause the buyer's failure to open the letter of credit. However, while the decision makes clear that the buyer *could* open the letter of credit without a port being nominated, it is not as clear when it comes to the question of whether, according to the contract, the nomination was a *precondition* for the buyer's obligation to open the letter of credit. Considering that the court of lower instance relied on the Convention's provisions on anticipatory breach (the right to suspend performance) to justify the buyer's failure to open the letter of credit, it would seem that the court of final instance, by implying the term that the seller's obligation was a 'primary' one,

[102] For an argument in favour of recognising a general right to withhold performance under the CISG, see P Schlechtriem, 'Intepretation, Gap-Filling and Further Development of the UN Sales Convention' <http://www.cisg.law.pace.edu/cisg/biblio/schlechtriem6.html>; P Schlechtriem, 'Subsequent Performance and Delivery Deadlines—Avoidance of CISG Sales Contracts Due to Non-conformity of the Goods' (2006) 18 Pace Int'l L Rev 83, 90-93; CISG Advisory Council (CISG-AC) Opinion No. 5, 'The Buyer's Right to Avoid the Contract in Case of Non-Conforming Goods or Documents' <http://www.cisg.law.pace.edu/cisg/CISG-AC-op5.html>.

[103] (1) A party may suspend the performance of his obligations if, after the conclusion of the contract, it becomes apparent that the other party will not perform a substantial part of his obligations as a result of: (a) a serious deficiency in his ability to perform or in his creditworthiness; (b) his conduct in preparing to perform or in performing the contract. [. . .] (3) A party suspending performance, whether before or after dispatch of the goods, must immediately give notice of the suspension to the other party and must continue with performance if the other party provides adequate assurance of his performance (Art 71 CISG).

[104] 'The seller may make such payment a condition for handing over the goods or documents' (Art 58(1) CISG, second sentence). Although the court in this case relied on Art 58, there are doubts as to its applicability to the case since it seems that the seller refused to deliver the goods because of the buyer's failure to pay for *past* deliveries under *different* contracts (see also D Maskow in Bianca and Bonell (n 83) 423 ('Where successive deliveries are agreed upon, every delivery has to be treated as a separate one. . .[T]he seller may not generally withhold delivery because a former delivery has not yet been paid')). See also art 85 CISG.

was similarly looking for a way to justify the buyer's non-performance. If this were the case, it is submitted, with respect, that this approach is not entirely satisfactory. It creates uncertainty and encourages an unjustifiable passivity by sending a signal that it may be possible for one party to simply stop its performance as soon as the other party fails to perform. As argued above, the Convention provides a number of possible remedies and the suspension of performance is justified only in a specified type of case.[105] Legal protection is further ensured by the availability of other remedies such as specific performance,[106] setting an additional period of time,[107] avoidance,[108] and damages.[109] It is clear that it is invoking these remedies (whichever is relevant), and not a mere stoppage of its own performance, that is a proper course for the injured party to follow. Ceasing to perform its own contract without a legally justifiable reason would put the innocent party in the position where it would itself commit a breach of contract. For these reasons, it is argued that unless there was clear evidence confirming the parties' intention to treat the seller's obligation as a condition for the performance of the buyer's obligation, the court has chosen an unhelpful legal route to protect the buyer.[110]

Another line of cases under the CISG has raised the question of whether the fact that the buyer has prevented the seller from curing the defects in the goods can be regarded as causing the seller's failure to provide conforming goods. In one case,[111] after delivering non-conforming goods, the seller offered to deliver new goods in accordance with art 48 CISG. The buyer rejected the offer and the court held that the buyer could not rely on the seller's breach because it 'had hindered the seller's cure of non-conformity'.[112] In another case,[113] although the court did not regard the buyer as having prevented the exercise of the seller's right to cure, the court recognised that it would have been possible for a seller

[105] See art 71 CISG. See also art 58 CISG and nn 102 and 104 with accompanying text.

[106] See arts 46 and 62 CISG.

[107] See arts 47 and 63 CISG.

[108] See arts 49 and 64 CISG.

[109] See arts 45, 61 and 74–77 CISG.

[110] A different approach was taken in another case under the CISG where the buyer argued that its failure to open a letter of credit was caused by the parties' dispute over the contract price which was brought about by the seller's attempt to change it. The arbitrator correctly rejected that argument by stating that '[the Buyer] must prove that [the Seller]'s behaviour made the opening of the required letter of credit impossible or almost impossible. The Arbitrator does not find in the file any such evidence. On the contrary, as it has been said, the parties' disagreement on the Fall/Winter season price list did not prevent [the Buyer] from opening a letter of credit on the basis of the first price list. Given that [the Buyer] does not bring evidence that its failure to open the letter of credit was at that time due to an impediment caused by [the Seller], its submission based upon Art. 80 of the CISG shall be rejected' (ICC Arbitration Case No 11849 of 2003 (Fashion products case) <http://cisgw3.law.pace.edu/cases/031849i1.html>).

[111] See Case No 2 U 31/96 Appellate Court Koblenz (Germany) 31 January 1997 (Acrylic blankets case) <http://cisgw3.law.pace.edu/cases/970131g1.html>.

[112] *Ibid.*

[113] Case No 271 C 18968/94 Lower Court München (Germany) 23 June 1995 (Tetracycline case) <http://cisgw3.law.pace.edu/cases/950623g1.html>.

to rely on art 80 if the buyer had thwarted the seller's right to cure.[114] It is suggested that it is correct to interpret art 80 CISG in this way. While the very fact of an offer to cure will usually indicate that a breach has already been committed, the seller nevertheless has a *legal right* to cure which, if successfully exercised, will lead to the cessation of the breach. Hence, if the buyer prevents the seller from curing the defects, the seller is prevented from providing a proper performance. This broad interpretation of art 80 is in line with its underlying ideas of fairness and good faith: if the seller is legally entitled to eliminate the breach and ensure proper performance, it seems unfair to disallow the seller to rely on art 80 if the buyer prevented its right to cure. What needs to be proved then is that the requirements of art 48 CISG[115] have been met and that the seller would have provided proper performance had the buyer not prevented the exercise of its right to cure.

[114] 'The buyer's claim for damages is also not excluded by Art 80 CISG, because buyer did not thwart the seller's possibility to remedy the lack of conformity within reasonable time' (*ibid*).

[115] Article 48(1) CISG: 'Subject to article 49, the seller may, even after the date for delivery, remedy at his own expense any failure to perform his obligations, if he can do so without unreasonable delay and without causing the buyer unreasonable inconvenience or uncertainty of reimbursement by the seller of expenses advanced by the buyer. However, the buyer retains any right to claim damages as provided for in this Convention.'

5

Foreseeability

1. GENERAL

THE 'FORESEEABILITY' TEST has been widely used as a method of limiting damages and it is its popularity amongst domestic systems as well as its perceived suitability to the needs of international commerce which encouraged drafters to introduce the test into the international instruments.[1] According to the CISG, damages awarded to the injured party 'may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract'.[2] The UPICC also provide that '[t]he non-performing party is liable only for harm which it foresaw or could reasonably have foreseen at the time of the conclusion of the contract as being likely to result from its non-performance'.[3] The PECL contain the following provision: '[t]he 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'.[4] There seems to be an agreement, at least insofar as the CISG is concerned, that it is the injured party who bears the burden of proving foreseeability.[5]

The existence of the foreseeability test can be justified on various grounds. First, it has been said that the test rests upon the notion that in determining the desirability of an act, regard is to be had to its foreseeable consequences.[6] This notion is arguably a part of a broader idea that '[t]he commonest person lives according to maxims of prudence wholly founded on foresight of

[1] See A Komarov, 'The Limitation of Contract Damages in Domestic Legal Systems and International Instruments' in D Saidov and R Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (Oxford, Hart Publishing, 2008) 250–52.

[2] Article 74 CISG.

[3] Article 7.4.4 UPICC.

[4] Article 9:503 PECL.

[5] See, eg, Case No 3 U 83/98 Appellate Court Bamberg (Germany) 13 January 1999 (Fabric case) <http://cisgw3.law.pace.edu/cases/990113g1.html>; H Stoll and G Gruber, 'Arts 74–77 CISG' in P Schlechtriem and I Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods*, 2nd English edn (Oxford, OUP, 2005) 771–2.

[6] PS Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford, Clarendon Press, 1979) 432.

consequences'.[7] The proponents of this view argue that since even outside law people often judge a person's action from the standpoint of whether he/she foresaw the consequences of his/her action, it is natural and fair[8] that the extent of legal liability should also depend on foreseeability by the party of the consequences of his/her actions.[9] The most widely accepted justification of the rule,[10] however, rests on its function of allocating risk in a fair[11] and reasonable[12] manner. The underlying aim is to make it possible for the parties to calculate the risks and their potential liability.[13] If, at the time of the conclusion of the contract, the party foresaw or ought to have foreseen a particular loss, it could have taken it into account and acted accordingly by excluding or reducing its potential liability, procuring insurance, increasing the amount of benefit to be obtained from the contract, or even refusing to enter into the contract. This risk allocation function has been viewed as an indication that the foreseeability test is related to the very nature and purpose of the contract[14] and that the breaching party can be held liable only to the extent that its liability is within the scope of the contract.[15] Finally, when approached from the perspective of the consequences and incentives to which it can give rise, the foreseeability rule has been justified on the grounds that it encourages commercial activity[16] and promotes economic efficiency. The former is explained on the basis that the rule not only enables the parties themselves to manage possible risks, associated with making and performing contracts,[17] but also reduces such risks by protecting the parties

[7] JS Mill, 'Sedgwick's Discourse' in JM Robson (ed), *The Collected Works of John Stuart Mill, Volume X, Essays on Ethics, Religion and Society* (London, University of Toronto Press, Routledge and Kegan Paul Ltd, 1969) 63.

[8] 'The principle that does not allow a debtor . . . to be made liable for the damages resulting from the inexecution of his obligation, above the sum to which he may reasonably have imagined they would amount, being grounded on natural law and equity, we ought to follow' (RJ Pothier, *A Treatise on Obligations, Considered in a Moral and Legal View* (Clark, NJ, The Lawbook Exchange Ltd, 1999) 99–100).

[9] See HLA Hart and T Honore, *Causation in the Law*, 2nd edn (Oxford, Clarendon Press, 1985) 254 stating that '[i]t is not surprising to find that lawyers often stress the importance of foreseeability in relation to problems of responsibility, for even outside law the fact that harm was or was not foreseeable is frequently an important factor in blaming or excusing people for its occurrence'.

[10] There are numerous sources in which this rationale has been relied upon (see, eg, Stoll and Gruber (n 5) 747; P Schlechtriem, *Uniform Sales Law: The UN-Convention on Contracts for the International Sale of Goods* (Vienna, Manz Verlag, 1986) 96).

[11] See Hart and Honore (n 9) 230, stating that foreseeability is a rule which promotes 'a fair balance between the contracting parties'.

[12] See EA Farnsworth, 'Legal Remedies for Breach of Contract' (1970) 70 Columbia L Rev 1208.

[13] See, eg, Pothier (n 8) 94; Farnsworth (n 12) 1207; H Bernstein and J Lookofsky, *Understanding the CISG in* Europe, 2nd edn (The Hague, Kluwer Law International, 2003) 140, note 163.

[14] See J Hellner, 'The Limits of Contractual Damages in the Scandinavian Law of Sales' (1966) 10 Scandinavian L S 48–9; Comment on art 7.4.4 UPICC.

[15] See A Kramer, 'An Agreement-Centred Approach to Remoteness and Contract Damages' in N Cohen and E McKendrick (eds), *Comparative Remedies for Breach of Contract* (Oxford, Hart Publishing, 2005) 249.

[16] See EW Patterson, 'The Apportionment of Business Risks through Legal Devices' (1924) 24 Columbia L Rev 335, 342.

[17] See Komarov (n 1).

from unusual and excessive losses.[18] Its ability to promote economic efficiency can be summarised thus:

> It saves transaction costs in that it represents the usual agreement that most parties would make if they negotiated on the question. It saves the plaintiff the cost of explaining the obvious consequences of breach, of which the defendant knows just as much. It creates an incentive upon the plaintiff to reveal facts peculiarly within the plaintiff's knowledge that will cause the cost of breach to be greater than the defendant would have expected. The defendant, knowing of these peculiar facts, can act accordingly by making a rational allocation of resources to reduce the probability of breach, by refusing to contract, by raising the price, or by excluding liability.[19]

2. THE FORESEEABILITY TEST

2.1 General

In contrast with the common law systems which require that loss be contemplated by both parties,[20] the instruments make it clear that it is foreseeability of the breaching party which is of legal significance.[21] Although this difference is probably of minor practical significance, the instruments' approach is preferable to that of the common law. First, it is more consistent with the 'risk allocation' rationale underlying the foreseeability rule which refers to the assumption of risk by the breaching party,[22] and second, the question of foreseeability of loss is only relevant in the case of the breaching party's knowledge because 'the plaintiff nearly always knows his own business and circumstances better than the defendant'.[23]

The instruments' foreseeability test is both subjective and objective: the party may be held liable not only for losses which it actually foresaw, but also for losses which it 'ought to have foreseen'[24] or 'could reasonably have foreseen'.[25] Thus, to make the party liable, it is not necessary to prove that this party *actually* foresaw the loss in question as long as it was in the position to *reasonably*

[18] See MG Bridge, *The Sale of Goods* (Oxford, OUP, 1997) 541 (referring to the view that regards the foreseeability rule 'as consonant with the wishes of the business community that a contracting party should not be the insurer of the other's contractual adventure').

[19] S Waddams, *The Law of Damages*, 4th edn (Toronto, Canada Law Book Inc, 2004) 569 (see this source for references to the relevant law and economics literature on the subject).

[20] See *Hadley v Baxendale* (1854) 9 Ex 341, 354.

[21] See art 74 CISG, art 7.4.4 UPICC and art 9:503 PECL.

[22] See AG Murphey, Jr, 'Consequential Damages in Contracts for the International Sale of Goods and the Legacy of *Hadley*' (1989) 23 Geo Wash J Int'l L and Economics 415 (also at <http://www.cisg.law.pace.edu/cisg/biblio/murphey.html>).

[23] AL Corbin, *Corbin on Contracts: A Comprehensive Treatise on the Working Rules of Contract Law* vol 5 (St Paul, Minn, West Publishing Co, 2002) 29.

[24] Article 74 CISG.

[25] Article 7.4.4 UPICC and art 9:503 PECL.

foresee that loss.[26] There is, at first sight, a difference in the way the instruments formulate the objective standard. The CISG uses the words 'ought to have been foreseen' and they may seem to impose a stricter requirement than that implied by the words 'could reasonably have foreseen' used by the UPICC and the PECL. It is unlikely, however, that this insignificant variation in wording will lead to the Convention being interpreted more restrictively than the UPICC and PECL and this suggestion finds support in the comments on the two sets of Principles. The comments on the UPICC state that art 7.4.4 corresponds to art 74 CISG[27] and the comments on the PECL expressly use the wording used in the CISG.[28]

The question arises as to whether it is the breaching party itself or a reasonable person in the same circumstances who 'ought to have foreseen' or 'could reasonably have foreseen' the loss. This question may be relevant where some characteristics of the breaching party are different from those attributable to a 'reasonable person'. While, in some legal systems, it is stressed that it is foreseeability by a *reasonable man* and not of a *party in breach* which is relevant,[29] the wording of art 74 CISG suggests that it is the breaching party itself who ought to have foreseen the loss—'the loss which the *party in breach* . . . ought to have foreseen'.[30] The same can be said about the position of the UPICC and the PECL which state that it is the non-performing party who 'could have reasonably foreseen' the loss.[31] The word 'reasonably' in this context refers to reasonable foreseeability of the *non-performing party* and not of a 'reasonable person'.

[26] See, eg, V Knapp, 'Arts 74–77 CISG' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Milan, Giuffrè, 1987) 541.

[27] See Comment on art 7.4.4 UPICC.

[28] See Comment A on art 9:503 in O Lando and H Beale (eds), *Principles of European Contract Law: Parts I and II* prepared by the Commission on European Contract Law (The Hague, Kluwer Law International, 2000).

[29] 'The debtor cannot escape liability by showing that he personally could foresee less than the reasonable man. This is in fact clear on the face of article 1150, which speaks of damage "which *one* could have foreseen"—not which *he* could have foreseen. The question to be asked is what a reasonable man in the "external circumstances" of the debtor (as opposed to his "internal circumstances", such as intelligence, caution) could have foreseen' (B Nicholas, *The French Law of* Contract, 2nd edn (Oxford, Clarendon Press, 1992) 231).

[30] This provision can be contrasted with the definition of the fundamental breach in art 25, which also uses the foreseeability test. According to art 25, '[b]reach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and *a reasonable person of the same kind in the same circumstances would not have foreseen such a result*'. It can be argued, therefore, that had the drafters intended to apply the same standard of foreseeability in relation to damages they would have formulated art 74 in a similar way.

[31] Article 7.4.4 UPICC and art 9:503 PECL. By contrast with art 25 CISG, the same standard of foreseeability is used in the definition of fundamental non-performance (see art 7.3.1(2) UPICC, art 8:103 PECL).

2.2 Relevant factors

2.2.1 Knowledge

There are a number of factors that need to be taken into account when applying the foreseeability test. The first important factor in assessing the breaching party's foreseeability is this party's knowledge. So far as the subjective standard of foreseeability is concerned, a person can only foresee a certain result if it has knowledge of relevant facts and matters enabling it to foresee that result. When it comes to the objective standard of foreseeability, no foreseeability can be imputed into a person without considering what knowledge that person had or ought to have had (or could reasonably have had). Knowledge (both actual and imputed) is thus an integral part of the foreseeability test and this is expressly recognised in the CISG, which refers to foreseeability 'in light of the facts and matters of which [the party] . . . knew or ought to have known'.[32] Because foreseeability can be both subjective and objective, knowledge can also be of two types: actual and presumed.

Actual knowledge of relevant facts is particularly important where the loss in question is of an unusual kind or of an unusually high extent because if there is nothing extraordinary about its type or extent, relevant knowledge and foreseeability will, in any event, be imputed. Therefore, if a party knows that a breach by the other party is likely to give rise to unusual losses it needs to notify the other party of the likelihood of such losses occurring before or at the time of the conclusion of the contract. Consider the case where the buyer knows that delay in delivery will cause it to process the goods in a country other than that originally intended and that such a change in location will cause the buyer extra expense. Clearly, if there is no particular reason why the seller would be expected to know of this consequence,[33] this loss would not be foreseeable to the seller unless it is duly informed before or at the conclusion of the contract.[34] More generally, however, there is no need for a rigid separation and distinction between actual and imputed knowledge because both have their respective roles to play. The extent of the buyer's lost profits and liability to its sub-buyers may be held foreseeable because of the supplier's *actual* knowledge that the buyer is a trader and the further knowledge *imputed* into the supplier, in the light of its own business experience, of the usual levels of profit margins received from the sale of the goods in question. In other words, a piece of actual knowledge often triggers a further presumption about what the seller is then *expected* to know.[35]

[32] Article 74 CISG.

[33] This knowledge can be imputed to the seller for many reasons: previous dealings between the parties, common knowledge about such practice of processing the goods, a relevant trade usage.

[34] Appellate Court Bamberg 13 January 1999 (n 5).

[35] For other examples, see Arbitration proceeding Case No 48 of 2005 (Ukraine) <http://cisgw3.law.pace.edu/cases/050000u5.html> ('The Seller *knew* from the very beginning that goods were purchased by the Buyer for further processing and sale of the derived products. Therefore, the Seller *had to realize* that stoppage of supply will cause certain losses for the Buyer' (emphasis added)).

It needs to be mentioned that the possibility of imputing knowledge and foreseeability has led some judges and commentators to argue, no doubt in the interests of uniformity,[36] that certain types of knowledge can generally be imputed and certain types of losses can generally be regarded as foreseeable. For example, one court stated that where commercial goods are sold to a merchant, a resale 'can always be assumed without any further indications'.[37] Changes in market conditions have also been regarded as part of the knowledge which can generally be imputed.[38] It has also been suggested that the breaching party should reckon with the fact that after the breach, the injured party will incur expenses in the attempt to 'bring about a state of affairs that would have existed had the contract been properly performed'.[39] The following types of loss have also been said to be generally foreseeable: liability to customers or costs of taking the goods back where the goods are sold to a commercial buyer;[40] compensation for missed uses of the goods to be delivered; additional costs for transportation, storage and insurance; the loss of clients resulting from the defect in the goods.[41]

This approach, it is submitted, is not helpful. Although the instruments' foreseeability rule allows that the extent of the breaching party's liability be determined by knowledge and foreseeability this party is *presumed* to have had, this should not mean that we should 'de-personalise' the rule entirely. The goals of certainty and uniformity that the described approach aims to achieve must be balanced against the rationale underlying the foreseeability rule. As shown, the rule pursues the purpose of allocating the risk in a fair and reasonable manner and considering the multiplicity of circumstances in which the breaching parties may find themselves, it seems grossly unfair to presume, from the mere fact that breaching parties are businesspersons, that they automatically find themselves in a position to foresee the losses referred to above. Such a sweeping presumption would negate the very purpose of the foreseeability rule by altogether ignoring the breaching parties' particular circumstances. Surely, a more balanced approach is to rely on presumed knowledge and foreseeability but only insofar as they can be reasonably inferred from the party's particular circumstances. This does not mean, however, that we should refrain from identifying factors and patterns which may lead judges and arbitrators to imputing certain types of knowledge. Without being 'set in stone', such factors and patterns can help

[36] See Schlechtriem (n 10) (stating that '[j]udicial discretion in the assessment of damages can be reduced by standardizing the damages in question . . .').

[37] Case No 10 Ob 518/95 Supreme Court (Austria) 6 February 1996 (Propane case) <http://cisgw3.law.pace.edu/cases/960206a3.html>.

[38] Case No 2 U 30/77 Appellate Court Hamm (Germany) 23 March 1978 (Brass poles case) <http://cisgw3.law.pace.edu/cases/780323g1.html> (decided on the basis of the ULIS).

[39] See Stoll and Gruber (n 5) 766.

[40] *Ibid*, 570.

[41] See F Enderlein and D Maskow, International Sales Law: United Nations Convention on Contracts for the International Sale of Goods, Convention on the Limitation Period in the International Sale of Goods (New York, Oceana, 1992) 301.

parties develop reasonable expectations as to how the instruments' foreseeability rule is likely to work in a particular case.

In general, a businessperson will be presumed to know of the facts and matters which will enable it to foresee the consequences of the breach if such knowledge can be expected of it taking into consideration its commercial experience.[42] Where traders are involved, it will often be reasonable to expect the breaching party to know that prices for the goods, particularly those in volatile markets, will fluctuate and that the injured party will suffer losses as a result. In one case decided under the ULIS,[43] the buyer's refusal to perform put the seller in the position where it had to purchase the goods from the supplier but was unable to find any use for the goods until the time when the price dropped considerably. The court ruled that the seller's loss was foreseeable:

> [The buyer] is a businessperson. Furthermore, the brass material that [the seller] purchased to perform its contract with the buyer is an article which depends on the market. Consequently, considerable fluctuations in price are to be expected. That includes a sudden drop in prices to the depths the seller uses to calculate its losses.[44]

In another case (this time, under the CISG),[45] the delivery of a defective packaging system caused the buyer, amongst other things, to incur additional costs relating to the maintenance of its production facility. The court held that because this loss would be foreseeable 'to any company dealing in implements of manufacture', this loss was foreseeable to the breaching seller as the latter itself was a manufacturer. It may also be the case that the buyer's delay in payment causes the seller to procure credit and in one case, the cost of doing so was held to have been foreseeable by the buyer.[46]

[42] See Knapp (n 26) 542.

[43] See Appellate Court Hamm, 23 March 1978 (n 38).

[44] See also ICAC Case No 166/1995, decision dated 12 March 1996 <http://cisgw3.law.pace.edu/cases/960312r1.html>, where the seller's apparently extensive commercial experience was decisive for the tribunal in concluding that various types of loss were foreseeable to the seller.

[45] *TeeVee Tunes, Inc et al v Gerhard Schubert GmbH* not reported in F.Supp.2d 2006, WL 2463537 (SDNY) (No 00 Civ 5189 (RCC)).

[46] See Case No 2 U 1230/91 Appellate Court Koblenz (Germany) 17 September 1993 (Computer chip case) <http://cisgw3.law.pace.edu/cases/930917g1.html>. See also CIETAC Arbitration proceeding 18 April 2003 (Desulfurization reagent case) <http://cisgw3.law.pace.edu/cases/030418c1.html>, where the American buyer's failure to pay caused the Chinese seller the loss of the duty drawback ('duty drawback' seems to refer to a refund of an import duty where the imported goods (or finished products manufactured from them) are subsequently exported from China). The tribunal held that that loss was foreseeable to the buyer on the ground that it ought to have known and foreseen 'relevant laws, regulations and policies of the State of the counter party before the international business carried out'. The tribunal reasoned that 'the Buyer, as a businessman in the international trade, [ought to] be prudential [with respect] to its rights and obligations . . .' and that it was reasonable to expect that it would be aware of Chinese trading policies. While the facts of the case are not set out in sufficient detail to enable drawing the conclusion as to whether the tribunal's decision was correct, its reasoning needs to be treated with caution. The mere fact that a party has entered into a contract with a party from another country is not in itself sufficient to impute knowledge of the intricacies of that country's trading policy and legislation. As has already been argued in the main text, the question of what the breaching party ought to have known and foreseen should be resolved on the basis of the particular circumstances of the case.

In several cases, besides relying on the breaching party's business experience, courts and tribunals have also taken into account some other factors in deciding as to whether it was appropriate to impute knowledge and foreseeability. One such factor was knowledge of the innocent party's business. In one case under the CISG,[47] the seller knew that the buyer was a car dealer and when its delivery of a non-conforming car made the buyer liable to its customer, the court ordered the seller to compensate the buyer for those damages as they were, in the court's opinion, 'foreseeable'. Where the seller sells a large quantity of the goods and knows that it sells the goods to a wholesaler in a sensitive market, it is likely to be found to be in the position to foresee that the buyer will lose custom, profits, and that its reputation and goodwill will be damaged.[48] In some cases, the seller may be held liable for loss of custom and profits even if the breach was trivial so long as the seller knew that the buyer was a middleman operating in a market which is saturated with the type of product delivered by the seller. In a case under the ULIS,[49] the Dutch seller who delivered cheese, only 3 per cent of which was found to be defective, was held to be in a position to foresee loss of custom and profits because 'at the time of contract formation both seller and buyer knew that the cheese market in Germany was saturated with Dutch imports so that the threat existed that purchasers such as buyer's customers might change suppliers even for trivially unsatisfactory deliveries other than the defects complained of by buyer'. In a similar vein, where the seller is aware that it sells the goods to be used in the buyer's manufacturing process, it is expected to foresee that non-delivery or non-conforming delivery is likely to cause the buyer to lose profits from selling the final product.[50] Where, however, the buyer demands damages for lost profits on its sub-sale contracts, they were held not to be foreseeable to the seller who had made a non-conforming delivery, where the buyer permitted a wrongful rejection of the goods by its sub-buyers.[51] It may also be the case that where the parties have had a long-standing

[47] See Case No 22 U 4/96 Appellate Court Köln (Germany) 21 May 1996 (Used car case) <http://cisgw3.law.pace.edu/cases/960521g1.html>.

[48] '[The Sellers] knew that they were delivering to a wholesaler who would resell the meat. The *Atlas*-delivery, furthermore, constituted a large amount, 172 tons, of meat. Therefore, at the time of the conclusion of the contract, [the Sellers] must have been aware that a deficient delivery would cause problems between [the Buyer] and its clients which could not be easily solved by [the Buyer], eg, through a short-time substitute delivery. [The Sellers] also had to take into account that [the Buyer] could lose clients completely in case of a deficient delivery and that it could thereby suffer additional damages' (*EK, L and A v F* Supreme Court (Switzerland) 28 October 1998 <http://cisgw3.law.pace.edu/cases/981028s1.html>). For cases where loss of custom and damage to reputation and goodwill were not held to be foreseeable in the circumstances (with no sufficient explanation being given, however), see CIETAC Arbitration proceeding 31 January 2000 (Clothes case) <http://cisgw3.law.pace.edu/cases/000131c1.html>; CIETAC Arbitration proceeding 26 October 1996 (Cotton bath towel case) <http://cisgw3.law.pace.edu/cases/961026c1.html>.

[49] Case No VIII ZR 210/78 Supreme Court (Germany) 24 October 1979 (Cheese case) <http://cisgw3.law.pace.edu/cases/791024g1.html>.

[50] Federal District Court (New York) 23 August 2006 (n 45).

[51] *Re: Siskiyou Evergreen, Inc Debtor*, Case No 602-66975-fra11, unreported, US Bankruptcy Court for the District of Oregon 29 March 2004 (United States)

business relationship, the breaching seller can be safely presumed to have been aware of the purpose for which the buyer bought the goods. If, in such a case, the buyer bought the goods for resale, the seller may be presumed to have foreseen that delay in delivering the goods (or non-delivery, for that matter) would make the buyer liable to its sub-buyers.[52] However, where the nature of the buyer's liability to third parties is unusual, excessive, or unjustified, losses flowing therefrom are unlikely to be foreseeable. In one case,[53] the buyer bought materials for use in the construction project it had been commissioned to carry out. As a result of the seller's delay in delivering the goods, the buyer had to pay a contractual penalty to its sub-contractor. The court held that while such penalty clauses 'can be expected to be included in construction contracts', the penalty paid in that particular case was not foreseeable by the seller because of the clause being too disadvantageous[54] to the buyer by requiring to pay the full amount of the penalty (which, presumably, was deemed to be excessive in the circumstances) within a short period, considering the large scale of the project. The court, relying on the 'assumption of risk' rationale of the foreseeability rule, stated that the risk that had materialised in that case did not conform to the risk assumed by the seller because the seller 'did not have to reckon with the fact that [the buyer] would forfeit the full contractual penalty with a delay in delivery of two weeks'.[55] Where the breaching seller had no reason to be aware at the time of concluding the contract that the buyer acted as an agent, it is highly unlikely that the buyer's loss of its agency commission would be regarded as a foreseeable loss.[56]

<http://cisgw3.law.pace.edu/cases/040329u2.html> ('At trial, Barroso conceded that the rejection of the several contracts he had with customers in Mexico was wrongful. It follows that the events could not have been foreseen by the seller'). The same result could, of course, have been achieved by means of the mitigation rule: by accepting unjustifiable rejection of the goods by its sub-buyers, the buyer failed to reduce or avoid its loss. For the discussion of the interrelationship between the foreseeability and mitigation rules, see below.

[52] 'Both parties confirmed during the hearings that they had had long-lasting business relations which fact was reflected in numerous contracts. In these circumstances, the [Seller], as a professional participant of the market of this kind of goods, could not have been unaware of the fact that the [Buyer] is not the consumer of the delivered goods and that it distributes them on the internal market of Russia, that naturally includes transshipment (resale) of the purchased goods by the [Buyer] to further customers, as was the case in the relations of the [Buyer] with its customer under Contract No 11-04/KK of 15 April 2004. Equally, having chosen the Russian law as the applicable law, the [Seller] could not have been unaware that failing to perform its obligations to the [Buyer] it will have to recover the loss suffered by the [Buyer] as a result of paying penalties to its contractor in accordance with the rules of Russian civil law' (ICAC Case 97/2004, decision dated 23 December 2004 <http://cisgw3.law.pace.edu/cases/041223r1.html>).

[53] Case No 419 O 48/01 District Court Hamburg (Germany) 21 December 2001 (Stones case) <http://cisgw3.law.pace.edu/cases/011221g1.html>.

[54] In fact, the clause was held to be void in accordance with the applicable domestic law.

[55] For other cases, where damages arising from liability to third parties were held unforeseeable (where no satisfactory explanation has been given, however), see Case No 43 O 136/92 District Court Aachen (Germany) 14 May 1993 (Electronic hearing aid case) <http://cisgw3.law.pace.edu/cases/930514g1.html>; CIETAC Arbitration proceeding 7 May 1997 (Horsebean case) <http://cisgw3.law.pace.edu/cases/970507c1.html>.

[56] CIETAC Arbitration proceeding 7 July 1997 (Isobutanol case) <http://cisgw3.law.pace.edu/cases/970707c1.html>.

Another factor that has been relied upon, along with knowledge of the innocent party's business, is knowledge of the nature of the goods. In one case, the tribunal held that the breaching seller should have known that the buyer was a clothing retailer and that the goods were seasonal in nature. Therefore, the seller ought to have known and foreseen that 'late delivery would mean that the goods could only be sold [at] reduced price once they were out of season and therefore profits would be lost'.[57] This overview demonstrates that while it is possible to discern a set of factors which may influence the court's or tribunal's decision in respect of whether to impute certain types of knowledge and foreseeability, the question of whether a particular loss was foreseeable must be resolved on a case-by-case basis. This overview also appears to support the view that the foreseeability rule 'would bear upon the different cases with varying degrees of rigour'.[58]

Another question to be addressed in this section is whether it is reasonable to presume that the breaching party will always expect the injured party to mitigate its loss and therefore, the foreseeable loss is only that which cannot be reasonably avoided or reduced.[59] For example, suppose that the seller refuses to deliver the goods at the contract price of £50,000. The buyer intended to resell the goods to its sub-buyer for £80,000 and it is possible for the buyer to purchase replacement goods at the current price of £60,000. Assuming that the foreseeability rule refers not only to the type of loss but also to its extent, is it the £30,000 or the £10,000 that is within the seller's foreseeability range? In other words, should the foreseeability rule take into account a reasonably available opportunity to mitigate the loss? It can be argued that it is justifiable to interpret the foreseeability rule in such a way not only because the mitigation rule is a method of limiting damages but also because taking measures of mitigating loss is what reasonable parties often do in protecting their own interest.[60] It is submitted, however, that this approach will introduce an unnecessary degree of complexity to the foreseeability rule and will also undermine the existence of the mitigation rule as a separate method of limiting damages since its function will be then performed by the foreseeability rule. This approach will also place an additional burden on the injured party by making it bear the burden of proof of both foreseeability and mitigation. As noted above, the burden of proving foreseeability is borne by the injured party while the burden of proving mitigation is generally borne by the breaching party.[61]

This section will be concluded on a more general point—that is, that imputed knowledge and foreseeability are dynamic concepts and in applying the foresee-

[57] ICC Arbitration Case No 8786 of January 1997 (Clothing case) <http://cisgw3.law.pace.edu/cases/978786i1.html>.

[58] Bridge (n 18) 543.

[59] The issue has been recently addressed in A Mullis, 'Recoverability of Lost Resale Profit and Compensation Paid to a Sub-Buyer under the Vienna Convention' at the Conference on 'Contract Damages: Domestic and International Perspectives' held in Birmingham, UK, June 2007.

[60] For the 'self-interest' rationale of the mitigation rule, see ch 6.

[61] See ch 6.

ability rule, it needs to be borne in mind that common knowledge, which is the basis for imputing knowledge to a given party, changes over time. It has been correctly stated that:

> [m]odern business practices (and equipment), accounting methods, and extensive communication of information make more knowledge available to [the] parties. This increased knowledge may make potential amounts of loss easier to compute.[62]

2.2.2 Other factors

Besides knowledge, a number of other factors can potentially influence the court's or tribunal's assessment of whether a particular loss was foreseeable in the circumstances. One such factor is a 'trade usage' and in a case decided under the ULIS, the court held that the foreseeability requirement could 'be conclusively met by a showing of trade custom as to foreseeability'.[63] This suggests the possibility that a particular trade usage may categorise certain losses as 'foreseeable' and where this is the case, it would seem appropriate to rely on the requirements of such a trade usage on the basis of two alternative lines of reasoning. One is to argue that a trade usage forms the background against which the businesspersons' understandings and expectations arise and therefore a particular usage, so long as it is a true trade usage,[64] can be considered as part of knowledge to be imputed into the breaching party. An alternative line of reasoning is that, in such cases, a trade usage already recognises the applicability of the foreseeability rule and it can then be argued that the parties have exercised their right to derogate from the *instruments'* foreseeability rule by implicitly agreeing[65] that it is the foreseeability rule, based on a trade usage, which is applicable.

Another consideration which may potentially influence the interpretation of the foreseeability rule in particular circumstances relates to whether a breach was deliberate or negligent. In fact, the PECL go much further than that by expressly requiring that, even if the loss was unforeseeable to the breaching party, it will still be liable for that loss if its 'non-performance was intentional or grossly negligent'.[66] While no such requirement exists in the CISG and the UPICC, the experience of other legal systems using a similar foreseeability rule teaches us that judges' and arbitrators' assessment of foreseeability may still be influenced by whether or not the breaching party's breach was deliberate.[67]

A difficult question is whether the foreseeability rule should be concerned with maintaining a degree of proportion between the loss and the amount of

[62] Murphey (n 22). For a similar view, see J Lookofsky, *Consequential Damages in Comparative Context: From Breach of Promise to Monetary Remedy in the American, Scandinavian and International Law of Contracts and Sales* (Copenhagen, Danmarks Jurist, 1989) 173.

[63] Supreme Court (Germany), 24 October 1979 (n 49).

[64] See arts 9 CISG, 1.8 UPICC, 1:105 PECL.

[65] See arts 6 CISG, 1.5 UPICC, 1:102 PECL.

[66] See art 9:503 PECL.

[67] See Bridge (n 18) 546.

benefit received by the breaching party under the contract. For example, if the seller's delivery of defective seeds to the farmer caused the latter substantial losses resulting from lost crop, should the seller be held liable in full for all the losses suffered by the farmer despite the fact that the price of seeds is incommensurate with the amount of losses? If not, is the foreseeability rule an appropriate tool for limiting damages in such cases? To begin with, it is well known that the foreseeability rule, in its pure form, is often not capable of limiting damages for disproportionate losses[68] as it may well be the case that such losses were foreseeable: in our example, the farmer may have specifically warned the seller, or the seller with its extensive experience in the agricultural sector could have reasonably expected, that defective seeds were likely to cause substantial losses to the farmer. To address this problem, some legal systems have, on occasions, applied a more restrictive foreseeability rule by holding the breaching party liable for disproportionate losses only where it *accepted* the risk of such losses as a term of the contract.[69] It is suggested that there is no basis for this latter approach (known as the 'tacit agreement rule') in the context of the international instruments. Adopting it would not only lead to non-uniformity in their application,[70] but would also undermine the 'risk allocation' rationale of the foreseeability rule for if, in our example, the seller was in a position to foresee the possibility of the farmer incurring substantial losses, it would certainly be reasonable to expect it to take measures to account for that risk (by charging a higher price, by procuring insurance, or by limiting or excluding its liability). Its failure to do so can, fairly and reasonably, be interpreted as the seller's implied assumption of that risk. As correctly suggested by some commentators, however, an outright dismissal of the possibility of the issue of disproportionate losses being within the sphere of the foreseeability rule may be too simple an approach. The proportion between the loss and contractual benefit is, it is submitted, a valid concern and in the absence of a specific provision in the instruments to that effect,[71] it should not come as a surprise if the foreseeability rule is used to limit damages in order to reduce the degree of disproportion.[72]

[68] See Farnsworth (n 12) 1208 ('in cases where the injured party's loss . . . is greatly out of proportion to the benefit that the party in breach was to have received in return . . . [foreseeability] does not restrict [liability enough]'); Waddams (n 19) 558 ('the theory that price and liability must be commensurate is a device for restricting liability, and the perceived need for such a device indicates that the rule as announced in *Hadley v Baxendale* is incomplete').

[69] See A Burrows, *Remedies for Torts and Breach of Contract*, 3rd edn (Oxford, OUP, 2004) 95.

[70] See Murphey (n 22).

[71] See, by contrast, comment (f) to section 351 of the US Restatement (Second) of Contracts.

[72] Other tools can be used to deal with this problem such as interpreting the contract in such a way as to imply the parties' intention to exclude disproportionate losses, applying the applicable standard of proof in a manner reducing the degree of disproportion, developing a relevant general principle or even applying the tools of the applicable domestic law for this purpose (see Bernstein and Lookofsky (n 13) 144). However, the latter approach is, it is submitted, not an appropriate route for dealing with this problem as the operation of the remedy of damages is exclusively within the scope of the instruments and no domestic rules should be allowed to interfere.

Yet another factor which may influence the court's or tribunal's assessment of foreseeability is the degree of detail with which circumstances of the loss are described. It has been suggested that if the circumstances in which the loss has arisen are described in general terms, the likelihood that the loss will be found to be foreseeable will increase[73]; conversely, describing such circumstances in more specific and precise terms may reduce the chances of the loss being foreseeable. If, in the example above, the farmer describes the cause of the loss in a precise technical language, known only to agricultural specialists, then the reliance on such a description of the conditions causing no crop to be produced may reduce the chances of the seller being in a position to foresee the loss, unless the seller itself possesses the relevant expertise. In this regard, it is important not to lose sight of the true purpose of the foreseeability rule and not to overemphasise the importance of the description of the *circumstances* giving rise to the loss, as opposed to the *nature and type of the loss itself*. The real concern of the foreseeability rule is the type and nature (as well as the extent) of the loss and as long as they were reasonably foreseeable, this, it is submitted, should be sufficient, even if the party did not have an in-depth understanding of the nature of the *circumstances* in which the loss has arisen. To return to our example, if it is reasonable to impute into the seller, having regard to its background and experience, knowledge that the delivery of defective seeds is likely to result in the farmer's inability to produce crop which, in turn, will result in, for example, lost profits and the farmer's liability to third parties, this is sufficient to hold the seller liable for these losses (provided also that the extent of actual losses was within the foreseeable range).[74]

3. FORESEEABILITY OF WHAT?

Legal systems that use the foreseeability rule to limit damages take different positions as to *what* precisely needs to be foreseen. English law, for example, generally requires that only the *type* of loss be foreseeable while French law requires foreseeability of the type as well as of the *extent* of the loss.[75] By simply referring to foreseeability of 'loss' or of 'harm', the international instruments do not make their position clear and there is no agreement amongst commentators in this respect. Some commentators argue, in relation to the CISG, that the type and the extent of the loss as well as the 'chain of events leading up to the loss' must be foreseen.[76] The Comments to the UPICC provide a different interpretation by stating that foreseeability in the UPICC 'relates to the

[73] Waddams (n 19) 562.

[74] For the argument that the rule also requires foreseeability of the extent of the loss, see below. For the discussion of the possible relevance of insurance considerations for the application of the foreseeability rule, see Waddams (n 19) 566–7.

[75] Nicholas (n 29) 231.

[76] See Stoll and Gruber (n 5) 766.

nature or type of the harm but not to its extent unless the extent is such as to transform the harm into one of a different kind'.[77] Comments to the PECL seem to imply that not only the type, but also the extent of the loss are required to be foreseen.[78] There seems to be no particular reason why three very similar provisions of the international instruments should be interpreted differently in this respect. The absence of clarity regarding what needs to be foreseen has far-reaching implications as it will generate not only a non-uniform application of the instruments but also uncertainty as to the injured party's entitlement to, and amount of, compensation. Each of the factors to which foreseeability may potentially refer must therefore be examined.

One such factor is the possibility of the occurrence of a loss and it is submitted that this factor must be generally regarded as foreseeable. Although businesspersons normally enter into contracts in order to perform and not to breach them, they must nonetheless be regarded as *always* being in the position to foresee that a breach may occur and that loss may result therefrom: the possibility of a breach and resulting losses is an integral part of a commercial activity. It can also be argued that damages are an instrument of protecting the party against this type of risk and that the foreseeability rule, being a part of the law of damages, cannot be interpreted in a way which suggests that a businessperson may be in a position where it could *not* foresee the possibility of a breach and the resulting losses. The very existence of the law of damages reflects the recognition of such a possibility.

Some decisions under the CISG appear to have interpreted the foreseeability rule as requiring foreseeability of *the precise amount* of the loss. In one case,[79] the tribunal denied the buyer's claim for loss of a profit margin on its sub-sale contract because 'the difference between the contract price and the resale price was not foreseeable by [Seller] at the time of the conclusion of the Contract'. Rarely, however, will it be possible for a party to be in the position to foresee the *precise* amount of the loss and the most the breaching party will usually be able to foresee at the time of the conclusion of the contract will be the type (nature) and extent of the loss. If the rule required foreseeability of the precise amount of the loss, the injured party would, in most cases, be denied compensation and such an interpretation would, surely, deprive the instruments' remedy of damages of any value and use.

Furthermore, it is sometimes argued that foreseeability should not be interpreted as referring to the nature (type) of the loss because this would deny damages to those who suffer loss in the amount 'that is fully within reasonable

[77] Comment on art 7.4.4 UPICC; one commentator supports this view and argues that the same should be the case for the CISG (S Eiselen, 'Remarks on the Manner in which the UNIDROIT Principles of International Commercial Contracts May Be Used to Interpret or Supplement Article 74 of the CISG' <http://www.cisg.law.pace.edu/cisg/principles/uni74.html>).

[78] See Illustration 1, Comment A on art 9:503 PECL (Beale and Lando (n 28)).

[79] CIETAC Arbitration proceeding 1 February 2000 (Silicon and manganese alloy case) <http://cisgw3.law.pace.edu/cases/000201c1.html>.

expectation of the party in breach, if that loss was of an unexpected type'.[80] According to this view, the type of loss should be of importance only where it is indicative of the extent of loss.[81] However, a better approach is to interpret the rule as requiring foreseeability of the type (nature) of the loss as it is a defining and integral feature of the notion of loss.[82] It is also suggested that foreseeability of the extent of the loss (which, as argued below, must also be foreseeable) is rarely possible without foreseeability of the type and nature of the loss because translating loss into money terms is hardly possible without an understanding of the nature or type of the loss. Arguments to the contrary are infrequent and interpreting the rule as requiring foreseeability of the type and nature of the loss has been, by and large, uncontroversial and, indeed, most systems using the foreseeability rule interpret it in this way.[83] This position, however, is not without difficulty: How are losses to be distinguished from one another? What are the criteria for determining whether the loss that was foreseeable was in fact of the same type as the one actually suffered? The only guidance that the instruments provide is the division between 'loss suffered' and 'loss of profit' and this division is, it is suggested, the necessary starting point. The real difficulty, however, lies at the point where it must be determined whether the loss that was foreseeable and the one which actually occurred fall within the same broad category and are of the same type. For example, are damage to property and losses incurred in mitigation, while both being losses 'actually suffered', of the same type for the purposes of foreseeability? It is suggested that headings under which losses were considered earlier in this work[84] can perhaps provide some additional guidance: expenditure *wasted* as a result of the breach, additional expenditure *incurred* as a result of the breach, damage to the performance interest, currency losses, damage to reputation and goodwill, loss of profit and loss of a chance. As is well known, though, no categorisation can ever be perfect and an overlap among groupings is inevitable. In attempting to categorise a particular loss, it is important not to get lost in a labyrinth of classifying losses but to keep sight of the 'risk allocation' rationale of the foreseeability rule.

The type of loss needs to be distinguished from its extent which refers to translating the *limits* of the loss into money terms. The importance and far-reaching implications of requiring that the extent of the loss be foreseeable is illustrated by several cases under the CISG. One such case[85] is where the tribunal interpreted the CISG as *not* requiring foreseeability of the extent of loss. In this case, the buyer's claim for damages for the penalty it had to pay to

[80] TA Diamond and H Foss, 'Consequential Damages for Commercial Loss: An Alternative to *Hadley v Baxendale*' (1994–1995) 63 Fordham L Rev 709.

[81] See *ibid*.

[82] For a similar view, see Stoll and Gruber (n 5) 766 ('the risk of loss is mainly characterized by the type of loss threatening').

[83] See above.

[84] See ch 3.

[85] ICAC Case 97/2004, decision dated 23 December 2004 <http://cisgw3.law.pace.edu/cases/041223r1.html>.

its customer was held to be foreseeable despite the seller's argument that the penalty was excessive. The tribunal held that the amount of the penalty was irrelevant on the ground that 'establishing . . . the amount of the penalty is entirely a matter to be agreed between the contracting parties . . . and [it] complies with the freedom of contract principle set forth in the CISG'. The implication of this decision is that as long as the penalty itself was foreseeable, the extent of the loss is irrelevant for the purposes of the foreseeability rule. This decision can be contrasted with several other decisions where the extent of the loss was deemed to be relevant. In one case,[86] for example, it was held that although the seller was in a position to foresee that a buyer would have a subsale contract and would make a profit therefrom, the seller could not reasonably expect that the profit margin exceeded the contract price by 100 per cent. The tribunal, however, did not deny damages altogether but awarded damages for lost profits in the amount of 20 per cent of the original contract price because that profit margin was 'reasonable' (and for that reason, presumably, foreseeable).[87] In another case,[88] the injured buyer who had to take out a loan to make an advance payment was rendered unable to return the loan on time and, as a result, had to pay additional interest on the sum in arrears. The court held that the breaching party could not foresee the interest rate on the sum in arrears in the buyer's country and instead awarded damages by reference to the rate which, in the court's opinion, would be foreseeable to that party.[89]

It is submitted that the instruments should be interpreted as requiring foreseeability of the extent of the loss. First, the 'risk allocation' rationale gives rise to the following question: when businesspersons assume a risk, what do they

[86] CIETAC Arbitration proceeding 3 June 2003 (Clothes case) <http://cisgw3.law.pace.edu/cases/030603c1.html>.

[87] For a very similar case where the same position has been taken, see ICAC Case 406/1998, decision dated 6 June 2000 <http://cisgw3.law.pace.edu/cases/000606r1.html> ('[Although] the buyer in principle has the right to recover damages for loss of profit . . . the seller neither knew nor ought to have foreseen that the buyer's loss of profit would be as much as approximately half the price of contract in dispute. Based on this conclusion and also considering the buyer's conduct, the Tribunal considers that the buyer's loss of profit to be compensated should be measured in the amount of 10%. Reaching this conclusion the Tribunal took into account that the contract had been concluded on CIF terms. Although the contract does not refer to Incoterms, the Tribunal considers it is reasonable and allowed relying on the Incoterms guidelines which reflect the practices of international trade. Regarding the basis of the term CIF, Incoterms 1990 provides that the insurance should cover the price stipulated in the contract plus 10%, ie, a total of 110%. It is commonly known that the mentioned 10% covers the expected profit of the buyer and is the ordinary amount of profit in the practice of international trade').

[88] Case No 95/3214 District Court of Kuopio (Finland) 5 November 1996 (Butter case) <http://cisgw3.law.pace.edu/cases/961105f5.html>.

[89] 'It has not been shown that K knew the interest rates in Lithuania, namely 7% per month and 0.5% per day interest on arrears, which essentially differs from interest rates in Western Europe. One could not even assume that he should have known it. It is the estimate of the Court, that K should have pre-estimated that the interest loss resulting from not fulfilling the contractual obligations could be about 10% of the sale price, meaning US $8,000' (*ibid*). For another decision under the CISG where the extent of loss was deemed relevant for the purposes of the foreseeability test, see Case No 271 C 18968/94 Lower Court München (Germany) 23 June 1995 (Tetracycline case) <http://cisgw3.law.pace.edu/cases/950623g1.html>.

assume the risk for—the type or the extent of the loss? There is little doubt that it is the financial considerations which underlie business planning and commercial activity and where businesspersons contemplate losses, they contemplate not only their nature but also the *approximate limits* of financial liability that they may entail. Therefore, if only the type of loss were to be foreseeable, a businessperson's ultimate consideration would be disregarded and there would always be a danger that foreseeability would lead to imposing liability to the extent which exceeds the boundaries of the assumed risk.[90] Thus, the view that foreseeability of the extent of the loss is required corresponds both to the way in which business people think and to the 'risk allocation' rationale underlying the foreseeability rule. Second, restricting foreseeability only to the type of loss is likely to give rise to uncertainty in the international legal environment by making it difficult for the parties to develop reasonable expectations regarding likely financial limits of liability in a situation where they breach their contracts.[91] It can even be argued that this uncertainty could encourage businesspersons to exclude the applicability of the international instruments and this would certainly contravene the instruments' unification and harmonisation aspirations. Third, the view that foreseeability refers not only to the type of the loss but also to the extent of the loss is supported by the legislative history of the CISG. According to the Report of the First Committee on the 1977 Vienna Draft, a proposal was considered to clarify the wording of what is now art 74 CISG. The proposed version that damages could be claimed for '. . . loss of such a *nature* which the party in breach could not reasonably have foreseen' was rejected[92] and this seems to evidence the drafters' intention not to restrict foreseeability only to the nature or type of the loss. Finally, the wording of art 74 also seems to suggest that the extent of loss is required for the purposes of foreseeability. The phrase that damages '*may not exceed*' the foreseeable loss seems to refer to some *concrete limit*. If only the type of loss were intended to be foreseeable, the wording would have to mean that the recoverable loss is that 'not exceeding the *type* of loss' and this would, surely, be odd. Although the latter two arguments are only relevant to the CISG, the first two arguments in themselves seem sufficient to justify the interpretation of the UPICC[93] and the PECL in the same manner.

One argument against the view that foreseeability refers to the extent of the loss is that the extent of the loss is a question of quantum or calculation whereas foreseeability is a test 'of remoteness and not one of quantification'.[94] It is

[90] For a similar view, see Stoll and Gruber (n 5) 766 ('If the extent of the loss is significantly higher than what was foreseeable, then a different loss materialized than that which was foreseeable').

[91] *Cf* HG Beale, *Remedies for Breach of Contract* (London, Sweet & Maxwell, 1980) 182).

[92] See Stoll and Gruber (n 5) 766 note 140.

[93] For a different view, see Comments to the UPICC and Eiselen (n 77) (arguing that the UPICC can be used to interpret the CISG in this respect: 'the Comment [to the UPICC] also makes it clear that the foreseeability relates to "*the nature or type of harm but not to its extent*". This should also be the approach under article 74 of the CISG').

[94] See GH Treitel, *Remedies for Breach of Contract: A Comparative Account* (Oxford, Clarendon Press, 1988) 161 (in relation to the ULIS and the CISG).

argued, with respect, that the extent of the loss is not an issue of calculation. The calculation of loss aims to determine the precise amount of the loss[95] whereas the extent of the loss, in contrast, refers not to the precise amount of the loss but represents a translation of the *limits* of the loss into money terms, or into a monetary 'range' within which losses are deemed foreseeable.

There is, however, a difficulty in reconciling the position that the extent of loss is required by the foreseeability rule with the fact that the instruments' provisions which contain two specific methods of calculating damages (the so-called 'concrete'[96] and 'abstract'[97] formulae) are not, at least expressly, subject to the foreseeability requirement.[98] One way to reconcile the two is to presume that the situations referred to in those provisions are *typical* situations which are always foreseeable[99] and to require foreseeability of the extent of the loss in all other situations. This would be consistent with the purpose of those methods of calculation, that is, to introduce simplicity and clarity when calculating damages.[100] It is suggested, however, that a better way of interpreting the instruments is to view the foreseeability rule as applicable to the situations referred to in the provisions on calculating damages. First of all, this would ensure a consistent application of the foreseeability rule to *all* cases. Second, although the situations referred to in the instruments' 'concrete' and 'abstract' formulae may well reflect losses which 'arise naturally' and are, for that reason, foreseeable, situations where the extent of such losses is unforeseeable cannot be ruled out. Suppose that the injured seller resells the goods in a reasonable manner and within a reasonable time in a sharply falling market. As a result, the difference between the contract price and the resale price is exceptionally high. It can be argued, in such a case, that while the buyer was in the position to foresee the possibility of price fluctuations (type of the loss), such a drastic fall (extent of the loss) was not foreseeable. Requiring that the extent of the difference be foreseeable would seem to correspond with the rule's purpose of allocating risks in a fair and balanced manner.[101] Finally, although the instruments' 'concrete' and 'abstract' formulae do not themselves refer to the foreseeability rule, this approach is not necessarily inconsistent with these formulae so long as they are

[95] As shown above, foreseeability does not refer to the precise amount of the loss.

[96] This formula calculates damages as the difference between the contract price and the price in a substitute transaction.

[97] This formula calculates damages as the difference between the contract price and the current price.

[98] Articles 75, 76 CISG, 7.4.5, 7.4.6 UPICC, 9:506, 9:507 PECL.

[99] See Farnsworth (n 13) 1201 (the losses '"arising naturally" . . . are those afforded under the standard formulas based on market price'); see also Hellner (n 14) 63–4, arguing that the said methods of calculation do not have any connection with foreseeability.

[100] See ch 8.

[101] This approach has been taken in a number of cases under the CISG (see CIETAC Arbitration proceeding 4 February 2002 (Styrene monomer case) <http://cisgw3.law.pace.edu/cases/020204c1.html>; Case No 4 R 219/01k Appellate Court Graz (Austria) 24 January 2002 (Excavator case) <http://cisgw3.law.pace.edu/cases/020124a3.html> (the decision is unusual because the injured seller's resale was considered in the context of art 74 CISG and not art 75)).

simply treated as *specific* methods of calculation whereas the foreseeability rule is a *general* rule and one method of limiting damages.

4. TIME OF FORESEEABILITY AND DEGREE OF PROBABILITY

Whether a particular loss was foreseeable is to be assessed as of the time of the conclusion of the contract.[102] Although this position has been criticised,[103] the rule is generally fair: only the risk assumed by the party at the conclusion of the contract should, as a rule, be of legal significance because the time of making the contract is the only time when the party has an opportunity to protect itself (for example, by raising the price, excluding or limiting liability, or by procuring insurance). If foreseeability were to be assessed at a time after the contract was concluded, the party would be denied an opportunity for self-protection.[104] This argument can, of course, be criticised on the ground that in practice, foreseeability of consequences is unlikely to affect the terms of the transaction because '[i]t is normally impracticable to fix a separate rate for every contract'.[105] This view has, however, been said to be speculative[106] and although the argument that the party can protect itself either at or before the making of the contract is just as speculative,[107] the time of concluding the contract should remain as a standard time for determining foreseeability. Whatever the reality may be, the law should not deny the breaching party an opportunity for self-protection. It should also be noted that clarity as to the precise moment in time may be important because negotiations 'leading to the conclusion of the contract may . . . last a certain period of time'.[108] In this regard, the precise moment by reference to which the question of foreseeability is to be resolved is that when the contract comes into existence.[109]

However, it by no means follows, either from the instruments' express requirement that the foreseeability rule be applied by reference to the time of concluding the contract or from the requirement's justification, that in some cases a later time for assessing foreseeability cannot be more appropriate. In fact, it is precisely the rule's 'assumption of risk' rationale which leads to this

[102] See arts 74 CISG, 7.4.4 UPICC, 9:503 PECL.

[103] It has been said, eg, that '[a] sounder decision can be made nearer the time of performance or breach. The true loss to the party who will be injured by a breach will be, on the average, more apparent the closer in time to the intended breach one tries to predict that loss. Fresher data will be available—a knowledge of prices at a time closer to when performance would be due, for example' (Murphey (n 22), who, however, is in favour of the 'time of making the contract' rule). See also R Samek, 'Relevant Time of Foreseeability of Damages' (1964) 38 Australian L J 125.

[104] See statement of a US court in *Patterson v Illinois Cent Ry Co*, 97S.W. 426, 123 Ky 783 (1906) cited in Corbin (n 23) 64.

[105] See Atiyah (n 6) 432–3; also Corbin (n 23) 64–5.

[106] See Treitel (n 94) 160.

[107] See *ibid*, 160.

[108] See Knapp (n 26) 542.

[109] See *ibid*, 542.

conclusion. One such case is where subsequent to the conclusion of the contract, the parties have agreed to change the terms of the contract. It can be argued that, at this stage, a renewed assumption of risk has occurred (at least, insofar as the renegotiated obligations are concerned) for if the potential breaching party has become aware of risks which were not foreseeable at the time of concluding the contract, it now has an opportunity to protect itself.[110] For example, if some time after the contract had been made the parties decided to renegotiate the delivery date and at that time the seller becomes aware that delay in delivery will cause the buyer to pay an unusually high penalty to a third party, it is appropriate, if this risk materialises, to hold that loss foreseeable by reference to the time when the delivery obligation was renegotiated so long as a reasonable opportunity was available to the seller to protect itself. The instruments' express reference to the 'time of the conclusion of the contract' will not necessarily preclude this result since the parties' agreement to change the terms of the contract can be interpreted as the parties' implied intention to derogate from the provision that foreseeability is to be assessed by reference to the time of the conclusion of the contract.[111] This result may also be justified in some cases involving long-term contracts which often provide that terms such as price, quantity or delivery dates are to be agreed at future points in time[112] and it can be argued that where such contracts are terminable at will, 'a new contract is formed at each and every point in any continuing and terminable relationship'.[113] Thus if, by the time when the parties to a long-term contract are to negotiate a term which was left open for future negotiation, one party becomes aware of risks which it could not foresee at the time of concluding the contract, it may be appropriate to assess the party's foreseeability by reference to the point of such negotiation because it has an opportunity to protect itself at least by terminating the contract. The problem of the date of assessing foreseeability in long-term contracts is likely to arise rarely in practice because 'the parties' assumption of risk will usually be broadly defined for the very reason that the contract is a long-term contract and the parties can be assumed to understand that things will change throughout the life of the contract, and the price and insurance will accordingly be calculated generally and with an eye on the long term'.[114]

So far as the required degree of probability of loss is concerned, the CISG refers to foreseeability of the loss 'as a *possible* consequence of the breach' and

[110] See A Kramer, 'Remoteness: New Problems with the Old Test' in Saidov and Cunnington (n 1) 297–8.

[111] See arts 6 CISG, 1.5 UPICC, 1:102 PECL. So far as the UPICC and PECL are concerned, the only restrictions might be those flowing from mandatory rules in the Principles themselves or those emanating from the applicable mandatory domestic, supranational, or international law (see arts 1:102, 1:103 PECL; arts 1.5 UPICC and comment to arts 1.1 and 1.5). The only restriction on the party autonomy in the CISG itself is art 12. For the possibility of restrictions, emanating from the applicable mandatory domestic law, in cases where the CISG is 'opted-into', see Schlechtriem (n 10) 35.

[112] For the discussion of long-term contracts, see ch 9.

[113] Kramer (n 110) 301.

[114] *Ibid*, 302.

this provision has, on occasions, been interpreted as imposing a more extensive liability in comparison with those systems which provide for foreseeability of loss 'as a *probable* result' of the breach.[115] However, despite a potentially broader scope of liability, it has been correctly pointed out that the words 'in light of the facts and matters' cut back a potentially extensive liability.[116] The UPICC and the PECL use a more restrictive standard by referring to foreseeability of loss which is 'likely to result from . . . non-performance'[117] or which is 'a likely result of . . . non-performance'.[118] However, as explained, this difference in wording between the CISG and the two sets of Principles[119] is unlikely to lead to different results in practice.

5. CONCLUDING REMARKS

On a number of occasions, it has been questioned whether the foreseeability rule is an appropriate method of limiting damages. It has been argued, for example, that the foreseeability rule is a 'product' of its time and is ill suited to the present age of a 'diverse and complex' economy. It has been suggested that in 'mass-transaction situations a seller cannot plausibly engage in an individualised "contemplation" of the consequences of breach and a subsequent tailoring of a transaction'.[120] More specifically, the period of pre-contractual negotiation, presupposed by the foreseeability rule, 'is far removed from the world of shipping and commodity sales, where transactions are often concluded between substitutes, brokers and ship's agents . . . on an expedited and informal basis'.[121] In such conditions, there is little opportunity for extensive negotiations apart from agreeing on the most essential terms. The incentive for disclosing informa-

[115] *See* JS Ziegel, *Report to the Uniform Law Conference of Canada on Convention on Contracts for the International Sale of Goods* <http://www.cisg.law.pace.edu/cisg/text/ziegel80.html>.

[116] See EA Farnsworth, 'Damages and Specific Relief' (1979) 27 AJCL 253.

[117] Article 7.4.4 UPICC.

[118] Article 9:503 PECL.

[119] *Cf* J Ramberg, *International Commercial Transactions* ICC Publication 624, 2nd edn (The Netherlands, Kluwer Law International, 2000) 127 ('Semantically there seems to be a difference between the words "possible consequence" and the words "likely to result". To mention a dramatic example one could say that the Third World War hopefully "is not likely to result" but nevertheless "might be possible"').

[120] R Danzig, '*Hadley v Baxendale*: A Study in the Industrialization of the Law' (1975) 4 JLS 279–80. The conclusion that foreseeability is a product of historical circumstances in England in the mid-1850s is difficult to support in the light of the statement made by Fuller and Eisenberg: 'Professor Danzig contends that the decision in *Hadley v Baxendale* was essentially a product of historical circumstances, particularly the peculiar state of industry, law, and the judicial system in England in the mid-1850s. This contention, however, is hard to reconcile with the fact that the principle adopted in *Hadley v Baxendale* also appears in the great French treatise by Pothier . . . In view of the differences between mid-1700s France and mid-1800s England, it seems highly unlikely that a principle which appears in both times and places is essentially of the peculiar state of industry, law, and the judicial system in either time or place' (LL Fuller and MA Eisenberg, *Basic Contract Law* (St Paul, Minn, West Group Publishing Co, 1981) 235–6).

[121] MG Bridge, 'The Market Rule of Damages Assessment' in Saidov and Cunnington (n 1) 438.

tion is also not well suited to the interests of some commercial circles such as middlemen[122] because possessing information regarding price differentials is '[a]n essential element of middleman entrepreneurship'[123]: clearly, if middlemen's counterparts possess relevant information they may prefer to bypass the middlemen and to contract directly with the ultimate buyer or supplier, as the case may be.[124] What can be said in response is that perhaps no general rule designed to accommodate a variety of circumstances can be expected to be ideally suited to all commercial sectors. If businesspersons in a particular trade find that the rule is wholly unsuitable to their needs, they can always avail themselves of the right to derogate from the unwanted rule.

The rule has also been criticised on the ground that it is inherently imprecise, involving a substantial degree of judicial discretion[125] and giving rise to uncertainty. This point touches upon a perennial dilemma, faced by any legal system, between relying on broad and flexible standards on the one hand, and specific but precise rules on the other. The law of damages, it seems, requires a balanced approach which would rely upon rules which would be sufficiently flexible to accommodate a variety of factual settings and, at the same time, would still have a discernible content. The foreseeability rule would appear to fit this description. It is certainly not true that it 'utterly lacks the descriptive content that allows it to be the principled basis for decision'[126] for it is clear about its underlying considerations and purposes; and while it may be based on flexible and broad standards, this will not necessarily create an unacceptable degree of uncertainty. In fact, recent empirical research suggests that broad principles do not necessarily lead to less predictable results than those reached by applying more detailed rules, and are more likely to achieve just and efficient outcomes.[127]

To end this discussion on a positive note, it needs to be noted that the foreseeability rule, which has existed for centuries,[128] is still widely used by many

[122] JT Landa, '*Hadley v Baxendale* and the Expansion of the Middleman Economy' (1987) 16 JLS 464 ('[M]arkets with middlemen are characterized by information asymmetry in the producer-middlemen market and the middleman-final consumer market: producer-sellers know only of the prices in their own market and not of the prices in the resale (second) market, while final consumers know of prices in the second market and not of prices in the first market. Only the middlemen possesses information on prices in both markets because, in his role or identity as the middleman, he is both a buyer (in the first market) and a seller (in the second market). Price information flowing between the two markets is the result of entrepreneurial activities of middlemen' (*ibid*, 459)).

[123] *Ibid*, 465.

[124] See *ibid*.

[125] See LC Bulow, 'Consequential Damages and the Duty to Mitigate in New York Maritime Arbitrations' (1984) LMCLQ 625.

[126] RA Epstein, 'Beyond Foreseeability: Consequential Damages in the Law of Contract' (1989) 18 JLS 124.

[127] See MP Ellinghaus and EW Wright, 'The Common Law of Contracts: Are Broad Principles Better than Detailed Rules? An Empirical Investigation' (2004–2005) 11 Texas Wesleyan L Rev 399.

[128] An attempt to introduce foreseeability first has been made in Roman law. Much later foreseeability was established as a limitation of damages in art 1150 of the French Civil Code. Since that time the rule has been said to gain influence in other legal systems, including English law (see F Ferrari, 'Comparative Ruminations on the Foreseeability of Damages in Contract Law' (1992–1993) 53 Louisiana L Rev 1264).

domestic legal systems and by the international commercial law instruments.[129] Such a wide acceptance of the foreseeability rule surely evidences, at least to some extent, that the rule is still an effective method of limiting damages which corresponds, by and large, to the modern demands of the commercial world.[130]

[129] See Treitel (n 94) 150, 152; Beale and Lando (n 28) 441; Komarov (n 1).

[130] There are, however, some recent examples of the attempts to abandon the rule. It has been reported that, in the course of preparing the reform of the French law of obligations, a proposal has been put forward to abandon the foreseeability rule (see Komarov (n 1) with further references).

6

Mitigation

1. GENERAL

AS IS THE case in some domestic legal systems,[1] the international instruments provide that damages may be reduced to the extent that the loss could have been reduced or mitigated by the injured party. The CISG provides that '[a] party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated'.[2] According to the UPICC, '[t]he non-performing party is not liable for harm suffered by the aggrieved party to the extent that the harm could have been reduced by the latter party's taking reasonable steps'.[3] Similarly, the PECL provide that '[t]he non-performing party is not liable for loss suffered by the aggrieved party to the extent that the aggrieved party could have reduced the loss by taking reasonable steps'.[4] Although it has been suggested that the rule is self-evident and needs no justification,[5] it nevertheless seems helpful to begin this chapter by exploring and articulating its underlying policies and considerations. This inquiry will reveal that the rule's nature is complex and multi-layered and the discussion below will demonstrate that there is often a direct link between the underpinnings of the rule and its practical application.

The requirement that the innocent party must take all reasonable measures to mitigate its loss can be justified on several grounds. First, it is often said to

[1] For a recent comparative overview, see A Komarov, 'The Limitation of Contract Damages in Domestic Legal Systems and International Instruments' in D Saidov and R Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (Oxford, Hart Publishing, 2008) 256–7, 261. For the history of the development of the rule in English law, see PS Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford, Clarendon Press, 1979) 425.

[2] Article 77 CISG.

[3] Article 7.4.8(1) UPICC.

[4] Article 9:505(1) PECL.

[5] A Tunc, *Commentary on the Hague Conventions of the 1st of July 1964 on International Sale of Goods and the Formation of the Contract of Sale* <http://www.cisg.law.pace.edu/cisg/biblio/tunc.html>.

promote economic efficiency[6] and avoidance of waste.[7] It has been suggested, for instance, that '[the] purpose of the rule on mitigation is to prevent the waste of resources in society, since they are obviously limited'.[8] For example, where the buyer fails to accept the delivery of perishable goods, waste will occur if the seller does not dispose of the goods and the mitigation rule is likely to encourage this seller to do so. Doubts have, however, been expressed as to whether this justification of the mitigation rule is relevant in all cases. It has been argued that 'many typical cases, such as the plaintiff's failure to buy in a rising market, involve no waste of community resources yet the defendant is held not to be liable for a loss that could have been avoided'.[9] It is suggested, in this regard, that even this typical case involves waste in the sense that, but for the mitigation rule, additional costs, such as opportunity costs of using money elsewhere, would have had to be incurred. If no mitigation rule had existed, the breaching party would have had to pay a higher amount of damages than it pays with the mitigation rule in force. In other words, if the two situations are compared, different amounts are paid to protect the *very same* expectation/performance interest. The mitigation rule therefore protects the injured party's expectation/performance interest with a lower amount of damages and provides the breach-

[6] See P Linzer, 'On the Amorality of Contract Remedies—Efficiency, Equity, and the Second Restatement' (1981) 81 Columbia L Rev 113–14; A Michaud, 'Mitigation of Damage in the Context of Remedies for Breach of Contract' (1984) 15 Revue Générale de Droit 300–01. Any argument based on economic efficiency faces the difficulty arising from the absence of a single definition of efficiency. One sense in which the term is used is that of avoiding waste and this understanding of the term is relied upon in the main text. Other senses are based on the concepts of Pareto (ie, an allocation of resources which results in no one being worse off and at least one person being better off—see, eg, RA Posner, *Economic Analysis of Law*, 6th edn (New York, Aspen Publishers, 2003) 12–13) and Kaldor-Hicks efficiency (where overall gains outweigh losses—see N Kaldor, 'Welfare Propositions of Economics and Inter-Personal Comparisons of Utility' (1939) 49 Economics J 549; JR Hicks, 'The Foundations of Welfare Economics (1939) 49 Economic J 696). These notions are not relied upon here for several reasons. First, it is the avoidance of waste argument that is usually put forward to justify the mitigation rule. Second, both Pareto and Kaldor-Hicks notions of efficiency, if applied strictly, would require the assessment of the impact of the allocation of resources on third parties (those other than the parties to the contract) and doing so comprehensively is unlikely to be possible. Finally, whether a person is better or worse off is to be judged according to each person's individual conceptions of welfare (see J Coleman (Book Review) 'The Normative Basis of Economic Analysis: A Critical Review of Richard Posner's the Economics of Justice' (1981–1982) 34 Stanford L Rev 1105, 1107). The latter two points make it difficult to apply these notions of efficiency properly and draw definite conclusions as to whether the mitigation rule promotes Pareto or Kaldor-Hicks efficiency.

[7] See RD Cooter, 'The Best Right Laws: Value Foundations of the Economic Analysis of Law' (1989) 64 Notre Dame L Rev 817; CT Wonnell, 'Efficiency and Conservatism' (2001) 80 Nebraska L Rev 643, 649.

[8] See AT Von Mehren and JR Gordley, *The Civil Law System: An Introduction to the Comparative Study of Law*, 2nd edn (Boston, Little, Brown & Co, 1977) 1115; also GG Letterman, *UNIDROIT's Rules in Practice: Standard International Contracts and Applicable Rules* (The Hague, Kluwer Law International, 2001) 211; *Chitty on Contracts*, 28th edn, vol 1 (London, Sweet & Maxwell, 1999) 1317; EA Farnsworth, *Contracts*, 4th edn (New York, Aspen Publishers, 2004) 779.

[9] S Waddams, *The Law of Damages*, 4th edn (Toronto, Canada Law Book Inc, 2004) 592; for a similar position, see MG Bridge, 'Mitigation of Damages in Contract and the Meaning of Avoidable Loss' (1989) 105 LQR 405.

ing party with an opportunity to use the remaining money elsewhere.[10] It would thus seem that the economic waste argument can generally justify the existence of the mitigation rule.[11] There are, however, at least two factors which can hamper the rule's ability to promote efficiency. One factor relates to the allocation of burden of proof and the extent to which a court or tribunal, seized of a dispute, will enforce the rule.[12] Another factor relates to the operation of the mitigation rule itself: the requirement of reasonableness, built in the rule, may lead to the situation where actions which seemed reasonable at the time of mitigation might in fact result in a complete failure to mitigate the loss and/or in unexpectedly high costs.[13] Thus, the rule's ability to achieve efficient outcomes is subject to these limitations.[14]

Another line of rationalisation of the mitigation rule is based on the ideas of fair dealing and good faith. It has been suggested, for example, that it is not *fair* to hold the breaching party liable for all loss resulting as a consequence of the breach if the injured party can reasonably avoid or mitigate its loss,[15] and both fair dealing[16] and good faith[17] have been interpreted as requiring the injured

[10] If money is defined as a claim on community resources (Posner (n 6) 6), it can be said that with the mitigation rule in force the breaching party does not lose an opportunity to exercise its claim on community resources.

[11] But see below for situations where the mitigation rule can lead to even greater costs than those that would have been incurred had the mitigation rule not existed.

[12] See below.

[13] For a similar view, see MA Eisenberg, 'The Duty to Rescue in Contract Law' (2002–2003) 71 Fordham L Rev 647, 659.

[14] The question may arise as to whether economic efficiency is a consideration underlying the international instruments and it is suggested, in this regard, that this consideration is not entirely alien to the instruments. Generally, it is sometimes said that economic efficiency is particularly important where commercial relations are on foot (see, eg, S Le Pautremat, 'Mitigation of Damage: A French Perspective' (2006) 55 ICLQ 206, 213). More specifically, it can be argued that the dominant philosophy underlying modern world trade is that of free trade which is strongly influenced by the theory of comparative advantages, and it is well known that free trade pursues, amongst other things, the goal of efficiency (see JH Jackson, WJ Davey, and AO Sykes, Jr, *Legal Problems of International Economic Relations: Cases, Materials and International Regulation of Transnational Economic Relations* (American Casebook Series), 3rd edn (St Paul, Minn, West Publishing Co, 1995) 7–14). There is no doubt that, to a considerable extent, the international instruments have been designed to facilitate international trade and thereby promote its underlying philosophy (see Preamble of the CISG; arts 1.7(1) and Comment 1 on art 7.4.8 UPICC; art 1:201 PECL).

[15] See J Cassels, *Remedies: The Law of Damages* (Toronto, Irwin Law, 2000) 339.

[16] See Comment D on art 1:201 PECL (O Lando and H Beale (eds), *Principles of European Contract Law: Parts I and II* prepared by the Commission on European Contract Law (The Hague, Kluwer Law International, 2000) 114).

[17] Good faith is a troublesome concept as it has been viewed from several standpoints: as an objective standard synonymous to 'fair dealing' (NE Nedzel, 'A Comparative Study of Good Faith, Fair Dealing, and Precontractual Liability (1997) 12 Tulane European Civil L Forum 153); as an objective standard accepted in a particular business community to which parties belong (D Sim, 'The Scope and Application of Good Faith in the Vienna Convention on Contracts for the International Sale of Goods' stating a possibility of such an approach to interpretation of good faith under the CISG <http://www.cisg.law.pace.edu/cisg/biblio/sim1.html#iiib>); as a subjective standard as perceived by a particular individual (Comment E on art 1:201 PECL (Lando and Beale (n 16) 114; R Powell, 'Good Faith in Contracts' (1956) 9 Current Legal Problems 23). Since the meaning of good faith in the second and third instances will depend on a particular community or individual respectively, it is only good faith in the first sense that is able to justify the mitigation rule.

party to be, to a certain extent, altruistic[18] by taking into account the interests of the other party. So far as the UPICC and PECL are concerned, because they expressly impose a general duty to act in accordance with 'good faith and fair dealing',[19] the mitigation rule can be said to be a specific manifestation of these standards. This view of the mitigation rule is further re-affirmed by the 'duty to cooperate', imposed by the UPICC and PECL,[20] which implies an obligation to take into account to some extent the legitimate interests of the other party as well as by art 1:302 PECL, which shows the connection between the mitigation rule and good faith by providing that reasonableness (the notion which underlies the mitigation rule)[21] 'is to be judged by what persons acting in good faith and in the same situation as the parties would consider to be reasonable'.[22] Justifying the mitigation rule in a similar way under the CISG may appear to be troublesome because it does not expressly provide for general principles of fair dealing and good faith.[23] Nevertheless, the CISG is now increasingly viewed as reflecting a general principle of good faith (despite the initial compromise to include it only as a standard of interpretation)[24] and, if this is correct, then the mitigation rule in the CISG can also be justified as a specific manifestation of a general principle of good faith.[25]

The 'duty' to mitigate is not a wholly altruistic duty as it also reflects conduct which is in the interests of the injured party.[26] In many cases, business persons

[18] Mitigation is, of course, not a wholly altruistic duty, as has been suggested by C Fried, *Contract as Promise: A Theory of Contractual Obligation* (Cambridge, Mass, Harvard University Press, 1981) 131 (see below).

[19] See art 1.7(1) UPICC and art 1:201 PECL.

[20] See art 5.1.3 UPICC and art 1:202 PECL.

[21] See below.

[22] T Wilhelmsson, 'Good Faith and the Duty of Disclosure in Commercial Contracting—The Nordic Experience' in R Brownsword, NJ Hird and G Howells (eds), *Good Faith in Contract: Concept and Context* (Aldershot, Ashgate, 1999) 184. See also Comment on art 5.1.3 UPICC, which expressly recognise the link between the duty to cooperate and fair dealing (as well as good faith). This Commentary also recognises the connection between the duty to cooperate and mitigation.

[23] Good faith is only expressly mentioned as a standard of interpreting the CISG (see art 7(1)).

[24] See, eg, MJ Bonell, 'Art 7 CISG' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Milan, Giuffrè, 1987) 84; U Magnus, 'General Principles of UN-Sales Law' <http://www.cisg.law.pace.edu/cisg/biblio/magnus.html>; P Koneru, 'The International Interpretation of the UN Convention on Contracts for the International Sale of Goods: An Approach Based on General Principles' (1997) 6 Minnesota J Global Trade <http://www.cisg.law.pace.edu/cisg/biblio/koneru.html>; *cf* EA Farnsworth, 'Duties of Good Faith and Fair Dealing under the UNIDROIT Principles, Relevant International Convention, and National Laws' (1995) 3 Tulane J Intl and Comparative L 56.

[25] J Klein, 'Good Faith in International Transactions' (1993) 15 Liverpool L Rev 131–2; H Stoll and G Gruber, 'Arts 74–77 CISG' in P Schlechtriem and I Schwenzer, *Commentary on the UN Convention on the International Sale of Goods*, 2nd English edn (Oxford, OUP, 2005) 787; U Magnus, 'Remarks on good faith' <http://www.cisg.law.pace.edu/cisg/principles/uni7.html>; Case No 7 Ob 301/01t Supreme Court (Austria) 14 January 2002 (Cooling system case) <http://cisgw3.law.pace.edu/cases/020114a3.html>; Case No 10 Ob 518/95 Supreme Court (Austria) 6 February 1996 (Propane case) <http://cisgw3.law.pace.edu/cases/960206a3.html>).

[26] See *DT Ltd v B AG* Commercial Court St Gallen (Switzerland) 3 December 2002 (Sizing machine case) <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/021203s1.html> stating that the '[seller] has his own self-interest reasons for minimizing any prospective loss and damages to the extent possible'.

try to reduce or avoid losses where reasonably possible and they often do so not because of their concern for the interests of the breaching party, but because they want to mitigate at least some damage done to their financial and commercial interests.[27] For example, it is well known that time is of the essence in commerce, and an injured seller may want to mitigate its loss as quickly as possible in order to recover at least some money to be able to invest it in a profitable venture. Otherwise, although it may be able to recover its damages in full at a later date, it may miss an opportunity to make this investment. Similarly, a buyer will often make every reasonable effort to find substitute goods to fulfil its sub-sale at the promised date, thereby avoiding a possible breakdown of commercial relationships, liability and damage to its reputation.[28] Finally, there is no guarantee that the claim for a full recovery of damages will be awarded and this, together with the fact that litigation/arbitration may take a considerable amount of time, may induce the injured party to mitigate to secure at least some money at an early stage. Thus, the mitigation rule can be said to reflect what many businesspersons would have been doing even if no mitigation rule had existed. To this extent, the rule also reflects a concern for interests of the injured party.[29]

Finally, a few remarks need to be made about the attempts to justify the existence of the mitigation rule on the basis of other rules on damages. First, while the conventional position is that the mitigation rule *limits* the protection of the expectation/performance interest,[30] there is a view which regards the mitigation rule as *complementary* to the protection of the expectation/performance interest. It has been argued that mitigation simply adds 'a supplementary policy to those policies justifying protection of the expectation interest and this supplementary policy is that the promisee should not leave it simply to the courts to ensure fulfilment of his expectations, but should rather take it upon himself to adopt other reasonable means to ensure fulfilment of his expectations'.[31] A somewhat similar view has already been taken in some cases under the CISG[32]

[27] For a similar view, see JJ White and RS Summers, *Uniform Commercial Code*, 5th edn (St Paul, Minn, West Publishing Co, 2000) 283.

[28] See, eg, *NV Maes Roger v NV Kapa Reynolds*, Appellate Court Gent (Belgium) 10 May 2004 <http://cisgw3.law.pace.edu/cases/040510b1.html> (where the court, commenting on the buyer's failure to mitigate, stated: 'As Buyer knew that not conducting a cover purchase would severely burden its relationship with its customers and that Buyer could not fulfill its obligations with the delivered plastic film, the damage suffered due to loss of good reputation or as a consequence, that the clientele sustained damages because of missing replacement foil, are attributed to the Buyer and limited to the amount of a possible cover purchase.').

[29] The other side of the same coin is to say that the mitigation rule discourages passivity and instead encourages dynamism, self-reliance, stoicism and responsibility for one's own welfare (see Bridge (n 9) 409–10; Pautremat (n 14)).

[30] See, eg, MB Kelly, 'Living without the Avoidable Consequences Doctrine in Contract Remedies' (1996) 33 San Diego L Rev 175, 181.

[31] A Burrows, 'Contract, Tort and Restitution—A Satisfactory Division or Not?' (1983) 99 LQR 217.

[32] Supreme Court 14 January 2002 (n 14) ('In the event of non-performance . . ., the obligee is generally justified . . . to undertake reasonable measures by itself to generate a situation corresponding to proper performance . . .').

and while it may have its attractions, it seems unlikely that the mitigation rule can be fully justified solely on this basis. This justification has also been criticised on the basis that '[a] party makes a contract *so that* the other party (backed up by the courts), *and not he himself*, will fulfil his contractual expectation'.[33]

Second, the existence of the mitigation rule is often explained in causal terms by suggesting that a loss that is reasonably avoidable cannot be regarded as having been caused by the breach.[34] Justifying the mitigation rule on this basis may have far reaching practical implications. For example, if this rationale is adopted, then mitigation will become, just like causation, a necessary condition for the right to claim damages.[35] Demonstrating mitigation would thus become essential for a valid claim for damages to be brought and the injured party will bear the burden of proving mitigation at the same time as it brings its claim. Both results are not in line with an established treatment of the mitigation rule. First, the rule is generally regarded as a method of *limiting* the recovery of damages and not as a necessary prerequisite to the right to claim damages.[36] Second, as shown below, in most cases the initial burden of proof (of a failure to mitigate) has been allocated to the breaching party. These reasons in themselves[37] are sufficient to downplay the significance of the causation rationale.

2. SCOPE OF THE MITIGATION RULE

Before examining specific mitigation measures, it may be helpful to give a few remarks to delineate the scope of the mitigation rule. First of all, it needs to be said that although the rule is often expressed in terms of a 'duty to mitigate', it is not, strictly speaking, accurate to treat it as such.[38] This duty is not enforceable and no liability will be incurred for a failure to mitigate. Mitigation is an

[33] M Chen-Wishart, *Contract Law*, 2nd edn (Oxford, OUP, 2008) 557.

[34] See *British Westinghouse Electric and Manufacturing Co v Underground Electric Railway Co of London Ltd* [1912] AC 673, 689 (HL); FH Lawson, *Remedies of English Law*, 2nd edn (London, Butterworths, 1980) 66–7; J Smith, *The Law of Contract*, 4th edn (London, Sweet & Maxwell, 2002) 228; A Ogus, *The Law of Damages* (London, Butterworths, 1973) 5; C Schmitthoff, 'The Duty to Mitigate' [1961] JBL 363. As shown by Honore, there is nothing extraordinary in regarding a failure to act as a cause (see AM Honore, 'Causation and Remoteness of Damage' in K Zweigert and K Drobnig (eds), *International Encyclopedia of Comparative Law*, vol 11, ch 7 (Martinus Nijhoff, 1971) 15).

[35] See R Goode, *Commercial Law*, 3rd edn (London, Penguin, 2004) 122 ('actual performance of steps in mitigation is not a prerequisite of the claimant's right to recover').

[36] See, eg, Comment 1 on art 7.4.8 UPICC.

[37] For other arguments against this rationale see MG Bridge, *The Sale of Goods* (Oxford, OUP, 1997) 547 ('it seems rather arbitrary to assert that the plaintiff's disputed loss has only one effective cause namely his own inanition rather than the preceding breach of contract'); Bridge (n 9) 400–01; similarly, CT McCormick, *Handbook on the Law of Damages* (St Paul, Minn, West Publishing Co, 1935) 128; also H McGregor, 'The Role of Mitigation in the Assessment of Damages' in Saidov and Cunnington (n 1) 331.

[38] This point has been made on innumerable occasions. For the examples in the context of the CISG, see Stoll and Gruber (n 25) 788; Knapp in Bianca and Bonell (n 24) 562; for a recent example in the common law context, see McGregor (n 37).

act which the injured party should take in its own interest in order not to be precluded from recovering damages for the loss which could have been reduced or avoided.[39]

Another point relates to the relationship between the mitigation rule and the situation where the innocent party itself contributes to its own loss by exacerbating that loss. Suppose that the buyer who is aware of the defects in the machinery supplied by the seller uses the machinery and increases its loss by producing defective goods and selling them to its customers. In this case, the buyer does not contribute to the seller's breach (supply of defective machinery) but increases its loss due to its own unreasonable behaviour. The question is whether a denial of damages for the loss thus arisen should be based on the buyer's failure to avoid its loss (mitigation) or on the lack of causal link between the seller's breach and the loss (causation). Clearly, this is an example of where causation and mitigation are just 'different labels for two sides of the same bottle'[40] and, in principle, either or both rules can be used as a legal basis. However, the UPICC and PECL contain a specific provision to this effect[41] which naturally provides the answer to this question. By contrast, the CISG does not contain a similar provision; nevertheless the same result can be achieved by means of either principles of causation (art 74) or mitigation (art 77), or both.[42]

Whether the mitigation requirement applies to anticipatory breach cases has been viewed as a challenging question.[43] It is submitted, however, that the mitigation requirement applies to anticipatory breach cases just as it does to actual breach cases.[44] There is no doubt that where the contract is avoided for anticipatory breach, the party is entitled to claim damages and, therefore, from a purely positivist perspective, this claim, like any other claim for damages, is subject to the mitigation rule. From a policy perspective, it can also be argued that if the instruments are serious about policies and considerations underlying the mitigation rule, then they should also be enforced in anticipatory breach cases. Moreover, both the mitigation rule and the doctrine of anticipatory breach are often justified on the same basis, that is, by reference to the need to

[39] The term a 'duty to mitigate' will be used in this work only for the sake of convenience.

[40] This phrase has been used in McCormick (n 37) 134.

[41] 'Where the harm is due in part to an act or omission of the aggrieved party or to another event as to which that party bears the risk, the amount of damages shall be reduced to the extent that these factors have contributed to the harm, having regard to the conduct of each of the parties' (art 7.4.7 UPICC); 'The non-performing party is not liable for loss suffered by the aggrieved party to the extent that the aggrieved party contributed to the non-performance or its effects' (art 9:505 PECL).

[42] As shown earlier (see ch 4), the injured party can also contribute to the other party's breach and while the mitigation rule could also, in principle, be relied upon in such cases it is better not to do so because the instruments contain specific provisions to this effect (arts 80 CISG, 7.1.2 UPICC, 8:101 and 9:505 PECL). This would also make the scope of the mitigation rule unnecessarily wide.

[43] See NM Galston and H Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (New York, Matthew Bender, 1984) 9–41. For a discussion of the doctrine of anticipatory breach and further references, see ch 2.

[44] For a similar position, see Secretariat Commentary on art 73 of the 1978 Draft; Comment A on art 9:505 PECL (Lando and Beale (n 16) 446).

avoid waste and promote economic efficiency.[45] In some cases, the application of the mitigation rule to anticipatory cases may lead to the result where the innocent party is *required* to avoid the contract, notwithstanding the remedy of avoidance being *a right*, as opposed to an obligation.[46]

Finally, the question has arisen as to whether the duty to mitigate extends as far as to require the injured party to *discover* a breach which has already been committed. In one case under the CISG, a German seller delivered defective aluminium hydroxide to a French glass manufacturer.[47] Without a prior examination, the buyer mixed the defective aluminium hydroxide with another substance, thereby producing defective glass. The court held that by failing to conduct a prior examination, the buyer had failed to mitigate its loss: had the buyer inspected the goods, 'the defect would have been revealed even by means of simple tests',[48] and the loss would have been either reduced or avoided. It is suggested that in cases such as this, a duty to mitigate *can* be interpreted in this way considering that the CISG imposes an obligation on the buyer to examine the goods.[49] Of course, the same result could have been achieved by holding that there was no causal connection between the seller's breach and the buyer's loss.

3. REASONABLE MEASURES

3.1 General

The innocent party is required to take only *reasonable* measures of mitigating loss and what is reasonable depends ultimately on the circumstances of a particular case. In abstract, several guidelines can be given. The policies underlying the mitigation rule must, it is submitted, influence the meaning of reasonableness. This means that a concern for economic efficiency and avoidance of waste would require the party to take the least costly measures. Fair dealing and good faith would require the innocent party to take the interests of the other party into account. At the same time, because the duty to mitigate is not a wholly altruistic duty and is also a reflection of a concern for the injured party itself, a proper application of the mitigation rule should aim to strike a balance between

[45] See, eg, D Saidov, 'Anticipatory Non-Performance and Underlying Values of the UNIDROIT Principles' (2006) 11 Uniform L Rev 795. The link between the mitigation rule and the doctrine of anticipatory breach is further evidenced by the remedy of suspension of performance which is available under the instruments in anticipatory breach cases. This remedy has been said to perform functions similar to those performed by the mitigation rule (see *ibid*).

[46] See arts 71 and 72 CISG; arts 7.3.3 and 7.3.4 UPICC; art 9:304 PECL. For a more detailed discussion of this issue and of how the mitigation rule operates in anticipatory breach cases, see ch 9.

[47] Case No 18 U 121/97 Appellate Court Köln (Germany) 21 August 1997 (Aluminium hydroxide case) <http://cisgw3.law.pace.edu/cases/970821g1.html>.

[48] *Ibid*.

[49] 'The buyer *must* examine the goods, or cause them to be examined . . .' (art 38 CISG).

the legitimate interests of both parties.[50] A guideline flowing from an attempt to strike such a balance is that reasonableness does not require the innocent party to take measures involving considerable risks (financial or otherwise) or damage to its reputation.[51] One decision under the CISG may, at first sight, appear to have held otherwise. In that case,[52] the court found that the German buyer had failed to mitigate its loss as it had only made efforts to make replacement purchases in a region where it operated, without taking into account other suppliers in Germany or abroad.[53] It is submitted, however, that a mere possibility of a replacement transaction abroad does not in itself mean that it will involve excessive risk and costs. On the contrary, it is reasonable to assume that, in international trade, replacement transactions will often have to be carried out abroad. What is crucial for determining the reasonableness of a particular (replacement) transaction is the nature and extent of risks involved if the party goes ahead with that transaction.[54]

3.2 Non-delivery, non-acceptance and non-payment

In the context of sales transactions, making a substitute transaction is a typical measure of mitigating loss.[55] Where a buyer fails to pay and take delivery of the goods, a seller can mitigate its loss by reselling the goods[56] and a buyer who does

[50] For a somewhat similar approach to the interpretation of the CISG, see Case No 4 R 219/01k Appellate Court Graz (Austria) 24 January 2002 (Excavator case) <http://cisgw3.law.pace.edu/cases/020124a3.html> ('The obligation stated in Art 77 CISG is to be interpreted taking into account the competing interests of the parties, as well as commercial customs and the principle of good faith' (with reference to Karollus)).

[51] Knapp in Bianca and Bonell (n 37) 560; Stoll and Gruber (n 25) 790; *Downs Investments Pty Ltd v Perwaja Steel SDN BHD* [2000] QSC 421 (unfortunately, it would seem that the court has come to this conclusion not on the basis of the CISG but following the position of the common law). For a similar position in English law, see Chitty (n 8) 1318; H McGregor, *McGregor on Damages*, 17th edn (London, Sweet & Maxwell, 2003) 253, 258.

[52] Case No 3 U 246/97 Appellate Court Celle (Germany) 2 September 1991 (Vacuum cleaners case) <http://cisgw3.law.pace.edu/cases/910902g1.html>.

[53] To illustrate why this decision may be interpreted as requiring the injured party to take considerable risks, it is helpful to recall the English case of *Lesters Leather and Skin Co v Home and Overseas Brokers* (1948–49) 82 Ll L Rep 202. In that case, a UK buyer suffered loss as a result of the defective delivery of snakeskins. The seller argued that the buyer ought to have mitigated its loss by having purchased the snakeskins in India. The court held that it was not reasonable for the buyer 'to go hunting the globe to find out where they can get skins' (*ibid*, 205) and this decision is sometimes interpreted as reflecting the position that reasonableness does not require the innocent party to risk its money too far (McGregor (n 51) 253).

[54] For measures to be recognised as mitigation, no notice is required to be given to the breaching party, contrary to suggestions made in some cases under the CISG (see ICC Arbitration Case No 10274 of 1999 (Poultry feed case) <http://cisgw3.law.pace.edu/cases/990274i1.html>; for a more detailed discussion, see ch 8). Contacting the breaching party for assistance in mitigating losses can, however, be a reasonable measure to mitigate loss (see n 112 and the discussion in the main text accompanying n 94).

[55] For a detailed discussion of the reasonableness of substitute transactions, see ch 8.

[56] See *Watkins-Johnson v Islamic Republic of Iran*, Iran-United States Claims Tribunal, Award 370 (429-370-1) 28 July 1989 <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/890728i2.html>.

not buy substitute goods after the seller failed to deliver will often be found to have failed to mitigate.[57] For a substitute transaction to be reasonable 'it must have been made in such a manner as is likely to cause a resale to have been made at the highest price reasonably possible in the circumstances or a cover purchase at the lowest price reasonably possible'.[58] This general guideline aims to ensure the maximum reduction of loss that is reasonably possible in the circumstances and it has already been followed in some cases under the CISG. In one case, after the buyer had breached the contract, the seller resold the goods at a very low price.[59] When the seller claimed the difference between the contract price and the resale price, the court denied the recovery of that difference on the ground that the resale was not a reasonable substitute transaction.[60]

It is generally accepted that a true substitute transaction must be made on terms similar to those in the original contract.[61] In most situations, this will probably be the case because the purpose of measures to mitigate the loss will be closely connected with the purpose for which the contract with a defaulting party was concluded. If, for example, the buyer made a contract with the seller in order to make a sub-sale, the buyer will attempt to reduce or avoid potential losses on its sub-sale by finding another seller willing to make a delivery on similar terms as those in the original contract. Nevertheless, a possibility of mitigating losses by means other than making a substitute transaction on similar terms cannot be ruled out. It may be reasonable for the innocent party to channel the resources, released as a result of the breach, in a different direction. Suppose that, after the seller's refusal to deliver, the buyer decides to invest the unpaid purchase price in a profitable venture. The returns from this investment may be sufficient to pay damages to the sub-buyer and to bring profit which will either set off or considerably reduce other losses. Although such cases are bound to be rare, a possibility of such measures being recognised as reasonable mitigation cannot be ruled out.[62]

While making substitute transactions is a typical measure of mitigating losses, various circumstances may restrict or preclude the injured party's ability to do so. One such circumstance may be where the buyer who has already paid the purchase price does not have sufficient financial resources to procure a substitute. Although this concern has been said to reflect an 'unreal conviction',[63]

[57] See ICAC Case 406/1998, decision dated 6 June 2000 <http://cisgw3.law.pace.edu/cases/000606r1.html>.

[58] See Secretariat Commentary on art 71 of the 1978 Draft Convention.

[59] The contract was for the sale of sacks of jute at a price of US$55.90 per 100 bags. The seller made a resale at a price of US$0.30 per sack.

[60] See *Internationale Jute Maatschappij BV v Marín Palomares SL*, Supreme Court (Spain) 28 January 2000 <http://cisgw3.law.pace.edu/cases/000128s4.html> (for further analysis of this decision, see below).

[61] For a detailed discussion, see ch 8.

[62] See JG MacIntosh and DC Frydenlund, 'An Investment Approach to a Theory of Contract Mitigation' (1987) 37 University Toronto L J 115 (arguing, from the standpoint of economic analysis, that there is nothing that would rule out such an interpretation of reasonable mitigation).

[63] See MG Bridge 'The Market Rule of Damages Assessment' in Saidov and Cunnington (n 1) 443.

in some cases under the CISG judges have been prepared to take the possibility of this difficulty into account.[64] A circumstance which may also make it difficult for the injured party to procure a substitute is the one involving the delivery of seasonal products. In one such case,[65] the buyer had failed to pay the price for a delivery of shoes. The seller, a shoe manufacturer, attempted to resell the goods but the resale turned out to be impossible as 'all customers were already well supplied and the stocks were still filled from the previous . . . season'. For this reason, the court held that the seller had not failed to mitigate its loss. In another case,[66] where a clothing manufacturer failed to deliver the goods on time, it was not possible for the buyer to procure substitute goods (for sale in its retail stores) as they had to be ordered several months in advance, whereas the breach was committed towards the end of the season. It was again held that that the buyer had not failed to mitigate its losses.

Another circumstance preventing the buyer from mitigating its loss by procuring a substitute transaction is where the sub-sale contract requires the delivery of the self-same goods as those in the original contract.[67] In one case under the CISG,[68] the buyer's sub-sale contract provided for the delivery of the same goods as those in the buyer's contract with the seller in terms of their specifications and place of manufacture (Korea) and, because of the time constraints,[69] that requirement made the buyer unable to procure a substitute to fulfil its sub-sale. Although, strictly speaking, the case does not involve 'self-same' goods, it nevertheless illustrates the same difficulty as the one which the buyer would have faced in the case of 'self-same' goods.[70]

Yet another situation rendering the injured party unable to mitigate by procuring a substitute is the so-called 'lost volume' situation, where the seller's supply exceeds the demand for the goods. In such a case, if the buyer breaches the contract and the seller resells the goods to another buyer, it may be the case that the seller would have sold the goods to that other buyer even if the first buyer had not breached and for this reason a resale is not true a substitute. In one case under the CISG,[71] the seller agreed to produce a piece of jewellery for

[64] See Appellate Court Gent 10 May 2004 (n 28).

[65] See Case No 17 U 146/93 Appellate Court Düsseldorf (Germany) 14 January 1994 (Shoes case) <http://cisgw3.law.pace.edu/cases/940114g1.html>.

[66] ICC Arbitration Case No 8786 January 1997 (Clothing case) <http://cisgw3.law.pace.edu/cases/97878 6i1.html>.

[67] For the discussion in the context of English law, see Goode (n 35) 384.

[68] CIETAC Arbitration proceeding 17 October 1996 (Tinplate case) <http://cisgw3.law.pace.edu/cases/961017c1.html>.

[69] '[the] [b]uyer being a Chinese company was unable to find Korean products on the Chinese market within a short time' (*ibid*).

[70] For a similar case, see CIETAC Arbitration proceeding 29 September 2004 (India rapeseed meal case) <http://cisgw3.law.pace.edu/cases/040929c1.html> (where the tribunal dismissed the seller's argument that the Chinese buyer ought to have procured a substitute delivery of rapeseed meal in its domestic market on the basis that the contract goods were indicated as 'India rapeseed meal').

[71] See Case No 1 Ob 292/99v Supreme Court (Austria) 28 April 2000 (Jewellery case) <http://cisgw3.law.pace.edu/cases/000428a3.html>.

the buyer and when the latter failed to pay, the seller claimed damages for the difference between the cost of manufacture and the contract price. The court accepted the claim and dismissed the buyer's objection that the seller had failed to mitigate by means of reselling that piece of jewellery, stating that the objection 'is ineffective as far as the promisee, in performing the substitute transaction, would have lost another similar transaction bringing the same profit as the first transaction'.[72] It seems that several other cases under the CISG can also be regarded as 'lost volume' cases. Those are cases where the goods were specifically produced or designed for the needs of a particular buyer thereby eliminating any demand for the goods. Thus, in one case[73] the fact that the textile manufacturing facility was produced specifically for the buyer's range of products made it virtually impossible for the seller to resell it.[74] In some other cases,[75] the impossibility of a seller's resale arose because the goods bore the buyer's trademark, logo, or signet. However, the fact that mitigation by means of reselling the goods themselves is not possible does not necessarily mean that mitigation is altogether impossible.[76] For example, it may have been reasonable, in the case of the delivery of jewellery,[77] for the seller to break up the jewellery and sell the precious stones of which it was made. In the case of the specifically designed textile manufacturing facility, the court agreed with the expert's conclusion that the seller's rapid disassembly and re-utilisation of the saleable parts of the machine was 'the most reasonable and prudent solution' in the circumstances.[78]

It has not always been the case that a substitute transaction was recognised as an appropriate measure of mitigating loss. In one case,[79] the seller, despite becoming aware some time after the contract had been concluded that the buyer

[72] See Case No 1 Ob 292/99v Supreme Court (Austria) 28 April 2000 (Jewellery case) <http://cisgw3.law.pace.edu/cases/000428a3.html>.

[73] See Commercial Court St Gallen, 3 December 2002 (n 26).

[74] The expert's finding was that 'the opportunity to have this machine resold as a whole [was] very improbable' (*ibid*).

[75] ICAC Case 107/2002, decision dated 16 February 2004 ('The seller, deprived of the possibility of independently selling the goods produced for the buyer (since according to the conditions of the contract the goods were marked with buyer's trademark and could not be sold by the seller to a third party without a written consent of the buyer as provided for in . . . the contract), repeatedly asked the buyer to give this consent . . ., yet obtained no consent of the kind'); Case No OR.96.0-00-13 Commercial Court Aargau (Switzerland) 26 September 1997 (Cutlery case) <http://cisgw3.law.pace.edu/cases/970926s1.html> (the situation related only to the sale of knives). In one case, the seller managed to resell the goods bearing the buyer's trademark (see Case No 7 O 43/01 District Court Göttingen (Germany) 20 September 2002 (Mattresses and bedding accessories case) <http://cisgw3.law.pace.edu/cases/020920g1.html>).

[76] The author has reconsidered his views expressed earlier (see D Saidov, 'Methods of Limiting Damages under the UN Convention on Contracts for the International Sale of Goods' (2002) 14 Pace Intl L Rev 366).

[77] See the case referred to earlier in this paragraph (text accompanying n 71).

[78] See the case referred to earlier in this paragraph (text accompanying n 73) and note, in particular, a detailed expert's report on the reasonableness of the measures.

[79] CIETAC Arbitration proceeding 29 September 1997 (Aluminium oxide case) <http://cisgw3.law.pace.edu/cases/970929c1.html>.

would not be able to perform, nevertheless ordered the goods (designated for the buyer) from its supplier and then resold them to a third party. The tribunal dismissed the claim for the difference between the contract price and the price in that resale on the ground of the seller's failure to mitigate. The inference seems to be that the seller ought to have refrained from ordering the goods and presumably in that case damages would have been the difference between (what would have been) the cost of purchasing the goods from the supplier and the contract price.[80] It is suggested that, first of all, the reasonableness of the seller's conduct ought to have depended on whether the seller could be said to have been in a 'lost volume' situation. If it would *not* have resold the goods to that third party had the buyer *not* breached, then ordering from the supplier and then reselling *might* have been a reasonable course of mitigating losses provided that losses resulting from a resale to a third party[81] would be lower than losses resulting from refraining from buying from the supplier.[82] In short, if the seller, before ordering the goods from its supplier, was in the position to estimate and compare losses resulting from a potential resale to a third party, the reasonable measure of mitigation ought to have been that which would have resulted in the lower amount of damages.[83]

In another case under the CISG,[84] as a result of the buyer's failure to make a payment for the delivered goods, the parties had concluded an agreement acknowledging the buyer's debt and providing for a payment schedule. When the buyer failed to make a payment and the seller claimed damages, the tribunal dismissed the buyer's argument that the seller had failed to mitigate on the following grounds:

[80] The decision is curious as the tribunal eventually awarded damages under the 'abstract' formula in art 76 CISG. This highlights the tension between 'concrete' and 'abstract' approaches to calculating damages. Although the tribunal began with the 'concrete' approach by enquiring what the claimant, in the light of its actual situation, ought to have done, it then suddenly moved away from measuring damages by reference to the claimant's actual circumstances and, instead, relied upon the 'abstract' formula with its 'built-in' mitigation rule (see ch 8).

[81] That is, the difference between the contract price and the price in the resale to a third party together with other possible losses.

[82] That is, the difference between the cost of acquisition and the contract price.

[83] This approach flows from the rationale underlying the mitigation rule. In particular, it ensures a least costly measure, thereby preserving an efficient outcome and a balance between the parties' interests by, on the one hand, protecting the interests of the breaching party and, on the other hand, only requiring the seller to act to the extent that can be reasonably expected.

A similar situation has arisen in another case under the CISG (CIETAC Arbitration proceeding 28 May 1999 (Veneer Import case) <http://cisgw3.law.pace.edu/cases/990528c1.html>) where the innocent buyer, after becoming aware that the seller would not be able to deliver the goods, concluded a contract to resell those goods (the situation arose due to the lack of communication between the buyer's internal departments). As a result of the seller's non-delivery, the buyer had to pay damages to its sub-buyer. The tribunal held that no compensation for damages paid to the sub-buyer could be awarded because by entering into the sub-sale contract, the buyer had failed to avoid that loss. This case again illustrates the situation where the mitigation rule and causation are simply two sides of the same coin. The same result could have been achieved (perhaps more easily) on the ground that paying damages to the sub-buyer was of the buyer's own making.

[84] ICAC Case 186/2003, decision dated 17 June 2004 <http://cisgw3.law.pace.edu/cases/040617r1.html>.

> the Respondent acknowledged its debt in [the] Agreement No 292 of 15 January 2003 and . . . the Claimant was entitled to expect not only that the Respondent would perform its obligations in good faith and in accordance with the agreed schedule but also to receive the monetary funds necessary for further use in its commercial activity. The Respondent itself by its execution of Agreement No 292 of 15 January 2003 put the Claimant in the position of a contracting party waiting for the performance [where] it could undertake nothing but wait for the Respondent's payments relying on its good faith; yet the Respondent abused [the] Claimant's trust and failed to perform [its] obligation to pay. Taking into consideration the above as well as the fact that the Respondent failed to indicate what exact measures, in its opinion, were not taken by the Claimant in order to mitigate the amount of the loss of profit, the Tribunal rejects Respondent's arguments.

It is sometimes the case that, after the breach, the breaching party offers to perform the contract on terms different from those in the original contract. The question then arises as to whether accepting such an offer is a reasonable measure of mitigation.[85] In one case,[86] after the conclusion of the contract the buyer offered to purchase the goods at a lower price than the contract price. The seller rejected the offer[87] and resold the goods to a third party at a price lower than both the original contract price and the price in the buyer's offer. The court dismissed the seller's claim for the difference between the contract price and the resale price on the ground that rejecting the buyer's offer had been a failure to mitigate the loss.[88] At the first sight, a different result appears to have been

[85] This issue has also been dealt with in English law. See, eg, *Payzu Ltd v Saunders* [1919] 2 KB 581 (CA); *Sotiros Shipping Inc v Sameiet Solholt (The Solholt)* [1983] 1 Lloyd's Rep 605 (CA). For a good analysis of the cases, see Bridge (n 37) 549–53.

[86] Supreme Court (Spain) 28 January 2000 (n 60).

[87] The seller did not strictly speaking reject the offer as it agreed to accept it subject to the 'buyer's payment on the issuance of a letter of credit drawn on a prestigious Dutch bank to cover the purchase price that buyer offered'. However, the Court itself treated that condition as a rejection taking into account that 'the commercial relationship that had existed between the parties since 1988 was without incidents concerning the payment of the supplied merchandise'. In addition, 'in the substitute sale no special guarantees of the payment of the price were demanded; [the] seller simply made payment conditional "after receipt of the invoice"'.

[88] In a very similar case (CIETAC Arbitration proceeding 1 March 1999 (Canned mandarin oranges case) http://cisgw3.law.pace.edu/cases/990301c1.html>), the tribunal also refused to award the difference between the contract price and the resale price and instead awarded the difference between the contract price and the price determined by reference to *both* the average price (in Germany) and the price offered by the buyer (based on the Chinese market price). This decision reflects a curious mixture of both the 'abstract' and 'concrete' approaches to assessing damages: assuming that accepting the buyer's offer was a reasonable course of action, the 'concrete' method in its pure form would have dictated awarding the difference between the contract price and the price in the buyer's offer. The tribunal, however, did not consider the price in the buyer's offer as decisive but merely as a helpful factor in determining what seemed to the tribunal as a 'reasonable price' on which it eventually relied. This approach is unfortunate because, as argued in detail below, the CISG expresses a preference for the 'concrete' measure, which is in harmony with the mitigation rule. What the tribunal ought to have done, therefore, was to calculate damages on the basis of what ought to have been a reasonable mitigation measure in the light of the claimant's actual circumstances.

reached in another case[89] where it was the seller who was willing to sell the goods at the price higher (US$215.00 per ton) than the contract price (US$190.00 per ton). The buyer rejected the proposal and insisted on the performance at the original contract price. After the seller had failed to deliver, the buyer made a cover purchase from a third party and the tribunal held that the cover purchase was a reasonable mitigation measure and that the buyer was not required to accept the seller's offer. It is suggested, however, that the decisions do not necessarily reflect different approaches to the interpretation of the reasonableness of mitigation. It is argued that what is crucial in these types of case is whether or not accepting the offer would lead to the injured party surrendering its right to damages and to avoid the contract.[90] If so, then accepting the breaching party's offer cannot be regarded as a reasonable measure to mitigate loss. This would be grossly unfair to the injured party and would, no doubt, contravene the mitigation rule's aim of striking a fair balance between the legitimate interests of both parties. If, however, accepting the offer does not lead to the injured party being deprived of its right to avoid the contract and to claim damages[91] for the difference between the original contract price and the newly accepted price, there is no reason why accepting the offer should not be a reasonable measure of mitigating loss. The decisions referred to in this paragraph do not make it clear as to whether these considerations were in the minds of judges and arbitrators and for this reason it is difficult to assess whether the results reached in those cases are correct.[92]

Finally, in some countries, a breach of contract will entail the innocent party paying a penalty to state authorities. For example, where the seller's domestic law requires it to sell foreign currency received from its international transactions to the state, it may have to pay a penalty for not doing so if the buyer fails to pay the contract price. In some cases where this situation has arisen, the applicable domestic law provided that the penalty would *not* be imposed if the seller brought a claim against the buyer within a specified period and, where the sellers had failed to do so, damages for the payment of the penalty were

[89] ICC Arbitration Case No 6281 of 1989 (Steel bars case) <http://cisgw3.law.pace.edu/cases/896281i1.html>. Although the case itself was governed by Yugoslav law, when the tribunal dealt with the issues of mitigation it also considered what the position would have been under the CISG.

[90] Such surrender can occur where accepting the breaching party's offer leads to a modification of the existing contract, as opposed to making a new contract, with no undertaking by the breaching party to compensate for the difference between the original and the renegotiated price.

[91] This may be the case where the acceptance of a newly offered price is regarded as making a new contract.

[92] The decisions in some other cases under the CISG can be criticised for failing to properly address the breaching parties' argument that the innocent parties had failed to reduce losses because they ignored the proposals made by the breaching parties (see CIETAC Arbitration proceeding 30 October 1991 (Roll aluminium and aluminium parts case) <http://cisgw3.law.pace.edu/cases/911030c1.html>; Case No 95/3214 District Court of Kuopio (Finland) 5 November 1996 (Butter case) <http://cisgw3.law.pace.edu/cases/961105f5.html>).

denied on the grounds of the seller's failure to mitigate that loss.[93] The innocent buyer may also find itself in the position of paying a penalty to state authorities but such a situation is likely to arise not as a result of currency regulations, but due to some other legislative requirements. For example, in one case,[94] the buyer had to pay a penalty to customs authorities as a result of the seller's failure to deliver the goods. Having established that the payment of the penalty was caused by the non-delivery, the tribunal implied that the buyer had not failed to mitigate that loss because it had, on several occasions, warned the seller that a failure to deliver would entail the penalty. Since in this case the penalty requirement emanated from a different type of legislation than that in earlier cases of non-payment, there is no reason to suppose that there was a similar provision enabling the buyer to avoid its loss by bringing a claim against the seller within a prescribed period.

3.3 Non-conforming delivery and delay in performance

A variety of mitigation measures may have to be taken where non-conforming goods were delivered but accepted by the buyer or where there was delay in performing the contract. To identify a reasonable way of mitigating losses, the purpose for which the party entered into the contract with the breaching party may have to be taken into account. Where the buyer accepts defective goods bought either for resale or for its own use, it may be worth attempting to cure the defects where reasonably possible. If the buyer intended to resell the goods, remedying the defect may bring the goods into their conforming state thereby enabling the buyer to resell them as planned.[95] If the goods were bought for the buyer's own use, curing them may likewise enable the buyer to use them as the buyer intended.[96] Provided that costs of cure are reasonable in the circumstances,[97] compensating the party for such costs will often be an appropriate compensation.[98] If cure is not

[93] Arbitration proceeding 9 July 1999 (Ukraine) (Metal production goods case) <http://cisgw3.law.pace.edu/cases/990709u5.html> ('If the Seller had not delayed presenting the Tribunal with the demand for the recovery from the Buyer of the debt for the goods until the expiration of 90 days since the date of customs clearance of the goods, Seller would not have incurred these damages'); Arbitration proceeding 27 October 2004 (Ukraine) (Lavatory paper case) <http://cisgw3.law.pace.edu/cases/041027u5.html>; Arbitration proceeding 10 May 1999 (Ukraine) (Sunflower seeds meal case) <http://cisgw3.law.pace.edu/cases/990510u5.html>.

[94] ICAC Case 85/2002, decision dated 26 June 2003 <http://cisgw3.law.pace.edu/cases/030626r1.html>.

[95] CIETAC Arbitration proceeding 31 January 2000 (Clothes case) <http://cisgw3.law.pace.edu/cases/000131c1.html>.

[96] The decision in ICC Arbitration Case No 8740 of October 1996 (Russian coal case) <http://cisgw3.law.pace.edu/cases/968740i1.html> may be relevant.

[97] This stems from both the mitigation rule and a general principle of reasonableness underlying the international instruments.

[98] This again demonstrates the connection between the mitigation rule and the calculation of damages. For a more extensive discussion of the 'cost of cure' method of calculating damages, see ch 8.

possible or reasonable, the buyer may still have to make full use of the goods on hand[99] and one way of doing so is to sell them at a reduced price.[100] In fact in some cases, reselling the goods may be the only way of mitigating the loss. In one case under the CISG[101] where non-conforming goods of a seasonal nature were delivered, the buyer argued that it had requested the seller to remedy the defects but received no response. As the end of the sale season was approaching and the storage fees were increasing (causing financial difficulties), the buyer again contacted the seller requesting the latter to collect the goods. The buyer finally suggested that because it could not afford to incur the cost of returning the goods itself, it had no choice but to resell the goods at a reduced price. The tribunal accepted that the buyer's conduct was in accordance with its duty to mitigate.

Where goods bought for use in the manufacturing process are delivered late, it may be reasonable to find a replacement for the period of delay, particularly if a timely commencement of manufacturing is of the essence.[102] Provided that the cost of such a replacement is reasonable in the circumstances, the buyer's conduct is likely to be a reasonable way of mitigating loss, and costs of replacement become, at the same time, an appropriate method of calculating damages for delay. It may also be reasonable for the buyer to use the goods from its existing stock to execute its plans during the period of delay.[103]

An interesting question is whether the mitigation rule can be interpreted as far as to require the injured buyer to attempt to renegotiate the terms of the contract with its sub-buyer. In one case under the CISG[104] the buyer claimed compensation for damages paid to its sub-buyer for delay in delivering the goods which in turn had been caused by the seller's failure to deliver on time. The tribunal held that the buyer had failed to mitigate that loss for several reasons. First, the buyer ought to have asked its sub-buyer about the possibility of changing the terms of the contract so as to extend the delivery date. Second, the buyer ought to have suggested compensation for being released from its obligations under the sub-sales contract, as provided for in art 409 of the Russian Civil Code[105] (applicable as domestic law). Third, the buyer also ought to have proposed, by reference to art 333 of the Russian Civil Code,[106] to reduce the amount

[99] See CIETAC Arbitration proceeding 5 July 1993 (Copperized steel tubes case) <http://cisgw3.law.pace.edu/cases/930705c1.html> ('in order to prevent the loss from spreading, the Buyer is responsible for making full use of usable copperized steel tubes').

[100] CIETAC Arbitration proceeding 29 March 1999 (Flanges case) <http://cisgw3.law.pace.edu/cases/990329c1.html>.

[101] CIETAC Arbitration proceeding 26 October 1996 (Cotton bath towels case) <http://cisgw3.law.pace.edu/cases/961026c1.html>.

[102] See Supreme Court Austria, 14 January 2002 (n 25).

[103] See ICC Arbitration Case No 8740 (n 96).

[104] ICAC Case 97/2004, decision dated 23 December 2004 <http://cisgw3.law.pace.edu/cases/041223r1.html>.

[105] According to art 409, parties can agree that an obligation can be terminated in exchange for compensation (payment of money, transfer of property, etc).

[106] According to art 333, if the amount of liquidated damages due for payment is evidently incommensurate to the consequences of the breach of an obligation, the court has the power to reduce it.

of penalty on the grounds that it was excessive. It may be helpful to address each of these grounds in turn.

So far as the first ground is concerned, if the tribunal's approach were correct and were to be followed, this would mean that in *every* case of delay in delivery, a buyer would have to attempt to renegotiate its sub-sales contract or, otherwise, face the reduction in its damages claim for money paid to its sub-buyer. With respect, this is a step too far: buyers cannot be expected to attempt to renegotiate their sub-sale contracts every time they face a damages claim by sub-buyers due to the sellers' delay in delivering the goods. By expecting too much of the injured party, the tribunal's approach disturbs the balance between the parties' legitimate interests which the mitigation rule was designed to create. While the second ground could be attacked on the basis of the same reasons, it is primarily flawed because it is inappropriate to rely on the applicable domestic law with respect to the issues which are governed by the CISG.[107] The Convention governs the matter of the cessation of rights and obligations[108] as well as the conditions whereby the parties can alter the terms of the contract[109] and domestic law ought not to have been allowed to interfere. No good reasons for the decision can be found in the third ground advanced by the tribunal. While there is little doubt that the legal treatment of liquidated damages clauses is outside the scope of the CISG, art 333 of the Russian Civil Code merely provides for the power of the *court* to reduce the amount of liquidated damages where they are 'incommensurate to the consequences of the breach of an obligation'. The effect of this provision is then to provide the buyer with a right to challenge, by bringing a legal action, the amount in a liquidated damages clause in its sub-sale contract. It follows, from the tribunal's reliance on this provision, that the injured party ought to have tried to negotiate the reduction of liquidated damages by referring to art 333 as a basis for a possible legal action. Once again, it is submitted that such an interpretation is an unjustified extension of the boundaries of the mitigation rule and is unduly burdensome on the injured party.[110] If the tribunal's real concern related to a possibly excessive liquidated damages claim, then an appropriate way of ensuring that the burden of paying an unusually high amount is not placed on the breaching party's shoulders ought to have been the foreseeability, and not the mitigation, rule.[111]

It should be stressed, however, that the argument that the mitigation rule does not require the injured party to attempt to renegotiate the terms of its sub-sale contract is advanced only as a *general* proposition. Because the meaning of reasonableness ultimately rests with the facts of a particular case, a possibility of

[107] See art 7 CISG.

[108] See art 4 CISG.

[109] See art 29 CISG.

[110] This argument is relevant if the tribunal's decision is interpreted as requiring the injured party to actually bring a claim to reduce the amount of liquidated damages. The injured party cannot be expected to bring such a claim every time it faces a liquidated damages claim by its sub-buyer.

[111] As argued earlier, the foreseeability refers to both the type and the extent of the loss (see ch 5).

some *exceptional* cases where renegotiating the sub-sale contract may be a reasonable measure of mitigating loss cannot be ruled out. It may be, for example, that the sub-buyer has unequivocally expressed its willingness, in the light of a long-standing business relationship or as a gesture of goodwill, to extend the delivery date or reduce the amount of liquidated damages. Under such circumstances, it is certainly reasonable to expect the buyer to pursue the course of renegotiating the sub-sale contract.[112]

4. MITIGATION AND EVENTS SUBSEQUENT TO THE BREACH

There is a close connection between the mitigation rule and the calculation of damages. For example, as seen above, a reasonable measure aimed at mitigating loss will often provide a basis for calculating damages.[113] In fact, it is possible to go further by suggesting that the mitigation rule cannot be separated from the problems of calculation, and nowhere is this more evident than in the context of the dilemma between the so-called 'concrete' and 'abstract' approaches to calculating damages.[114] Here, the relationship between the two is that of reciprocal influence.[115] On the one hand, the mitigation rule influences the specific methods the law adopts for calculating damages. For example, the instruments' concrete formula[116]—the difference between the contract price and the price in a substitute transaction—can be said to reflect a typical measure of mitigating loss. The instruments' abstract formula[117]—the difference between the contract price and the current price—can also be said to incorporate the mitigation rule; in other words, the mitigation rule is 'built in' as a part of the abstract formula. On the other hand, the role and functioning of the mitigation rule depend on whether a particular legal system prefers the 'concrete' or the 'abstract' approach to calculating damages. For instance, by estimating damages as the difference between the contract price and the price in a substitute transaction, the instruments' concrete formula is based on the injured party's *actual* conduct. A true application of the mitigation rule would likewise require an assessment of the party's *actual* conduct and this is why the mitigation rule is in perfect

[112] A possible range of measures to mitigate loss is, of course, wider than the one addressed in the work. Other examples of reasonable mitigation, provided by cases under the CISG, include: expediting the shipment (*Delchi Carrier SpA v Rotorex Corporation* 1994 WL 4955787), contacting the breaching party to receive information which could help in mitigating losses (ICAC Case 54/1999, decision dated 24 January 2000 <http://cisgw3.law.pace.edu/cases/000124r1.html>), hiring an attorney in the breaching party's country (Case No 31 C 534/94 Lower Court Alsfeld (Germany) 12 May 1995 (Flagstone tiles case) <http://cisgw3.law.pace.edu/cases/950512g1.html>).

[113] Examples include making a substitute transaction or incurring costs to cure the defects (see above).

[114] For an extensive discussion of these approaches to calculation, see ch 8.

[115] This discussion is partly based on D Saidov and R Cunnington, 'Current Themes in the Law of Contract Damages: Introductory Remarks' in Saidov and Cunnington (n 1) 21.

[116] See arts 75 CISG, 7.4.5 UPICC and 9:506 PECL.

[117] See arts 76 CISG, 7.4.6 UPICC and 9:507 PECL.

harmony with the 'concrete' approach. By contrast, the 'abstract' formula causes the mitigation rule to lose its 'identity' and because mitigation is 'built into' the 'abstract' (market) formula it 'does not expressly appear as a separate issue'.[118] For this reason, those legal systems which generally prefer the 'abstract' measure do not let the events occurring subsequent to the breach influence the calculation of damages. For instance, some common law systems presume that the innocent party ought to have mitigated at the time of the breach[119] (or soon thereafter) and consequently any gains or losses made after that time are generally ignored when damages are calculated. It is not surprising, therefore, that where the 'abstract' approach is the starting point, the injured party may often find itself either under- or over-compensated.[120]

The instruments generally prefer the 'concrete' approach to calculating damages and the mitigation rule should not therefore lose its identity.[121] However, the instruments also provide for the possibility of using the 'abstract' formula and this may give rise to a conflict and tension between that formula and the mitigation rule. Although, as will be argued in a later chapter, the mitigation rule should have priority, it is hoped that such cases will be rare and in fact there is now evidence that the 'abstract' formula can successfully complement the mitigation rule.[122] Thus, because the 'concrete' approach and the mitigation rule are the starting point so far as the instruments are concerned, benefits received and losses made subsequent to the breach and avoidance[123] are to be taken into account. This explains, for example, why in a case under the CISG[124] where the buyer who lost an opportunity to resell the goods because of the seller's breach and then delayed reselling the goods in an attempt to speculate on market prices was denied the recovery of storage costs. The tribunal held that the buyer ought to have resold the goods in good time. Although a similar result would probably have been achieved in the common law systems adhering to the 'abstract' measure, this would not have been so on the ground of the buyer's failure to mitigate by reselling the goods, but because the buyer would have been presumed to have mitigated at the time of the breach (or shortly thereafter), thereby ignoring any losses or gains occurring after that time. One reason underlying this approach is that speculation is in fact encouraged: the buyer's conduct after the time when it had reasonable opportunity to mitigate is its own speculation. This

[118] See McGregor (n 37).

[119] See, eg, ss 50(3) and 51(3) of the English Sale of Goods Act.

[120] A number of considerations have been put forward to justify such results (for a detailed discussion, see ch 8).

[121] See, however, the discussion in a later chapter where in a number of cases under the CISG, judges and arbitrators preferred the 'abstract' measure and did not give sufficient weight to the mitigation rule.

[122] For a detailed discussion and analysis, see ch 8.

[123] By contrast with some common law systems, the 'abstract' formula in the instruments refers not to the time of breach but to the time of avoidance of the contract (and, in case of the CISG where the goods were taken over, the reference point is the time of such taking over).

[124] CIETAC Arbitration proceeding 30 March 1999 (Electric heaters case) <http://cisgw3.law.pace.edu/cases/990330c3.html>.

policy is then ensured by means of maintaining a symmetrical position: because the party chooses to speculate, it should do so at its own risk and that is why it is only fair that losses as well as gains should not be taken into account in calculating damages.[125] Hence, storage costs incurred by the buyer after the time it could have resold the goods would have been at the buyer's risk. The instruments' 'concrete' approach would appear to be not as conducive to speculation as some of the common law regimes.[126] Nor can symmetry be thus maintained: while the buyer, in this case, will have to *bear the risks* of its speculation (by being denied damages for its storage costs), it will *not enjoy the fruits* of its speculation by retaining any gains it may make by reselling them at a higher price than the one it would have received had it resold in good time, because gains will have to offset any losses the buyer may have suffered (such as profit margin on a lost sub-sale or storage costs that would have been incurred even if the buyer had resold the goods in good time). It can be argued, however, that discouraging speculation and lack of symmetry are not good reasons for derogating from the 'concrete' measure since the latter is more in line with the fundamental compensatory purpose of damages, that is, achieving, as much as possible, a *true* compensation for the *actual* loss.[127]

The problem of the extent to which benefits gained subsequent to the breach are to be taken into account also arises in cases where after the breach the injured party enters into a transaction more favourable to itself than the original contract. This may occur, for example, where the buyer after the seller's breach purchases goods of higher quality than those under the original contract and as a result makes a greater profit than it would have made otherwise.[128] It may even be the case that profits thus received will outweigh all losses the buyer may have initially suffered as a result of the breach (for example, costs of returning the original goods and the difference between the contract price and the price at which the goods of higher quality were bought). If so, is this buyer entitled to damages? Again, from the perspective of the 'concrete' measure, the actual situation in which the buyer eventually found itself as a result of the breach cannot be ignored and, because no loss has been suffered, no damages

[125] See, eg, *AKAS Jamal v Moolla Dawood, Sons & Co* [1916] 1 AC 175; *Campbell Mostyn (Provisions) Ltd v Barnett Trading Company* [1954] 1 Lloyd's Rep 65.

[126] A legal regime strictly adhering to the 'concrete' measure can be criticised on the ground that it encourages artificial transactions by forcing the injured parties, like the buyer in the case above (see n 124 and accompanying text), to resell the goods only in order to buy them immediately afterwards to enable themselves to continue to speculate (see SM Waddams, 'The Date for the Assessment of Damages' (1981) 97 LQR 445, 447).

[127] For a similar argument made recently in the context of the common law, see D McLauchlan, 'Expectation Damages: Avoided Loss, Offsetting Gains and Subsequent Events' in Saidov and Cunnington (n 1).

[128] For the case under the CISG where the seller argued that, as a result of its breach, the buyer bought better goods than those which the seller had failed to deliver, see Case No 411 O 199/02 District Court Hamburg (Germany) 26 November 2003 (Phtalic anhydride case) <http://cisgw3.law.pace.edu/cases/031126g1.html>. For an important English case on this subject, see *British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* (n 34) 690.

are due to the buyer. Because the instruments express a preference for the 'concrete' measure, benefits which would not have been received but for the breach must be taken into account in calculating damages.

It can be argued, however, that the question of whether benefits in question actually flow from the breach is a difficult one. English law, for example, has traditionally drawn the distinction between benefits arising from a breach and mitigation on the one hand and those which are independent of breach and mitigation on the other. While the former are taken into account because they form 'part of a continuous dealing with the situation' arising from the original transaction, the latter are considered to be disconnected from that transaction and for this reason are to be ignored.[129] Although it is not always clear how the line is to be drawn between the two types of case, the distinction is sometimes justified on the ground that benefits are to be regarded as disconnected from the breach, mitigation and the original contract in cases where the innocent party does *more* than it is required by the duty to mitigate.[130] This position once again reflects reluctance to take into consideration what is deemed to be the party's *own speculation*. Any benefits or risks flowing from such speculation are to be ignored and the breaching party is considered to have nothing to do with the injured party's speculation as it is a matter wholly peculiar to the injured party's circumstances. It is evident that this treatment again reflects the 'abstract' approach to damages. While this approach has a number of substantial benefits,[131] it is not generally in line with the 'concrete' approach and spirit of the international instruments.[132] It is also noteworthy that, even within the common law itself, the soundness of the said distinction is sometimes strongly doubted and it remains to be seen whether it will prove to be a workable one in the future.[133]

5. THE RECOVERABILITY OF COSTS INCURRED IN MITIGATING LOSS

In taking measures to mitigate loss, the innocent party will often incur various costs such as costs arising from finding and concluding a substitute transaction, curing the defects, attempting to return the goods, etc. Subject to such costs being reasonable in the circumstances,[134] they are recoverable under the inter-

[129] *British Westinghouse Electric and Manufacturing Co Ltd v Underground Electric Railways Co of London Ltd* (n 34) 690.

[130] See McGregor (n 37).

[131] See ch 8.

[132] However, as will be shown in ch 8, the 'abstract' measure is not entirely alien to the instruments and, in fact, on a number of occasions judges and arbitrators applying the CISG have preferred to rely on the 'abstract' measure.

[133] See McLauchlan (n 127) ('Attempting to formulate a general principle to be applied in determining whether a post-breach gain constitutes a relevant compensating advantage, as opposed to a mere collateral benefit, is hazardous, especially given . . . the multifarious range of factual circumstances that come before the courts'); see also an overview in Saidov and Cunnington (n 115) 22.

[134] For a more detailed discussion of the reasonableness of costs, see the discussion on costs of cure in ch 8.

national instruments. Under the CISG, they are recoverable as 'loss suffered as a consequence of the breach'[135] and the UPICC and PECL contain a specific provision to this effect.[136] Although the recoverability of costs incurred in mitigating loss may seem self-evident, it may nevertheless be helpful to articulate a rationale for this position. First, the principles of full compensation and the protection of the expectation/performance interest will dictate the recoverability of such costs for if they were truly aimed at mitigating loss, they would not have been incurred had there been no breach. In other words, their recoverability is necessary in order to place the party in the position in which it would have been had the contract been performed. Second, it has been argued that '[i]nasmuch as the law denies recovery for losses that can be avoided by reasonable effort and expense, justice requires that the risk incident to such effort should be carried by the party whose wrongful conduct makes them necessary'.[137] A related argument is that the recoverability of costs incurred in mitigation provides an appropriate incentive to the innocent party to mitigate by ensuring that it will not be worse off as a result of mitigation.

6. BURDEN OF PROOF

The position taken in a vast majority of cases under the CISG is that the breaching party bears the burden of proving, by establishing relevant facts and presenting supporting evidence,[138] that the injured party failed to mitigate its loss.[139] This burden has also been interpreted as requiring the breaching party to refer to *specific* measures the injured party ought to have taken[140]; but, if the injured party has in fact taken some measures, the breaching party must prove that they were not reasonable measures of mitigating loss by showing specific alternative courses of action that ought to have been taken.[141] For example, if

[135] See Knapp (n 38) 561.

[136] See art 7.4.8(2) UPICC and art 9:505(2) PECL.

[137] AL Corbin, *Corbin on Contracts*, vol 5 (St Paul, Minn, West Publishing Co, 2002) 237.

[138] Article 77 CISG seems to support this result by providing that 'the party in breach *may claim* a reduction in the damages'. The relevant provisions of the UPICC and PECL (arts 7.4.8(1) UPICC and 9:505(1) PECL) formulate the mitigation rule in stronger terms by stating that the injured party 'is not liable' for the loss which could have been reasonably avoided. Although this formulation may appear to treat the mitigation rule as a necessary precondition for the right to claim damages, it is suggested that the Principles' provisions should not be so interpreted. There is no good reason for deviating from a widely accepted treatment of the mitigation rule as merely a method of limiting damages and an established practice, as evidenced by cases under the CISG, of placing the initial burden of proof on the breaching party (see also the discussion above in relation to the possibility of justifying the mitigation rule by reference to the principle of causation).

[139] See Supreme Court Austria (n 25); *Treibacher Industrie, AG v TDY Industries Inc* US District Court [Alabama] 464 F.3d 1235 [11th Cir 2006]; ICC Arbitration Case No 8574 of September 1996 (Metal concentrate case) <http://cisgw3.law.pace.edu/cases/968574i1.html>; see further other cases referred to below.

[140] See, eg, ICAC Case 186/2003 (n 84); see also cases referred to in n 141.

[141] See, eg, Supreme Court Austria, 6 February 1996 (n 25); *Treibacher Industrie AG v TDY Industries Inc* (n 139); ICC Arbitration Case No 8574 (n 139).

the seller argues that an alleged cover purchase was made at too high a price, it must prove that cheaper substitutes were reasonably available to the buyer.[142] While generally recognising the breaching party's burden of proof, the decisions are less uniform when it comes to the consequences of the breaching party's failure to meet that burden. In some cases, a presumption has immediately been drawn that the injured party *had not* failed to mitigate its loss.[143] In some other cases, the injured party has received a less favourable treatment. In one case,[144] despite the expert's report that procuring a substitute was not possible in several parts of the buyer's country (Germany), the court ruled that because it might have been possible to procure a substitute in other parts of the country or abroad, damages ought to be reduced. The court's view of the role of allocating burden of proof was expressed thus:

> The buyer purchased from a Dutch seller in the present case, therefore offers from foreign countries, at least from all of Germany, should have been considered. It is decisive that the buyer does not offer any explanation regarding its efforts to instigate a substitute purchase. It is true that the burden of proof for a failure to mitigate damages is on the creditor, that is, the seller in the present dispute . . . But the onus of proof is irrelevant because the buyer was at least obliged to submit which offers for a substitute transaction it obtained and from which companies. The legal consequence of Art 77 CISG is solely a reduction in the amount by which the loss should have been mitigated. However, as the buyer's submissions are overall incomplete, the Court cannot determine the extent of the damages, so that a set-off with a claim for loss of profit is also unjustified for these reasons.

It is possible, therefore, that even where judges recognise that it is the breaching party who bears the burden of proof (and where it fails to do so), the injured party may still be required to provide evidence of taking measures to mitigate its loss.[145] Finally, in some other cases, judges and arbitrators themselves appear to have taken the initiative in establishing whether the injured party had mitigated its loss.[146] Although the latter two approaches may be seen as undermining the purpose of allocating burden of proof (ie, establishing a true state of affairs by placing a responsibility for doing so on the parties themselves), it is probably

[142] See Case No 1 U 167/95 Appellate Court Hamburg (Germany) (*Iron molybdenum case*) <http://cisgw3.law.pace.edu/cases/970228gl.html> 28 February 1997.

[143] *Treibacher Industrie AG v TDY Industries Inc* (n 139).

[144] See Appellate Court Celle, 2 September 1998 (n 52).

[145] For a somewhat similar approach, see ICAC Case 97/2004 (n 104). From a practical perspective, such an approach may be sensible since, as noted in one case under the CISG (Commercial Court St Gallen (n 26), the injured party is usually in a better position than the breaching party to identify the most reasonable measures that it is able to take in the circumstances. In that case, the court seems to have gone so far as to suggest that art 77 CISG requires the injured party to disclose any relevant facts relating to its measures to mitigate losses; there is, however, no support for such an interpretation in art 77 CISG. Such an interpretation would only be possible if the burden of proof were placed on the injured party and, as shown, this has not been the case in a vast majority of decisions under the CISG. The case also illustrates that the applicable procedural rules may impose on the injured party a duty to assist the court in providing evidence.

[146] See Supreme Court Austria (n 25); ICAC Case 71/1999, decision dated 2 February 2000 <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/000202r1.html>; ICAC Case 385/1998, decision dated 18 October 1999 <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/991018r1.html>.

inevitable that such approaches will be taken from time to time. As has been pointed out on many occasions,[147] legal systems differ insofar as judicial approaches to taking evidence are concerned and this difference is probably reflective of a broader difference between judicial cultures: some systems are strictly adversarial, while some others are characterised by a greater involvement of judges in the course of judicial proceedings (eg, taking of witness testimony and appointing and examining experts). The interpretation and enforcement of the mitigation rule will therefore inevitably depend on the applicable procedural rules and a broader judicial culture within which a particular dispute is considered. This will, of course, have a negative impact on the prospects of achieving uniform results.

[147] See, eg, H Kötz, 'Civil Justice Systems in Europe and the United States' (2003) 13 Duke J Comparative Int'l L 61; The Rt Hon Lord Mance, *The Common Law and Europe: Differences of Style or Substance and Do They Matter?* (Holdsworth Club Presidential Address delivered in Birmingham Law School on 24 November 2006, published by Holdsworth Club of the University of Birmingham, 2007).

Part III
Proof of Loss and Calculation of Damages

7

Standards of Proving Loss and Determining the Amount of Damages[1]

1. GENERAL

TO BE AWARDED damages, the innocent party must prove that it has suffered loss and legal systems often require that loss be proved with a particular degree of precision or certainty.[2] This requirement is also regarded as another method of limiting damages because compensation will generally be awarded only to the extent that losses have been proved with the required degree of certainty.[3] Of the three instruments, only the UPICC contain an express requirement with respect to the degree of certainty with which loss must be proved by stating that '[c]ompensation is due only for harm, including future harm, that is established with a reasonable degree of certainty'.[4] The UPICC also contain two other mechanisms dealing with uncertainty in proving losses. Article 7.4.3(2) provides that '[c]ompensation may be due for the loss of a chance in proportion to the probability of its occurrence' and if 'the amount of damages cannot be established with a sufficient degree of certainty, the assessment is at the discretion of the court'.[5] The CISG and the PECL contain no analogous provisions. This chapter will begin by examining these provisions of the UPICC. The remaining part of the chapter will explore the question of whether similar standards can be developed under the CISG and PECL.

[1] This chapter is a revised and an updated version of D Saidov, 'Standards of Proving Loss and Determining the Amount of Damages' (2006) 22 J Contract L 1.

[2] See GH Treitel, *Remedies for Breach of Contract: A Comparative Account* (Oxford, Clarendon Press, 1988) 192.

[3] See, eg, EA Farnsworth, 'Legal Remedies for Breach of Contract' (1970) 70 Columbia L Rev 1145, 1213 ('[the requirement of certainty] further diminishes the protection that the law affords the promisee's expectation').

[4] Article 7.4.3(1) UPICC.

[5] Article 7.4.3(3) UPICC.

2. THE STANDARD OF 'REASONABLE CERTAINTY'

2.1 General

As noted, the UPICC require that losses be proved with 'a reasonable degree of certainty' and this standard can be justified from the standpoint of the notion of reasonableness. Generally, the standard of proof refers to how much needs to be shown and to the level of precision which must flow from the presented evidence to prove the alleged loss. It is widely recognised that absolute certainty in proving losses cannot be required because the nature of some losses will often prevent the injured party from presenting evidence which would prove the alleged losses with absolute certainty.[6] For this reason, the standard is based on the idea that the innocent party must prove its loss only with such a degree of precision which can be *reasonably* expected of the party taking into account the nature of the loss and other relevant circumstances. If reasonableness is a general principle underlying the UPICC, it can even be argued that the standard of 'reasonable certainty' is its specific manifestation.[7]

The first question to be addressed is whether this standard refers to the fact and/or amount of loss and before this question can be answered it has to be asked whether a distinction between the fact and amount of loss needs to be drawn at all. It has been suggested, for example, that the distinction is 'meaningless for nearly all practical purposes'[8] because:

> 'the fact of loss' and 'the amount of loss' are in effect different terms for the same thing, since proof of the amount of loss with a reasonable degree of certainty conclusively establishes the fact of loss, and, conversely, the only way to prove the fact of loss would seem to be by proving with reasonable degree of certainty at least a minimum amount of loss. It thus would seem that an attempted distinction between these two is of no real significance.[9]

Indeed in many cases, proving the fact of loss will necessarily involve proving its amount and proving the amount will naturally establish the fact of loss. However, it seems that this will not always be the case for it is possible for the innocent party to establish the fact of loss without proving its amount. This may happen, for example, in cases involving loss of reputation or loss of profit due

[6] For example, proving lost profits may involve guesswork either in relation to hypothetical future or past events and the occurrence of such events will depend on different contingencies such as economic conditions, prices, preferences of consumers, etc.

[7] For the view justifying 'the standard of certainty' as a means of allocating the risk between the parties see CT McCormick, *Handbook on the Law of Damages* (St Paul, Minn, West Publishing Co, 1935) 105; MD Weisman and Clements, 'Protecting Reasonable Expectations: Proof of Lost Profits for New Business' (1991) 76 Massachusetts L Rev 186, 196).

[8] See AF Halaby, 'No Summary Judgement for You! One State's (Unjustified) Treatment of Contract Claims for Lost Profits' [1998] U Miami Business L Rev 57, 61–62.

[9] See Note, 'Damages—Loss of Profits Caused by Breach of Contract—Proof of Certainty' (1932–1933) 17 Minnesota L Rev 194, 196.

to the interruption or destruction of a newly established business[10] where the court or tribunal may be persuaded, in the light of economic conditions surrounding the business and the party's commercial experience, that despite a failure to prove the monetary value of the loss the party will have suffered lost profits. This situation may also arise in the context of the costs incurred as a result of the breach. In one case under the CISG, although a party had failed to prove the amount of the expenses it had incurred due to the breach, the court took the view that the party had nevertheless suffered some loss.[11] Similarly, in a case where the UPICC were applied, the panel stated that '[i]n many of the Claims the Claimants' documentary or other evidence established that an alleged loss had, in fact, occurred. But the evidence was insufficient in those Claims to demonstrate with a reasonable degree of certainty the amount of the loss'.[12] Thus, because the distinction between the fact and amount of the loss needs to be drawn, it is submitted the standard of 'reasonable certainty' applies to both the fact and amount of the loss.[13]

Like any other standard based on the notion of reasonableness, this rule is not capable of being precisely defined[14] and its meaning can only be determined by reference to a particular set of facts. The UPICC refer to the applicability of the standard to a 'harm'[15] and since no particular type of harm or loss is specified, it follows that any type of recoverable loss must be proved with 'reasonable certainty'.[16] The amount and types of evidence the injured party will be required to present are those which could be reasonably expected of the party taking into account the nature of the alleged loss and all relevant circumstances of the case.

It is probably true that, in general, it is more difficult to prove 'loss of profit' (*lucrum cessans*) than 'loss suffered' (*damnum emergens*). Proving lost profit often involves inquiry into a hypothetical future or past: in trying to prove loss

[10] See DL Goetz, KL Moore, DE Perry, DS Raab, and JS Ross, 'Article Two Warranties in Commercial Transactions: An Update' (1987) 72 Cornell L Rev 1159, 1247–1249.

[11] Case No T 171/95 District Court Saane (Switzerland) 20 February 1997 (Spirits case) <http://cisgw3.law.pace.edu/cases/970220s1.html>.

[12] United Nations Compensation Commission, Panel of the Commissioners, Panel F1, Recommendation S/AC.26, 23 September 1997 <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13621&x=1>.

[13] For the discussion of the question of whether the practice of US courts of flexibly applying the standard to the fact and amount of loss (ie, sometimes applying the standard to both aspects of the loss and sometimes applying the standard only to the fact of the loss) would be appropriate in the context of the instruments, see Saidov (n 1) 11–13.

[14] 'What is a "reasonable estimate" and what is "reasonable certainty"? No answer that is even "reasonably" definite can be made to such questions, in the abstract and unrelated to a specific set of facts . . . [I]n any living case, the "reasonableness" of anything must be determined by one or more specific living men whose judgment must necessarily depend upon their mental power, their own specific education and life experience, and their emotional characteristics and background' (AL Corbin, *Corbin on Contracts: A Comprehensive Treatise on the Working Rules of Contract Law* Vol 5 (St Paul, Minn, West Publishing Co, 2002) 107).

[15] See art 7.4.3(1) UPICC.

[16] The same is generally the case in the US law: 'The requirement with respect the certainty of proof is the same when the plaintiff is asking damages to reimburse his pecuniary losses as when he is asking damages to make up for gains prevented' (Corbin (n 14) 113).

of volume the seller may argue that had the buyer bought the goods it would have sold more than it in fact did, and a possibility of selling more goods will be linked either to hypothetical past or hypothetical future; where the buyer claims lost profits as a result of the breach of a long-term contract, it may be difficult in the absence of specific sub-sale contracts, to establish what profit margins, if any, the buyer would have received had there been no breach; the owner of a new manufacturing business may have difficulty proving lost profits it would have earned from reselling the final product had the seller delivered the contract goods. In all these cases, the question of whether loss has been suffered will depend on a number of factors such as future prices, relevant economic conditions, behaviour of third parties, etc. Because we do not possess perfect knowledge,[17] proving lost profits with 'reasonable certainty' in such cases can be difficult. By contrast, losses falling into the category of 'loss suffered', which refers to the diminution in party's existing assets and financial situation,[18] would involve fewer problems of proof because the party will often have records of costs incurred as a result of the breach.[19]

2.2 Proving 'loss suffered'

The buyer's liability to its sub-buyers arising from the seller's breach can be sufficiently established by presenting a settlement agreement or the sub-sale contract containing a relevant liquidated damages clause[20] together with a receipt of the payment issued by the sub-buyer.[21] Invoices have often been accepted by courts and tribunals as sufficient evidence of the expenses incurred as a result of the breach.[22] Documents issued by relevant organisations can also provide evidence of the costs incurred. For instance, a bank's report can verify that the buyer has incurred costs in opening a letter of credit or an auditing company's report can certify some other expenditure made.[23] Where the buyer had to pay a penalty

[17] See S Waddams, *The Law of Damages*, 4th edn (Toronto, Canada Law Book Inc, 2004) 517.

[18] See ch 3.

[19] Of course, this will not always be the case. It may well be the case that it is easier to prove lost profits than 'loss suffered' where, for instance, the buyer presents its sub-sale contract. By contrast, it may be far from easy for it to prove its costs caused by the breach if such costs will have to be incurred in the future.

[20] In one case under the CISG, a mere presentation of sub-sale contracts with no evidence of the actual payment of damages to sub-buyers has been held insufficient to establish the loss (see CIETAC Arbitration proceeding 7 July 1997 (Isobutanol case) <http://cisgw3.law.pace.edu/cases/970707c1.html>).

[21] See CIETAC Arbitration proceeding 7 April 1999 (PVC Suspension case) <http://cisgw3.law.pace.edu/cases/990407c1.html>.

[22] See Case No. 7 O 147/94 District Court Paderborn (Germany) 25 June 1996 (Granulated plastic case) <http://cisgw3.law.pace.edu/cases/960625g1.html>; ICC Arbitration Case No 7585 of 1992 (Foamed board machinery) <http://cisgw3.law.pace.edu/cases/927585i1.html>; ICC Arbitration Case No 7531 of 1994 (Scaffold fittings case) <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/947531i1.html>; ICAC Case 166/1995, decision dated 12 March 1996 <http://cisgw3.law.pace.edu/cases/960312r1.html>.

[23] See ICAC Case 166/1995 (n 22).

to customs authorities as a result of the seller's breach, the presentation of the decision issued by the authorities together with payment orders has been held sufficient to prove that loss.[24] Experts' reports have also been accepted as evidence of cost of curing the non-conformity.[25] Where the seller had to incur storage charges as a result of the buyer's failure to accept the delivery on time, receipts for the payment of storage fees were accepted as sufficient evidence of this loss.[26] Damage to reputation/goodwill[27] may be proved on the basis of records demonstrating the difference between the volume of sales and profits made before and after the loss,[28] testimony of competent witnesses,[29] the dependence of the buyer's business on contract goods,[30] testimony by former customers and other witnesses indicating that business was discontinued because of defective deliveries.[31] A good example of how damage to reputation can be demonstrated is provided by one US case where the buyer, whom the court found to have had an 'excellent reputation' in the industry before the breach, claimed that its reputation had been damaged. One piece of evidence related to the fact that one customer after becoming aware of the buyer's problems required the buyer to procure a performance bond before it would proceed with the project.[32]

[24] ICAC Case 85/2002, decision dated 26 June 2003 <http://cisgw3.law.pace.edu/cases/030626r1.html>.

[25] See Case No. 3 O 196/01 District Court Köln (Germany) 25 March 2003 (Racing carts case) <http://cisgw3.law.pace.edu/cases/030325g1.html>; see also *Srl RC v BVBA RT* Appellate Court Antwerp (Belgium) 27 June 2001 <http://cisgw3.law.pace.edu/cases/010627b1.html> (where the 'abstract' calculation of damages for non-conforming delivery, provided by an expert, was relied upon).

[26] See CIETAC Arbitration proceeding 30 December 2002 (Manganese case) <http://cisgw3.law.pace.edu/cases/021230c1.html>.

[27] See D Saidov, 'Damages to Business Reputation and Goodwill under the Vienna Sales Convention' in D Saidov and R Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (2008, Hart Publishing, Oxford) 403–5.

[28] See ICC Arbitral Award No 3880 of 27 September 1983, in S Jarvin and Y Derains, *Collection of ICC Arbitral Awards 1974–1985: Recueil Des Sentences Arbitrales De La CCI* (The Hague, Kluwer Law International, 1990) 161; Tampere Court of First Instance (Finland) 17 January 1997 (Canned food case) <http://cisgw3.law.pace.edu/cases/970117f5.html>; see also *NV Maes Roger v NV Kapa Reynolds* Appellate Court Gent (Belgium) 10 May 2004 <http://cisgw3.law.pace.edu/cases/040510b1.html> (where the lower instance found that the buyer 'could not realize sales and the quality problem led to cancelled or dismissed business relationships with the [b]uyer'. However, this finding was rejected by the Appellate Court).

[29] *Barrett Co v Panther Rubber Mfg Co* 24 F.2d 329, 337 (C.A.1 1928) ('The testimony of competent witnesses shows that the reputation of its product was high with jobbing trade . . .'); *Delano Growers' Cooperative Winery v Supreme Wine Co, Inc* 473 N.E.2d 1066, 1076 ('Supreme presented testimony of its former officers to support the evidence that Delano caused the injury to Supreme's business reputation'); *Simpson v Restructure Petroleum Marketing Services* 830 So.2d 480, 486 (La.App. 2 Cir., 2002).

[30] Tampere Court of First Instance, 17 January 1997 (n 28) ('the business activities of [the buyer] rested on the shoulders of Diamante products'); *Barrett Co v Panther Rubber* (n 29).

[31] Tampere Court of First Instance, 17 January 1997 (n 28); *Sol-O-Lite Laminating Corp v Thos W Allen* 223 Or. 80, 353 P.2d 843 ('Four customers who had done business with defendant . . . testified concerning their receipt of the defective material and how they had reduced or terminated their dealings because of it'); *Davidson v Barclays Bank* [1940] 1 All ER 316, 324.

[32] *Marvin Lumber and Cedar Company, Marvin Windows of Tennessee, Inc v PPG Industries, Inc* 401 F.3d 901, 913 (C.A.8 (Minn.), 2005).

2.3 Proving loss of profit

The difficulty of satisfying the standard of 'reasonable certainty' in proving lost profits may depend on a capacity, and a situation, in which the injured party has acted.[33] It has been suggested, for example, that the problem of proving lost profits rarely arises where the seller is not in a lost volume situation (ie where its ability to supply does not exceed demand for the goods)[34] because its losses depend on either the resale ('concrete' formula) or the current ('abstract' formula) price.[35] Once the hurdle of establishing the relevant price is overcome,[36] loss of profit can be easily established with 'reasonable certainty' because it can be calculated as the difference between the contract price and the resale[37] or market price.[38] There are cases, however, where neither the 'concrete' nor the 'abstract' formula fully eliminates the problem of proving lost profits. Suppose that the seller intended to invest the purchase price into a potentially profitable venture shortly after the due date for payment. If damages under the 'concrete' or 'abstract' formula are awarded later than the time when the seller could have made an investment, the seller could argue that the damages awarded do not compensate it fully for lost profit it would have received otherwise: while it was compensated for the loss of 'profit margin', the award does not take into account lost profit it *could* have earned had an investment been made.[39] Where this is the case, the seller's burden of proving its lost profit is not fully discharged by meeting the requirements of either the 'concrete' or 'abstract' formula (whichever is applicable) because it will also have to prove that it would have made an investment and thereby would have made an additional profit.

It will be more difficult to meet the 'reasonable certainty' requirement where the seller is in a 'lost volume' situation where its capacity to supply exceeds the demand for the goods and where, as a result of the buyer's breach, it has sold fewer goods than it would have sold otherwise. Even if it resells the goods to a third party, it can argue that this transaction would have been made even if the buyer had performed. As discussed above, the seller will have to prove that: its capacity exceeds the demand for the goods; even if the buyer had performed the

[33] See EA Farnsworth, *Contracts*, 4th edn (New York, Aspen Publishers, 2004) 801–03; Comment, 'Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery' (1955–1956) 65 Yale L J 992, 1000–15.

[34] See Farnsworth (n 33) 801.

[35] See *ibid*.

[36] See ch 8.

[37] In one case under the CISG, the resale contract price was proved by presenting a resale contract supported by a witness statement of the buyer in the resale transaction (see ICC Arbitration Case No 10274 of 1999 (Poultry feed case) <http://cisgw3.law.pace.edu/cases/990274i1.html>).

[38] See arts 75, 76 CISG, 7.4.5, 7.4.6 UPICC, 9:506, 9:507 PECL. For a detailed discussion of these methods of calculation, see ch 8.

[39] As discussed in the next chapter, to avoid double compensation it must be taken into account that the margin received from the buyer was, in the sense, the 'price' the seller would have paid to make a profit on the investment (see ch 8).

contract, it would have been able to sell more goods than it did due to the breach; the additional sale would have been profitable.[40]

It has been argued that few difficulties of proving loss arise in the case of a buyer who buys a fixed quantity of goods for prompt delivery because, once again, the 'concrete' and 'abstract' methods of calculation reduce the difficulty of proof.[41] At this point, it is relevant to note that, in contrast with the injured seller, these methods of calculation compensate the buyer not for loss of profit but for the non-receipt of the goods: the difference between the contract price and either the re-purchase or current price compensates the buyer for the higher amount of money it had to pay or will have to pay to purchase substitute goods. This compensation, however, will usually be sufficient to fully compensate the buyer because it now has the goods on hand (or is in the position to purchase them) and can therefore make the planned profit on a sub-sale. The only difficulties of proof the buyer will face are those relating to proving a cover purchase[42] or the current price.[43] In some cases, however, despite having obtained substitute goods the buyer may still suffer loss of profit. Suppose that the need to make a cover purchase has caused delay in reselling the goods and the buyer now has to reduce the resale price because the goods were seasonal in nature. To prove its loss of profit, the buyer will need to demonstrate that had the seller performed the contract, it would have been able to sell the goods at a higher price and, in such cases, an original sub-sale contract and evidence of an arrangement whereby the sub-buyer accepted the goods at reduced prices may be sufficient to prove the buyer's loss of profit. The buyer may also suffer loss of profit where the seller provides non-conforming goods but the buyer accepts the delivery and manages to resell the goods at a lower price than initially planned and resale contracts, bills of lading, and relevant tax invoices have been accepted by some tribunals as sufficient evidence of such a resale.[44] Similarly, it may be the case that because the goods were needed for resale at a specific time, the buyer has to

[40] For a detailed discussion, see ch 3.

[41] Farnsworth (n 33) 801.

[42] See Case No. 21 O 703/01(028) District Court Braunschweig (Germany) 30 July 2001 (Metal case) <http://cisgw3.law.pace.edu/cases/010730g1.html> (where the buyer has proved a substitute transaction by presenting a number of documents including a contract with the buyer's subsidiary for the purchase of substitute goods, 'packing list' certifying that the goods had been packed and were ready for shipment to the destination, invoices, transportation documents, and certificates of the receipt of the goods at the destination); Case No. 411 O 199/02 District Court Hamburg (Germany) 26 November 2003 (Phtalic anhydride case) <http://cisgw3.law.pace.edu/cases/031126g1.html> ('The fact that in the sales contract . . . with Company H the date given is the 29th of March 2003 is readily consistent with the submission of the Buyer that this contract was signed on 2 April 2002—after the additional period of time (*Nachfrist*) given to the Seller had expired. The shipment dates of the bills of lading . . . do not conflict with the substitute purchase having been concluded on 2 April 2002, since according to the submission of the Buyer it was a purchase of goods already on water. Even if it might appear unusual that the conditions of a "Local Letter of Credit" did not allow a ninety-day period and fell considerably short of the payment goal of ninety days agreed upon for the substitute purchase, the court does not doubt the truthfulness of the substitute purchase in its overall evaluation.')

[43] See ch 8.

[44] CIETAC Arbitration proceeding, 7 April 1999 (n 21).

reduce the price to persuade the sub-buyers to accept late delivery. In one such case involving the sale of shoes, the court stated that the buyer ought to have provided:

> a detailed account of which consignment of shoes she had firmly sold at what price, to which customers and, with which stipulated times of delivery; further, at what point in time she received the shoes from the [seller] and forwarded them to her customers. Finally, [the buyer] would have had to submit that her customers were entitled under their contracts to refuse acceptance of the goods based on late delivery.[45]

Finally, proving lost profit with 'reasonable certainty' is likely to be most difficult in the case of long-term contracts where resolving the question of whether or not the buyer has suffered loss of profit will involve inquiry into a number of factors (often unknown at the time of proceedings) including: future price levels[46] and demand for the goods, quantity of the goods to be sold, the buyer's ability to resell the goods, state of competition in a relevant trade sector of trade concerned, etc. One helpful way of determining loss with 'reasonable certainty' could be to examine the buyer's past business experience[47] and if the conditions in which the buyer made profits in the past are similar to the present conditions and to those which can be reasonably expected to surround the buyer's business in the future, then a reasonable estimation of loss can in some cases be made by reference to the buyer's past dealings. This approach has already been taken in international arbitration practice. In a case where a UK importer had brought a claim against a Hungarian export company for non-delivery, the tribunal stated that the 'estimation of a loss of profit is mainly based on expectation of the future. In this context the Tribunal has to start taking into account the history of developments in the past'.[48] The injured buyer can of course argue that its business has grown in comparison with the volume in its previous dealings and therefore it is entitled to higher profits than those received in the past. In such a case, the buyer will have to present strong evidence to support this argument and 'mere commercial optimism'[49] is unlikely to be sufficient. For example, in another arbitration case (governed by Lebanese law) where a Lebanese distributor claimed damages for breach of contract against a Western European car manufacturer, the tribunal stated that:

[45] Case No. 7b O 142/75 District Court Münster (Germany) 24 May 1977 (Shoes case) <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/770524g1.html> (decided on the basis of the ULIS).

[46] See CIETAC Arbitration proceeding 19 January 2003 (Ferrochrome case) <http://cisgw3.law.pace.edu/cases/030119c1.html> ('The Buyer submitted its internal production cost calculation schedule and three sales invoices . . . The Arbitration Tribunal holds that [the] internal production cost calculation schedule is for its internal use only; the Buyer did not provide the relevant contract and the market price of the same kind to sustain the sales price which it alleged.')

[47] See, eg, McCormick (n 7) 107; Corbin (n 14) 126; Note, 'The Requirement of Certainty in the Proof of Lost Profits' (1950) 64 Harv L Rev 317, 319).

[48] ICC Case No 5418 (n 90) 131.

[49] This statement was made in *ibid*, 132.

> the Lebanese distributor had claimed as damages . . . 3 years of lost profit based on the profit in 1961, and alternatively, based on the average of the last 3 years. Although it was not contested that the sales of the claimant had gone up, the automotive sales market was too uncertain to apply the first alternative.[50]

Having regard for comparable business is another factor which can help determine lost profits with 'reasonable certainty'. If there are businesses which carry out a similar commercial activity and operate under similar circumstances, evidence relating to the profitability of such businesses may shed some light on what the party's future profits would have been had the contract been performed.[51] A state of competition in the relevant trade sector can also provide some guidance in this respect because if the claimant would have faced fierce competition in selling the goods if the contract had been performed, this fact would demonstrate potential difficulties that the party would have encountered in selling the goods. At the same time, the party's past business experience could demonstrate it has successfully withstood the competition.[52]

3. JUDICIAL DISCRETION

The UPICC confer the power on a court to assess damages at its own discretion where losses cannot be established with the required degree of certainty.[53] The comments on the UPICC explain that this provision has been introduced to empower the court 'to make an equitable quantification of the harm sustained' as opposed to 'refus[ing] any compensation or award[ing] nominal damages'.[54] The main difficulty with this provision is the uncertainty it generates regarding the circumstances in which courts and tribunals will exercise their discretion. It is submitted that a threshold for invoking this provision must still be high. First of all, courts and tribunals must be convinced that the injured party has indeed suffered the alleged loss. Courts and tribunals must also ensure that all reasonably available evidence has been presented and that their discretion is exercised within the confines of such evidence. This suggestion is in line with the way the UPICC have thus far been interpreted. In one case,[55] the tribunal was convinced that some loss has been suffered despite the fact that damages in question

[50] ICC Arbitration Case No 1250 of May 1964 (see *Collection of ICC Arbitral Awards 1974–1985: Recueil des Sentences Arbitrales de la CCI* (compiled by S Jarvin and Y Derains) (Kluwer Law International, The Hague 1990) 32).

[51] See *Ginza Pte Ltd v Vista Corporation Pty Ltd* [2003] WASC 11, Supreme Court of Western Australia 17 January 2003, also at <http://cisgw3.law.pace.edu/cases/030117a2.html> (where the court specifically asked a counsel of one of the parties about whether any assessment of comparable businesses has been carried out (for the purposing of assessing damage to goodwill)).

[52] See Note (n 47) 321.

[53] 'Where the amount of damages cannot be established with a sufficient degree of certainty, the assessment is at the discretion of the court' (art 7.4.3(3) UPICC).

[54] Comment 2 on art 7.4.3 UPICC.

[55] See ICC Arbitration Case No 5835 of June 1996 <http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13618>.

fell 'into the category of damages which normally not established . . . in an arithmetically satisfactory manner'. In another case,[56] the tribunal expressly stated that the claimant had suffered some loss despite its failure to prove it with 'reasonable certainty'. The tribunal stated that 'in exercising such discretion, the Panel took into account the level and type of evidence that should reasonably be required of a Claimant given the overall circumstances at the time of the loss'.[57] In yet another case, the tribunal explained that:

> This discretion in the assessment of damages operates . . . within the confines of a scrupulous examination of the evidence presented by the Parties. The Tribunal continues to operate within a frame defined by the law, and specifically must avoid acting as an amiable compositeur (which powers the present Tribunal does not have).[58]

4. STANDARDS OF PROVING LOSSES AND DETERMINING THE AMOUNT OF DAMAGES UNDER THE CISG

4.1 General

The CISG is silent as to the standards of proving loss and determining the amount of damages similar to those in the UPICC.[59] To decide whether a particular matter should be dealt with by the CISG, it needs to be determined, first of all, whether this matter is governed by the Convention and, if so, where there is any relevant general principle which could resolve it.[60] If the matter is not governed by the Convention or if no relevant general principle can be found, the matter will be dealt with by law applicable by virtue of private international law.[61] These guidelines have certainly been insufficient to achieve anything even remotely reminiscent of uniformity and the discussion of the CISG, in both cases and scholarly writings, reveals different approaches to dealing with the issues of standards of proving losses and determining the amount of damages among which the following can be identified.

[56] See United Nations Compensation Commission (n 12) (see also accompanying text).

[57] *Ibid.*

[58] ICC Arbitration Case No 9950 of June 2001 <http://www.unilex.info/case.cfm?pid=2&do=case&id=1061&step=FullText>.

[59] See Commercial Court Zürich (Switzerland) 10 February 1999 ('The CISG does not determine which degree of certainty is necessary for a judge to form his or her profit hypothesis'); Case No. HG 970238.1 District Court Saane (Switzerland) 20 February 1997 ('CISG does not provide any principle regarding damages whose exact figure is not verifiable') (Art books case) <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/990210s1.html>.

[60] Article 7(2) CISG.

[61] *Ibid.*

4.1.1 The matter is a procedural issue outside the CISG

Article 4 CISG states that the Convention governs only the issues of formation of contracts and substantive law[62] and the matters of procedural law have often been treated as being outside the CISG.[63] In this regard, the question of whether the standards of proving loss and determining the amount of damages are a matter of substantive or procedural law may be of some importance in terms of deciding whether it is a matter governed by the Convention. Thus, it has been argued that because the issue of certainty with which loss needs to be proved is a matter of procedural law, it is beyond the scope of the CISG and needs to be dealt with on the basis of the applicable law.[64] This approach has been taken in several cases under the CISG.[65] In one case, for example, the court stated, with reference to s 54 of the Swiss Code on Civil Procedure, that '[s]ubmissions must be clear, complete and definite'.[66] In another case, the court relied on the domestic civil procedural rules according to which 'any contention of a party is sufficiently substantiated, if . . . it is detailed to such an extent that a court is in a position to take evidence on that allegation'.[67] In some other cases, courts have exercised their discretion in determining the amount of damages derived from domestic procedural rules and it is submitted that these cases can also be regarded as examples of where determining the amount of damages has been regarded as a matter of domestic procedural law. For example, in several cases

[62] See art 4 CISG ('This Convention governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract'). See Case No. VIII ZR 121/98 Federal Supreme Court (Germany) 24 March 1999 (Vine wax case) <http://cisgw3.law.pace.edu/cases/990324g1.html>; *FCF SA v Adriafil Commerciale Srl* Supreme Court (Switzerland) 15 September 2000 <http://cisgw3.law.pace.edu/cases/000915s1.html>.

[63] See Federal Supreme Court (Germany) 24 March 1999 (n 62); Supreme Court (Switzerland) 15 September 2000 (n 62).

[64] See J Lookofsky, *Consequential Damages in Comparative Context: From Breach of Promise to Monetary Remedy in the American, Scandinavian and International Law of Contracts and Sales* (Danmarks Jurist, Copenhagen 1989) 283, note 158; H Bernstein and J Lookofsky, *Understanding the CISG in Europe: A Compact Guide to the 1980 United Nations Convention on Contracts for the International Sale of Goods*, 2nd edn (The Hague, Kluwer Law International, 2003) 144; EC Schneider, 'Consequential Damages in the International Sale of Goods: Analysis of Two Decisions' <http://www.cisg.law.pace.edu/cisg/wais/db/articles/schnedr2.html>.

[65] Case No A98/126 District Court Sissach (Switzerland) 5 November 1998 (Summer cloth collection case) <http://cisgw3.law.pace.edu/cases/981105s1.html>.

[66] See Commercial Court Zürich, 10 February 1999 (n 59). Although this standard has not been stated in the part of the decision (para 2(d) of the decision) which has dealt with damages, it seems that it was the standard the court had in mind when it held (para 3.1(b) of the decision) that 'the [buyer]'s submissions regarding the damage . . . do not come close to a sufficient substantiation'.

[67] *DT Ltd v B AG* Commercial Court St. Gallen (Switzerland) 3 December 2002 (reference has been made to § 56 of Swiss Code on Civil Procedure) <http://cisgw3.law.pace.edu/cases/021203s1.html>. See also District Court Sissach (Switzerland) 5 November 1998 (n 65) ('law of evidence is determined by the *lex fori*, as the law of evidence belongs to the procedural law. Therefore, each Court applies its own law of evidence'); Case No. CI 04 162 Appellate Court Valais/Wallis (Switzerland) 21 February 2005 (CNC machine case) <http://cisgw3.law.pace.edu/cases/050221s1.html>; Case No 32 O 508/04 District Court Bayreuth (Germany) 10 December 2004 (Tiles case) <http://cisgw3.law.pace.edu/cases/041210g1.html>; Hamburg Arbitration proceeding, Partial award of 21 March 1996 (Chinese goods case) <http://cisgw3.law.pace.edu/cases/960321g1.html>.

judges and arbitrators relied on s 287 of the German Code of Civil Procedure which granted the power to evaluate damages.[68] A similar approach has been taken in another case where the tribunal stated that:

> the arbitrator fixes the . . . amount of damages at his discretion . . .The legal basis for such a discretionary determination of the amount of damages is sec. 273 of the Austrian Code of Civil Procedure, which is also applicable within the scope of the CISG.[69]

As has been correctly pointed out, judicial discretion may exist not only within the framework of rules governing the extent of recoverable damages, but also *as a substitute for such rules*[70] and the latter category of cases seems to be precisely of this nature (ie, where judicial discretion is, in a sense, a legal standard for determining the amount of damages).

4.1.2 Not all procedural issues are outside the scope of the CISG

It is also possible to take a more flexible approach by not regarding every procedural issue as being outside the CISG. As one commentator has suggested, 'the CISG may indirectly govern procedural matters'.[71] This suggestion finds support in cases under the CISG touching upon the allocation of burden of proof—an issue which is often regarded as procedural and which has been viewed, by the majority of courts and commentators, as governed by the CISG.[72] Therefore, it may still be possible for standards of proving losses and determining the amount of damages to fall within the Convention's scope even if they are regarded as a procedural issue. If this is the case, the next step is to find a general principle capable of establishing a relevant standard. Otherwise

[68] See Case No. 5 O 543/88 District Court Hamburg (Germany) 26 September 1990 (Textiles case) <http://cisgw3.law.pace.edu/cases/900926g1.html>; Hamburg Chamber of Commerce, Partial award of 21 March 1996 ('National law, including the tribunal's power to evaluate [damages], laid down in Sect. 287 ZPO, applies to determination of damages'), *ibid*; ICC Arbitration Case No 8611/HV/JK of 23 January 1997 (Industrial equipment case) <http://cisgw3.law.pace.edu/cases/978611i1.html> ('the arbitrator must be free to judge the damages following his own convictions on the basis of the known data and on the assumption of a normal course of business (see Art. 287 of the German Civil Procedural Code)').

[69] Vienna Arbitration proceeding SCH-4318, decision dated 15 June 1994 (Rolled metal sheets case) <http://cisgw3.law.pace.edu/cases/940615a4.html>.

[70] See Treitel (n 2) 174.

[71] P Schlechtriem, 'Arts. 1–6 CISG' in P Schlechtriem and I Schwenzer (eds), *Commentary on the UN Convention on the International Sale of Goods (CISG)*, 2nd (English) edn (OUP, Oxford 2005) 72.

[72] See, eg, *Rheinland Versicherungen v Srl Atlarex and Allianz Subalpine SpA* District Court Vigevano (Italy) 12 July 2000 <http://cisgw3.law.pace.edu/cases/000712i3.html>; Commercial Court Zürich (Switzerland) 10 February 1999 (n 59); for the most recent statements to this effect in scholarly writings, see I Schwenzer and P Hachem, 'The Scope of the CISG Provisions on Damages' in Saidov and Cunnington (n 27) 98; A Mullis, 'Twenty-Five Years On—The United Kingdom, Damages and the Vienna Sales Convention' (2007) 71 Rabels Zeitschrift für ausländisches und internationales Privatrecht 35, 48.

the applicable standard will have to be found by reference to the rules of private international law.[73]

4.1.3 The standards of proving loss and determining the amount of damages are a matter of substantive law

Even if procedural issues are outside the scope of the CISG, the standards of proving loss and determining the amount of damages may still be within its scope if they are treated as an issue of substantive law. Although they may, at the first sight, appear to be a procedural issue, the distinction between procedural and substantive law is not clear-cut for 'there exists no systematic abstract criterion that would enable a given case to be classified unequivocally and rationally as being either of a "procedural" or a "substantive" nature'.[74] It is also worth pointing out that standard of proving loss is regarded as part of the substantive law by such well known restatements of contract law as the UPICC[75] and US Restatement (Second) of Contracts.[76] On the basis of these considerations, it can be argued that even if the CISG does not govern the issues of procedural law, one way of bringing the issue of the standards of proving loss and determining the amount of damages into the scope of the CISG is to argue that it is a matter of substantive law[77] and then to find a general principle capable of developing the relevant standard.

4.1.4 The CISG governs the issue of proving loss and contains relevant requirements

In a number of cases under the CISG, the Convention appears to have been interpreted as containing a specific standard of proof. In one case the court stated that '[u]nder Art. 74 CISG, the [buyer] would have to exactly calculate her damage'.[78] In another case, the CISG was interpreted as requiring that damages be calculated 'precisely'.[79] One court stated that '[a] damages claim according to Art. 74 CISG

[73] Article 7(2) CISG.

[74] See CG Orlandi, 'Procedural Law Issues and Law Conventions' (2000) 5 Uniform L Rev 23, also at <http://www.cisg.law.pace.edu/cisg/biblio/orlandi.html> (with further reference).

[75] See art 7.4.3(1).

[76] See s 352.

[77] Regarding the standards of proving loss and determining the amount of damages as a matter of substantive law does not of course guarantee that courts and tribunals will inevitably view the issue as falling within the Convention because they can still regard it as falling outside its scope. This approach seems to have been taken in a case under the CISG decided by a US court. The court stated that '[i]n conformity with *the common law*, to recover a claim for lost profit under UNCCISG, a party must provide the finder of fact with sufficient evidence to estimate the amount of damages with reasonable certainty' (*Delchi Carrier SpA v Rotorex Corporation* 1994 WL 495787 (emphasis added)).

[78] Case No 3 U 246/97 Appellate Court Celle (Germany) 2 September 1998 (Vacuum cleaners case) <http://cisgw3.law.pace.edu/cases/980902g1.html>.

[79] See Case No 22 U 4/96 Appellate Court Köln (Germany) 21 May 1996 (Used car case) <http://cisgw3.law.pace.edu/cases/960521g1.html>.

. . . necessitates a specific ascertainment of damage'.[80] Similarly, one tribunal held that under the CISG the claimant 'must substantiate and strictly prove the existence and exact amount of its damage'.[81] Two comments need to be made in relation to these decisions. First, this approach to interpreting the CISG may be welcomed by those who believe that there is no fundamental objection to the 'creative development of the Convention's written rules [as] it is justified by the need to promote uniformity of interpretation'.[82] However, these decisions can be criticised for failing to demonstrate how judges and arbitrators arrived at their conclusions. Nowhere does the CISG mention such standards and it is suggested that this approach is dangerous because if followed, it will encourage courts and tribunals to read into the CISG the rules which it simply does not contain. Second, the meaning of such standards as 'precise', 'exact', or 'specific' ascertainment of damages is not clear. Are they, for example, similar to the 'reasonable certainty' standard in the UPICC or do they require proving loss with mathematical precision and absolute certainty? The latter is most likely to be a correct answer and if this is true, these standards can be criticised because, as recognised by different legal systems,[83] it is rarely possible for losses to be proved with mathematical certainty. Imposing such a high standard of proof is likely to diminish the level of protection damages afford to the injured party and this is likely to deter business persons from applying the CISG thereby impeding the Convention's aspiration of becoming a uniform sales law instrument.

4.1.5 Relying on non-national sources of law

Some decisions under the CISG have introduced an interesting approach by holding that the amount of damages was to be determined *ex aequo et bono*.[84] The concept of *ex aequo et bono* is generally understood as '[a]ccording what is equitable and good'.[85] In the context of international law, it has been said that '[a] decision-maker . . . who is authorized to decide *ex aequo et bono* is not

[80] Case No 10 O 5423/01 District Court München (Germany) 20 February 2002 (Shoes case) <http://cisgw3.law.pace.edu/cases/020220g1.html>.

[81] ICC Arbitration Case No 9187 of June 1999 (Coke case) <http://cisgw3.law.pace.edu/cases/999187i1.html>.

[82] R Herber, 'Preamble and Arts. 1–7 CISG' in P Schlechtriem (ed) *Commentary on the UN Convention on the International Sale of Goods (CISG)*, 2nd edn (in translation) (Oxford, Clarendon Press, 1998) 65–66.

[83] See, eg, Treitel (n 2) 192 ('[m]ost systems of law impose some requirement as to "certainty" of damage, but the requirement is not in any of them regarded as an absolute one').

[84] District Court Hasselt (Belgium) 18 October 1995 <http://www.unilex.info/case.cfm?pid=1&do=case&id=266&step=Abstract>); *Vital Berry Marketing NV v Dira-Frost NV* District Court Hasselt (Belgium) 2 May 1995 <http://cisgw3.law.pace.edu/cases/950502b1.html>; *Steinbock-Bjonustan EHF v NV Duma* District Court Kortrijk (Belgium) 4 June 2004 <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/040604b1.html>; *JM Smithuis Pre Pain v Bakkkershuis* Commercial Court Hasselt (Belgium) 20 September 2005 <http://cisgw3.law.pace.edu/cases/050920b1.html>.

[85] See BA Garner (ed), *Black's Law* Dictionary, 7th edn (St Paul, Minn, West Publishing Co, 1999) 581.

bound by legal rules and instead follow equitable principles'.[86] One commentator has also referred to several definitions of *ex aequo et bono* that have been given in legal literature:

> 'The power to decide ex aequo et bono . . . is generally considered as an authorization to act contra legem, to depart from the law, to change the law, to accept a claim not recognized by the law or to reject a claim based on the law.' To decide ex aequo et bono is to seek a 'resolution . . . that is equitable, minimizes harm to either party, and enables potential adversaries to maintain a valuable commercial relationship; the role of such an arbitrator is said . . . to be that of an amiable compositeur.' 'The amiable compositeur is in fact a judge, but one who enjoys greater flexibility in adopting a solution . . ., even though from a strictly legal point of view [the solution] may not be . . . correct.'[87]

Deciding matters *ex aequo et bono* is not a rare phenomenon in international commercial arbitration (and sometimes even features in the decisions of national courts as the cases referred to above demonstrate). It is submitted that the CISG would only allow determining damages on this basis where the parties agreed on such a determination in their contract, thereby derogating from the Convention's rules on damages,[88] or if the matter of proving loss and determining damages fell outside the Convention (or if there were no relevant general principle) and the applicable rules allowed damages to be thus fixed.[89]

4.1.6 Judicial discretion not based on any legal principle

Courts and tribunals sometimes exercise their discretion in fixing damages which is not derived from any legal basis. For example, in one case (governed by Hungarian law) the tribunal stated that in 'international arbitration cases the tribunal is not bound by specific rules for the taking of evidence provided that both parties were allowed to present their case'.[90] A similar approach appears to have been taken in some other cases where the arbitrators' award of damages was explained in terms of the amount being 'sufficiently proven',[91] 'plausible and trustworthy',[92] 'proven to [the tribunal's] satisfaction',[93] or

[86] See *ibid*, 581.

[87] PJ McConnaughay, 'Rethinking the Role of Law and Contracts in East-West Commercial Relationships' (2001) 41 Virginia J Intl L 470, with further references.

[88] See art 6 CISG.

[89] See, eg, art 17(3) of the ICC Rules of Arbitration 1998 ('The Arbitral Tribunal shall assume the powers of an *amiable compositeur* or decide *ex aequo et bono* only if the parties have agreed to give it such powers'); art 22.4 of the LCIA Rules 1998 ('The Arbitral Tribunal shall only apply to the merits of the dispute principles deriving from "ex aequo et bono", "amiable composition" or "honourable engagement" where the parties have so agreed expressly in writing'). For the discussion of the possible reliance on some other non-domestic sources of law, see Saidov (n 1) 60–63.

[90] ICC Arbitration Case No 5418 of 1987 (see *Collection of ICC Arbitral Awards 1986–1990: Recueil des Sentences Arbitrales de la CCI 1986–1990* (compiled by S Jarvin, Y Derains, and JJ Arnaldez) (The Hague, Kluwer Academic Publishers Group, 1994) 134).

[91] See ICC Case No 6076 of 1989 (see *ibid*, 246).

[92] See ICC Case No 5294 of 22 February 1988 (see *ibid*, 188).

[93] See ICC Case No 3572 of 1982 (see *ibid*, 163).

'appropriate'[94] with no reference to any legal standard. There are many cases under the CISG where similar statements have been made. For example, determining the amount of damages has been discussed in terms of being 'reasonable',[95] 'sufficiently proved'[96] or supported by 'sufficient evidence',[97] or substantiated 'in detail'[98]; and, once again, these statements did not seem to be based on any legal standard. Clearly, if the standard of proving losses and determining the amount of damages is a matter governed and capable of being resolved by the CISG, such an approach cannot be correct. It is only where the matter is outside the CISG, that courts and tribunals *may* have a power to do so.[99]

4.2 The matter is governed and capable of being resolved by the CISG

In the light of this non-uniform treatment, it is submitted that standard of proof is a matter that is governed by the CISG.[100] First, art 74 CISG undoubtedly requires the injured party to prove its loss. Second, the issue of proving loss and determining the amount of damages is an integral part of the *exercise* of the right to damages. The right to damages is expressly governed by the Convention and if determining a relevant standard of proof were held to be a matter outside the Convention's scope, this would mean that not only the *exercise* of the right to damages *under the CISG* would be non-uniform but also that the implementation of policies and considerations underlying the law of damages as a whole would be undermined. The CISG contains a relevant general principle of reasonableness[101] which is capable of developing an appropriate standard of proof: it can be argued that because it will often not be possible for the injured party to prove its losses with absolute precision what should be required is that loss be proved only with such a degree of precision which can be *reasonably* expected

[94] See ICC Arbitration Case No 6829 of 1992 (see *Collection of ICC Arbitral Awards 1991–1995: Recueil des Sentences Arbitrales de la CCI 1991–1995* (compiled by JJ Arnaldez, Y Derains, and D Hascher (The Hague, Kluwer Academic Law Publishers, 1997) 282).

[95] See Case No 95/3214 District Court of Kuopio (Finland) 5 November 1996 (Butter case) <http://cisgw3.law.pace.edu/cases/961105f5.html>; post-1989 CIETAC Arbitration proceeding (*Contract #QFD890011*) (*Cloth wind coats case*) <http://cisgw3.law.pace.edu/cases/900000c1.html>.

[96] See CIETAC Arbitration proceedings 1995 <http://www.unilex.info/case.cfm?pid=1&do=case&id=210&step=Abstract >; *SA P v AWS* Tribunal de Commerce Namur (Belgium) 15 January 2002 <http://cisgw3.law.pace.edu/cases/020115b1.html>.

[97] See Case No 7 O 43/01 District Court Göttingen (Germany) 20 September 2002 (Mattresses and bedding accessories case) <http://cisgw3.law.pace.edu/cases/020920g1.html>.

[98] See Case No 12 U 62/97 Appellate Court Hamburg (Germany) 5 October 1998 (Circuit boards case) <http://cisgw3.law.pace.edu/cases/981005g1.html>.

[99] For further discussion, see Saidov (n 1) 65–67.

[100] This position is now increasingly gaining acceptance in scholarly writings, see CISG Advisory Council (CISG-AC) No. 6 'Calculation of Damages under CISG Article 74' <http://www.cisg.law.pace.edu/cisg/CISG-AC-op6.html>; Schwenzer and Hachem (n 72) 99; Mullis (n 72) 49; J Gotanda, 'Using the UNIDROIT Principles to Fill Gaps in the CISG', in Saidov and Cunnington (n 27) 119.

[101] See, eg, AH Kritzer, 'Reasonableness', <http://www.cisg.law.pace.edu/cisg/text/reason.html#schl> (with further references).

of this party taking into account all circumstances of the case. In other words, the party must prove its losses with a 'reasonable degree of certainty'. Because the CISG is capable of developing this standard, it is unnecessary to use the 'reasonable certainty' standard in art 7.4.3 UPICC to supplement the CISG in this respect. Nevertheless, the UPICC can help formulate this standard under the CISG with greater precision and further inform our understanding of it.[102]

5. LOSS OF A CHANCE AND JUDICIAL DISCRETION

As discussed above, the UPICC contain some other mechanisms for dealing with uncertainty of losses such as the possibility of claiming damages for loss of a chance and exercising judicial discretion. It has been argued in an earlier chapter that loss of a chance is a recoverable loss under both the CISG and the PECL for two reasons.[103] First, there are good reasons for treating a chance as an important 'asset' in commercial transactions which should be afforded legal protection. The second reason is based on the recognition that loss of a chance is also a standard of proving losses. From this standpoint, it has been argued that the recoverability of loss of a chance should be possible if we take a liberal approach to damages which disfavours an 'all-or-nothing' result in awarding damages and aims to strike a fair balance between the interests of both parties. The UPICC carry this liberal policy even further by allowing damages to be assessed at the discretion of the court where the injured party cannot prove its loss with sufficient certainty and/or its lost chance to profit. The difficult question is whether the interpretation of the CISG and PECL can be stretched that far and it is submitted that in principle, this standard of determining damages can be developed under these instruments. In fact, as some cases under the CISG demonstrate,[104] this is what judges and arbitrators sometimes do anyway where

[102] See J Gotanda, 'Using the UNIDROIT Principles to Fill Gaps in the CISG' in Saidov and Cunnington (n 27) 120. The position under the PECL is not entirely clear. The official comments to the PECL acknowledge that the European legal systems 'generally require a sufficient degree of 'certainty' of loss in order to award damages' (O Lando and H Beale (eds), *Principles of European Contract Law: Parts I and II*, prepared by the Commission on European Contract Law (The Hague, Kluwer Law International, 2000) 442). How should this statement be interpreted? Was it the drafters' intention to leave the matter to domestic law otherwise applicable or were the PECL intended to cover the issue of standard of proof precisely because it would seem to be a common feature of European legal systems that losses need to be proved with a 'sufficient degree of certainty'? In principle, it would seem that the analysis presented above in relation to the CISG can be equally applicable to the PECL (see arts 1:106, 1:302; see also comments on art 1:302 explaining that various provisions of the PECL are based on the notion of reasonableness).

[103] See ch 3.

[104] See District Court Saane, 20 February 1997 (n 59) (where although the exact amount of damages could not be established, the court was persuaded that the seller had suffered some loss); CIETAC Arbitration proceeding 5 February 1996 (Peanut case) <http://cisgw3.law.pace.edu/cases/960205c1.html> ('the Arbitration Tribunal deems that the Buyer's claim for a price difference . . . and interest on this amount is not supported by sufficient evidence and should not be accepted. However, considering that . . . the Seller's failure to deliver the goods deprived the Buyer of its expectation for making a profit . . . [t]he Arbitration Tribunal deems that a reasonable sum for

they feel that the consideration of fairness dictates that despite the injured party's inability to prove losses, it has suffered some loss. While an exercise of such discretionary powers should be viewed as exceptional and subject to the considerations set out above in relation to the UPICC, this approach is nevertheless nothing more than a continuation of the instruments' policy of striking a fair balance between the interests of both parties.[105]

compensation is 1/3 of the price difference claimed by the Buyer'); CIETAC Arbitration proceeding 27 April 2000 (Wool case) <http://cisgw3.law.pace.edu/cases/000427c1.html> ('the Arbitration Tribunal holds that based on principles of equity, the Buyer shall compensate certain amount to the Seller, and US $10,000 would be reasonable.'); for an example of an approach where a tribunal simply split losses on what presumably seemed equitable to the tribunal, see CIETAC Arbitration proceeding 31 December 1996 (High carbon tool steel case) <http://cisgw3.law.pace.edu/cases/961231c2.html>.

[105] See, eg, M Will, 'Arts. 45–52 CISG' in CM Bianca and MJ Bonell, *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Milan, Giuffrè, 1987) 379; the same spirit undoubtedly emanates from a number of provisions of the PECL (see arts 1:106, 1:201, 1:202).

8

Calculation of Damages (Part I)

1. GENERAL

ONCE IT IS known for what losses damages need to be awarded, those losses need to be translated into monetary terms.[1] Labels used to describe this process are many and include such terms as 'quantum', 'quantification', 'measure', 'assessment', and 'calculation'.[2] The purpose of this chapter is to identify and discuss various methods of translating losses into money terms which can be used under the international instruments. Before embarking upon an examination of the specific methods of calculating damages, it may be helpful to briefly outline a general structure of the instruments' damages provisions insofar as it is relevant to the issue of calculation. The structure of all three instruments in this respect is very similar, as they all provide two specific formulae for calculating damages in cases where the contract has been avoided[3] (terminated).[4] The two formulae are well known to domestic legal systems. The first formula can be used where the injured party concludes a transaction in substitution of the breached contract and its essence is to calculate the difference between the price in the original contract and the price in the substitute contract.[5] This formula is often referred to as the 'concrete' method of calculation because it requires the examination of the claimant's *actual* circumstances. By contrast, the second formula, often referred to as the 'abstract' method of calculation, does not look into the claimant's actual circumstances and is, instead, based on the presumption that the claimant's damages consist of the difference between the original contract price and the so-called 'current price'.[6] All other losses which are either not covered by these methods of calculation or which occur in cases where the contract has not been avoided/terminated, are to be compensated under the instruments' general provisions on damages which provide for the basic principle of *full compensation* and,

[1] GH Treitel, *Remedies for Breach of Contract: A Comparative Account* (Oxford, Clarendon Press, 1988) 105.

[2] E Peel, *Treitel on The Law of* Contract, 12th edn (London, Thomson–Sweet & Maxwell, 2007) 1013.

[3] The term used by the CISG.

[4] The term used by the UPICC and PECL.

[5] See arts 75 CISG, 7.4.5 UPICC and 9:506 PECL.

[6] See arts 76 CISG, 7.4.6 UPICC and 9:507 PECL.

whether implicitly or expressly, pursue the purpose of putting the injured party in the position in which it would have been had the contract been properly performed.[7] Although these general provisions do not contain any specific method of calculation, there is no doubt that various calculation methods can be used under the umbrella of these provisions so long as they are in line with the principle of full compensation and aim to protect the party's 'expectation/performance' or 'positive' interest. Finally, it needs to be noted that, in contrast with the CISG and PECL, the UPICC attempt to provide guidance on how to calculate damages for loss of a chance.[8]

The discussion in this chapter will generally track the structure of the instruments' provisions. First, the work will address the methods of calculating damages in cases where the contract has been avoided; and second, the issue of calculating damages will be dealt with in the context of different types of breach where the contract has not been avoided. The remaining issues relating to the calculation of damages will be examined in the next chapter.[9]

2. CALCULATION IN CASE OF THE AVOIDANCE OF THE CONTRACT

2.1 'Concrete' method of calculation

2.1.1 General

According to the CISG, '[i]f the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods, the party claiming damages may recover the difference between the contract price and the price in the substitute transaction as well as any further damages recoverable under article 74'.[10] The wording of the corresponding provisions of the UPICC[11] and PECL[12] is similar. However, because the two sets of Principles are potentially applicable to transactions other than sales transactions, their provisions make a broad reference to a 'replacement'[13] and 'substitute'[14] transactions. As noted, because this method of calculation looks to the claimant's *actual* conduct and situation, it is often

[7] See arts 74 CISG, 7.4.2 UPICC and 9:502 PECL. For further discussion, see ch 2.

[8] See art 7.4.3(2) UPICC.

[9] See ch 9.

[10] Article 75 CISG.

[11] 'Where the aggrieved party has terminated the contract and has made a replacement transaction within a reasonable time and in a reasonable manner it may recover the difference between the contract price and the price of the replacement transaction as well as damages for any further harm' (art 7.4.5 UPICC).

[12] 'Where the aggrieved party has terminated the contract and has made a substitute transaction within a reasonable time and in a reasonable manner, it may recover the difference between the contract price and the price of the substitute transaction as well as damages for any further loss so far as these are recoverable under this Section' (art 9:506 PECL).

[13] See art 7.4.5 UPICC.

[14] See art 9:506 PECL.

referred to as the 'concrete' assessment of damages. This method of assessment is known to many legal systems[15] and is sometimes used by the parties in a damages calculation clause in their contract.[16] It can, perhaps, be justified on the basis that it is in line with what injured parties often do in practice.[17] Thus, it may often be in the injured party's interest[18] to conclude a replacement transaction after avoiding the contract with the breaching party to enable itself to proceed with the arrangements planned in connection with the contract with the breaching party (eg, sub-sale). This rule is also closely linked with a duty to mitigate. Since concluding a replacement transaction will often be a typical measure of mitigating losses, the 'concrete' method of calculation can be said to reflect, to that extent, the exercise of the duty to mitigate.[19] The rule of concrete assessment has been praised for introducing a degree of simplicity, clarity and certainty into the law of damages. The praise is probably due to the rule's ability to alleviate, in many cases, the difficulty of proving and assessing damages as the act of making a reasonable substitute transaction within a reasonable time will often fix the injured party's damages[20] (with further losses, of course, being recoverable under a general provision on damages).

Damages assessed under the 'concrete' method of calculation will compensate the *seller* for the *profit margin* it expected to receive from the sale of goods to the buyer. If upon non-acceptance by the buyer, the seller resells (in a reasonable manner and within a reasonable time) the goods at a lower price than that in the contract with the buyer, it is clear that the difference between the contract price and the price in a resale compensates the seller for a decreased profit margin (if any).[21] However, so far as the buyer is concerned, the 'concrete'[22] assessment leads not to an award of lost profit,[23] but to damages for not

[15] See Notes on Article 9:506 PECL in O Lando and H Beale (eds), *Principles of European Contract Law: Parts I and II*, prepared by the Commission on European Contract Law (The Hague, Kluwer Law International, 2000) 448; F Enderlein and D Maskow, *International Sales Law: United Nations Convention on Contracts for the International Sale of Goods; Convention on the Limitation Period in the International Sale of Goods* (NY, Oceana, 1992) 303.

[16] See CIETAC Arbitration proceeding 20 January 1993 (Ferrosilicon case) <http://cisgw3.law.pace.edu/cases/930120c1.html>.

[17] See Secretariat Commentary on Article 71 of the 1978 Draft, para 3.

[18] V Knapp, 'Arts. 74–77 CISG' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Milan, Giuffrè, 1987) 548–49.

[19] For a similar view, see, eg, P Schlechtriem, *Uniform Sales Law: The UN-Convention on Contracts for the International Sale of Goods* (Vienna, Manz Verlag, 1986) 97. For a 'self-interest' rationale underlying the existence of the mitigation rule, see ch 6.

[20] See JO Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention*, 3rd edn (Deventer, Kluwer Law International, 1999) 448–49.

[21] See ICC Arbitration Case No 7585 of 1992 (Foamed board machinery case) <http://cisgw3.law.pace.edu/cases/927585i1.html>.

[22] The same point applies to the 'abstract' measure in arts 76 CISG, 7.4.6 UPICC and 9:507 PECL.

[23] See CIETAC Arbitration proceeding 30 July 1996, where both parties incorrectly referred to the 'concrete' assessment as a method of calculating lost profits (Ferro-molybdenum alloy case) <http://cisgw3.law.pace.edu/cases/960730c2.html>; see also Arbitration Proceeding Case No 48 of 2005 (Ukraine) <http://cisgw3.law.pace.edu/cases/050000u5.html> (where the tribunal incorrectly viewed damages under art 76 CISG as compensating the buyer for lost profits).

having received the goods at an agreed price. As pointed out by one commentator,[24] the buyer can have two kinds of expectation—the expectation of receiving the subject matter and the expectation of putting it to some profitable use, the former being that which the instruments' 'concrete' formula aims to protect.

2.1.2 The 'concrete' method of calculation: preconditions and application

The preconditions for using the 'concrete' method of calculation are as follows. First, all three instruments expressly state that their provisions are to be used only where the contract has been avoided[25] and where a substitute contract was made after avoidance.[26] These requirements can be explained by the following reasons: it is usually the avoidance of the contract which makes it clear that the contract will not be performed,[27] and it is only avoidance that cancels the parties' rights and obligations under the contract, thereby giving them a legal right to free themselves from performing the contract and often enabling them to procure a substitute.[28] Second, this method of calculation can only be used if the innocent party has *in fact* concluded a substitute transaction, and for this reason, the arbitration case where the tribunal applying the CISG awarded damages in accordance with this method where the buyer was yet to procure a substitute[29] was not correctly decided. Third, a transaction made after avoiding the contract with a breaching party must truly aim at *replacing* the original contract. It has been further suggested that to perform this function a substitute transaction needs to be, in general, related to the original contract and to be able to secure the injured party's interest in the performance of the original contract.[30] These are, however, guidelines of a very general nature and the greatest challenge is to define what constitutes 'a substitute' in the light of specific situational settings.

For instance, can the manufacturer, after rejecting the seller's delivery, use the goods purchased earlier to fulfil orders which were initially planned to be satisfied by means of the seller's delivery? In a case under the CISG based on similar facts,[31] the court stated that previously ordered goods could not be considered

[24] See Treitel (n 1) 123.

[25] For the discussion of the issue whether this method of calculating damages can be used in cases where the contract has not been avoided, see below.

[26] See arts 75 CISG, 7.4.5 UPICC and 9:506. See also H Stoll and G Gruber, 'Arts. 74–77 CISG' in P Schlechtriem and I Schwenzer (eds), *Commentary on the UN Convention on the International Sale of* Goods, 2nd English edn (Oxford, OUP, 2005) 775.

[27] Stoll and Gruber (n 26) 775.

[28] *Ibid*. It may, of course, be possible for a party to procure a substitute without avoiding the contract. However, an innocent party may often not want to do so as long as there is a possibility that the other party will still perform the contract because, eg, it does not need two sets of similar goods or does not have financial resources to buy similar goods twice. The course of action which provides this party with the greatest legal security and freedom to act is to avoid the contract.

[29] CIETAC Arbitration proceeding 30 October 1991 (Roll aluminium and aluminium parts case) <http://cisgw3.law.pace.edu/cases/911030c1.html>.

[30] See Stoll and Gruber (n 26) 775.

[31] *Delchi Carrier SpA v Rotorex Corp* 1994 WL 495787.

as substitute goods. The reason for this decision is most likely based on the fact that the buyer in that case was in a specific type of lost volume situation where the demand for the goods exceeded the buyer's ability to supply. Given that the true purpose of the goods ordered previously was to satisfy orders *in addition* to those that the seller's delivery was intended to fulfil, they were not truly a replacement sale because by using them to meet the demand for one set of orders the buyer lost an opportunity to satisfy other additional orders it would have realised had there been no breach. A true replacement transaction would, therefore, appear to be that which does not leave a party in the position in which it loses an additional unit of profit.

What if the same question arises under a similar set of facts but where no loss of volume occurs? Suppose that the buyer has goods in stock which it had bought before concluding the contract with the seller or, at the latest, before the seller breached the contract. Suppose further that after avoiding the contract with the seller, the buyer uses the goods from its stock to fulfil orders which the seller's goods were intended to fulfil. Will the buyer be allowed, under the 'concrete' method of assessment, to claim the difference between the price of previously ordered goods and the price under its contract with the seller? On the one hand, it can be argued that this should not be possible. First, it is sometimes suggested that a true replacement transaction must be concluded with an intention to substitute an original transaction,[32] and if this is correct it is hardly possible to argue that the goods, bought before the contract with the breaching party or before the breach, were bought with an intention to replace that contract. Second, it will be remembered that one of the preconditions for using the 'concrete' method of assessment is that a replacement be made *after* avoiding the contract. Consequently, it can be argued that where goods were bought before the avoidance of the contract with a breaching party, such a purchase would never fall within the scope of the 'concrete' method of calculation. On the other hand, it can be suggested that the international instruments do not require (at least not in express terms) that the purchase of an alleged substitute be accompanied by an intention to replace contract goods. To qualify as a substitute, a transaction needs to be able to perform the *function* of replacing the contract with the breaching party regardless of whether this was the claimant's intention at the time of making that transaction. In addition, it can be proposed that because the instruments require that a substitute transaction be made in a reasonable manner, it is the *reasonableness* of using that transaction as a substitute for the original contract that should be decisive. The same argument could be used to address the point concerning the time of avoidance. It can be argued that although the requirement for a substitute to take place after avoidance is based on sound rationale, it may be reasonable for a party to use the goods from its stock as a substitute even before the contract is formally avoided.

[32] B Borisova, 'Commentary on the Manner in which the UNIDROIT Principles May Be Used to Interpret or Supplement Article 75 of the CISG' <http://www.cisg.law.pace.edu/cisg/principles/uni75.html>.

It has been suggested that there might be cases where it is certain that the promisor will not perform the contract because, for example, it has clearly stated so. In such a case, it has been argued that it would be contrary to good faith for a breaching party to argue that the innocent party ought to have sent a notice of avoidance before making a substitute contract.[33]

It is submitted that, in the interests of clarity, certainty and uniformity in the application of the international instruments, it is better not to deviate from the express wording of the instruments' provisions and to interpret a substitute only as a transaction occurring after the time of avoidance. This is not to say that, where goods were bought before avoidance, damages cannot be calculated as the difference between the price in that transaction and the original contract because, as will be argued below, this method of calculation should be possible under the instruments' provisions on a general measure of damages.[34] This means, however, that the provisions expressly setting out the 'concrete' calculation[35] will be restricted only to those cases where a substitute occurred after avoidance and this would remove all cases involving 'previously ordered goods' from the scope of these provisions.

The situation involving previously ordered goods raises a more general question of whether there must be some type of connection between an original contract and an alleged substitute. It seems that some connection must exist between the two transactions, but this connection need only be established for the purpose of demonstrating that an alleged substitute was indeed a replacement for the original contract. In other words, the question to be asked should be whether an alleged substitute was made because the original contract failed to materialise and whether this alleged substitute transaction would have been made if the original contract had been performed.

A number of factors can potentially be relevant for demonstrating the existence of the connection between the two contracts. For example, in a case[36] involving a sale of iron-molybdenum, the court took into account the similarity of terms in both contracts and the period of time within which an alleged substitute had been made. With respect to the former, the court held that an alleged cover transaction which involved the purchase of approximately 17–20 tonnes of goods with 60 per cent concentration of molybdenum was similar to the originally agreed delivery of approximately 18 tonnes with minimum 64 per cent concentration of molybdenum. The fact that an alleged substitute had been made within two weeks after the seller's refusal to deliver led the court to state that 'the connection in time between the two contracts [was] so close that reasonable doubts concerning the contract's designation as a cover transaction

[33] See Stoll and Gruber (n 26) 776.

[34] See arts 74 CISG, 7.4.2 UPICC and 9:502 PECL.

[35] Articles 75 CISG, 7.4.5 UPICC and 9:506 PECL.

[36] Case No 1 U 167/95 Appellate Court Hamburg (Germany) 28 February 1997 (Iron molybdenum case) <http://cisgw3.law.pace.edu/cases/970228g1.html>.

[were] not present'.[37] A different result was reached in another case[38] where a tribunal ruled that an alleged substitute was not a replacement contract simply on the basis that an alleged substitute was under the CIF terms as opposed to C&F terms in the original contract, and that the due date for delivery was later than in the original contract. It is suggested that these grounds *in themselves* do not necessarily constitute sufficient basis for not recognising an alleged substitute as a replacement because, as discussed below, a substitute contract does not always have to contain terms identical to those in the original contract. For the result in this case to be justifiable, additional factors ought to have been invoked to demonstrate that the differences relating to terms of delivery reflected a lack of causal connection between the original contract and the alleged substitute.[39]

A claimant's conduct subsequent to the alleged substitute can also be taken into account in deciding whether there is a connection between the two transactions and, consequently, a genuine substitute transaction. For instance, if the buyer demands the delivery of the very same goods from the same seller after the alleged substitute has taken place, this fact may be deemed to indicate that the alleged cover was not in fact a substitute for the original contract.[40] Sometimes tribunals also take into consideration the purpose for which an injured party has entered into the contract with the breaching party and determine whether an alleged substitute would be able to fulfil that purpose. In one case, the tribunal having identified differences concerning a number of contract terms (name, specification, country of origin, manufacturing date, quantity of the goods and delivery dates) in the alleged substitute and the buyer's sub-sale contract, ruled that the alleged substitute was not a true replacement.[41]

One well-known difficulty of establishing a connection between an alleged substitute and an original contract arises in cases where the injured party is involved in a continuous trading with similar goods.[42] Such a situation often occurs in some sectors of trade such as commodities, for example, 'where merchants conduct their buying and selling activities across a broad front'.[43] Where this is the case, it may be difficult or even impossible to ascertain whether an alleged substitute has been made to replace the contract with a breaching party or whether this transaction is just another transaction concluded in a usual

[37] *Ibid*.

[38] CIETAC Arbitration proceeding 18 April 1995 (Clothes case) <http://cisgw3.law.pace.edu/cases/950418c1.html>.

[39] One such factor could, eg, be the buyer's sub-sale contract the terms of which correspond to the terms of the original contract. For the discussion of this factor, see below.

[40] See CIETAC Arbitration proceeding 11 February 2000 (Silicon metal case) <http://cisgw3.law.pace.edu/cases/000211c1.html>.

[41] See CIETAC Arbitration proceeding 30 November 1997 (Canned oranges case) <http://cisgw3.law.pace.edu/cases/971130c1.html>.

[42] This difficulty has been pointed out on numerous occasions. See, eg, Stoll and Gruber (n 26) 776; R Goode, *Commercial Law*, 3rd edn (London, Penguin, 2004) 388. This situation may have arisen in Case No 7 U 2959/04 Appellate Court München (Germany) 15 September 2004 (Furniture leather case) <http://cisgw3.law.pace.edu/cases/040915g2.html>.

[43] MG Bridge, *The Sale of Goods* (Oxford, OUP, 1997) 555–56.

course of business. One way that may alleviate the injured party's burden of proof is for this party to send a notice,[44] whether in conjunction with the notice of avoidance[45] or independently, informing the breaching party of its intention to make a substitute transaction. However, it is suggested that sending such a notice should not necessarily be regarded as sufficient proof that an alleged substitute was a replacement transaction. Given that an injured party has an incentive to identify a transaction which is most beneficial to its financial interests in the sense that a seller, for example, has an incentive to identify a resale with the lowest price,[46] care needs to be exercised to ensure that an alleged substitute can indeed be treated as a reasonable replacement to the broken contract.

It should be further noted that there is no agreement as to what the appropriate course of action is where it is impossible to establish a true substitute transaction. While some sources suggest that the provisions containing the 'concrete' method of calculation should not be used in such cases and the 'abstract' method should be used instead,[47] others argue that '[t]he fact that any of a number of transactions may have been the substitute transaction does not amount to the conclusion that there was no substitute transaction',[48] and it is sufficient to point to several of those transactions as long they can perform the function of replacing the broken contract.[49] So, how 'concrete' should the provisions containing 'concrete' methods be? In other words, is it necessary for a claimant to identify one specific transaction as an actual substitute or is it sufficient, in cases where no actual substitute can be established, to point to any transaction(s) which can be viewed as a reasonable substitute? It is suggested that in order to preserve clarity and relative simplicity of the 'concrete' method of calculation, it is better to treat this method as requiring that a specific transaction has *actually* been made to replace the broken contract. As noted above, to meet this requirement, it will have to be established that the alleged substitute was made because of the failure of the original contract to materialise, and because it would not have been made had the original contract been performed.

The next precondition for using the 'concrete' method of assessment is that a replacement transaction be carried out in a 'reasonable manner' and it is submitted that this requirement further informs the definition of what is a substitute transaction. In very general terms, it has been said that a replacement procured in a 'reasonable manner' is a transaction based on a conduct expected

[44] Stoll and Gruber (n 26) 775; Honnold (n 20) 449; JS Ziegel, 'The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives' in N Galston and J Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (NY, Matthew Bender, 1984) 9–39.

[45] See arts 26 CISG, 7.3.2 UPICC and 9:303 PECL.

[46] See JJ White and RS Summers, *Uniform Commercial Code*, 5th edn (St Paul, Minn, West Publishing Co, 2000) 266.

[47] Secretariat Commentary on Article 72 of the 1978 Draft, para 2.

[48] J Yovel, 'Comparison between Provisions of the CISG (Measurement of Damages when Contract Avoided: Article 76) and the Counterpart Provisions of the PECL (Article 9:507)' <http://www.cisg.law.pace.edu/cisg/text/peclcomp76.html>.

[49] *Ibid*.

of a prudent, careful, and reasonable businessman.[50] Making a substitute transaction in a reasonable manner is also closely linked with the notion of good faith[51] and it is certainly arguable that the reasonableness of a transaction is to be judged from the standpoint of good faith. More specifically in the context of sales transactions, a reasonable manner is understood to mean the seller's resale at the highest price reasonably possible or the buyer's re-purchase at the lowest price reasonably possible.[52]

In practice, judges and arbitrators often take into account the market price in deciding whether a substitute transaction was made in a reasonable manner (and this is the point where there is little difference between 'concrete' and 'abstract' calculation methods). If the price in a buyer's substitute transaction is lower than the market price, it is very likely that this substitute will be deemed to be reasonable.[53] The same most probably applies to cases where the price in a substitute transaction corresponds to the market price.[54] In some cases, it may be that the price in the seller's substitute transaction, which is lower than the market price, will be found to be reasonable. For instance, in one case the tribunal held that it was reasonable for a price in a substitute transaction to be slightly lower than the market price where, as a result of the buyer's refusal to accept goods, the 'goods became backlogged at the port and were at a disadvantageous position to be resold'.[55]

The existence/absence of more favourable alternatives is also relevant for demonstrating that a price in a substitute transaction was reasonable and, in one case,[56] the burden of demonstrating such alternatives was placed on the breaching party. Thus, a German court dismissed the breaching seller's argument that the buyer could have obtained a cheaper substitute because the seller had failed to sufficiently demonstrate 'where and at what possible lower price the buyer at the relevant point [in] time could have bought cheaper goods'.[57] In another

[50] See ICC Arbitration Case No 10274 of 1999 (Poultry feed case) <http://cisgw3.law.pace.edu/cases/990274i1.html>; ICC Arbitration Case No 8128 of 1995 (Chemical fertiliser case) <http://cisgw3.law.pace.edu/cases/958128i1.html>.

[51] '[R]easonableness is to be judged by what persons acting in good faith and in the same situation as the parties would consider to be reasonable . . .' (art 1:302 PECL). Good faith may also come into play if we recall the link between the concrete formula and mitigation, on the one hand, and possible justification of the mitigation rule from the standpoint of good faith (see ch 6).

[52] Secretariat Commentary on Article 71 of the 1978 Draft, para 4.

[53] See CIETAC Arbitration proceedings 10 June 2002 (Rapeseed dregs case) <http://cisgw3.law.pace.edu/cases/020610c1.html>; 10 August 2000 (Silicon metal case) <http://cisgw3.law.pace.edu/cases/000810c1.html>.

[54] See *Downs Investments Pty Ltd v Perwaja Steel SDN BHD* [2000] QSC 421; CIETAC Arbitration proceeding 4 September 1996 (Natural rubber case) <http://cisgw3.law.pace.edu/cases/960904c1.html>; ICC Arbitration Case No 10329 of 2000 (Industrial product case) <http://cisgw3.law.pace.edu/cases/000329i1.html>.

[55] CIETAC Arbitration proceeding 4 June 1999 (Industrial raw material case) <http://cisgw3.law.pace.edu/cases/990604c1.html>.

[56] Case No 411 O 199/02 District Court Hamburg (Germany) 26 November 2003 (Phtalic anhydride case) <http://cisgw3.law.pace.edu/cases/031126g1.html>.

[57] *Ibid*.

case,[58] the seller's resale at a 20 per cent discount as compared to the original price was deemed reasonable after it had unsuccessfully tried to resell the goods at a better price for two months.

The next question is whether, to be a reasonable substitute, a replacement transaction needs to be concluded on the same terms as the original transaction and whether goods need to correspond to the original contract in terms of type, quality, and quantity. The starting point is that because the purpose of making a substitute transaction is to replace the original contract, a substitute contract generally needs to be on similar terms than those in the original contract.[59] Nevertheless, it is also accepted that a substitute transaction need not always be on *identical* terms to the original contract.[60] This position stems from the notion of reasonableness which only requires that a replacement be a *reasonable* substitute[61]; but it should nevertheless be tempered by a guideline that a transaction cannot be a substitute if it 'is so different from the original contract in value or kind as not to be a reasonable substitute'.[62] Despite these guidelines, it is difficult to draw a clear line between the types and extent of differences which can be justified by the notion of reasonableness and those which cannot be so justified. Considering specific situations may, however, shed some further light on this matter.

Where a substitute transaction involves goods which are not identical to those in the original contract, it may have been carried out in a reasonable manner if substitute goods are of the same technical specification.[63] Even if they are not, they may still be treated as a reasonable replacement if the difference in specifications is 'slight', 'minor' or 'unimportant'.[64] In rare circumstances, it may perhaps be possible for a reasonable substitute to involve goods *entirely different* from those under the original contract, if the latter were unique and if finding different type of goods was the only reasonable option to replace the contract goods.[65] It is further intimated that the purpose for which an injured party had made the original contract will often be important in deciding whether a substitute has been made in a reasonable manner. Thus, in one case,[66]

[58] ICC Arbitration Case No 10274 (n 50).

[59] See Stoll and Gruber (n 26) 774, 776; Borisova (n 32); ICC Arbitration Case No 8128 (n 50) ('The first condition is that goods in replacement are of the same type and quality').

[60] See Secretariat Commentary on Article 71 of the 1978 Draft, para 4; Stoll and Gruber (n 26) 776. See also Comment 2 to § 2-712 UCC.

[61] See Secretariat Commentary on Article 71 of the 1978 Draft, para 4.

[62] See Comment B on Article 9:506 PECL and illustration 2 in Lando and Beale (n 15) 448.

[63] See District Court Hamburg 26 November 2003 (n 55).

[64] ICC Arbitration Case No 8128 (n 50) (where the specifications of substitute chemical fertilisers differed from those under the original contract in terms 'purity and water content').

[65] See Case No 419 O 48/01 District Court Hamburg (Germany) 21 December 2001 (Stones case) <http://cisgw3.law.pace.edu/cases/011221g1.html>. Although the preconditions for applying art 75 CISG were not met in this case, it provides an illustration where apparently unique goods (natural stone) were involved and where the buyer argued that it had to find some other material to use in its construction works.

[66] CIETAC Arbitration proceeding 17 October 1996 (Tinplate case) <http://cisgw3.law.pace.edu/cases/961017c1.html>.

the tribunal dismissed the breaching seller's argument that the buyer ought to have procured a substitute on the ground that the contract between the buyer and its sub-buyer provided for the goods to be produced in Korea and therefore, it would have been unreasonable for the buyer to procure goods made in some other country.[67]

A well-known difficulty of determining whether a substitute has been made in a reasonable manner arises in the situation where an injured buyer has acquired goods superior to the contract goods. In abstract, it is impossible to state whether procuring superior goods will constitute a reasonable substitute. If identical or similar goods are reasonably available at a lower price than that of superior goods, then clearly purchasing superior goods is not a reasonable substitute. If superior goods were the only ones reasonably available to the buyer, then purchasing them may be considered as a reasonable replacement provided that the value of benefits received by the buyer as a result of using superior goods (which, of course, the buyer would not have had had the seller performed the contract) are taken into account. This means that the amount of damages calculated under the 'concrete' formula will have to be reduced by the amount reflecting the value of such benefits.[68]

Sometimes contracts allow a breaching party performing in alternative ways and where this is the case, the question arises as to how the requirement of making a substitute transaction 'in a reasonable manner' should be interpreted. For instance, if the breaching seller had an option to deliver between 8 and 10 tonnes of potatoes, should the buyer be allowed to claim the difference between the price of 10 tonnes of potatoes it has bought in replacement, and the contract price for the same quantity? The question may be important because, assuming the overall price in both contracts did not vary depending on the quantity purchased, the greater the quantity the higher the difference will be between the contract price and the price in a substitute transaction. Although in some cases it may be possible to determine the precise quantity the seller would have delivered had it performed the contract, in many cases this will not be possible. For this reason, a workable solution could be adopting a particular presumption regarding what the breaching party would have done. In this regard, it is relevant to note that the approach of some common law systems is to assume that the breaching party would have performed the contract in the way which is least burdensome to itself. For instance, if, in our example, delivering the minimum quantity is considered to be a least burdensome way of performing, it will be assumed that the seller would deliver 8 tonnes of potatoes and the buyer's

[67] No goods of Korean origin were reasonably available to the buyer in the light of time limitations. For a similar case under the CISG, see CIETAC Arbitration proceeding 29 September 2004 (India rapeseed meal case) <http://cisgw3.law.pace.edu/cases/040929c1.html> (where the tribunal dismissed the seller's argument that the Chinese buyer ought to have procured a substitute delivery of rapeseed meal in its domestic market on the basis that the contract goods were indicated as 'India rapeseed meal').

[68] For a similar view in the context of the UCC, see White and Summers (n 46) 209.

substitute needs to be a replacement for that quantity.[69] It is suggested that a similar approach should be taken in the context of the international instruments for two reasons. First, injured parties need certainty as to what is considered to be reasonable in such circumstances and establishing a presumption does provide a clear guidance. Second, given that most traders are driven by self-interest and commercial rationality, a presumption that a breaching party would have acted in the way which is least burdensome or most beneficial to itself seems to be a fair and a reasonable one to draw. The next question is whether this should be an irrebuttable presumption, as appears to be the case in the common law, or whether it should be possible for the injured party to rebut it. It would seem that while this presumption *itself* will rarely be untrue, disagreements may well arise as to what would have been the conduct which is most beneficial or least burdensome to the breaching party. The common law, for example, assumes that the seller in our example would have always been better off by selling the minimum permissible quantity (ie, 8 tonnes of potatoes) and this assumption, it is submitted, cannot be true in *all* situations for it may well be the case that the seller would have expected the market prices to fall and in that case it might have deemed it beneficial to itself to sell the maximum quality before the expected market fall.[70] Now, because the presumption that the breaching party would have acted in the way most beneficial/least burdensome to itself *and* the question of *what precisely* such actions would have been are interconnected,[71] it is better for a drawn presumption, accompanied by a court's view of what specific course of action the breaching party would have taken, to be rebuttable. It would be unfair and contrary to the compensatory purpose of damages to wholly deprive the injured party of an opportunity to present evidence as to what the breaching party's conduct would have been.

Another situation which gives rise to the question of whether a substitute is reasonable is where an injured party makes a substitute transaction with its affiliate, subsidiary or parent company. One court decision seems to imply that purchasing substitute goods from a subsidiary company does not in itself prevent a transaction from being a reasonable substitute and it is suggested that this is the correct approach.[72] Although making a substitute transaction with an affiliate

[69] See, eg, Peel (n 2) 1029; S Waddams, *The Law of Damages*, 4th edn (Toronto, Canada Law Book Inc, 2004) 536–37. For a similar approach taken in a case under the CISG involving art 76 CISG, see Arbitration proceeding Case No 48 (n 23). The question of what manner of performance would have been the least burdensome or most beneficial may require a careful consideration in the light of the particular circumstances (see the section on long-term contracts in ch 9). See CIETAC Arbitration proceeding 4 February 2002 (Styrene monomer case) <http://cisgw3.law.pace.edu/cases/020204c1.html>, where the injured seller, who had an option of delivering '+/– 5%' of the specified quantity, resold 5% less than that quantity and where this resale was found to be reasonable.

[70] See Peel (n 2) 1029.

[71] This is so because the presumption *in itself* that the breaching party would have acted in a most beneficial/least burdensome way does not resolve the matter and the answer to the question of what *precisely* such a conduct would have been is necessary.

[72] Case No 21 O 703/01(028) District Court Braunschweig (Germany) 30 July 2001 (Metal case) <http://cisgw3.law.pace.edu/cases/010730g1.html>. Another decision appears to imply a contrary position (see CIETAC Arbitration proceeding 30 April 1997 (Molybdenum alloy case)

may in some cases be a factor raising suspicions as to its reasonableness, the decisive question is whether this transaction has been concluded in a reasonable manner. To prevent an injured party from abusing the situation at the expense of the breaching party (for example, if the seller sells the goods to its subsidiary at an unusually low price), market prices for the goods in question could be used as a reference point regarding what is a reasonable price[73] and the question of whether reasonable alternatives were available to the injured party will need to be explored.

Finally, it may be the case that the breaching party offers performing the contract but on terms different from those initially agreed. For instance, a breaching buyer may offer to buy the goods at a lower price than that in the original contract. It is submitted that in this type of case, there is no reason why the seller's resale to the breaching buyer cannot, in appropriate cases, be regarded as a reasonable substitute[74] provided that there were no other alternative reasonably available to the seller of reselling to a third party at a higher price than that offered by the buyer. In fact, in one case,[75] rejecting the breaching buyer's offer and reselling at an even lower price than the one offered by the buyer was considered as a failure to mitigate. The seller's claim for the difference between the contract price and the resale price was dismissed and the award of damages was based on the difference between the contract price and the price offered by the buyer.[76]

<http://cisgw3.law.pace.edu/cases/970430c1.html>). A similar approach to the one suggested in this work has been taken in an arbitration case governed by the UCC. In that case, the innocent buyer made a cover purchase from its parent company holding 100% interest in the buyer. The tribunal stated that it 'would not go so far as to say that no transaction between parent and wholly owned subsidiary can ever constitute a reasonable purchase . . . [and that] a purchase from an affiliate may in some circumstances be used to establish cover' (ICC Arbitration Case No 6955 of 1993 in JJ Arnaldez, Y Derains and D Hascher, *Collection of ICC Arbitral Awards, 1991–1995: Recueil des Sentences Arbitrales de la CCI* (The Hague, Kluwer Law International, 1997) 267, 296).

[73] See ICC Case No 6955 (n 72) where the tribunal stated that establishing that a cover purchase from a parent company was reasonable 'would seem to require either a showing that the purchase would have been a reasonable one in the market place or that the price charged was no more than the reasonable costs of the parent in producing the product'.

[74] Provided that accepting the buyer's offer is not interpreted as renegotiating the original contract and waiving the seller's right to damages.

[75] *Internationale Jute Maatschappij BV v Marín Palomares SL* Supreme Court (Spain) 28 January 2000 <http://cisgw3.law.pace.edu/cases/000128s4.html>. For the discussion of the issue of whether accepting a breaching party's offer can be a reasonable measure of mitigation, see ch 6.

[76] It seems that this was also a 'concrete' method of calculating damages, albeit different from the one provided for in art 75 CISG, because it referred to the claimant's *actual* circumstances. This decision raises a question whether art 76 ought to have been used instead or whether art 76 is simply an alternative measure. If the buyer's offer reflected the current price at the time, there would be little difference between the court's method of calculation and 'abstract' calculation in art 76. However, if there were a substantial difference between them, the question would be of great importance. If the buyer's offer contained a higher price than current price, it can be argued that the 'abstract' measure in art 76 would overcompensate the seller because had it acted reasonably by accepting the buyer's offer, its damages would have been lower. The question emphasises a dilemma between whether the instruments should give priority to 'concrete' measures and mitigation in the light of the claimant's actual circumstances or whether, in cases such this, art 76 and, arguably, its basis of 'presumed mitigation' should be available as an alternative. This question will be returned to below.

The final precondition for using the concrete formula is that a substitute transaction needs to be made *within a reasonable time* after avoidance.[77] What is a reasonable time depends on the circumstances of the particular case. Nevertheless, there seems to emerge a rather uniform trend concerning the maximum period which can be considered reasonable. Thus, several months (usually 2–3 months) have been the longest period that judges and arbitrators have thus far been prepared to regard as reasonable[78] and on several occasions,[79] it has been stated that the period of six months was outside a reasonable period of time.[80] The relevant factors in deciding whether the period of time in question is reasonable in the circumstances can include the nature and characteristics of the goods, the purpose for which the original contract was made and the availability/absence of markets. Avoidance can only become effective if the notice of avoidance has been given by the party avoiding the contract,[81] and in this regard, a concern has been expressed that because the injured party is able to control the time of avoidance, there is a risk that it may engage in speculation at the expense of the breaching party. For example, an innocent buyer who still keeps the goods may decide not to avoid the contract at once in order to see whether the market price for the goods is going to rise.[82] If its speculation proves unsuccessful and the market price persistently falls, the difference between the contract price and the price in a late substitute transaction will be higher than it would have been had the contract been avoided earlier. It has been correctly suggested that such speculation at the expense of the breaching party can be

[77] See arts 75 CISG, 7.4.5 UPICC and 9:506 PECL.

[78] See *GmbH Lothringer Gunther Grosshandelsgesellschaft für Bauelemente und Holzwerkstoffe v NV Fepco International* Appellate Court Antwerp (Belgium) 24 April 2006 <http://cisgw3.law.pace.edu/cases/060424b1.html>; *Downs Investments v Perwaja Steel* (n 54); Case No 17 U 146/93 Appellate Court Düsseldorf (Germany) 14 January 1994 (Shoes case) <http://cisgw3.law.pace.edu/cases/940114g1.html>.

[79] Appellate Court Antwerp 24 April 2006 (n 78); *NV Van Heygen Staal v GmbH Stahl und Metalhandel Klockner* Appellate Court Gent (Belgium) 20 October 2004 <http://cisgw3.law.pace.edu/cases/041020b1.html>.

[80] In the remaining cases 'reasonable time' ranged from several days to a few weeks: *R GmbH v O AG* District Court Zug (Switzerland) 12 December 2002 <http://cisgw3.law.pace.edu/cases/021212s1.html> (2 days); CIETAC Arbitration proceeding 18 August 1997 (Vitamin case) <http://cisgw3.law.pace.edu/cases/970818c1.html> (5 days); *Treibacher Industrie, AG v TDY Industries, Inc* US District Court [Alabama] 464 F.3d 1235 [11th Cir 2006] 27 April 2005, also at <http://cisgw3.law.pace.edu/cases/050427u1.html> (17 days). Where a replacement transaction is concluded on the same day as the day of avoidance, it will almost always be made within a reasonable time (see CIETAC Arbitration proceeding 4 February 2002 (n 69)).

[81] There is no agreement, as far as the CISG is concerned, as to whether a notice of avoidance (art 26) becomes effective upon dispatch or upon receipt by the breaching party (for a brief overview of different positions and for the argument that a notice of avoidance becomes effective upon receipt by the breaching party, see P Schlechtriem, 'Effectiveness and Binding Nature of Declarations (Notices, Requests or Other Communications) under Part II and Part III of the CISG' (1995) Cornell Review of the Convention on Contracts for the International Sale of Goods 95 (also available at <http://www.cisg.law.pace.edu/cisg/biblio/schlecht.html>)). Under the UPICC and PECL, a notice of termination becomes effective upon receipt by the breaching party (see art 1.10 and Comment 4 on Article 7.3.2 UPICC and art 1:303 and Comment on Article 4:112 PECL).

[82] If so, the buyer is likely to prefer not to avoid the contract and to keep the goods.

countered by the mitigation rule which can require that an earlier date at which the injured party ought to have avoided the contract should be taken as the reference date.[83]

Finally, it needs to be noted that in contrast with § 2-706 UCC[84] and contrary to suggestions by some tribunals,[85] the international instruments do not require that an injured party provide the breaching party with a notice of its intention to make a substitute transaction.[86] As noted earlier, such a notice may, in some cases, help alleviate the burden of establishing a substitute transaction. More generally, the notice requirement takes account of the breaching party's interests since it has a direct interest in being informed about the other party's course of action. The injured party's decision to make a substitute contract will often affect the breaching party's practical decisions[87] and if a substitute were to materialise, it is likely to affect the breaching party's legal position.[88] Therefore, because giving a notice would appear to be in the interests of both parties, it is advisable that an innocent party inform the other party, either together with a notice of avoidance or separately, of its intention to make a substitute transaction.[89]

2.1.3 The difference between the contract price and price in the substitute contract

The amount of damages to be awarded under the 'concrete' formula is calculated as the difference between the contract price and the price in a transaction

[83] See P Schlechtriem, 'Damages, Avoidance of the Contract and Performance Interest under the CISG' <http://www.cisg-online.ch/cisg/Schlechtriem_Damages_Avoidance.pdf>. It can, of course, be argued that there is nothing wrong in an innocent party's speculating at the market. What cannot be allowed, though, is for this speculating to occur at the breaching party's expense. This seems to be the general attitude of English sales law and, to balance these two considerations, an 'abstract' formula is adopted as a general measure with any speculation being, at the same time, *at the risk* and *for the benefit* of the innocent party. Similarly to the case discussed earlier (n 76), the situation where the mitigation principle dictates that the injured party ought to have avoided the contract earlier, the question arises whether the next step is to rely on the 'abstract' formula with its presumed mitigation rationale or whether the 'concrete' assessment (difference between the contract price and the price that would have been paid/received had the contract been avoided at the time required by the mitigation rule) should still be used. This question will be addressed below.

[84] § 2-706 UCC requires that where the resale is a 'private sale', the 'seller must give the buyer reasonable notification of his intention to resell'.

[85] CIETAC Arbitration proceeding 31 December 1996 (High carbon tool steel case) <http://cisgw3.law.pace.edu/cases/961231c2.html> (the tribunal seems to have gone as far as to suggest that the injured seller ought to have consulted the buyer regarding the resale price).

[86] The absence of such a requirement has been confirmed in several decisions (see ICC Arbitration Case No 10274 (n 50); ICC Arbitration Case No 6281 of 26 August 1989 (Steel bars case) <http://cisgw3.law.pace.edu/cases/896281i1.html>).

[87] Communicating an innocent party's intention to make a substitute transaction may give rise to a breaching party's expectation that a claim for damages will soon be brought and this, in turn, may induce the breaching party to make preparations (such as hiring a lawyer) for defending the claim.

[88] For example, if a substitute transaction meets the preconditions described above, it will predetermine the amount of damages the breaching party is likely to pay.

[89] For cases where such notice was given see District Court Hamburg 26 November 2003 (n 56); ICC Arbitration Case No 10274 (n 50).

which is found to be a true substitute. The only issue to be borne in mind in performing this straightforward exercise is that it may be necessary to adjust one of the two prices. The terms of a substitute transaction may not be identical to the original contract and it may be necessary to perform the necessary adjustments to make the two prices comparable.

One example is where a substitute transaction is made on different trade terms. For instance, in one case,[90] the original contract was made under the CFR terms while the buyer's substitute was concluded on FOB terms. Because the FOB price did not take account of freight, the tribunal added the amount of freight to the price of the substitute contract and only then did it subtract the contract price from the adjusted price of the substitute transaction. The same result can, of course, be achieved if the amount of freight is subtracted from the CFR price.[91] Another example involves a country which imposed value added tax (VAT) on domestic sales and therefore the sales price would include the amount of VAT while 'export sales' prices would not. In that case,[92] after the buyer had breached its 'export' contract (the price of which did not include VAT), the seller resold the goods to a domestic buyer (at a VAT-inclusive price). To make the two prices comparable the tribunal deducted the amount of the VAT from the resale price.

Yet another more difficult case of adjustment is where one transaction is made on 'cash' terms while the other is on 'credit' terms. Suppose that the buyer failed to buy the goods for, say, £54,000 payable in semi-annual instalments over a three-year period and the seller resold them for £35,000 on 'cash' terms. As pointed out by some commentators,[93] in such circumstances, it will not be correct simply to calculate the difference between the two prices and award damages of £19,000 because the present value of £54,000 payable over six instalments is likely to be less than £54,000 payable at once.[94] First, the maximum amount the seller will be receiving per year is £18,000 and, therefore, taking £54,000 as the reference price and thereby assuming that this is the amount the seller will receive at once gives the seller a windfall. Second, it needs to be remembered that with time the value of money tends to decrease. For these reasons, in this type of case, judges and arbitrators will have to find a way to discount and determine the present value of £54,000 to arrive at the correct award of damages.

[90] See CIETAC Arbitration proceeding 15 November 1996 (Oxytetrecycline case) <http://cisgw3.law.pace.edu/cases/961115c1.html>.

[91] For another case of the adjustment of price involving art 75 CISG, see CIETAC Arbitration proceeding 8 November 2002 (Canned asparagus case) <http://cisgw3.law.pace.edu/cases/021108c1.html>.

[92] See CIETAC Arbitration proceeding 16 August 1996 (Dioctyl phthalate case) <http://cisgw3.law.pace.edu/cases/960816c1.html>.

[93] See White and Summers (n 46) 267 (main text and note 6).

[94] See *ibid*.

2.1.4 Relationship with other losses

The international instruments provide that besides damages for the difference between the contract price and the price in a substitute transaction, an injured party can also recover damages for any further loss.[95] The latter can include a great variety of losses. The seller, for example, may claim damages for costs relating to storage, care and maintenance of the goods incurred between the buyer's breach and the seller's resale. The injured seller may also claim interest on any loan it may have had to take out as a result of not getting the price on the expected date. The buyer, in turn, may have suffered costs of hiring a broker in order to find a substitute or may have had to pay damages to its sub-buyer for delay in delivery.

Care needs to be taken to ensure that further damages do not over-compensate the innocent party. Thus, it has been correctly held that where damages are awarded under the 'concrete' formula, the buyer cannot claim additional damages for loss of profit it would have earned on the sub-sale because a substitute transaction provides the buyer with the goods to perform its sub-sale contract and earn that profit.[96] Similarly, the seller cannot claim damages for a profit margin it expected to receive from the original sale together with damages for the difference between the contract price and the price in a substitute resale as this would constitute a double recovery.[97] Nevertheless, the injured party may claim damages caused by delay between the due date for performance and the date of the performance of a substitute transaction. For example, if the buyer buys the goods for using them in its manufacturing business, it may suffer loss of profit due to a halt in the manufacture until substitute goods are bought. In such a case, it is appropriate to award both damages under the 'concrete' formula *and* loss of profit caused by delay.[98]

2.1.5 Burden of proof

Assuming that burden of proof is a matter governed by the international instruments, the injured party bears the burden of proving that preconditions required

[95] See arts 75 CISG, 7.4.5 UPICC and 9:506 PECL.

[96] See CIETAC Arbitration proceeding 10 October 1996 (Petroleum coke case) <http://cisgw3.law.pace.edu/cases/961010c1.html>; Case No 12 HKO 4174/99 District Court München (Germany) 6 April 2000 (Furniture case) <http://cisgw3.law.pace.edu/cases/000406g1.html>. See also the discussion below in relation to damages for non-conforming goods.

[97] See CIETAC Arbitration proceeding 16 August 1996 (n 92).

[98] See Case No 1 Kfh O 32/95 District Court Ellwangen (Germany) 21 August 1995 (Spanish paprika case) <http://cisgw3.law.pace.edu/cases/950821g2.html>. The seller may also suffer loss of profit or loss of a chance to profit if it has lost an opportunity to invest part of the price as result of the buyer's non-payment. In this case, damages under the 'concrete' formula cannot be awarded fully together with damages for loss of profit or loss of a chance to profit because had the contract been performed part of the profit margin from selling the goods would have been a payment for further opportunity to profit. Therefore, if damages for loss of profit/loss of a chance are awarded, the amount of the planned investment needs to be subtracted from damages calculated under the 'concrete formula'.

for using the 'concrete' formula have been met. Namely, the injured party will need to prove that it has duly avoided the contract and has made a substitute transaction in a reasonable manner and within a reasonable time. At the same time, if the breaching party claims that one or more of the preconditions have not been met, it will bear the respective burden of proving that assertion. For example, if the breaching seller claims that a substitute transaction has not been concluded in a reasonable manner, it may have to prove that goods at lower prices were reasonably available to the buyer. A failure to do so has, to date, led to the award of damages for the difference between the contract price and the price in a substitute transaction.[99]

2.2 'Abstract' method of calculation

2.2.1 General

The other method of calculation, which is expressly provided for in the instruments in cases where the contract is avoided, aims to compensate for the difference between the contract price and the 'current' price. Article 76(1) CISG provides that '[i]f the contract is avoided and there is a current price for the goods, the party claiming damages may, if he has not made a purchase or resale under art 75, recover the difference between the price fixed by the contract and the current price at the time of avoidance as well as any further damages recoverable under art 74. If, however, the party claiming damages has avoided the contract after taking over the goods, the current price at the time of such taking over shall be applied instead of the current price at the time of avoidance'. The wording of the corresponding provisions of the UPICC and PECL is similar.[100] However, because the two sets of principles cover not only sales transactions but also other transactions, they do not refer to the current price of the 'goods' but to the 'performance contracted for' price.[101] The provision analogous to the second sentence of art 76(1) CISG is also absent from the UPICC and PECL.

This method is well known in domestic legal systems.[102] It is often referred to as 'abstract' calculation for the reason that it does not purport to examine the

[99] See ICAC Case 155/1994, decision dated 16 March 1995 <http://cisgw3.law.pace.edu/cases/950316r1.html>; District Court Hamburg 26 November 2003 (n 56) ('The seller did not sufficiently submit where and at what possible lower price the buyer at the relevant point of time could have bought cheaper goods').

[100] Article 7.4.6 UPICC: 'Where the aggrieved party has terminated the contract and has not made a replacement transaction but there is a current price for the performance contracted for, it may recover the difference between the contract price and the price current at the time the contract is terminated as well as damages for any further harm'. Article 9:507 PECL: 'Where the aggrieved party has terminated the contract and has not made a substitute transaction but there is a current price for the performance contracted for, it may recover the difference between the contract price and the price current at the time the contract is terminated as well as damages for any further loss so far as these are recoverable under this Section'.

[101] See *ibid*.

[102] Lando and Beale (n 15) 449.

claimant's particular circumstances.[103] Instead, this 'depersonalised'[104] formula simply presumes that it is possible for an injured party to make a substitute transaction at the current price as soon as it has freed itself from the original contract.[105] In this sense, the formula can perhaps be said to presume mitigation.[106] At the same time, however, there may be tension between the 'abstract' formula and the mitigation rule because the former, being preoccupied with a hypothetical transaction, is not concerned with the claimant's *actual* behaviour whereas the mitigation rule is concerned with a concrete conduct on the claimant's part. It is also well known that the application of the 'abstract' formula may often lead to over- or under-compensation.[107] For example, suppose that the buyer who planned to resell the contract goods to a sub-buyer manages to reach a settlement with the latter and thereby avoid liability for non-delivery caused by the seller's non-delivery. Suppose further that the contract price was £50,000 and the price in a sub-sale was £60,000. If the current price (at the time of avoidance) was £70,000, the market formula would award the buyer £20,000 instead of £10,000 (£60,000 – £50,000) representing the buyer's actual loss of profit margin. Conversely, if the current price fell to £40,000, the 'abstract' formula would lead to no damages since the current price is actually lower than the contract price. In this case, the buyer is under-compensated because it has still suffered loss of profit of £10,000. Similar considerations may arise where the buyer, *after* the expiration of a reasonable period of time (as required by the 'concrete' method), purchases goods at a price lower than the current price at the time of avoidance. In this case, awarding damages under the 'abstract' formula will most likely over-compensate the buyer. How can such results be justified in the light of the compensatory purpose of damages?

There are many possible justifications. First, in the context of English sales law where the 'abstract' method of calculation represents the main presumptive rule of calculating damages, it is often said that the arrangements the injured party has made with third parties (sub-sale or cover purchase) is a circumstance 'peculiar to the injured party' with which the breaching party 'has nothing to do' and that 'it does not lie in the breaching party's mouth' to say that the injured party is over-compensated.[108] Second, it can be argued[109] that the law should

[103] '[T]he market rule is founded on abstraction. It is concerned not with the factual situation of the plaintiff-buyer but with the position of the notional, reasonable buyer, who is hypothesized as locked into remedial action on a single, statutorily defined date' (Goode (n 42) 386).

[104] See EA Farnsworth, 'Legal Remedies for Breach of Contract' (1970) 70 Columbia L Rev 1145, 1198.

[105] See, eg, Stoll and Gruber (n 26) 781; Case No 19 U 97/91 Appellate Court Hamm (Germany) 22 September 1992 (Frozen bacon case) <http://cisgw3.law.pace.edu/cases/920922g1.html> ('This provision relies upon the idea that obligor is entitled to conduct [a] cover transaction at the market price').

[106] Goode (n 42) 368 (taking a similar view with respect to s 51(3) of the Sale of Goods Act).

[107] See, eg, Bridge (n 43) 576; White and Summers (n 46) 212–13.

[108] See, eg, *Rodocanachi, Sons & Co v Milburn Brothers* (1886) 18 QBD 67; *John Neil Mouat v Betts Motors Ltd* [1959] AC 71.

[109] D Simon and GA Novack, 'Limiting the Buyer's Market Damages to Lost Profits: A Challenge to the Enforceability of Market Contracts' (1978–1979) 92 Harv L Rev 1395, 1396, 1403.

not worry about over-compensating the injured party because if the 'abstract' formula is not used, it will be the breaching party who will keep the advantage of market movements.[110] From this perspective, the 'abstract' formula can be viewed as a kind of gain-based measure aimed at preventing a breaching party's unjust enrichment.[111] Third, it has been argued that over-compensation can be justified because what the injured party loses is an *opportunity* to make a profit from market movements and it is an opportunity which a breaching party keeps to itself by breaching the contract.[112] It has been further suggested that this opportunity 'has the value assigned by the market, which weighs the chance of winning or losing and arrives at a quantification of those chances in the form of the market price'[113] and for this reason, 'market damages represent the true value of the market opportunity denied to the plaintiff'.[114] Fourth, in relation to cases where a party delays finding a substitute in order to observe market movements, it can be argued that there is nothing wrong in speculating.[115] In this respect, the 'abstract' formula maintains symmetry by giving the party the fruits of its speculation (thereby encouraging speculation) and at the same time, forcing it to bear the risk of unsuccessful speculation. This way, speculation does not occur at the expense of the breaching party. Fifth, it has been suggested that if the mitigation rule were to set a limit on the recovery of damages, it would encourage 'artificial transactions' in the sense that an injured seller, for example, wishing to speculate on a rising market would sell the goods to reduce its loss, as required by the mitigation rule, and then would immediately repurchase them.[116] The law, it has been argued, should not encourage such artificial transactions.[117] The 'abstract' formula has also been said to be the most practical rule because it does not pretend to 'search for the elusive goal of perfect compensation' and in contrast with the 'concrete' assessment, does not involve the complexity and high costs associated with the inquiry into the claimant's particular circumstances.[118] It has been further suggested that the 'abstract' formula can be viewed as a kind of statutory liquidated damages clause which may

[110] If we take the very first example in the previous paragraph of the main text, it can be argued that if the innocent buyer is not overcompensated by a £20,000 award, the breaching seller will effectively benefit as a result of its own breach.

[111] Simon and Novack (n 109), 1403; Yovel (n 48).

[112] *Ibid* 1419; RE Scott, 'The Case for Market Damages: Revisiting the Lost Profits Puzzle' (1990) 57 University Chicago L Rev 1155, 1169.

[113] Simon and Novack (n 109) 1419.

[114] *Ibid,* 1420.

[115] See Bridge (n 43) 583.

[116] See S Waddams, 'The Date for the Assessment of Damages' (1981) 97 LQR 445, 447. To some extent, this point can be countered by arguing that the upshot of the mitigation rule is that the recovery is, in any event, limited to the amount of *avoidable loss* and that it is not necessary for an injured party to *actually* mitigate its loss since whether the seller makes an artificial sale and then repurchases the goods or not is of no significance (apart from additional mitigation costs) because the amount of recovery is likely to be the same in both cases.

[117] *Ibid,* 447.

[118] Waddams (n 69) 29–30.

encourage performance and deter breaches.[119] Finally, probably the most important justification is based on the view that the 'abstract' formula has the advantage of simplicity and certainty since, by referring to a hypothetical transaction, it avoids the complexity, uncertainty and length of time associated with the need to examine the claimant's circumstances. With this in mind, it can be contended that the 'abstract' assessment is much better suited than its 'concrete' counterpart to those sectors of trade where certainty regarding parties' legal positions and speed are of utmost importance.[120] Therefore, it is the kind of 'rough justice'[121] rather than the goal of perfect compensation that some traders would arguably prefer. It may also be claimed that the avoidance of complexity and length of time associated with examining the claimant's circumstances may be more appropriate for the purpose of efficient administration of justice.[122]

2.2.2 Relationship between 'concrete' and 'abstract' measures

For some legal systems, the starting point is the 'abstract' measure[123] while some other systems seem to allow an injured party to select between the 'concrete' and 'abstract' measures.[124] The international instruments appear to show their preference for the 'concrete' measure by stipulating that the difference between the contract price and the current price can be claimed where no substitute transaction has been made.[125] In other words, the 'concrete' measure has precedence over the 'abstract' measure and if the injured party has made a replacement transaction which meets the requirements of the 'concrete' method of calculation, damages will have to be calculated 'concretely'.[126] Despite the drafters'

[119] EA Peters, 'Remedies for Breach of Contract Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article Two' (1963–1964) 73 Yale L J 199, 259.

[120] '[A] punctilious insistence upon standards and time is much more justifiable in the case of commodities traders active on a broad front who engage in the complex managerial process of stitching together their various purchase and resale commitments' (MG Bridge, 'The Evolution of Modern Sales Law' [1991] LMCLQ 52, 59); 'Certainty and speed is a virtue of futures trading, uncertainty a possible recipe for disaster. Time is money in the market area . . .' (S Fisher and M Hains, 'Futures Market Law and Practice and the Vienna Sales Convention' [1993] LMCLQ 531, 555). See also MG Bridge, 'Uniformity and Diversity in the Law of International Sale' (2003) 15 Pace Int'l L Rev 55, 67.

[121] CT McCormick, *Handbook on the Law of Damages* (St Paul, Minn, West Publishing Co, 1935) 184–5.

[122] See MG Bridge, 'The Market Rule of Damages Assessment' in D Saidov and R Cunnington, *Contract Damages: Domestic and International Perspectives* (Oxford, Hart Publishing, 2008) 446 ('A perfect sense of justice in the application of rules of damages assessment is at odds with the efficient administration of justice').

[123] See ss 50(3) and 51(3) of the English Sale of Goods Act.

[124] See ss 2-706, 2-708, 2-712 and 2-713 UCC.

[125] See arts 76 CISG, 7.4.6 UPICC and 9:507 PECL.

[126] See Ziegel (n 44) 9–39. See also B Nicholas, 'Vienna Convention on International Sales Law' (1989) 105 LQR 201, 230 (who expresses regret regarding the precedence of art 75 over art 76 CISG in cases where the injured seller resells at a price higher than the current price and points out that the result of the 'concrete' formula in art 75 debarring the use of art 76 is harsh because the breaching buyer is thereby allowed to keep the benefit of a good bargain made by the seller. This position echoes the approach taken by English sales law which generally favours the 'abstract' measure and

intention to introduce certainty by means of this hierarchical structure,[127] the answer to the question of how relentless the instruments are in their commitment to the 'concrete' measure remains uncertain. Besides the important consideration of certainty, this question is also significant since the answer to it will demonstrate whether the argument that, in comparison with some domestic systems, the instruments (the CISG in particular) are less well suited to certain trade sectors is justifiable, and whether the instruments can reap the benefits and implement worthy policies associated with the 'abstract' assessment. To answer this question, the relationship between the instruments' 'concrete' and 'abstract' formulae needs to be explored.

It is usually recommended that the abstract formula be used: where the innocent party fails to conclude a substitute transaction; where the requirements of the 'concrete' method of calculation have not been met; or where it is impossible to determine which transaction is a replacement for the breached contract.[128] The latter situation has been discussed above and it is suggested that where it is impossible to establish an actual replacement transaction, it is certainly justifiable to resort to the 'abstract' measure. The first two situations, however, raise a difficult issue as to the relationship between the 'abstract' measure and the mitigation rule. The innocent party's failure to make a replacement transaction or to conclude a transaction in a reasonable manner or within a reasonable time will often constitute a failure to mitigate. At this point, a difficult situation arises: should the abstract measure *alone* be applied with the mitigation rule being ignored, or should the amount of avoidable loss set the ceiling for recovery? If the 'abstract' measure in its pure form is applied, the mitigation rule will be disregarded because this measure is based on a *hypothetical* substitute transaction and in that sense, it can be said to presume mitigation. At the same time, however, it contravenes the mitigation rule for by looking at a hypothetical transaction, it is not concerned with whether the injured party has taken *actual* steps to mitigate its loss. Several cases under the CISG highlight this difficulty by showing that it is often the case that where the requirements of art 75 are not met, judges and arbitrators simply resort to art 76 with no or little regard for the mitigation rule.[129] In many cases, this approach may be justified since the

highlights the existing tension stemming from the choice and relationship between the 'concrete' and 'abstract' measures).

[127] See Honnold (n 20) 452.

[128] See, eg, JS Sutton, 'Measuring Damages under the United Nations Convention on the International Sale of Goods' (1989) 50 Ohio State LJ 737 (also at <http://www.cisg.law.pace.edu/cisg/biblio/sutton.html>).

[129] See CIETAC Arbitration proceeding 29 September 1997 (Aluminium oxide case) <http://cisgw3.law.pace.edu/cases/970929c1.html> where, although the tribunal found that the seller had failed to mitigate its loss by purchasing the goods from its supplier despite there having been no indications that the buyer would be able to perform the contract, the tribunal did not calculate damages on the basis of how the seller ought to have mitigated its loss (which, presumably, would have been refraining from purchasing the goods from its supplier with the result that damages would be a compensation for loss of the profit margin). Instead, the tribunal relied on the 'abstract' formula in art 76; CIETAC Arbitration proceeding 1 March 1999 (Canned mandarin

'abstract' measure is based on a hypothetical substitute with reference to the 'current/market' price and it will often reflect how an innocent party ought to have reasonably mitigated its loss.[130] However, in some cases the application of the mitigation rule would lead to results different from those flowing from the 'abstract' measure.

Take the example of the injured seller who rejected the breaching buyer's offer to purchase the goods and resold them at a price lower than the one offered by the buyer. The application of the mitigation rule ('concrete' measure) may disallow the recovery exceeding the difference between the contract price and the price offered by the buyer. From the standpoint of the mitigation rule, if the price offered by the buyer is higher than the current price, the 'abstract' measure (the difference between the contract price and the current price) will overcompensate the seller because had it acted reasonably by accepting the buyer's offer, its damages would have been lower.[131] Another example is where an innocent seller, after the buyer's failure to accept the goods, delays avoiding the contract to see whether the market price is going to rise. If this speculation proves unsuccessful because the market has been falling and the seller eventually avoids the contract and resells the goods, the mitigation rule may require that damages be assessed as if the contract were avoided earlier when the price was higher. The 'abstract' measure would give the seller the difference between the contract price and the current price at the time of avoidance and this difference is higher than the amount arrived at by means of the mitigation rule.[132] Yet another example of speculation relates to the buyer who has a sub-sale contract and either fails to make a replacement transaction within a reasonable time or fails to find a replacement. The 'abstract' measure would give the buyer the difference between the contract price and the current price at the time of avoidance while the mitigation rule would often prevent the award exceeding the amount of avoidable loss which, in such cases, means that the buyer ought to have bought a replacement and fulfilled its sub-sale. In a rising market, damages

oranges case) <http://cisgw3.law.pace.edu/cases/990301c1.html> (discussed below—see note 135 and accompanying paragraph in the main text); Case Nos 1 U 143/95 and 410 O 21/95 Appellate Court Hamburg (Germany) 4 July 1997 (Tomato concentrate case) <http://cisgw3.law.pace.edu/cases/970704g1.html> ('As the buyer does not claim to have bought goods in replacement and there is a current price for the goods at issue, the buyer is entitled to recover the difference between the price fixed by the contract and the (higher) current price at the time of avoidance according to Art. 76(1) CISG' and Case No A3 1997 61 District Court Zug 21 (Switzerland) October 1999 (PVC and other synthetic materials case) <http://cisgw3.law.pace.edu/cases/991021s1.html>, which seem to demonstrate how easy the courts have found it to dispense with the inquiry as how losses ought to have been mitigated and to resort to art 76 CISG; see also CIETAC Arbitration proceeding 30 July 1996 (Molybdenum iron case) <http://cisgw3.law.pace.edu/cases/960730c1.html> and CIETAC Arbitration proceeding 30 July 1996 (n 23).

[130] See Arbitration proceeding Case No 48 dated 2005 (n 23).

[131] For the discussion of a CISG case based on similar facts and the tribunal's position, see note 135 below and an accompanying paragraph in the main text.

[132] Such a situation may rarely arise, however, because avoidance of the contract should generally be effective only if done within a reasonable period of time and this means that it has to be in line with the mitigation rule.

flowing from the 'abstract' measure (the difference between the current price and contract price) at the time of actual avoidance are likely to be higher than damages for the loss that would have occurred had the buyer avoided the contract within a reasonable time and/or purchased a substitute.[133]

The instruments' position is ambivalent with respect to the question of whether the 'abstract' measure alone should be applied with the duty to mitigate being ignored or whether the amount of avoidable loss should set the ceiling for recovery. On the one hand, they seem to allow resort to the 'abstract' measure whenever the replacement transaction has not been made or where an alleged substitute was not made in a reasonable manner or within a reasonable time. The availability of the 'abstract' measure in such cases, seemingly *as of right*, would suggest that the question whether the party has actually mitigated its loss can be ignored, particularly since the 'abstract' measure already presumes, to a significant extent, a hypothetical mitigation. On the other hand, the mitigation rule is clearly enunciated and it would seem, therefore, that damages awards were not intended to exceed the amount of avoidable loss. According to this approach, the amount of reasonably avoidable loss sets the ceiling for recovery in *all* cases including those where the 'abstract' measure is used. How should this contradiction be resolved? It is submitted that it cannot be resolved without restricting the scope or diminishing the role of either the 'abstract' formula or the mitigation rule. There are strong arguments supporting both approaches and it is by no means easy to resolve this difficulty.

To support the use of the 'abstract' formula, it can be said that if the mitigation rule sets the ceiling for recovery in *all* cases, this will, in cases similar to the above examples, deprive the 'abstract' measure of its purpose. Focus on the *actual* mitigation is in harmony with the 'concrete' measure but not with the 'abstract' measure which is based on a *hypothetical* substitute transaction (often representing a mitigation measure). Allowing an 'actual mitigation' to interfere with a rule already based on a 'hypothetical mitigation' would be anomalous. Since the instruments provide for the 'abstract' formula, it seems reasonable to infer that the instruments were intended to incorporate policies and purposes underlying this formula.[134] One purpose underlying the abstract measure is to promote simplicity and certainty in calculating damages by dispensing with the need to examine the claimant's particular circumstances and to apply the mitigation rule (which would necessitate such an inquiry). In short, the abstract measure does not presuppose the application of the mitigation rule. This approach has been taken in one case[135] decided under the CISG where the breaching buyer offered to purchase the goods (the contract price of which was $12.20) at a price of $11.40 per box of the goods. The seller rejected the offer and

[133] The comment in n 132 is relevant here as well.

[134] The policy arguments set out earlier can also be invoked to render further support for the use of the abstract formula (see above).

[135] CIETAC Arbitration proceeding 1 March 1999 (n 129).

resold the goods at a price of $7.79 per box. The tribunal determined that a reasonable current/market price was $10.40 and awarded the difference between the contract price ($12.20) and the current/market price ($12.20 – 10.40 = $1.80). This clearly demonstrates the tribunal's preference for the abstract measure with a complete disregard for the mitigation rule which, if applied, would have most likely dictated accepting the buyer's offer to purchase at a price of $11.40 as that would have reduced losses ($12.20 – 11.40 = $0.80).

To support the priority of the mitigation rule, it can be argued that the existence of the express provision on mitigation cannot be ignored and for this reason, damages must never exceed the amount of avoidable loss. With respect to some of the examples above, it can also be argued that ignoring the mitigation rule would allow an innocent party to engage in speculation and to be over-compensated. Finally, it can be suggested that the instruments generally seem to favour the calculation of damages in accordance with the claimant's *actual* situation by giving precedence to the 'concrete' formula and by pursuing the purpose of putting the party in the position in which it would have been had the contract been properly performed. The mitigation rule should override the 'abstract' measure because, as explained, it is in harmony with the 'concrete' measure.

It is suggested that it is the fundamental principles of full compensation and protecting the party's expectation/performance interest which should turn the scale in favour of the latter position to prevent over-compensation in cases similar to the examples above.[136] This would mean that the scope of the 'abstract' measure would have to be restricted where it is evident that its application would result in a windfall.[137] Nevertheless, it is to be hoped that such cases will be rare and in fact some cases under the CISG demonstrate that the 'abstract' measure in art 76 often complements the mitigation rule. In several cases, where the seller's resale did not meet the requirements of art 75, it has been held that the seller ought to have mitigated its loss by reselling at the current market price and consequently, damages were calculated in accordance with art 76.[138] Similarly, in one case, the tribunal held that the injured buyer ought to have mitigated its loss by procuring substitute goods at the market price and calculated damages according to the 'abstract' measure.[139]

[136] A potentially difficult relationship between the 'abstract' formula and the mitigation rule results, it is suggested, from the drafters' failure to clarify this relationship. By stipulating the possibility of the reliance on the 'abstract' formula, the drafters ought to have foreseen the potential conflict with the duty to mitigate.

[137] A similar approach seems to have been taken in the context of art 76, in the case of anticipatory breach, in P Schlechtriem, 'Calculation of Damages in the Event of Anticipatory Brach under the CISG' <http://www.cisg-online.ch/cisg/FS%20Hellner.pdf> 1, 11, 13–14.

[138] Arbitration Award of June 1999 (China) (Peanut kernel case) <http://cisgw3.law.pace.edu/cases/990600c1.html> ('[The] [s]eller should take reasonable measures to resell the goods at the current market price to mitigate its loss. [The] [s]eller's reasonable and direct loss of profits should be the difference between the contract price and the current market price.'); Appellate Court Hamm 22 September 1992 (n 105).

[139] Arbitration proceeding Case No 48 dated 2005 (n 23).

This work's suggestion that the mitigation rule should set the ceiling for recovery where the 'abstract' measure produces a windfall may not, however, be in line with a number of cases under the CISG which reflect an attitude favourable to the use of the 'abstract' measure. Some cases reveal that judges and arbitrators have not been particularly concerned with the problem of the relationship between the 'abstract' measure and the mitigation rule and have often resorted to the former paying little or no attention to the latter.[140] This attitude may stem from the fact that it is relatively simple and convenient to use the 'abstract' formula in practice or, to some extent, from the desire not to place too strong an emphasis on the duty to mitigate. The remaining cases relating to situations where the contract has been avoided and touching upon the relationship between arts 75 and 76 also reveal an attitude which favours the 'abstract' measure. Thus, in one case,[141] the 'concrete' and 'abstract' formulae, contained in arts 75 and 76 respectively, were treated as alternatives. The court stated that '[t]he [s]eller may choose between reselling the goods and recovering the difference between the contract price and the price in the substitute transaction following Art. 75, or, without reselling the goods, [Seller] may recover the difference between the contract price and the current price at the time of the avoidance, Art. 76(1)'.[142] Although this interpretation clearly contravenes the structure of these provisions under the CISG (which only allows resorting to art 76 if art 75 cannot be applied), it reflects a desire to confer a higher standing on the 'abstract' formula in art 76 than it actually has. In some other more extreme cases, arbitrators appear to have treated the 'abstract' measure in art 76 as a starting point, thereby effectively taking an approach similar to that of the English sales law. In one case,[143] where the seller failed to deliver the goods (and partly delivered defective goods) bought for resale, the tribunal awarded the buyer the difference between the contract price and 'the average market price' without even considering whether the buyer has attempted to find a replacement in accordance with arts 75 and 77.[144] In another case,[145] the tribunal carefully considered whether art 76 could be used and only after concluding that it could not be applied did it resort to art 75.[146] It is once again difficult to justify this

[140] See note 129.

[141] Case No 4 R 219/01k Appellate Court Graz (Austria) 24 January 2002 (Excavator case) <http://cisgw3.law.pace.edu/cases/020124a3.html>.

[142] *Ibid*.

[143] ICAC Case 175/2003, decision dated 28 May 2004 <http://www.cisg.law.pace.edu/cases/040528r1.html>.

[144] The tribunal did not ignore the mitigation rule completely by noting that insuring the goods allowed the buyer to reduce the loss. The duty to mitigate, however, was not considered from the standpoint of whether the buyer ought to have found a replacement to fulfil its sub-sale.

[145] ICC Arbitration Case No 8740 of October 1996 (Russian coal case) <http://cisgw3.law.pace.edu/cases/968740i1.html> (see the buyer's third counterclaim).

[146] For another case where a similar approach has been taken, see Case No 18-40 "K" Arbitration Court of Moscow City (Russia) 3 April 1995 (Russian coal case) <http://cisgw3.law.pace.edu/cases/950403r1.html>.

approach considering the Convention's express requirement to apply the 'concrete' measure first.

2.2.3 The 'abstract' formula: preconditions and application

The first condition for using the 'abstract' formula is that the 'concrete' formula must be inapplicable and the relationship between the two has been discussed above. The second precondition is that it can be used only where the contract has been avoided.[147] This provision potentially enables the injured party to engage in a speculative delay in avoiding the contract at the expense of the breaching party.[148] This danger can be countered by the rules on the avoidance of the contract. Under the UPICC and PECL, the injured party loses the right to avoid the contract unless it does so within a reasonable time.[149] So far as the CISG is concerned, the same limitation is expressly imposed in specified cases only[150] and it is not clear whether it will be applicable to situations outside those cases.[151] There is a possibility, therefore, that in cases other than those specifically referred to in the CISG, the 'reasonable time' limitation will not be applicable and to that extent, the rules of avoidance under the CISG will not be capable of countering the injured party's speculation.[152] In any event, as argued above, the problem of speculation can be adequately dealt with by the mitigation rule.[153] In addition, a means of countering the problem of speculative delay in avoiding the contract has been introduced into the CISG,[154] which provides that if the party has avoided the contract after 'taking over the goods, the current price at the time of such taking over shall be applied instead of the current price at the time of avoidance'.[155] Consequently, in cases where the party has

[147] The original proposal in the 1978 Draft Convention referred to the current price 'at the time he first had the right to declare the contract avoided' (see art 72(1) of the 1978 Draft Convention <http://www.cisg.law.pace.edu/cisg/1978draft.html>). However, some of the delegates took the view that since it might be difficult to establish the precise moment when the contract could first be declared avoided, the provision was too elastic and uncertain and potentially creates room for a great deal of litigation. The provision referring to the time of avoidance was, therefore, considered to be more certain (see deliberations at the 10th Plenary Meeting of the 1980 Vienna Diplomatic Conference <http://www.cisg.law.pace.edu/cisg/plenarycommittee/summary10.html >).

[148] See examples above.

[149] See arts 7.3.2 UPICC and 9:303 PECL.

[150] See arts 49(2) and 64(2)(b) CISG.

[151] For the view that this limitation should apply to all cases and not just those specifically referred to in the CISG, see, eg, J Yovel, 'Buyer's Right to Avoid the Contract: Comparison between Provisions of the CISG (Article 49) and the Counterpart Provisions of the PECL (Articles 9:301, 9:303 and 8:106)' <http://www.cisg.law.pace.edu/cisg/text/peclcomp49.html#jyvii>.

[152] See Treitel (n 1) 119 (who assumes that the reasonable time limitation under the CISG is applicable to all cases).

[153] For a similar view, see Stoll and Gruber (n 26) 785.

[154] Knapp (n 18) 555; Comment (b) on Article 76 in J Ziegel and C Samson, *Report to the Uniform Law Conference of Canada on Convention on Contracts for the International Sale of Goods* (1981) <http://www.cisg.law.pace.edu/cisg/wais/db/articles/english2.html>; Honnold (n 20) 451.

[155] Article 76(1) CISG.

taken over the goods, it will not be able to engage in speculation by delaying the time of avoidance.

The provision on 'taking over of the goods' has, however, been criticised for two reasons. First, the injured party may find itself in the position where it is not yet aware of the breach at the time where the goods have been taken over.[156] This may be the case, for example, where there is a hidden defect in the goods which could not reasonably have been discovered at that time.[157] Assessing damages by reference to the current price at the time of taking over in such cases has been said to cause prejudice to the buyer[158] and it is further submitted that such an assessment is not entirely in line with the rationale underlying the 'abstract' formula. The formula implies that a party is in the position to make a hypothetical replacement transaction. However, the party would not see the need of finding a replacement unless it is aware of the breach. For this reason, it would appear that awareness of the breach is a necessary assumption underlying the 'abstract' formula.[159] Second, this provision has been criticised for being partial in operation as it is generally applicable only to the buyer.[160] This means that the CISG contains an asymmetry by placing a greater emphasis on, and containing an additional means of countering, the danger of speculation in the case of an injured buyer. There is no evidence that there is a policy consideration justifying a more extensive legal treatment of this problem (than that applicable to the injured seller) insofar as the buyer is concerned.

These concerns can be alleviated by the following. The provision on 'taking over of the goods' will not be relevant in many cases such as those where goods have not been delivered.[161] Similarly, the situation where the injured party may not be aware of the breach at the time of taking over will arise only in some, but not all, cases, and the first concern is confined to such cases only. It is submit-

[156] See Treitel (n 1) 119; Schlechtriem (n 19) 97.

[157] See Treitel (n 1) 119.

[158] See *ibid*.

[159] It is recognised that the injured party's awareness of the breach is an assumption underlying the 'abstract' formula in English sales law (see *ibid*, 117).

It is interesting to pose the question as to whether the approach of English law, which generally determines the market price as of the date of the breach, is more in line with the rationale underlying the 'abstract' formula than the approach of the international instruments because the date of breach or the period shortly thereafter are considered to be the time when the injured party would find a replacement. The 'breach date' rule is in absolute harmony with the policy of encouraging speculation as all benefits and losses after that date are generally ignored in assessing damages (see, eg, Bridge (n 43) 561). The 'time of avoidance' rule also encourages speculation but, in the absence of the rules on avoidance and mitigation, speculation would occur at the expense of the breaching party. In this sense, the approach of English sales law arguably leads to more symmetrical and fair results. The time of taking over of the goods is clearly intended to counter speculation and is therefore based on a different policy than the one underlying the 'abstract' measure with reference to the 'breach date' rule. It is submitted that the question would have been important had the 'abstract' formula constituted a *prima facie* measure of damages under the international instruments as, in that case, it would have played a primary role in the assessment of damages.

[160] See Treitel (n 1) 119. See also Honnold (n 20) 451 ('sellers seldom avoid the contract *after* taking over the goods').

[161] See Ziegel and Samson (n 154).

ted, however, that in such cases, the 'abstract' formula should be inapplicable. The formula assumes that the injured party is able (in this case, at the time of taking over) to find a hypothetical replacement and, as noted, the party will not see the need to do so unless it is aware of the breach. Since the concern stems from the party's unawareness of the breach, the assumption underlying the formula is not present.

The next precondition for using the 'abstract' formula is that there must be a 'current price' for the goods. The CISG provides that 'the current price is the price prevailing at the place where delivery of the goods should have been made or, if there is no current price at that place, the price at such other place as serves as a reasonable substitute, making due allowance for differences in the cost of transporting the goods'.[162] The UPICC attempt to clarify the meaning of the term 'current price' by stating that it 'is the price generally charged for goods delivered or services rendered in comparable circumstances at the place where the contract should have been performed or, if there is no current price at that place, the current price at such other place that appears reasonable to take as a reference'.[163] Despite these guidelines, cases under the CISG demonstrate that the greatest difficulty associated with the application of the 'abstract' formula stems precisely from the need to determine the 'current price'.

In capitalist economic systems, the current price is usually understood to mean the 'market price',[164] that is, the price at which the goods can be sold or bought at the relevant market. However, it seems that there exists a possibility that the current price will be a price other than the market price[165] and for this reason the two cannot be treated as always having an identical meaning. Nevertheless, because in the vast majority of cases the current price will be derived from the market price, it is necessary to briefly explore the notion of a market because, generally, it is only by means of an understanding of what constitutes a market that the market price can be properly ascertained.[166] The term 'market' does not have a precise meaning[167] but, in its broadest sense, it has been

[162] Article 76(2) CISG.

[163] Article 7.4.6(2) UPICC. PECL do not contain a similar provision.

[164] See Nicholas (n 126) note 30; DWM Waters, 'The Concept of Market in the Sale of Goods' (1958) 36 The Canadian Bar Rev 360, 365 ('there appears to have been no contention in the courts against at least regarding the words 'market or current' as identical in meaning).

[165] This seems to be the position of Comment 2 on Article 7.4.6 UPICC ('[The current price] will often, but not necessarily, be the price on an organised market. Evidence of the current price may be obtained from professional organizations, chambers of commerce, etc.').

[166] See, however, Waters (n 164) 385–6 (arguing, in the context of the common law, against gearing the 'market price' to the meaning of 'market' on that basis that 'with the widening of the economic horizon and trade levels, evidence of 'market prices' is increasingly drawn from more remote sources, for example, foreign exchanges and a variety of publications' and that '[s]ometimes prices will be quoted when in fact buyers or sellers are nowhere to be found'. It would seem, however, that what this commentator is really advocating is the extension of the notion of the 'market price' and this seems to be the approach that is taken by the international instruments which do not confine the abstract formula to the 'market price' and instead refer to the presumably broader notion of the 'current price').

[167] Goode (n 42) 382 (with a further reference).

said to be 'any place or system by which intending buyers of goods . . . can find or be put in touch with intending suppliers of those goods . . ., and vice versa'.[168] It is helpful to point out that in the context of English sales law the term 'available market' has been interpreted to mean 'that the situation in the particular trade in the particular area was such that the particular goods could freely be sold'[169] and it has been stated that the market price is to be fixed by the laws of supply and demand.[170] It is suggested that there is no reason why these guidelines could not be used for determining whether or not a market exists for the purposes of the 'abstract' formula under the international instruments. In fact, a somewhat similar approach to defining a market has been taken in a case[171] under the CISG where it has been stated that a market should provide an objective basis for determining the value of goods and that this objective basis is 'formulated by the existence of a variety of suppliers and a variety of consumers seeking similar goods and purchasing them for a current value determined on the basis of supply and demand'. According to another case under the CISG, that market implies that there are 'regular business transactions for goods of the same type'.[172] It is also widely accepted that, in modern economy, markets do not necessarily imply the existence of a particular physical location. As noted, markets should be rather understood as a 'situation in a particular trade' or 'a particular level of trade'.[173]

It is also important to note that, in the context of English sales law, a market has generally been said to exist where it can absorb all goods by 'would-be sellers' and has the capacity to supply (meet the demand of) all 'would-be buyers'.[174] Nevertheless, this position has not been taken to an extreme. In one case[175] involving the sale of 15,000 tons of lard, it has been held that where it was possible for the injured party to buy smaller quantities (up to 2,000 tons at time) over a period of time, a market could be said to exist. It is submitted, in this regard, that a similar stance with respect to the notion of a 'market' should be taken in the context of the instruments. Indeed, since the rationale underlying the 'abstract' formula is based on the injured party's being in the position to make a substitute transaction, it seems to follow therefrom that a market should generally be able to absorb all of the seller's goods or to meet the entire demand of the injured buyer.[176] At the same time, this approach does recognise that a

[168] Goode (n 42) 153.
[169] *Thompson (WL) v Robinson (Gunmakers)* [1955] Ch 177, 187.
[170] *Charter v Sullivan* [1957] 2 QB 117, 128.
[171] ICC Arbitration Case No 8740 of October 1996 (n 145).
[172] Appellate Court München 15 September 2004 (n 42).
[173] See *Heskell v Continental Express Ltd* [1950] 1 All ER 1033, 1056.
[174] See *Thompson (WL) v Robinson (Gunmakers)* (n 169); *Benjamin's Sale of Goods,* 7th edn (London, Thomson–Sweet & Maxwell, 2006) 1009.
[175] *Garnac Grain Co Inc v HMF Faure & Fairclough Ltd* [1968] AC 1130, 1138.
[176] This point is at the core why the 'abstract' formula is inapplicable to the lost volume situation. Where the seller's supply exceeds the demand for the goods, there is no market for the goods because it is not able to absorb the seller's goods. To reverse this point, it can be argued that had there been a market for the seller's goods, a lost volume situation would not have arisen.

market may exist in circumstances where not all goods can be available at once (the reverse being that not all goods can be absorbed at once) so long as it is *reasonable* for the injured party to satisfy its interest by going into that market in the light of its business situation.

In short, it is thought that the meaning of a market can be understood by reference to the following general characteristics. First, although it is impossible to state the number of potential buyers and sellers, there must be a 'sufficiency'[177] of buyers and sellers required to constitute a market. Second, the market should provide a means whereby potential buyers and sellers can be put in touch with each other.[178] Third, it seems that there must be a certain degree of activity[179] or regularity of transactions. Fourth, a market must be one for similar or comparable goods.[180] Fifth, markets do not necessarily imply the existence of a physical location. Finally, a market generally exists where all goods can be absorbed or the entire demand can be met by it. Nevertheless, where the injured party's needs cannot be met at once, there may still be a market if it provides an opportunity for this party to satisfy its needs over a period of time and it is reasonable for it to do so.

Upon a proper analysis, it is likely that the absence of one (and, certainly, of more than one) of the aforementioned characteristics will lead to the conclusion that there is no market for the goods in question. For example, in one case under the CISG[181] involving the contract for the supply of coal, it has been found that coal has a variety of specifications and its value is dependent on the particular needs of each customer and, for these reasons, there was no objective basis for establishing the market price. It is suggested that the tribunal's inability to find a market for coal can be primarily explained by the absence of the third characteristic feature, that is, the lack of the necessary degree of activity or regularity of transactions.[182] The dependence of the value of coal on a variety of specifications and the particular needs of a customer rendered coal a 'specialized' type of goods and, as pointed out by one commentator, some goods 'can be specialized to the point of insufficient activity to evidence a market'.[183] It is suggested that it is this latter statement that best explains the decision in that case.

[177] See Bridge (n 43) 568.

[178] See note 168; Bridge (n 43) 568.

[179] See Bridge (n 43) 569.

[180] Some judges and arbitrators applying the CISG seem to have taken a flexible approach to this issue by being prepared to rely upon similar goods where identical goods cannot be found (see the quote from the ICC Arbitration Case No 8740 of October 1996 (n 145) reproduced above (see the main text accompanying n 171); see also cases discussed below). Article 7.4.6(2) UPICC also reflects a degree of flexibility in this respect by defining the current price as 'the price generally charged for goods delivered or services rendered in *comparable* circumstances' (emphasis added). For a stricter approach in the context of English law, see Goode (n 42) 383.

[181] ICC Arbitration Case No 8740 of October 1996 (n 145).

[182] The decision implies that a market must consist of 'many purchasers and sellers actively engaged in *regular* trading' (*ibid* (emphasis added)).

[183] See Bridge (n 43) 569.

Despite the possibility of setting out the general characteristics of a market, difficulties may arise regarding the appropriateness of using a particular market in specific circumstances. One such situation is where the seller breaches a forward contract and no forward market exists for the goods in question. Can the buyer rely on a spot market to determine the current price?[184] It is suggested that, in principle, this should be possible[185] as long as such a hypothetical transaction can, in the circumstances, be considered as a reasonable substitute considering the buyer's business situation and what the buyer intended to do with the goods. The problem of the comparability of prices should not be acute since it would seem that prices at these markets (the so-called 'physical' markets), albeit not necessarily identical, would generally reflect a similar price movement.[186] Another situation is where the only market available is the so-called 'black market'[187] and the question is whether such a market can be used as the basis for determining the current price. The position in some common law systems is that, in principle, the market price can be derived from a 'black market'[188] and it is suggested that, in principle, the same could be argued in the context of the international instrument so long as, in the particular circumstances, this market provides a sound basis for determining the current price. An important factor is whether or not it is reasonable to expect the injured party to make a hypothetical cover in a black market. If procuring a cover in a black market would constitute a breach of the law, then doing so cannot be reasonable[189] and, therefore, a black market cannot be relied upon to determine the current price in these circumstances.

Turning to other considerations relating to the current price, it should be mentioned that the Convention's starting point is that the current price is the price 'at the place where delivery of the goods should have been made'[190] whereas the UPICC (because they are also applicable to contracts other than sales) refer to the place 'where the contract should have been performed'.[191] The seller's delivery obligation is set out in art 31 of the CISG[192] and the provision

[184] There are numerous sources setting out the types and definitions of markets (see, eg, *Gebruder Metelmann GmbH & Co KG v NBR (London) Ltd* [1984] 1 Lloyd's Rep 614 (in the context of sugar markets); Goode (n 42) 153–5; also MG Bridge, *The International Sale of Goods: Law and Practice* 2nd edn (Oxford, OUP, 2007), 26–37; for a helpful collection of materials with further comments, see P Todd, *International Trade Law* (London, Thomson–Sweet & Maxwell, 2003) 16–49).

[185] For a similar position in the context of English law, see Bridge (n 43) 569.

[186] Because the prices in physical and futures markets have been said to reflect similar price movements (see, eg, *Gebruder Metelmann GmbH & Co KG v NBR (London) Ltd* (n 184)), it seems reasonable to suppose the same can be said in relation to spot and forward prices (both being in a physical market).

[187] A black market has been defined as that where 'the goods are bought and sold surreptitiously' (*Benjamin's Sale of Goods* (n 174) 1011).

[188] See *John Neil Mouat v Betts Motors Ltd* (n 108).

[189] See *Benjamin's Sale of Goods* (n 174) 1011–12.

[190] Article 76(2).

[191] Article 7.4.6(2).

[192] 'If the seller is not bound to deliver the goods at any other particular place, his obligation to deliver consists: (a) if the contract of sale involves carriage of the goods—in handing the goods over

referring to the current price at the place of delivery has been criticised because it may not be suitable for the injured buyer. The application of art 31 will often lead to the market in the seller's country[193] and it may be practically difficult and inadequate for the buyer to prove market prices in that country.[194] Relying on the price at the place of the arrival of the goods can therefore be more appropriate for the buyer[195] and it has been suggested that to resolve this difficulty art 76(2) CISG might need to be interpreted flexibly.[196] There is a danger, however, that flexibility can only be achieved at the expense of contravening the text of art 76(2). It is, of course, possible to hold that there is no current price in the seller's country and then to rely on the current price in the buyer's country on the basis that the latter is the place that 'serves as a reasonable substitute', as required by art 76(2). But this may not always be the case as the current price in the seller's country may well exist. In such cases, a court or tribunal can either try to find a justification for holding that there is no current price at the place of delivery in order not to deviate from art 76(2) openly or simply ignore its wording and rely on the price in the buyer's country. This latter approach appears to have been taken in one case under the CISG,[197] where the injured buyer who had its place of business in Russia claimed damages under the 'abstract' formula relying on the current price in the Russian market. The tribunal readily accepted the buyer's argument without paying attention to art 76(2), which requires that, first of all, every effort be made to determine the current price at the place of delivery.[198] It is suggested that this approach should not be followed because the Convention's express requirement as to the use of the current price at the place

to the first carrier for transmission to the buyer; (b) if, in cases not within the preceding subparagraph, the contract relates to specific goods, or unidentified goods to be drawn from a specific stock or to be manufactured or produced, and at the time of the conclusion of the contract the parties knew that the goods were at, or were to be manufactured or produced at, a particular place—in placing the goods at the buyer's disposal at that place; (c) in other cases—in placing the goods at the buyer's disposal at the place where the seller had his place of business at the time of the conclusion of the contract' (art 31 CISG).

[193] Each of the three places listed in art 31 will often be in the seller's country (see note 192).

[194] See Honnold (n 20) 452.

[195] Ziegel (n 154) ('I prefer the test in UCC 2-713(2) viz "the place for tender (of the goods) or, in cases of rejection after arrival or revocation of acceptance, as of the place of arrival"').

[196] *Ibid*.

[197] See ICAC Case No 175/2003, decision dated 28 May 2004 (n 143). A similar approach may have been taken in Arbitration proceeding Case No 48 of 2005 (n 23) where the tribunal relied on the market price on the Ukrainian market (the buyer's place of business). This statement would be true if the place of delivery were a place other than Ukraine and it is not clear from the decision what the place of delivery was.

[198] This statement is true if the place of delivery were the place other than the buyer's country. This seems to have been the case because the contract was on 'CPT' ('Carriage Paid To . . .') terms according to which the seller's delivery obligation consists of delivery into the custody of the carrier (or to the first carrier, there are subsequent carriers) for transporting the goods to the destination (see J Ramberg, *ICC Guide to Incoterms 2000: Understanding and Practical Use* (ICC Publishing SA, Paris 1999) 125). However, at the same time the decision refers to the provision in the contract according to which the seller had an obligation to deliver the goods to the place of destination. If, on the true construction of the contract, the seller undertook to deliver to the place of destination, then, of course, the criticism of the case is incorrect.

of delivery cannot be ignored even if that would lead to a more sensible result than that to be reached by strictly adhering to the text of the CISG.[199]

The CISG further provides that in cases where there is no current price at the place of delivery, 'the price at such other place as serves as a reasonable substitute, making due allowance for differences in the cost of transporting the goods'[200] should be used. Similarly, the UPICC provide that if no current price exists at the place where the contract should have been performed, 'the current price at such other place that appears reasonable to take as a reference'[201] should be used. What is a 'reasonable substitute' or a 'place that appears reasonable . . . as a reference' cannot be defined precisely. In very general terms, it has been said that reasonableness of substitution needs to be determined 'from the point of view of an average merchant, in light of the justifiable interests of both parties'.[202] It has been further suggested that the substitute place is reasonable if it offers comparable conditions and is least disadvantageous to the breaching party.[203] This place is sometimes said to be the one which is physically most proximate.[204] The reported cases under the CISG in which this issue has arisen were not, at least expressly, concerned with balancing the interests of parties. Nor did they appear to search for the place which is physically most proximate. Instead, it is striking that in all these cases the arbitrators preferred to rely on what they called the 'international market price'. In doing so, they all took care to ensure that the international market price be fixed in accordance with the conditions comparable to the terms of the original contract. Thus, in one case,[205] where the FOB contract was avoided in April 1997, the international FOB market price in April 1997 was taken as a reasonable substitute price. In another case,[206] where the contract was for No. 2 copper scrap, 'the fair international market price for No. 2 scrap copper' was taken as the basis for the application of the 'abstract' formula, thereby ensuring that the substitute price

[199] At the first sight, this approach seems to have been taken in CIETAC-Shenzhen Arbitration 18 April 1991 (Silicate iron case) <http://cisgw3.law.pace.edu/cases/910418c1.html> where the US buyer claimed damages under art 76 CISG relying on the market price in the United States while the place of delivery was a Chinese port. The tribunal dismissed the buyer's argument and relied on the current price in the Chinese market but it did so not because the Convention contains an express requirement to this effect but for other unrelated reasons (the reason being that the current price in the Chinese market reflected more accurately the delivery conditions of the contract). It is submitted that although the result is correct so far as art 76(2) CISG is concerned, the proper legal basis for reaching this result ought to have been art 76(2) itself.

[200] Article 76(2).

[201] Article 7.4.6(2).

[202] Knapp (n 18) 556.

[203] Stoll and Gruber (n 26) 784.

[204] *Ibid*.

[205] See CIETAC Arbitration proceeding 25 December 1998 (Basic pig iron case) <http://cisgw3.law.pace.edu/cases/981225c2.html>.

[206] See CIETAC Arbitration proceeding 12 January 1996 (Scrap copper case) <http://cisgw3.law.pace.edu/cases/960112c1.html>.

related to the goods of precisely the same technical specifications.[207] In yet another case,[208] the tribunal appeared to fix the international market price on 'CIF Rotterdam' terms as it was expressly pointed out that the original contract price included freight to Rotterdam.[209]

Is the reliance on the international market price appropriate? In the age of the globalisation of markets, the existence of and reliance on international market prices can hardly be surprising and there is evidence of a substantial reliance on such prices in other areas of law.[210] It is suggested, therefore, that so long as they can be duly proven, such prices should be used for the purposes of the 'abstract' formula.[211] It is further submitted that if international market prices can be truly said to exist and can be validly ascertained, they are likely to alleviate the difficulty of finding and ascertaining a current price. They may also render the issues relating to a 'physical location' of a market and consequently those relating to the 'place of delivery' and 'reasonable substitutes' in arts 76(2) CISG and 7.4.6(2) UPICC, less important. A possible existence of an international market price, however, may create a false sense of irrelevance of the notions of comparability to the original contract. As has been partly seen from the cases discussed in the previous paragraph, either an international market price which is identical or comparable to the terms of the original contract will need to be found or an international market price will constitute a general yardstick which will then need to be adjusted to approximate to the terms of the original contract.[212]

Under the CISG, if there has been no taking over of the goods or if the contract has been avoided before such taking over, the current price needs to be determined as of the time of the avoidance of the contract.[213] However, it is

[207] The case is to be criticised for taking the position that the current price must be the price at the time of the delivery of the goods which is incorrect as the CISG clearly provides that the relevant time is that of the avoidance of the contract (see *ibid*).

[208] See CIETAC Arbitration proceeding 2 May 1996 ("FeMo" alloy case) <http://cisgw3.law.pace.edu/cases/960502c1.html>.

[209] This seems to imply the tribunal's awareness of the necessity to adjust the international market price in accordance with the terms of the contract to make the two prices comparable. No mention has, however, been made of an insurance charge which is also a part of the CIF price.

[210] This author has come across numerous model petroleum contracts in which the determination of value of petroleum has been based on 'international market prices' (for an overview of different types of upstream petroleum contract referring to international market prices, see, eg, Z Gao, *International Petroleum Contracts: Current Trends and New Directions* (London, Graham & Trotman, 1994) 129, 182; for the discussion of the nature and structure of oil markets, see EE Smith, JS Dzienkowski, JS Lowe, OL Anderson and GB Conine, *International Petroleum Transactions*, 2nd edn (Denver, Rocky Mountain Mineral Law Foundation, 2000) 749–60).

[211] See CIETAC Arbitration proceeding 29 September 2004 (n 67) ('The Arbitration Tribunal notes that India rapeseed meal is not popular goods purchased internationally, and has no international price quote').

[212] *Soinco v NKAP* Zurich Arbitration proceeding (Switzerland) 31 May 1996 <http://cisgw3.law.pace.edu/cases/960531s1.html> ('the world market price cannot be simply taken to be the [London Metal Exchange] price . . . [and] the necessary adjustments to reflect transportation and other costs free Hungarian border [had to be made]').

[213] See arts 76(1) CISG, 7.4.6(1) UPICC and 9:507 PECL.

suggested that this requirement needs to be interpreted with a reasonable degree of flexibility. As mentioned, the rationale underlying the 'abstract' formula is that an injured party is in the position to make a hypothetical transaction as soon as the contract is avoided. However, it will not always be possible for an injured party to be in the position to find a substitute precisely on the date of avoidance and it seems fair, therefore, that a reasonable period after the avoidance of the contract should still be regarded as meeting the requirements of the 'abstract' formula. For example, in some cases where the current price could not be established as of the time of avoidance, arbitrators have treated the current price several days after that time as acceptable for the purposes of art 76 CISG.[214] It is submitted that this approach is consistent with the rationale underlying that provision.

So far as the CISG is concerned, the current (or, where appropriate, market) price needs to relate to the goods of the same description and quantity as those in the contract.[215] The UPICC appear to take a somewhat flexible approach by referring to the current price for goods delivered 'in comparable circumstances'.[216] The question is: how similar should the description of the goods, for which current/market price is available, be to satisfy the requirements of the 'abstract' formula? The cases thus far decided under the CISG demonstrate that arbitrators generally try to ensure that the description of the goods the current price of which is relied upon be as similar as possible to that of the contract goods. One case[217] involved the sale of 20 tons of ferro-molybdenum (60 per cent molybdenum content), 'CFR Pusan', with goods being loaded in a specified port in China. The buyer alleged that it had made a substitute re-purchase of 20 tons ferro-molybdenum with 60 per cent of molybdenum content on 'CFR Rotterdam' terms and the tribunal refused to recognise that transaction as a proper substitute and instead relied on the 'abstract' formula by adopting, as a starting point, the price in the buyer's alleged substitute transaction and then subtracting from it the difference between the freight rates to Rotterdam and Pusan (the difference being US $89,000). In another case,[218] involving the sale of 'no-name' vacuum cleaners, as opposed to branded ones, it has been held that there was no market for 'no-name' vacuum cleaners and consequently art 76 CISG was not applied.

[214] See CIETAC Arbitration proceeding 20 January 1993 (n 16); CIETAC-Shenzhen Arbitration 18 April 1991 (n 199). There are cases in which arbitrators appear to have taken too flexible an approach by not making an effort to determine the date of the avoidance of the contract and taking the current price nearest to (and preceding) the time of delivery under the contract as the basis (CIETAC Arbitration proceeding 23 April 1995 (Australian raw wool case) <http://cisgw3.law.pace.edu/cases/950423c1.html>; CIETAC Arbitration proceeding 11 February 2000 (n 40)). It is argued that by failing to determine the date of avoidance and to examine whether the current price was available at that date, the arbitrators failed to comply with the requirement of art 76(1).

[215] See Secretariat Commentary on Article 72 of the 1978 Draft.

[216] Article 7.4.6(2) UPICC.

[217] See CIETAC Arbitration proceeding 30 July 1996 (n 22).

[218] See Case No 3 U 246/97 Appellate Court Celle (Germany) 2 September 1998 (Vacuum cleaners case) <http://cisgw3.law.pace.edu/cases/980902g1.html>.

An arguably more lenient approach has been taken in some other cases under the CISG. For example, in one case, a seller from China agreed to sell to a buyer from Luxemburg 500 tons of silicon and manganese alloy, 'CFR Rotterdam', delivery period September-October 1998. In awarding the injured buyer damages under art 76 CISG (with the contract held as having been avoided on 30 October 1998), the tribunal relied, as a starting point, on the 'FOB Rotterdam' price (loading being in the main port in China) for the goods of better quality.[219] The tribunal then made two adjustments to that price. First, it was held that the price of the goods of superior quality would exceed that of the contract goods by approximately 15 per cent and therefore to make the current price comparable to the contract price, it had to be reduced by the said percentage. Second, because the contract price was the 'CFR Rotterdam' price, the freight rate from the stipulated loading port to Rotterdam had to be added to the 'FOB' price. This decision demonstrates that arbitrators have been prepared to be flexible in interpreting the notion of the 'current price' by making necessary adjustments to the price of the goods the description of which differed from that in the original contract.

It seems that this approach should generally be welcomed as it is not always possible to find the current price for the goods of identical description. Nevertheless, a word of caution with respect to making adjustments is provided by the English case *Esteve Trading Corporation v Agropec International (The Golden Rio)*,[220] which raises considerations which seem to be equally applicable in the context of the international instruments. The central issue in that case was whether there was an available market or current price for soya beans that had already been shipped from a Brazilian port on FOB Antwerp/Ghent terms (July shipment). The court held that no 'FOB' market price was available for the following reasons. First, because the shipment period has expired at the relevant point in time which, in that case, was August, no FOB price could be available because an FOB contract requires the actual placement of goods on board the vessel within the shipment period and this is not possible when a shipment period has passed. Second, although prices quoted on a commodity exchange were available[221] for soya beans in the month of July (that is, within the shipment period), it was held that those prices could not be used to determine the current price because they were the prices for the goods 'in free circulation'. By contrast, '[o]nce soya beans have been committed to a particular vessel for a particular destination they are not long 'in free circulation', because they are no longer available to be bought and shipped to any destination of the buyer's choice'.[222] It was then stated that 'in general the f.o.b. value of goods which has been committed for shipment or shipped to a particular destination or destinations will be

[219] The silicon content was above 17% and manganese content was above 65% while, according to the contract, the goods were to contain 14% silicon and 60% manganese.

[220] [1990] 2 Lloyd's Rep 273.

[221] Those were the prices established and published by the Chicago Board of Trade (CBOT).

[222] *The Golden Rio* (n 220) 276.

less than [the quoted price] for the same month because the buyer's freedom to choose where the goods should be sent (and therefore the number of those to whom he can re-sell) is restricted'.[223] Thus, it was the price on CIF terms with further adjustments (deduction of costs of insurance and freight) that could provide evidence of the market price since dealings with goods in transit are generally possible only on CIF terms.[224]

It is suggested that these points are relevant so far as the international instruments are concerned. Take the first point regarding the expiration of the shipment period at the relevant point in time. In the context of the 'abstract' formula, the relevant time for determining the current price is generally the time of the avoidance of the contract. If as in *The Golden Rio,* the contract price is an FOB price and the contract is avoided after the expiration of the shipment period, it can be argued that there can be no FOB price current during the shipment period as the shipment period has already passed and the 'abstract' formula implies the injured party's ability to procure a replacement on these terms. In short, relying on the FOB price after the expiration of the shipment period would contravene the rationale underlying the abstract formula.[225] The same would most probably apply to a situation similar to that in a CISG case, described earlier, where the original contract was on 'CFR Rotterdam' terms (September-October shipment period) and, after the contract was held avoided on 30 October 1998, the tribunal determined the current price on the basis of an FOB price with adjustments whereby the costs of freight were added to make the price comparable to the CFR price. If the contract had been avoided on 1 November, it could have been argued that the initial reliance on the FOB price was not appropriate since on 1 November, it would not have been possible for the buyer to procure a replacement on FOB terms with September–October shipment as that period would have passed. The only comparable price in such a case would have to be a CIF or CFR price since it is only those terms that would have enabled the buyer to procure the goods in transit which had been shipped during the shipment period. This approach, of course, assumes that the current price *must be* for the goods shipped within the shipment period. This assumption is, however, justified in certain trade sectors such as commodities trade in which 'strings' are formed and the latter concern goods of the same type to be shipped from the same port and *within the same shipment period*.[226] In

[223] *The Golden Rio* (n 220) 276.

[224] See J Ramberg, *International Commercial Transactions*, 3rd edn (Stockholm, ICC—Norstedts Juridik, 2004) 98 ('CFR- and CIF-terms . . . are commonly used for sale of goods in transit').

[225] For other cases under the CISG involving adjustments of prices, see CIETAC Arbitration proceeding 24 April 1997 (Oxidised aluminium case) <http://cisgw3.law.pace.edu/cases/970424c1.html>; CIETAC Arbitration proceeding 29 September 1997 (n 129); CIETAC Arbitration proceeding 11 February 2000 (n 40). Since those decisions do not clearly state the date when the contract was avoided, it is difficult to say whether the adjustment of an FOB price to CIF/CFR prices or vice versa was correct in the circumstances.

[226] Bridge (n 42) 159–60; K Takahashi, 'Right to Terminate (Avoid) International Sales of Commodities' [2003] JBL 102, 116.

addition, as stated in a well-known English case, although '[t]here is usually no difference whatever between goods loaded at the end of January instead of the beginning of February . . . [commodity transactions are] not a trade in goods but in contracts for the shipment of goods. A January contract may be far more valuable than one for shipment in February'.[227] It is also suggested that the second point made in *The Golden Rio* rejecting the possibility of comparing the FOB price for the goods already committed to a particular contract with that of the goods in 'free circulation' may also need to be taken into account in applying the 'abstract' formula under the international instruments since this approach reflects the economic realities of a marketplace.

The capacity in which the injured party has acted under the contract also needs to be taken into account in determining the current price. If it is the seller, then the 'selling' current/market price is relevant and vice versa, if the injured party is the buyer, it is the 'buying' current/market price that is relevant.[228] Although the difference between the two will usually not be significant, there may be cases where this difference is considerable.[229] In the same vein, it may need to be determined whether the contract price was a wholesale or a retail price as there is often a noticeable difference between the two.[230] Thus, to ensure the relevance of the current/market price relied upon as well as the accuracy of the comparison between the contract and current/market prices, the nature of the market relationship between the parties and the kind of price stipulated in the contract need to be taken into consideration.

At the same time, it must be emphasised that a relentless drive to ensure the strict comparability of prices may create a dangerous and arguably unfair situation where no current prices are found to exist, thereby rendering the party unable to claim damages under the 'abstract' formula. It is submitted that ultimately, the crucial consideration should be this: which hypothetical transaction can be considered a reasonable replacement considering the injured party's circumstances including the purpose for which it concluded the contract and the business environment and trade sector in which it operates? Thus, it may be the case that there is no wholesale market for the goods in question and a hypothetical cover at a retail market is the only option. In such a case, it may be justifiable to take a retail price as the basis for determining the current price.[231] The problem of too strong an emphasis on the comparability of prices can also be avoided by exercising a reasonable degree of flexibility, as has already been

[227] *Procter & Gamble Philippine Manufacturing Corporation v Kurt A Becher* [1988] 2 Lloyd's Rep. 21, 22.

[228] *Benjamin's Sale of Goods* (n 174) 1012; Waters (n 164) 378.

[229] See *Kwei Tek Chao v British Traders and Shippers Ltd* [1954] 2 QB 459, 497–8.

[230] *Heskell v Continental Express Ltd* (n 173) ('Retail prices differ largely from wholesale prices'). For a case under the CISG, where the wholesale current price was relied upon, see ICAC Case 175/2003, decision dated 28 May 2004 <http://cisgw3.law.pace.edu/cases/040528r1.html>.

[231] For a similar position in the context of English law, see *Benjamin's Sale of Goods* (n 174) 1012.

done in a number of cases,[232] by means of adjusting prices and/or looking at comparable goods and transactions, for example.

The determination of the current price is a question of fact[233] and it has been correctly stated that the current price must be 'reliably verifiable'.[234] The nature of evidence that needs to be presented to prove the current price is likely to depend on the location and/or type of the market in question. The evidence of the current price can be provided, for example, by the relevant professional organisations and chambers of commerce.[235] There have been cases where the current price was derived from an offer by a third party to sell the same goods as those under the contract and on similar terms[236] or from the price the seller received from reselling of the contract goods.[237] In the same vein, it seems that an offer by a third party to buy the goods from the buyer or the price in its sub-sale contract (or previous sales by the buyer of similar goods to third parties)[238] may, in some cases, provide a basis from which the current price can be derived.[239] The terms of the original contract may also provide an indication of the current price. For example, in one case,[240] the tribunal determined the current price on the basis of the amount of refund, set by the contract, to be provided by the seller if there is a shortage of delivery. However, none of these approaches to establishing the current price can be regarded as being of universal application. The question of whether a particular price is indicative of the current price must be decided in the context of a particular case.[241] Other sources of evidence[242] of the current price may include prices quoted on exchanges,[243] surveys carried out by an independent company with a view to

[232] Some such cases have been addressed above. For other cases, see the discussion below and the following section on 'Burden of proof'.

[233] See Waters (n 164) 384.

[234] Yovel (n 48).

[235] See Comment 2 on Article 7.4.6 UPICC.

[236] See CIETAC-Shenzhen Arbitration 18 April 1991 (n 199); CIETAC Arbitration proceeding 20 January 1993 (n 16).

[237] CIETAC Arbitration proceeding 26 June 2003 (Alumina case) <http://cisgw3.law.pace.edu/cases/030626c1.html>.

[238] See ICAC Case 175/2003, decision dated 28 May 2004 (n 230).

[239] H McGregor, *McGregor on Damages*, 17th edn (London, Thomson–Sweet & Maxwell, 2003) 688.

[240] See ICAC Case 133/1994, decision dated 19 December 1995 <http://cisgw3.law.pace.edu/cases/951219r1.html>.

[241] For a similar approach, see McGregor (n 239) 688, 706.

[242] The applicable rules on the admissibility of evidence will have an impact on what can be brought as evidence in a particular case.

[243] See Schlechtriem (n 137) 9 note 19. See also CIETAC Arbitration proceeding 12 January 1996 (n 206) (where, it seems, the reference was intended to be made to a specialised commodity exchange).

It is widely accepted that art 76 CISG does not require the existence of official or unofficial market quotations (see para 6 of the Secretariat Commentary on Article 72 of the 1978 Draft; Stoll and Gruber (n 26) 782). However, it has been pointed out that 'the lack of such quotations raises the question whether there is a 'current price' for the goods' (para 6 of the Secretariat Commentary on Article 72 of the 1978 Draft).

determine the current price,[244] opinions of experts[245] or traders[246] regarding the existence and level of the current price, specialised industry, trade sector, or financial publications.[247]

The cases under the CISG demonstrate that it is not only necessary to *prove* the current price, but also that arbitrators have been placing an equal emphasis on the need for *flexibility* in fixing the current price and in doing so, have often exercised their discretion. Thus, in fixing the current price they have relied on the prices which appeared to them as 'practical', 'feasible', 'reasonable',[248] or 'fair'[249] in the circumstances.

The desire to be flexible has occasionally spilled over to the final determination of damages under art 76 CISG. In one case, the tribunal, having determined the difference between the contract price and the market price, further reduced the amount thus obtained by 10 per cent due to 'the price cut-off tendency on the markets for these goods in Ukraine'.[250] This decision is not easily justifiable since as far as art 76 CISG is concerned, the difference between the current and contract prices ought to have fixed the final award of damages (unless there were further losses recoverable under art 74). If indeed there was a widespread tendency to reduce the 'market price', then perhaps it ought to have incorporated the respective level of the reduction into the fixation of the current price from the beginning and this way, the same result would have been achieved without the difficulty of reconciling the method of calculation with art 76 CISG.[251]

2.2.4 Burden of proof

The injured party bears the burden of proving the preconditions for the application of the 'abstract' formula.[252] It must prove that: the contract has been avoided; a substitute transaction meeting the requirements of the provision containing the 'concrete' formula has not been made; there exists a current price

[244] ICAC Case 133/1994, decision dated 19 December 1995 (n 240).

[245] Appellate Court München 15 September 2004 (n 42).

[246] See Waters (n 164) 384.

[247] See CIETAC Arbitration proceeding 24 April 1997 (n 225); CIETAC Arbitration proceeding 29 September 2004 (n 67); Schlechtriem (n 137), 9 note 19; Waters (n 164) 384.

[248] See CIETAC Arbitration proceeding 18 August 1997 (n 80); CIETAC Arbitration proceeding 25 October 1994 (High tensile steel bar case) <http://cisgw3.law.pace.edu/cases/941025c1.html>.

[249] See CIETAC Arbitration proceeding 12 January 1996 (n 206); CIETAC Arbitration proceeding 24 April 1997 (n 225).

[250] Arbitration proceeding Case No 48 of 2005 (n 23).

[251] The decision also leaves room for different interpretations. One way to interpret the decision is to argue that because there was a widespread tendency in the Ukrainian market to reduce what the tribunal called the market price, then, perhaps the tribunal did not determine the market price correctly and it is the *reduced amount* which was the true market price at the time. Another interpretation is to view the decision as having correctly decided the level of the *market* price and then to argue that the *current* price was actually lower than the market price because of the tendency to reduce the market price.

[252] This is, of course, subject to the issue of burden of proof being governed by the international instruments.

at the relevant time and place.[253] The breaching party then has the burden of rebutting the claims thus raised.[254] However, sometimes the tribunals do not strictly allocate the burden of proof in this manner. For instance, in one case[255] the tribunal requested *both* parties to submit evidence regarding the existence of the current price. It is suggested that this approach should not be followed as it contravenes the proper allocation of burden of proof (assuming that it is a matter governed by the instruments).[256] It should also be pointed out that in some cases under the CISG where the injured party (or both parties, as was the case in the case just referred to) failed to establish the current price, the tribunals have taken the initiative of finding a way themselves to determine the current price.[257] Although this approach could be applauded for its flexibility and the tribunal's determination to fix the current price where possible, it can be said to undermine, to some extent, the purpose underlying the allocation of burden of proof—that is, its being a mechanism of dealing with uncertainty by raising/rebutting presumptions based on the evidence presented by the *parties*. If this approach is followed, it may be the case, for example, that despite the injured party's own inability to prove its claim for damages by failing to establish the current price, a court/tribunal might itself fix the current price and thereby help that party succeed.[258] It seems, however, that whether or not a court/tribunal is able to pursue the matter in question on its own initiative will often be a matter addressed by the applicable rules of procedure[259] and for this reason, a non-uniform treatment of claims for damages (more generally and in the context of the 'abstract' formula in particular) is to be expected.

[253] See *Novia Handelsgesellschaft mbH v AS Maseko* Tallinn Circuit Court (Estonia) 19 February 2004 <http://cisgw3.law.pace.edu/cases/040219e3.html>; ICAC Case 133/1994, decision dated 19 December 1995 (n 240); Stoll and Gruber (n 26) 783.

[254] Burden of proof can be understood in two senses. 'In its broadest sense, 'burden of proof' refers to the ultimate establishment of the truth of the basic proposition . . . In its narrow sense, [it] refers to a party's obligation to go forward with the evidence to rebut the other party's initial or prima facie proof . . . The basic distinction is that, in its broadest sense, burden of proof always rests on the same party, while the burden of going forward with the evidence changes from party to party throughout the trial' (RR Anderson, 'Incidental and Consequential Damages' (1987) 7 J L Commerce 327, 393–4).

[255] See CIETAC Arbitration proceeding 30 June 1999 (Peppermint oil case) <http://cisgw3.law.pace.edu/cases/990630c1.html>.

[256] See ch 1.

[257] See *ibid*; ICAC Case 133/1994, decision dated 19 December 1995 (n 240).

[258] Such an approach can, of course, also favour the breaching party.

[259] Cases referred to in this context have been decided by CIETAC and ICAC arbitration. The arbitration rules of these institutions allow the tribunals to take the initiative in collecting evidence (see arts 37 and 38 of the CIETAC Arbitration Rules May 2005 <http://www.cietac.org.cn/english/rules/rules.htm> and para 31 of the ICAC Rules March 2006 <http://www.tpprf-mkac.ru/en/>). For a case under the CISG where the court has emphasised its *inability*, according to the applicable procedural rules, to collect evidence on its own initiative for the purpose of determining the current price under art 76 CISG, see Tallinn Circuit Court 19 February 2004 (n 253).

2.2.5 Relationship with other losses

The instruments provide that in addition to damages awarded under the 'abstract' formula, the injured party may also recover damages for any further losses.[260] These losses may include various additional costs the injured party has incurred or will incur as a result of the breach. For instance, the seller may incur extra costs of storage and maintenance of the rejected goods or the buyer may incur liability towards its sub-buyers due to delay in delivery. Courts/tribunals need to ensure that the award of damages for further losses does not over-compensate the injured party. The buyer cannot, as a rule, claim damages for the lost profit margin on a sub-sale together with damages under the 'abstract' formula since the latter implies that the buyer is *in the position* to purchase the goods to fulfil its commitments.[261] It is where a necessary delay between the breach and the earliest reasonable opportunity to make a hypothetical replacement transaction causes the buyer loss of profit (stoppage in the manufacturing process) that the buyer may claim damages for lost profits for the period of delay.

Some commentators seem to suggest that the injured buyer *can* claim damages for the lost profit margin it expected to receive on a sub-sale if it exceeds damages under the 'abstract' formula.[262] It is contended, with respect, that this position is not well founded. If the buyer is able to prove that it would have earned a higher level profit margin and if it has not made a replacement transaction (which will often constitute a failure mitigate), then, it is submitted, it has a choice: either to claim damages 'abstractly' or 'concretely'.[263] Under the latter approach, damages may be awarded, subject to the duty to mitigate, for the loss of the *actual* profit margin the buyer would have made on a sub-sale (that is, the difference between the contract and *sub-sale* prices) and this award would preclude a claim based on the 'abstract' formula.[264] However, if the 'abstract' formula (the difference between the contract and *current* prices) is relied upon, it is argued that further loss, in the amount by which the expected actual profit margin exceeds damages under the 'abstract' formula, cannot be claimed. Although the wording of the

[260] See arts 76(1) CISG, 7.4.6(1) UPICC and 9:507 PECL.

[261] For a case under the CISG, where the buyer was thus over-compensated, see CIETAC Arbitration proceeding 30 November 1997 (n 41).

[262] See Stoll and Gruber (n 26) 786; Knapp (n 18) 554.

[263] There is no reason why the injured party should not have this choice under the international instruments. The instruments' provisions cannot be interpreted as *requiring* the party to rely on the 'abstract' formula in cases where no replacement transaction has been made (the only hierarchy established is that between arts 75 and 76 CISG, 7.4.5 and 7.4.6 UPICC, 9:506 and 9:507 PECL).

[264] See ICAC Case 160/1997, decision dated 5 March 1998 <http://cisgw3.law.pace.edu/cases/980305r2.html> ('[the] buyer's claim for the award of the price difference between the current market price and the price fixed by the contract between the parties, claimed with reference to Art. 76 of the CISG, was rejected by the Tribunal. The Tribunal's conclusion . . . was based on the position that the lost profit, which is to be compensated to the buyer, should be calculated based on the difference between the price for the goods as fixed in the contract between [the] buyer and the third party, and the price for the goods as fixed in the contract between [the] buyer and [the] seller, and thus, . . . lost profit of the buyer is fully compensated for.'

relevant provisions suggests that *any further loss*, including loss of profit, can be claimed, the award of the amount of the expected profit margin on sub-sale together with damages under the 'abstract' formula runs deeply against the rationale and considerations underlying the 'abstract' formula. First, as noted, it implies that the buyer can buy a replacement and fulfil its sub-sale contract thereby earning its profit margin. Second, numerous policy considerations[265] justify the existence of the 'abstract' approach as *an alternative*, and not as a supplement to the 'concrete' approach to calculating damages.[266] For these reasons, awarding damages for the profit margin lost on a sub-sale together with damages under the 'abstract' formula would not only overcompensate the injured party but it would also completely nullify the purpose and considerations underlying the 'abstract' formula contained in the instruments.

In a similar vein, the 'abstract' formula implies, in relation to the seller, that it is able to resell the goods and thereby earn a profit margin. Therefore, an additional award of damages for the seller's profit margin would constitute a double recovery. There may be cases where as a result of not receiving the payment on time, the seller has lost an investment opportunity. In such cases, a claim for loss of profit (or loss of a chance to profit) along with damages under the 'abstract' formula may be justified so long as it is borne in mind that, had the contract been performed, a part of the profit margin that the seller would have received from selling the goods would have been directed towards making an investment.

2.2.6 Cases where the 'abstract' formula is inapplicable

The instruments' abstract formula is not applicable where at least one of its preconditions is not met and/or where at least one of the assumptions underlying the formula is not present. The formula's central assumption is that the injured party is in the position to make a replacement transaction and where this is not the case, the formula becomes irrelevant. One example of where that assumption is not present, even where there is a market for the goods in question, is where the injured buyer's sub-sale contract requires the delivery of 'self-same' goods as those in the contract with the seller.[267] In an already-mentioned case under the CISG,[268] the buyer's sub-sale contract provided for the delivery of the same goods as those in the buyer's contract with the seller in terms of their specifications and place of manufacture (Korea) and, because of the time constraints,[269] that requirement made the buyer unable to procure a substitute to fulfil its sub-sale. Although the situation is not strictly speaking that involv-

[265] See above.

[266] A similar position seems to have been taken in the Secretariat Commentary on the 1978 Draft Convention (stating that art 72 (a counterpart of art 76 CISG) 'sets forth an alternative means of measuring damages where the contract has been avoided but no substitute transaction was entered into').

[267] For the discussion in the context of English law, see Goode (n 42) 384.

[268] CIETAC Arbitration proceeding 17 October 1996 (n 66).

[269] [The] [b]uyer being a Chinese company was unable to find Korean products on the Chinese market within a short time' (*ibid*).

ing self-same goods, it highlights the same difficulty faced by a buyer in the case of 'self-same' goods which renders the buyer unable to procure a substitute.[270] Another example where the injured party is not in the position to make a replacement transaction is a lost volume situation, whether it is a lost volume seller or buyer-seller. One way to explain this is to state that even if the injured party may seem to be in the position to make a hypothetical transaction, that would be a transaction which it would have made in any event and therefore it cannot be a replacement for the original contract. Another explanation is that where supply exceeds demand (lost volume seller) or where demand exceeds supply (lost volume buyer-seller), there is no market in which the seller could sell or the buyer-seller could buy in order to resell the goods. Had there been an available market for the goods in question, a lost volume situation would not have arisen in the first place. Where the instruments' 'abstract' formula is not applicable, damages may still be claimed under a general provision on damages.

3. NON-CONFORMING DELIVERY

3.1 General

The next situation to consider is where the seller provides a non-conforming delivery[271] which is either accepted by the buyer or which *has* to be accepted because the buyer has failed to avoid the contract. The difference between this case and those discussed previously is that, here, the buyer does not avoid the contract and has goods, albeit non-conforming, on hand. The important point, so far as the issue of calculation is concerned, is that because the buyer has actually received the goods, the buyer would not usually seek to find a substitute. Hence, the formulae referring to prices in an actual or hypothetical replacement transaction are irrelevant. By contrast with some domestic legal regimes,[272] the international instruments do not contain a specific provision relating to the calculation of damages in the case of non-conforming delivery. This means that the legal basis for the award of damages in such a case would be the instruments' general provisions on damages.[273]

[270] For a similar case, see CIETAC Arbitration proceeding 29 September 2004 (n 67).

[271] Article 35(1) and (2) CISG: '(1) The seller must deliver goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract. (2) Except where the parties have agreed otherwise, the goods do not conform with the contract unless they: (a) are fit for the purposes for which goods of the same description would ordinarily be used; (b) are fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgement; (c) possess the qualities of goods which the seller has held out to the buyer as a sample or model; (d) are contained or packaged in the manner usual for such goods or, where there is no such manner, in a manner adequate to preserve and protect the goods.'

[272] See, eg, § 2-714 UCC and s 53(2) and (3) SGA.

[273] Articles 74 CISG, 7.4.2 UPICC and 9:501 PECL.

3.2 Concrete v abstract calculation

The dilemma between the 'concrete' and 'abstract' calculation equally arises in cases of non-conforming delivery. Suppose that the seller delivers defective goods bought for resale and the buyer manages to persuade its sub-buyers to accept the defective goods without any price reduction and without incurring any liability towards the sub-buyers. Under the 'concrete' approach to calculation, no damages are due to be awarded to the buyer because it has suffered no loss. The goods, despite the defects, were resold as planned and the buyer earned the same amount of profit that it would have earned had the goods been conforming. The 'abstract' approach may, however, lead to a different result. If, for example, the difference between the (market) value of conforming goods and those actually delivered is relied upon as a specific means to calculate damages 'abstractly', and if there is a difference between these two values, the buyer would be entitled to an award of this difference. This would be so, despite the fact that the buyer has suffered no actual loss,[274] and some legal systems prefer the latter result.[275]

The position of the international instruments is not entirely clear and it has been noted, with respect to art 74 CISG, that it 'does not directly disallow'[276] the 'abstract' approach to calculation. It is suggested, in this regard, that the structure the instruments adopt with respect to cases where the contract has been avoided, could be used by analogy in cases of accepted non-conforming delivery. This would mean that the 'abstract' approach should be limited only to those cases where the 'concrete' calculation could not be applied and, in any event, the mitigation rule should set the ceiling for recovery. Applying this approach to the example in the previous paragraph, a 'concrete' approach would lead to no recovery as the claimant has suffered no *actual* loss and it can also be argued that persuading the sub-buyers to accept the goods on the same terms without incurring any liability was a reasonable mitigation measure which led to the complete avoidance of the loss. In short, it is suggested the instruments should generally be interpreted as expressing a preference for the 'concrete' measure coupled with the mitigation rule which is in harmony with the 'concrete' approach by looking at what are reasonable measures to avoid loss in the light of the injured party's *actual* situation.

However, it needs to be pointed out that the differences between the 'concrete' and 'abstract' approaches to calculation should not be exaggerated. These

[274] There have, however, been attempts to argue that the buyer, in such cases, does suffer certain losses such as injury to its reputation (see Bridge (n 42) 122). Although this may well be true in some cases, it cannot be assumed that this will always be the case. Even in cases where the buyer does in fact suffer injury to its reputation, this loss is unlikely to correspond to the amount of loss awarded and under the 'abstract' formula. For these reasons, this argument on its own cannot justify the 'abstract' approach to the calculation of damages.

[275] See *Slater v Hoyle & Smith* [1920] 2 KB 11.

[276] B Zeller, *Damages under the Convention on Contracts for the International Sale of Goods* (NY, Oceana, 2005) 120.

differences seem to be largely confined to the type of cases referred to above and in the majority of cases the two approaches seem to converge to a significant extent. This convergence can be seen even in legal regimes which generally prefer the 'abstract' approach. For example, damages for breach of warranty in English sales law are prima facie measured by 'the difference between the value of the goods at the time of delivery to the buyer and the value they would have had if they had fulfilled the warranty'.[277] It may often be the case that there is no market price for defective goods and so the said difference between the two values can be derived from the costs *actually* incurred by the injured party to bring the goods into their conforming state,[278] or the value of defective goods may be determined on the basis of the price for which they were *actually* resold by the buyer.[279] Thus, considerations emanating from the injured party's actual situation will often enter into the formula which has been a primary vehicle for implementing the 'abstract' approach to calculating damages in cases of defective delivery.

3.3 Specific methods of calculation

3.3.1 Buyer's resale

Buyers often resell defective goods at reduced prices and in several cases the amount by which a profit margin on sub-sale had been reduced has been awarded as damages for defective delivery.[280] The buyers have also been awarded lost profits even where no resale of defective goods had taken place. In one case under the CISG, where the seller failed to supply a conforming packaging production system, the buyer was awarded damages for profits it would have earned from the orders that would have materialised had the goods been conforming.[281] The buyer may also suffer loss of custom[282] as a result of

[277] Section 53(3) SGA.

[278] See Goode (n 42) 378–9.

[279] See McGregor (n 239) 719.

[280] Case No 3 U 83/98 Appellate Court Bamberg (Germany) 13 January 1999 (Fabric case) <http://cisgw3.law.pace.edu/cases/990113g1.html> ('As a result of the deviation in colour and texture, the buyer had to offer its customer a reduction in price of 10% . . . [and] [t]he seller is obliged to reimburse the buyer for this loss of profit under Art. 74 CISG'); CIETAC Arbitration proceeding 4 November 2002 (Beech log case) <http://cisgw3.law.pace.edu/cases/021104c1.html>; CIETAC Arbitration proceeding 11 April 1997 (Silicon metal case) <http://cisgw3.law.pace.edu/cases/970411c1.html>. See also CIETAC Arbitration proceeding 26 November 1998 (Leather gloves case) <http://cisgw3.law.pace.edu/cases/981126c1.html> (where, although there was no award of damages for defective delivery, a similar result was achieved by means of the tribunal's recognition that the buyer's resale at a 30% discount was reasonable and order that the buyer pay only 70% of the contract price).

[281] See *TeeVee Tunes Inc et al v Gerhard Schubert GmbH* not reported in F.Supp.2d 2006, WL 2463537 (SDNY) (No. 00 Civ 5189 (RCC), also at: <http://cisgw3.law.pace.edu/cases/060823u1.html> (the issue of mitigation has not been addressed).

[282] For the argument that it is not entirely accurate to treat loss of custom as a separate head of loss and that it is rather loss of profit flowing from loss of custom that best describes this loss, see ch 3.

defective delivery and indeed in some cases under the CISG it was deemed appropriate to award such damages.[283]

3.3.2 Cost of cure

Where buyers cure the defects in the goods, the costs of doing so are a convenient and accurate measure of the loss suffered as a result of defective delivery. In contrast with the previous method of calculation which compensates for the loss in the amount of the profit margin, the 'cost of cure' measure compensates for the loss in the reduction in the value of the goods. Loss of profit, either based on the loss of a profit margin on sub-sale or on the reduced volume of production and sales, cannot usually be claimed in addition to damages under the 'cost of cure' measure as cure brings the goods into their conforming state which will then enable the buyer to earn profits therefrom as planned. However, if, for example, cure causes delay or stoppage in the manufacturing process resulting in loss of profit which would not have occurred had the goods been conforming, damages for this amount of loss of profit should be recoverable along with costs of cure. In principle, this method can be used not only where an injured party has *actually* incurred costs of cure but also where no such expenses have been made.[284]

Costs of cure must be truly necessary and directed at curing the defect in question. It should also be pointed out that the duty to mitigate, and arguably a general principle (idea) of reasonableness underlying the international instruments, require that costs of cure be reasonable. In the context of some domestic legal systems, the requirement of reasonableness has been said to necessitate an assessment of: whether the innocent party has effected cure or intends to do so[285]; the innocent party's conduct subsequent to the breach; and whether or not there is a proportion between the cost of cure, the contract price, the benefit already received by the injured party and the benefit to be obtained from cure.[286] It is submitted that there is no reason why these factors should not be taken into account in assessing the reasonableness of cure under the international instruments. There are signs that judges and arbitrators applying the CISG have already approached the 'cost of cure' measure in the manner outlined above. Thus, the requirement of costs being necessary or appropriate for effecting cure has been expressly mentioned in several decisions. In one case involving the delivery of

[283] See *EK, L & A v F* Supreme Court (Switzerland) 28 October 1998 <http://cisgw3.law.pace.edu/cases/981028s1.html>.

[284] See CIETAC Arbitration proceeding 21 May 2006 (Diesel generator case) <ttp://cisgw3.law.pace.edu/cases/060521c1.html> (where the buyer did not in fact effect cure and where reasonable costs of cure were awarded on the assumption that that amount will be used by the buyer to cure the non-conformity in the future); for the discussion of the recoverability of future losses, see ch 3.

[285] '[A] claimant's intention to cure a particular breach is *evidence* of the *extent* of his non-pecuniary loss flowing from the breach' (M Chen-Wishart, *Contract Law*, 2nd edn (Oxford, OUP, 2008) 531).

[286] See *ibid*, 531; Peel (n 2) 1014–15.

defective racing cars, the court referred to the need of costs of repair being 'usual and appropriate for corrective actions performed by a specialist workshop'[287] and, in another case, the tribunal made it clear that the costs of making defective coal usable had to be 'necessary'.[288] The requirement that costs be directly related to curing the defects in question has also emerged. In one case under the CISG,[289] non-conformity caused the buyer to 'double pass' the materials through the non-conforming equipment to ensure that a conforming product was manufactured. The buyer then claimed damages for, as the court put it, additional 'variable overhead' costs and costs of labour incurred in executing the 'double passing'. To calculate these costs, the buyer took the annual depreciation and repair costs for its entire plant, computed an hourly overhead rate on that basis, and then applied that rate to the 'double passing' process. The court correctly denied such calculation on the basis that it is not 'accurate to attribute the same proportionate cost of repairs to [the equipment in question] as is attributable to [the buyer's] other machinery'.[290] It was also found to be inappropriate to apply the 'overall depreciation figure', determined by reference to the buyer's other machinery, to the equipment delivered by the seller.[291]

Some decisions reflect a concern that the costs of cure should not be excessive. For instance, in one case[292] involving the delivery of defective clothes, the costs of remedying the defects incurred by a German buyer were found to be in line with 'the average labor fee in Germany' and this conclusion was also confirmed by 'an audit report issued by an independent auditor'. In one case, the importance of maintaining the proportion between the cost of curing defects on the one hand, and the contract price and the benefit to be received from cure on the other, has also been expressly emphasised.[293] Finally, it needs to be noted that if cure results in bringing the goods into a better state than that in which they would have been had they been conforming,[294] this level of improvement needs to be taken into account to reduce damages. This follows both from the compensatory purpose of damages[295] and the 'concrete' approach to calculation.

[287] Case No 3 O 196/01 District Court Köln (Germany) 25 March 2003 (Racing carts case) <http://cisgw3.law.pace.edu/cases/030325g1.html>.

[288] ICC Arbitration Case No 8740 of October 1996 (n 145).

[289] *Mansonville Plastics (BC) Ltd v Kurtz GmbH* 2003 BCSC 1298.

[290] *Ibid*.

[291] '[I]t does not seem appropriate to apply the same rate of depreciation to an old machine such as the continuous pre-expander as is applied to new equipment' (*ibid*).

[292] CIETAC Arbitration proceeding 31 January 2000 (Clothes case) <http://cisgw3.law.pace.edu/cases/000131c1.html>. See also District Court Köln 25 March 2003 (n 287) where the expert's view of the reasonableness of the costs was accepted by the court.

[293] See Case No 7 Ob 301/01t Supreme Court (Austria) 14 January 2002 (Cooling system case) <http://cisgw3.law.pace.edu/cases/020114a3.html> (see particularly the decision of the court of the second instance). For a well-known English contract case dealing, among other things, with the question of maintaining a proportion between the cost of cure and contract price and benefit to be received from cure, see *Ruxley Electronics and Construction Ltd v Forsyth* [1996] AC 344 (HL).

[294] See Waddams (n 69) 129–32.

[295] See art 7.4.2(1) UPICC, which requires that 'any gain to the aggrieved party resulting from its avoidance of cost or harm' needs to be taken into account.

3.3.3 Difference in value

Damages for the delivery of defective goods can also be measured by the difference between the value of defective goods actually delivered and the value of conforming goods that ought to have been delivered under contract (the 'difference' formula). As noted, this 'difference' formula can be seen as a primary vehicle for implementing the 'abstract' approach to damages and although it has been argued that it is the 'concrete' approach that is generally favoured by the international instruments,[296] the 'difference' formula can still be applied where neither of the first two methods is applicable.[297] This may be the case, for example, where the buyer is unable to prove its lost profits *and* where the goods in question are incapable of cure. The question of what point in time is relevant for determining these two values is not expressly addressed by the international instruments and remains unresolved.[298] In this regard, it has been pointed out that if an analogy is drawn with the instruments' 'abstract' formulae which generally refer to the 'current price' at the time of avoidance,[299] the time of breach is irrelevant.[300] It has also been argued that '[t]he further forward the moment for determination is extended, the more accurately the exact extent of the foreseeable damages may be determined'.[301] For these reasons, either the time the action is lodged or the time of judgment has been suggested as being the more appropriate points in time and of the two, it is the latter that is usually preferred.[302] It remains to be seen whether this is the approach that the courts and tribunals will follow.

Like the 'cost of cure' measure, the difference between the value of conforming goods and those actually delivered aims to compensate not for loss of profit

[296] See Case No 6 R 160/05z Appellate Court Linz (Austria) 23 January 2006 (Auto case) <http://cisgw3.law.pace.edu/cases/060123a3.html>, where the decision implies that the 'abstract' measure in cases of defective delivery is available as of right under the CISG ('In cases where the contract is upheld and the seller delivers defective goods, the buyer is entitled to claim the reduction in value as a non-performance loss. The reduction in value is formed by the difference between the value of the goods in a condition that would conform to the contract and the actual value of the delivered defective goods' (with reference to commentators)).

[297] This is not to say that the 'cost of cure' measure cannot be used as a means of taking the 'abstract' approach to calculation since the essence of the 'abstract' approach is simply to rely on a fixed formula 'in abstract' with no regard to the claimant's actual circumstances. The 'cost of cure' measure can be used as such a formula in the same way as the 'difference' formula. This can be done, eg, where the buyer's loss of profit margin on sub-sale is ignored and reasonable costs of cure are awarded instead.

[298] As has been correctly noted (Stoll and Gruber (n 26) 763), the question is relevant in the context of the 'abstract' approach to calculation since, under the 'concrete' approach, the point in time will either vary or will not be relevant (eg, damages can be simply fixed by reference to the price under a sub-sale contract).

[299] This is subject to the special case under the CISG, where the goods have been taken over, at the time of such taking over.

[300] See S Eiselen, 'Remarks on the Manner in which the UNIDROIT Principles of International Commercial Contracts May Be Used to Interpret or Supplement Article 74 of the CISG' <http://www.cisg.law.pace.edu/cisg/principles/uni74.html>.

[301] Eiselen (n 284) 36.

[302] See *ibid*; see also Stoll and Gruber (n 26) 763.

but for the reduction in the value of the goods.[303] Because this compensation can be said to restore, in monetary terms, the injured party to the position of having conforming goods, and because the value of an asset generally takes account of future profits to be made from that asset, awarding loss of profit in addition to damages under this 'difference' formula would constitute a double recovery.[304] However, if a claim for loss of profit is confined to a particular period which does not cover the entire working life of goods,[305] damages under the 'difference' formula can be awarded for the period for which lost profits are *not* claimed.[306] In such a case, when applying the 'difference' formula, the depreciation of the goods needs to be taken into account.[307]

The 'difference' formula would require determining the value of both conforming and non-conforming goods and it is likely that in most cases it is the market value which provides a reference point. Difficulties arise where there is no relevant market value, particularly in the case of non-conforming goods. As previously noted, in such cases, the price the buyer obtained from reselling defective goods may provide an indication of their value. It has also been suggested above that costs of cure can evidence the difference between the value of conforming goods and the value of defective goods. Where this has not been possible, the tribunals have simply awarded a price allowance usually based on a rate which seemed reasonable to the tribunals in the circumstances.[308]

[303] As noted above, 'cost of cure' measure is sometimes viewed as a specific means of determining the difference the value of conforming goods and those actually delivered (see ICC Arbitration Case No 8740 of October 1996 (n 145)).

[304] See, eg, Waddams (n 69) 82–83; RL Dunn, *Recovery of Damages for Lost Profits,* 6th edn (Alameda CA, Lawpress, 2006) 566; KM Kolaski and M Kuga, 'Measuring Commercial Damages via Lost Profits or Loss of Business Value: Are these Measures Redundant or Distinguishable?' (1998–1999) 18 J L Commerce 1.

[305] In principle damages can be claimed for the entire working life of the goods. However, this will not always be possible. For example, in one case under the CISG where damages (albeit not lost profits) were calculated with reference to the entire working life, the court has stated that although the equipment 'may have a 20-year life span, it does not necessarily follow that [the buyer] will keep using it for the full 20-year period. It could become functionally obsolete or uneconomic in a shorter period, much in the same fashion as personal computers become obsolete even though they are still able to perform to their initial specifications. There are numerous other contingencies which may cause [the buyer] to cease operating the equipment prior to 2017' (*Mansonville Plastics (BC) Ltd v Kurtz GmbH* (n 289).

[306] This was the claim brought in the English case *Cullinane v British 'Rema' Manufacturing Co Ltd*. [1954] 1 QB 292, which, however, was not upheld by the court. For the discussion of this widely criticised case, see Goode (n 42) 381.

[307] See Bridge (n 43) 598. See also the text accompanying note 289.

[308] See CIETAC Arbitration proceeding 29 May 1996 (Handicrafts case) <http://cisgw3.law.pace.edu/cases/960529c1.html>; CIETAC Arbitration proceeding 8 August 1996 (Diaper machine case) <http://cisgw3.law.pace.edu/cases/960808c1.html> (Although it is not entirely clear, the tribunal may have relied upon the remedy of the reduction of the price.); CIETAC Arbitration proceeding 5 July 1993 (Copperised steel tubes case) <http://cisgw3.law.pace.edu/cases/930705c1.html>. The same approach is reported to have been taken in the context of English sales law, see Bridge (n 43) 592 ('Experienced trade umpires will often award a price allowance, though the method of calculation is not commonly stated').

3.4 Defective delivery, the meaning of 'loss' and the problem of 'performance interest'

The cases of non-conforming delivery may raise the difficult question regarding the *meaning* of loss. It has already been seen that the same question arises when a particular legal regime has to make a choice between the 'concrete' and 'abstract' methods of calculation. It seems, however, that in cases of non-conforming delivery the problem of the meaning of 'loss' extends beyond the framework of the dilemma between the 'concrete' and 'abstract' approaches. The problem arises where, at first sight, defective delivery does not appear to result in noticeable adverse financial consequences for the innocent party. A few examples will be given to illustrate the problem.

An interesting example (1) has been given where a company conscious of human rights buys goods from a seller under the contractual condition that no child labour would be used in manufacturing the goods and is prepared to pay twice the amount of the market price to ensure that the condition is complied with.[309] Suppose further that the seller breached the contract by employing children in the manufacturing of the goods but this does not change the tangible properties of the goods and the buyer can fulfil its business plans with no loss in profits. Another example (2) is where a professional photographer orders a car of a particular colour, paying extra to ensure compliance, but a car of a different colour is delivered.[310] Despite a breach, the market price of the car actually delivered is higher than that of the one ordered. In these examples, although a breach of contract has clearly occurred, it is not immediately clear whether the buyers can be said to have suffered any loss and, if so, how that loss can be described and measured. It is submitted that the complexity of this problem cannot be fully revealed and adequately analysed through the framework of the dilemma between the 'concrete' and 'abstract' approaches to calculation.[311] The inability of the 'abstract' approach (the difference between the (market) value of conforming and non-conforming goods) to rationalise the meaning of loss in such cases is demonstrated by its failure to produce consistent results: while there will be no damages in example 2, damages may be due in example 1 if there is a market value for both goods manufactured with and without child labour.[312] The 'concrete' approach, in turn, will only lead to the recoverability of such losses if, in the first place, the law is prepared to award compensation

[309] I Schwenzer and P Hachem, 'The Scope of the CISG Provisions on Damages' in Saidov and Cunnington (n 122) 94. A number of cases demonstrating the companies' concerns over human rights issues and the use of child labour in particular have been recently reported in media (see, eg, 'Gap acts over Indian child labour' <http://news.bbc.co.uk/2/hi/business/7098975.stm> accessed on 29 November 2007).

[310] *Ibid*.

[311] See also ch 3.

[312] *Cf* C Hawes, 'Damages for Defective Goods' (2005) 121 LQR 389. For further examples, see ch 3 and D Saidov and R Cunnington, 'Current Themes in the Law of Contract Damages: Introductory Remarks' in Saidov and Cunnington (n 122) 25–6.

for damage to the 'subjective value' the party has placed on the performance (non-economic interest). Thus, although the role of the performance interest in calculating damages is connected with the choice between 'abstract' and 'concrete' approaches (for they can still be used to help place an appropriate monetary value),[313] it is nevertheless an independent issue requiring separate treatment.[314] As has been suggested in an earlier chapter,[315] damage to the performance interest should be viewed as a recoverable head of loss only in cases where a party places a subjective or non-economic value on performance. In calculating damages for this loss it needs to be borne in mind that here the emphasis is placed not so much on the economic consequences of the breach as on the subject-matter of the bargain, the injured party's right to performance and the other party's duty to perform:[316] the injured party did not receive performance to which it had a legal right and it has been proposed that in such cases, 'the scope of losses to be compensated has to reflect the very purpose of the duty that has been breached'.[317]

Although it may be very difficult to prove such losses, the difficulties are not insurmountable. One way to place a monetary value on this loss is for a court or tribunal to 'ask itself, hypothetically, if the parties had agreed on a liquidated damages clause, whether . . . it would have included compensation for non-pecuniary benefits'.[318] If so, the amount of such a hypothetical clause could provide an estimate of the loss. To return to the above examples, it can be argued that because the buyers in both examples paid an additional price to ensure compliance with the contractual terms, calculating damages by reference to that additional price is a sound measure because it reflects precisely the value the injured party placed on the performance. In example 1, it may also be possible to calculate damages by reference to a market because there may be different market values for goods manufactured with and without child labour.[319] In example 2, losses can also be calculated on the 'cost of cure' basis (corrective paintwork) and such a measure can be both 'concrete' (if the works have *actually* been done) and 'abstract' (by reference to costs which are reasonable to carry out such works).[320] In some cases, damages can even be calculated, subject to the requirements proposed earlier,[321] by reference to gains made by the breaching party as a consequence of its breach. For instance, in example 1

[313] See below.

[314] See Saidov and Cunnington (n 312) 135.

[315] See ch 3.

[316] Schwenzer and Hachem (n 309).

[317] *Ibid*.

[318] A Ogus, 'The Economic Basis of Damages for Breach of Contract: Inducement and Expectation' in Saidov and Cunnington (n 122).

[319] 'Today there are . . . markets for products manufactured under inhumane conditions, as opposed to markets for products produced in compliance with basic human rights, or products that are fairly traded' (Schwenzer and Hachem (n 309)).

[320] There may be little difference between the two as 'concrete' cost of cure measures can only be awarded if the costs incurred were reasonable.

[321] See ch 2.

damages may have to be calculated by reference to the savings made by the breaching manufacturer as a result of using child labour.

4. DELAY IN DELIVERY

Where the seller delivers late and the buyer accepts the delivery without avoiding the contract, there again arises the need to make a choice between the 'concrete' and 'abstract' calculation.[322] It is clear by now that the instruments' position is to rely on the 'concrete' calculation first and *only* if this is not possible can the 'abstract' approach be taken.[323] What loss can the buyer be said to suffer and how should this loss be measured? The answer depends on the purpose for which the buyer has bought the goods. If the buyer bought the goods for resale, then under the 'concrete' approach, it is the profit margin (or a part thereof) that the buyer planned to receive on a sub-sale that the buyer might claim as damages. The delay in delivery may either prevent the sub-sale (because sub-buyers reject the late delivery) or force the buyer to sell the goods at a reduced price. It may, however, not be possible to establish loss of an *actual* profit margin because the buyer has not yet concluded a sub-sale contract or because it is impossible to relate the contract goods to any particular sub-sale contract since the buyer is a large trader involved in a regular sale of the goods in question. In such cases, the 'abstract' measure may be appropriate[324] and the relevant formula is the difference between the value of the goods at the due date and that at the actual date of delivery. The value at both dates is usually understood by reference to the market value.[325] This formula does not compensate the buyer for lost profit and awards damages for the difference in value of the subject-matter resulting from the breach.

If the buyer has bought the goods for its own use, such as the use of the goods at its manufacturing plant, delay may, for example, cause the manufacture to remain idle resulting in loss of profits which would otherwise have been earned. Alternatively, it may force the buyer to hire a substitute piece of equipment for the period of delay and thereby incur additional costs. The buyer may attempt to mitigate its loss by using its current stock to fulfil its business plans.[326]

[322] Suppose the buyer still persuades its sub-buyers to buy the goods at the same price at which they would have bought the goods had the goods been delivered on time. From the standpoint of the 'concrete' approach to calculation, the buyer has suffered no loss (assuming no additional expenses were incurred in reselling the goods at a later date than originally planned). On a falling market, however, the 'abstract' approach may allow damages for the difference between the value of the goods at the due date and their value at the actual date of delivery (for a good illustration see *Sally Wertheim v Chicoutimi Pulp Company* [1911] AC 301).

[323] It is submitted that the mitigation rule should still set the ceiling for recovery.

[324] This approach is analogous to the instruments' position expressly enunciated in cases where the contract is avoided (see above).

[325] For the considerations relating to the definition of a market and relevant market prices, see above.

[326] See ICC Arbitration Case No 8740 of October 1996 (n 145).

However, it may be the case that although loss of profit may thus be avoided, the buyer will suffer additional losses such as costs incurred in purchasing additional goods to restore the balance in its stock or even lost profits or lost opportunity to profit suffered due to the inability to fulfil other (potential or actual) orders which it would have satisfied had there been no delay. The buyer may also have to pay its workforce while the production remains idle or its materials may get damaged during the period of delay.[327] It is evident therefore that different types of loss may flow from delay in delivery and the award of damages will depend on what losses are claimed in a particular case. The 'abstract' formula is generally irrelevant in such cases since '[t]he complaint of the buyer is not that he acquired an asset whose realizable value was diminished through the delay—for he did not intend to realise it at the due delivery date—but that he has been deprived of the use of an asset for the period of delay'.[328] Finally, in cases of delay, the buyer may often make a cover purchase as a precautionary measure and it has been correctly pointed out that the benefits received from the use of the goods bought as cover[329] or the resale of those goods[330] need to be taken into consideration in calculating damages.[331]

5. OTHER CASES: LOST PROFITS

It is important to highlight some other cases, not covered above, which mainly involve loss of profit. These cases include those where the contract has been avoided but where neither the 'concrete'[332] nor the 'abstract'[333] formulae expressly provided for by the instruments could be used, *or* where the 'concrete' formula could not be applied but the injured party has not invoked the 'abstract' formula and has instead relied upon another 'concrete' method of calculation. The legal basis for this calculation should be the instruments' general provisions on damages.[334]

So far as the seller is concerned, it may be the case that neither of the two specific formulae provided for in the instruments can be used because supply exceeds demand for the goods (lost volume).[335] To determine the amount of lost

[327] See Bridge (n 43) 571.
[328] Goode (n 42) 376.
[329] If the buyer manages to find a replacement for the period of delay and earn profits therefrom, these profits will either reduce the amount of profits lost during the period of delay or may even nullify the claim for lost profit if the cover has been found for the *entire* period of delay and if at least the same amount of profits as that which would have been earned but for the breach has been generated.
[330] This will be the case where the buyer had made a profit from a purchase and subsequent resale of goods bought as cover.
[331] See Schlechtriem (n 83).
[332] Articles 75 CISG, 7.4.5 UPICC, and 9:506 PECL.
[333] Articles 76 CISG, 7.4.6 UPICC, and 9:507 PECL.
[334] Articles 74 CISG, 7.4.2 UPICC, and 9:501 PECL.
[335] See, generally, ch 3.

profit ('net profit') where no production has yet taken place and no costs have yet been incurred, the manufacturing costs that would have been incurred to produce the goods (including an amount of overheads which can be reasonably attributed to this contract) will have to be subtracted from the seller's sales price ('gross profit').[336] If the seller has, by the time of the breach, begun its reliance on the contract, its overall damages can be calculated by determining the amount of 'net profit', adding costs actually incurred in relying on the contract, all other losses suffered as a result of the breach[337] and subtracting the amount of any benefits received as a result of the breach.[338] For example, suppose that the contract price was £20,000 and the seller would have incurred £12,000 to produce the goods. At the time of the breach, the seller has spent only £9,000 (out of £12,000). Suppose further that after the breach the seller sold whatever had been produced as scrap for £3,000 at the same time having spent £1,000 to find a buyer. Overall losses can be calculated as follows: £8,000 ('net profit': £20,000 – £12,000) + £9,000 (production costs incurred) – £3,000 (price received from the sale of scrap) + £1, 000 (cost of searching for a buyer) = £15,000. If the seller acts as a middleman who manages to persuade its supplier to keep the goods at no charge after the buyer's breach and incurs no additional costs, its damages, in a true lost volume situation, will consist of the difference between the price in its contract with its supplier and the price in the contract with the buyer.[339] Where the seller acquires the goods from its supplier and then resells them to a customer who would have bought the goods even if no breach had occurred, the seller should then be entitled to the award of the 'net' profit margin it would have received had the buyer paid the price.[340] The mitigation rule

[336] See CIETAC Arbitration proceeding 26 October 1993 (Frozen beef case) <http://cisgw3.law.pace.edu/cases/931026c1.html> (where the seller claimed the difference between the price and costs of manufacture but where this claim was rejected due to the lack of evidence; the tribunal then simply awarded damages in the amount of 10% of the contract price). See also ICC Arbitration Case No 9078 of October 2001 <www.unilex.info> ('The damage to be compensated is calculated as the difference between the hypothetical financial situation of the damaged party as it would have been had the breach of contract not occurred, and the financial situation of the Claimant party as it actually resulted (Differenztheorie). In this calculation, which is necessarily of a hypothetical nature, the lost gross income must be determined, and from that gross income all the costs connected or necessary for generating such gross income must be deducted, irrespectively of the nature of such costs, whether direct costs (for merchandise and labour) or indirect costs (fixed costs, such as administration, direct depreciation or cost of use of machinery and equipment).'

[337] These may include costs incurred in attempting to mitigate losses or damages paid to a supplier of raw materials rejected after the buyer's breach.

[338] Such benefits may include the value of what the seller has on hand (eg, raw materials not used due to the stoppage of production and whatever the seller has produced) or money received by the seller where it sold whatever has been produced for scrap.

[339] This situation may have taken place in the ICC Arbitration Case No 10274 of 1999 (n 50) ('The sole arbitrator noted that the claimant was able to reach an agreement with the producer K that K would keep the remaining 300 mt of feed product A at no cost for claimant. Claimant had claimed the lost profit under the contract, which amounted to the difference between the price at which it had purchased feed product A and its anticipated sales price to respondent and the sole arbitrator awarded this amount').

[340] 'Net' profit is to be determined by subtracting from the purchase price (gross profit) all costs the seller would have incurred to purchase the goods from its supplier and to deliver them to the buyer.

may require that a lost volume seller take measures to reduce its loss by either selling the goods on hand at scrap or some other secondary market at a lower price and where this is possible,[341] benefits actually derived or which would have been received had the seller mitigated its loss from such a resale, ought to be taken into account. More specifically, damages will need to be calculated by subtracting such benefits from the amount of net profit and adding any costs the party has incurred (or would have incurred had it acted reasonably) by mitigating its loss.[342]

The two formulae expressly enunciated by the instruments may also be irrelevant to the injured buyer. In general, this will be the case where there is no possibility of finding a replacement and/or there exists no current price for the goods. This situation may arise where demand for the goods exceeds supply (loss of volume) or where the goods are highly specialised or the buyer's sub-sale contract required the delivery of self-same goods. Where the buyer-manufacturer finds itself in a lost volume situation, damages for lost profits are usually calculated as the difference between the costs of manufacturing the goods and related costs on the one hand, and the price at which the finished product is sold on the other. For example, in one case under the CISG in determining the amount of 'net' lost profits flowing from the loss of volume in sales of air conditioners, the court subtracted from the sales price costs necessary to earn that profit including manufacturing cost, average commission to be paid, commercial/financial costs and royalty payments which had to be made.[343] Where the goods are specialised, making it impossible both to make a cover transaction and to find a current price for the goods, the calculation of the buyer's lost profits will depend on whether the buyer intended to use them as a profit earning asset or to resell them. In the latter case, lost profits will again need to be determined by the difference between the costs of acquisition and the resale price. The calculation in the former case is likely to be more complex and will require taking account of the following considerations: whether there was some other possibility for the buyer to mitigate its loss; number and content of actual and potential orders[344] for the products to be manufactured; the period for which lost profits are claimed;[345] costs that would have been incurred to manufacture a final product; losses, other than lost profits, suffered as a consequence of the breach;[346] and benefits received as a result of the breach. Where

[341] See Bridge (n 43) 588.

[342] For a more detailed example of calculating damages in case of a lost volume car dealer see, RJ Harris, 'A General Theory for Measuring Seller's Damages for Total Breach of Contract' (1961–1962) 60 Michigan L Rev 577, 602–5.

[343] *Delchi Carrier SpA v Rotorex Corp* (n 31) (fixed costs were incorrectly held to be irrecoverable (see also *Delchi Carrier SpA v Rotorex Corp* 71 F.3d 1024 [2nd Cir. 1995].

[344] Proving prices in potential orders is likely to be difficult and may require relying on the predictions as to the future price movements for the product in question.

[345] In principle, it should be possible to claim lost profits for the period of working life of an asset (see, eg, Goode (n 42) 371).

[346] These losses may include liability to customers for non-delivery and/or costs incurred in attempting to mitigate losses.

the buyer's sub-contract requires the delivery of the very same goods as those under the contract with the seller, the buyer is again deprived of a profit margin with no possibility of cover and lost profits are measured as the difference between the contract price and the price in the sub-sale contract.[347] Leaving aside the issue of why the buyer is not able to find a replacement, it is important to note that, in some cases, in order to calculate the difference between the contract price and the price in a sub-sale contract, it may be necessary to make adjustments to one of the prices to make the two comparable. In one case under the CISG,[348] to make the sub-sales CIF price comparable to the FOB contract price, the tribunal deducted costs of freight and insurance from the CIF price. It should also be noted that in some cases under the CISG,[349] although recognising that the buyer failed to mitigate its loss by procuring a substitute, tribunals have nevertheless awarded what seemed to them a reasonable profit margin under a sub-sale. It is suggested that this flexible approach can only be justified if the loss of profit would still have occurred even if the buyer had reasonably concluded a replacement transaction.[350]

Finally, as shown above, the instruments expressly provide that the difference between the contract price and the price in the replacement transaction can be claimed *after* the contract has been avoided. However, it is often the case that the injured party makes a replacement transaction *before* its avoidance of the contract. The question is whether the injured party is in this case precluded from claiming the difference between the contract price and the price in a substitute transaction. It is suggested that this claim should not be allowed on the basis of the instruments' 'concrete' formula since this would contravene its requirements. However, it is further submitted that contrary to some decisions under the CISG,[351] there is no good reason why such a calculation should not, in principle, be possible under the instruments' general provision on damages[352] and this has been the position in some other cases under the CISG.[353]

[347] See CIETAC Arbitration proceeding 17 October 1996 (n 66) (no reasonable opportunity to mitigate losses as the goods under the contract with the seller and the sub-sales contract were the same goods in terms of specifications and place of manufacture (Korea)).

[348] See CIETAC Arbitration proceeding 14 March 1996 (Dried sweet potatoes case) <http://cisgw3.law.pace.edu/cases/960314c1.html>.

[349] See ICAC Case 406/1998, decision dated 6 June 2000 <http://cisgw3.law.pace.edu/cases/000606r1.html>.

[350] This is provided that all other requirements of the law of damages are met (such as foreseeability, standard of proof, causation). The decision could have been less questionable if the tribunal had applied art 76 CISG and it is not clear why it had not done so.

[351] See *Frischaff Produktions GmbH v Guillem Export SL* Appellate Court Valencia (Spain) 31 March 2005 <http://cisgw3.law.pace.edu/cases/050331s4.html>.

[352] Articles 74 CISG, 7.4.2 UPICC and 9:501 PECL. For a similar view, see Schlechtriem (n 83).

[353] See ICC Arbitration Case No 8574 of September 1996 (Metal concentrate case) <http://cisgw3.law.pace.edu/cases/968574i1.html>; CIETAC Arbitration proceeding 8 April 1999 (New Zealand raw wool case) <http://cisgw3.law.pace.edu/cases/990408c1.html>.

9

Calculation of Damages (Part II)

1. GENERAL

THE PREVIOUS CHAPTER explained the difference between the two main approaches ('concrete' and 'abstract') to calculating damages and examined the methods of assessment of what might be regarded as 'typical' losses arising in international sales transactions. While continuing to address the issues relating to the calculation of damages, this chapter aims to explore the challenges posed by some specific situations, such as those arising in anticipatory breach cases and long-term contracts, as well as by the peculiarities of certain types of loss (such as currency losses, loss of a chance and damage to business reputation/goodwill). The chapter will conclude by addressing the question of the currency in which damages are to be awarded.

2. ANTICIPATORY BREACH

2.1 General

Calculating damages where a party commits an anticipatory breach is usually perceived as a particularly challenging area of the law of damages. One reason is that because an anticipatory breach occurs before the due date for performance, there is a wider range of dates by reference to which damages can be potentially calculated: not only are the due date for performance and the date of the avoidance of the contract candidates for this role, but also the date when an anticipatory breach actually occurs (that is, the date when the innocent party becomes aware of the other party's inability or unwillingness to perform). The consequences of choosing one of these dates are serious as the amount of damages may vary significantly depending on which date is relied upon. This problem is particularly acute in the context of the 'abstract' formula[1] since it is the date by reference to which the current/market price is to be fixed that is at stake. Therefore, it is only in such cases that one is truly faced with the choice between the three dates. In the case of the 'concrete' formula,[2] it is not really the question

[1] That is, the difference between the contract price and the current/market price.
[2] That is, the difference between the contract price and the price in the replacement transaction.

of which of the said dates is appropriate since the formula relies on the actual substitute transaction. Rather, the relevant questions are whether this formula is relevant in anticipatory breach cases and, if so, whether its requirements (reasonable manner and reasonable time) have been met.

In contrast with some legal systems which generally prefer the due date of performance,[3] the instruments' 'concrete' and 'abstract' formulae refer to the time of the avoidance of the contract.[4] The question is whether in anticipatory breach cases it is appropriate to rely on these formulae. Although there has been little discussion of this issue in legal literature, no one thus far seems to have doubted the relevance and the correctness of using these formulae and there is a good reason why this is so. As discussed in detail above,[5] both formulae are in line, albeit to a different extent, with the 'duty' to mitigate which should equally apply to anticipatory breach situations.[6] These formulae can be said to reflect (again, to a different extent) the conduct expected of the injured party, *regardless of* whether an anticipatory or an actual breach has been committed. Therefore, there is little doubt that these formulae are relevant for anticipatory breach cases.

2.2 Relevant time for calculating damages and the problem of over-compensation

The instruments' formulae[7] generally calculate damages by reference to the time of avoidance[8] which, in the anticipatory breach context, would often precede the due date of performance and the amount of loss thus calculated can be higher than the loss calculated by reference to the due date for performance. For example, where on a falling market buyer's damages are calculated either by reference to a replacement transaction concluded after avoiding the contract but before the due date or by reference to a current/market price at the time of avoidance, damages thus calculated will be higher than those calculated by reference to the later due date. It has been argued that this is not a satisfactory result because, as a consequence of the anticipatory breach, the buyer is put in a

[3] See MG Bridge, *The Sale of Goods* (Oxford, OUP, 1997) 565.

[4] For the discussion of the relevance of the time of taking over in art 76(1) CISG to anticipatory breach cases, see note 8 below.

[5] See ch 8.

[6] For the explanation of why the 'duty' to mitigate is applicable in anticipatory breach cases, see ch 6.

[7] See arts 75 and 76 CISG, 7.4.5 and 7.4.6 UPICC, 9:506 and 9:507 PECL.

[8] It will be remembered that according to art 76(1) CISG, if the goods have been taken over, the current price is to be determined by reference to the date of such taking over. At first sight, this provision may appear to be relevant to anticipatory breach cases. Potentially relevant situations are those involving instalment contracts where the receipt of defective goods gives a sound basis to conclude that a fundamental breach will occur with respect to the remaining instalments (see art 73(2) CISG). However, art 76(1) seems to imply that the 'abstract' formula applies precisely to those goods which were *actually taken over* and, in the case of instalment contracts, the goods in the remaining instalments have not yet been taken over and therefore the 'taking over' part of art 76(1) will not be relevant.

better position than if the contract had been performed.[9] For this reason, when it comes to the 'abstract' calculation, some legal systems generally prefer to calculate damages by reference to the due date of performance.[10]

In response to this concern, it can be argued that such a result is a price to be paid for the law's recognition of the doctrine of anticipatory breach and the latter's aim to provide certainty and security to the innocent party who has found itself in an insecure position before the due date of performance. Bearing in mind that the law requires the party to mitigate its loss (which usually means making a replacement transaction before the due date for performance), it would be impossible to calculate damages by reference to both the date when the party ought to have mitigated and the due date for performance since these would normally be different dates. In other words, since the law wants the innocent party *both* to be able to claim damages in anticipatory breach cases and to perform its duty to mitigate, calculating damages by reference to the due date for performance would be impossible. This becomes evident where, after avoidance, the party makes a replacement transaction in a reasonable manner and within a reasonable time (thus satisfying the mitigation rule) and invokes the 'concrete' formula; where this is the case, the due date for performance is automatically excluded since it is the price in the replacement transaction that will be relied upon.[11] Consequently, relying on the due date for performance is only possible where the 'abstract' formula is the starting point. It is also worth pointing out that the difficulty of reconciling the reliance on the due date and the mitigation rule is recognised even in those systems which generally prefer to calculate damages by reference to the due date for performance.[12] Thus, subject to the discussion below, it is almost inevitable that the concern for over-compensating the innocent party will be over-ridden by the mitigation rule.

The concern for over-compensation may nevertheless be partly alleviated by interpreting the instruments' 'concrete' and 'abstract' formulae in accordance with their underlying rationale. So far as the 'concrete' formula is concerned, it is well established that a replacement transaction needs to be on similar terms to those in the original contract. In anticipatory breach cases, this means that the innocent party needs to make every reasonable attempt to find a replacement transaction for the delivery[13] at the date fixed in the original contract.[14] Similarly, if the 'abstract' formula is relied upon, it needs to be remembered that it is based on the assumption that the party is in the position to make a hypothetical replacement transaction which, just like an actual replacement transaction, is to be based, if reasonably possible, on similar terms to those in

[9] See Bridge (n 3) 565.
[10] See, eg, *ibid*, 564–65 (in the context of the English sales law).
[11] See arts 75 CISG, 7.4.5 UPICC, and 9:506 PECL.
[12] See Bridge (n 3) 565.
[13] Seller's resale or buyer's re-purchase, as the case may be.
[14] See P Schlechtriem, 'Calculation of Damages in the Event of Anticipatory Breach under the CISG' <http://www.cisg-online.ch/cisg/FS%20Hellner.pdf>.

the original contract. This should be interpreted to mean the price for delivering the goods at the delivery date fixed by the original contract *current at the time of avoidance*.[15] Such prices can sometimes be determined at the relevant forward or futures markets. This approach derives, to a significant extent, from the view that the contract itself represents an asset[16] or an effective commercial resource which, although to be performed in the future, nevertheless has a present value. This point seems particularly relevant here since the view that the contract is a commercial asset having a present value has been relied upon to justify the existence of the doctrine of anticipatory breach.[17] Thus, although an actual replacement contract is concluded before the due date for performance and the current price is measured at the time of avoidance, these prices, being for future delivery, are the market's best guess at the time as to what the price for the goods is likely to be at the due date.[18] This, it is hoped, will alleviate the concern that because the price at the due date is not relied upon, the party might be put in a better position than if the contract had been performed.

2.3 The application of the 'concrete' and 'abstract' formulae

Calculating damages in anticipatory breach cases would not then be much different from doing so in cases of an actual breach. If an innocent party has sufficient grounds to suspect that the other party will commit a fundamental breach, it can avoid the contract, make a replacement transaction and claim the difference between the contract price and the price in the replacement transaction (the 'concrete' formula).[19] The discussion above concerning the interpretation of the requirements of a replacement transaction being made in 'a reasonable manner' and 'reasonable time'[20] should generally be relevant here as well.

The requirement that a replacement transaction be made within a reasonable time after avoidance is integrally linked to the mitigation rule. This means that, in principle, a contract needs to be avoided and a replacement transaction needs to be made at the point in time which would lead to the lowest amount of damages: the buyer needs to avoid and re-purchase when the price is at its lowest and

[15] See P Schlechtriem, 'Calculation of Damages in the Event of Anticipatory Breach under the CISG' <http://www.cisg-online.ch/cisg/FS%20Hellner.pdf>.

[16] *Ibid.*

[17] See D Saidov, 'Anticipatory Non-Performance and Underlying Values of the UNIDROIT Principles' (2006) 11 Uniform L Rev 795, 798.

[18] It is widely recognised that the market prices have factored into themselves the available information about the future (see Bridge (n 3) 565 note 579; S Waddams, *The Law of Damages,* 4th edn (Toronto, Canada Law Book Inc, 2004) 70).

[19] See *Downs Investments Pty Ltd v Perwaja Steel SDN BHD* [2000] QSC 421; Case No 99 O 123/92 District Court Berlin (Germany) 30 September 1992 (Shoes case) <http://cisgw3.law.pace.edu/cases/920930g1.html>; Case No 11 O 210/92 District Court Krefeld (Germany) 28 April 1993 (Shoes case) <http://cisgw3.law.pace.edu/cases/930428g1.html>.

[20] See ch 8.

the seller needs to avoid and resell when the price is at its highest. In every case, the mitigation rule requires the innocent party to address two questions: (1) is it entitled to avoid and make a replacement within a reasonable time thereafter as soon as it becomes aware of the anticipatory breach?; or (2) is it required to wait and observe the price movements before it can avoid the contract and make a replacement? This is a difficult position for the innocent party to be in as it has to predict the future market price movements and calculate costs resulting from two alternative courses of action. In this regard, it is sometimes argued that because of the uncertainty inherent in market price movements, it can never be unreasonable for the innocent party to fail to predict the market price[21] and because the market price already factors into itself all available information, there can be 'no room for inquiring whether, in market conditions, the buyer's repurchase is reasonable'.[22] Consequently, under this approach, if immediately after anticipatory breach the buyer avoids the contract and makes a replacement transaction while the market was falling, the buyer should nevertheless be awarded a higher price difference, resulting from this replacement, than the one that would have resulted had it made a replacement later in time. This result has been justified on two grounds. First, it introduces symmetry, for if the market had risen the seller would have been spared the higher amount of damages.[23] Second, the higher cost of an early replacement can be treated as a cost resulting from mitigation.[24] These arguments are attractive, but this approach still leaves us with the difficult question of what should happen to the mitigation rule. Some advocates take a somewhat extreme view by preferring to calculate damages with reference to the 'due date of performance' at the expense of virtually ignoring the mitigation rule,[25] while some others recognise that the mitigation rule should be enforced but appear to de-emphasise it to some extent.[26] More specifically, the latter would seem to suggest that virtually any replacement transaction, if made 'where a reasonable opportunity offered',[27] should be regarded as a reasonable mitigation measure and the resulting price difference should be awarded regardless of whether the party is, from the standpoint of the mitigation rule, over- or under- compensated.

Indeed, it will often not be realistic to expect the innocent party to predict the price movements either because the market is a highly fluctuating one or because the due date of delivery under the original contract is too far in the future. In such cases, avoiding the contract shortly after anticipatory breach and making a replacement transaction soon afterwards should be treated as a reasonable mitigation measure and damages can be calculated 'concretely' by reference to that transaction. That said, there may still be situations where a party may be in

[21] Waddams (n 18).
[22] Bridge (n 3) 565 note 579.
[23] See *ibid*, 565.
[24] *Ibid*; Waddams (n 18).
[25] Waddams (n 18).
[26] Bridge (n 3) 565.
[27] *Ibid*, with a further reference.

a position to make reasonable predictions about the likely market movements: it may well be the case that an experienced and well informed buyer might be in the position to expect, with a high degree of likelihood, either a rise[28] or a fall in the market price.[29] This buyer may also be in the position to assess the amount of costs (eg, storage costs) it will incur if it buys the goods long before the due date. In such a case, there is, in principle, no reason why the mitigation rule should not be interpreted as requiring the buyer to wait in order to buy the goods when the price falls and to reduce other additional costs. Admittedly, such cases are rare and in the light of the difficulty of predicting future price movements it will *usually* be reasonable for the innocent party to avoid the contract and to find a replacement transaction shortly after anticipatory breach.[30] A difficulty, faced by a court/tribunal, of determining whether in the case at hand the injured party was in the position to reasonably predict the market movement may be partly alleviated by the fact that it is usually the breaching party who bears the initial burden of proving the injured party's failure to mitigate[31]: if the breaching party fails to satisfy its burden of proof, damages can then be assessed on the presumption that the injured party has acted reasonably.

Similar considerations apply to the 'abstract' formula which refers to the current price at the time of the avoidance of the contract. As explained, this provision should, primarily, be interpreted to refer to the price for future delivery, as fixed by the original contract, current at the time of avoidance.[32] If, however, no such prices can be found (eg, because there are no relevant forward or futures markets),[33] there is no good reason why the current price for the delivery at an earlier date or for immediate delivery cannot be relied upon. The formula is based on a hypothetical replacement transaction which should be interpreted in the same way as the actual replacement transaction.[34] The latter, in turn, does not have to be identical as long as it provides a reasonable substitute[35] and where no price for the delivery date fixed by the original contract can be found,

[28] For example, it may well be clear to an experienced trader that due to bad weather conditions in a number of main tomato-producing countries and the resulting shortage of supply, the market price of tomatoes will be rising.

[29] For a similar view, see Schlechtriem (n 14) ('where performance is due in the future, the uncertainty of price developments in cases of anticipatory breach must be considered: the more certain price increases are, with the consequence that cover transactions should be undertaken promptly, the sooner a buyer aggrieved by the seller's anticipatory breach will be expected to avoid and cover').

[30] '[A] cover transaction should be allowed right (i.e. within a "reasonable" period) after avoidance, even if it subsequently turns out that waiting would have paid. Of course, in wildly fluctuating markets, the aggrieved party should not cover in the spot market at peak prices—but this advice is only to be followed if there is some likelihood of prices going down again' (*ibid*).

[31] See ch 6.

[32] This seems to have been the case in CIETAC Arbitration proceeding 29 March 1996 (Caffeine case) <http://cisgw3.law.pace.edu/cases/960329cl.html> where damages were calculated by reference to the price current at the time when the goods were to be delivered.

[33] Forward markets will be relevant if the buyer bought goods for use while futures markets may be appropriate if the buyer bought the goods for the purpose of speculation (Waddams (n 18) 72).

[34] See Schlechtriem (n 14).

[35] See ch 8.

relying on prices for the delivery at an earlier date is likely to be the only reasonable course to take. It has also been pointed out[36] that where prices at the delivery date, as fixed in the original contract, are forecasted to be higher than current prices, it is justifiable, in the light of the mitigation rule, to avoid the contract at once and to rely on the price for immediate delivery current at the time of avoidance.[37]

Where there is no price for future delivery at the date fixed by the original contract,[38] there is often a danger that the 'abstract' formula would either over- or under-compensate the innocent party: the price current at the time of avoidance may turn out to be lower or higher than the price at the due date of delivery, with the result that the difference between the two will put the innocent buyer into, respectively, a better or worse financial position than that in which it would have been had the contract been performed.[39] When addressing this problem, it is important to remember that a conclusion as to whether the party has in fact been over- or under-compensated can only be reached if judicial/arbitral proceedings and the assessment of damages take place at or after the due date of performance. With this in mind, it is suggested that if the proceedings and the assessment of damages take place before the due date, there is generally no other choice but to award damages by reference to the current price at the time of avoidance (for immediate delivery or delivery some time before the due date) so long as the time of avoidance is in line with the mitigation rule.[40] The problem of over- or under- compensation seems only relevant where the proceedings and the assessment of damages take place *after* the due date when the prices at the time are in fact known. Where this is the case, should the innocent party be allowed to claim damages by reference to the current price at the time of avoidance before the due date, even if these damages will result in over-compensation? It is suggested that a subsequently acquired knowledge of the

[36] See Schlechtriem (n 14).

[37] The link between the avoidance of the contract and the mitigation rule needs to be borne in mind. The mitigation rule will often dictate when the contract ought to have been avoided. It would appear, from the facts of one CISG case, that the date when the contract was actually avoided (January or July 1994) was not significant because 'the current price for tomato concentrate from southern France was continuously *FF* 6.10/tin higher than as stipulated with the seller up to and including July 1994'. Although the mitigation rule is not expressly addressed, this holding nevertheless seems to reflect the court's implicit recognition of the rule and its connection with the avoidance of the contract. Damages were awarded under art 76 CISG (Case Nos: 1 U 143/95 and 410 O 21/95 Appellate Court Hamburg (Germany) 4 July 1997 (Tomato concentrate case) <http://cisgw3.law.pace.edu/cases/970704g1.html>).

[38] As noted, the reliance on this price, which is based on the market's best guess as to the prices at the date fixed by the contract, approximates, as much as possible, a hypothetical replacement at the time of avoidance to a hypothetical transaction had the assessment actually been made at the due date under the original contract.

[39] It has been suggested that there is nothing wrong with the innocent party being under-compensated as this is the risk the party takes when it claims damages under the 'abstract' formula at the time of avoidance and that the problem to be dealt with is the risk of over-compensating the party (Schlechtriem (n 14)). This view is, of course, open to criticism in that it is based on an 'asymmetrical' treatment of the innocent party's position.

[40] See n 37.

actual prices at the due date cannot be ignored and this result should generally be prevented.[41] One way of doing so is to require the innocent party, where possible,[42] to make a replacement transaction as soon as possible, and to calculate damages 'concretely' by reference to that transaction. The risk of over-compensation is thus eliminated or substantially reduced because a replacement transaction would be concluded at a price current at the due date or shortly thereafter. Where a replacement transaction is not possible, damages will have to be calculated 'concretely' by reference to the party's actual loss.[43] If the buyer bought the goods for resale and this intention is evidenced by a sub-sale contract, damages can be calculated as the difference between the contract price and the price in a sub-sale contract. If no sub-sale contract has been made, the buyer will have to prove the price at which it would have resold the goods. Where no specific sub-buyer can be shown, the current/market price for the goods can be relied upon (provided the buyer proves that it would have been able to sell the goods). If the goods were bought for use in a manufacturing process, damages can be calculated as lost profits and other losses suffered as a result of the necessary delay (until the time when a substitute can reasonably be expected to be obtained) or, in more extreme cases where no substitute is possible, damages can be calculated by reference to lost profits flowing from an inability to manufacture and sell the product which was ultimately caused by the non-delivery. So far as the innocent seller is concerned, if it acts as a middleman, damages can be calculated as the difference between the price in the contract with its supplier and the price in the contract with the buyer. If it has manufactured the goods itself, actual loss will be the difference between the costs of manufacture and the sales price to the buyer.

The methods of calculating damages 'concretely' can also be used in cases other than those where the innocent party might be over-compensated by the 'abstract' measure. It is argued that the instruments should not be interpreted as requiring the innocent party to necessarily resort to the 'concrete' and 'abstract' formulae for which they *expressly* provide.[44] There is no reason why the party cannot choose to rely on some other 'concrete' method of calculation. This is usually done where a replacement transaction is not possible and instead of resorting to the 'abstract' formula, the innocent party invokes another method

[41] If the innocent buyer had interpreted the mitigation rule as requiring it to wait, then in cases under consideration, the buyer's forecast proved correct and the buyer should make a replacement and calculate damages by reference to that replacement. So far as cases where it was not possible for the party to mitigate by making a replacement contract, it can be argued that the 'abstract' formula cannot be used because its assumption that the party is in the position to make a replacement is not present.

[42] There may be various reasons why it is not possible to find a replacement. For example, it may not be possible to find another supplier because the goods are highly specialised or unique or because the goods need to be ordered quite a long period in advance and the buyer is not left with sufficient time to do so to enable itself to resell to its sub-buyer at the agreed date (see ICC Arbitration Case No 8786 of January 1997 (Clothing case) <http://cisgw3.law.pace.edu/cases/978786i1.html>).

[43] The legal basis would be the instruments' general provisions on damages.

[44] That is, arts 75 and 76 CISG, 7.4.5 and 7.4.6 UPICC, 9:506 and 9:507 PECL.

of 'concrete' calculation. In one case under the CISG where the buyer avoided the contract before the due date for delivery but after it had become clear that the seller would not be able to provide a timely delivery of seasonal goods, the buyer was awarded damages for the lost profit it would have received from selling the goods at its retail store. The tribunal specifically stated that a replacement transaction was not possible as the goods needed to be ordered at least three to four months in advance to meet delivery deadlines and 'since the seller's anticipatory breach was on 29 March and the buyer required delivery for 5–7 April to meet the peak sale time . . ., the buyer would not have sufficient time to purchase replacement goods'.[45]

Another challenging area is where, before the due date for performance, it becomes clear to the seller who has not completed the manufacture of the goods, that the buyer will not perform the contract. What is the seller to do and how should damages be measured? Although, in contrast with some domestic systems,[46] the instruments do not contain a specific provision to this effect, it can be safely said that the calculation of damages in such cases will be dependent on how the mitigation rule would apply to the given facts. It may or may not be reasonable to complete the manufacture and damages will have to be quantified by reference to what is reasonable in the circumstances. Reasonableness is to be judged not with the benefit of hindsight but according to the circumstances in which the seller found itself at the time of anticipatory breach.[47] While it is evident that there can be no hard and fast solution to this problem, it may be helpful to give a simple illustration. Suppose that at the time of anticipatory breach, the seller has only spent £2,000 as it had just begun to manufacture a piece of machinery for which the buyer agreed to pay £50,000. The costs of manufacture are £40,000. Knowing that a resale of the machinery will bring not more than £35,000, the seller nevertheless completes the manufacture, resells for £33,000 and claims £17,000 in damages. The seller's conduct would, most likely, be considered unreasonable since it knew that if it completed the manufacture its loss would be at least in the range of £15,000 (£50,000 – 35,000), which is a higher amount than the loss it would have suffered if it had discontinued the manufacture (£12,000 (£10,000 + £2,000)).[48] If, however, the seller knew, at the

[45] See ICC Arbitration Case No 8786 (n 42). In another case (Case No HG 95 0347 Commercial Court Zurich (Switzerland) 5 February 1997 (Sunflower oil case) <http://cisgw3.law.pace.edu/cases/970205s1.html>), similar damages have been awarded without any inquiry as to whether the innocent buyer could have reasonably made a replacement contract and it is clear that, in the light of the expressly enunciated mitigation rule, this is not the correct approach. The award of these damages would only have been justifiable if there had been no reasonable opportunity to mitigate.

[46] § 2-704(2) UCC: 'Where the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization either complete the manufacture and wholly identify the goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner'.

[47] For the same view, see JJ White and RS Summers, *Uniform Commercial Code,* 5th edn (St Paul, Minn, West Publishing Co, 2000) 296.

[48] Of course, any benefits received as a result of the breach need to be taken into account. These benefits can include money received from selling whatever the seller manufactured by the time of anticipatory breach as scrap. The seller may also channel its resources, initially allocated to the

time of anticipatory breach, that it would be able to sell this machinery for £45,000, it is reasonable to complete the manufacture as damages thus calculated (£7,000 (£50,000 – 45,000 + 2,000)) are lower than the losses that would have been suffered had it stopped the manufacture. It will, of course, be incumbent on the seller to exercise care in making predictions about the current and future market prices and this is why it has been recommended that 'the lawyer and client should preserve evidence which formed the basis for the decision and document by letter or contemporaneous memoranda when and why the decision to complete or not to complete was made'.[49] It would also follow from these examples that the main criterion for determining the reasonableness of a decision is the comparison between the amount of losses to be suffered if the manufacture is completed and the amount of losses if the manufacture is discontinued—if the latter is a higher amount, the seller should generally complete the manufacture.[50]

However, making a decision as to what is a reasonable course of action may be complicated by other factors and in some cases, for example, a decision to complete the manufacture may be reasonable despite the higher amount of resulting losses. This may be the case where the seller cannot afford to discontinue the manufacture because it might lose many skilled employees and some of them might even find jobs with the seller's competitors.[51] The nature of the materials used to manufacture the contract goods can also be a factor which may have to be taken into account in determining a reasonable course of action for the seller to take. One case under the CISG,[52] albeit not involving anticipatory breach, provides a relevant example. In this case, the seller, an exporter of plastic products, agreed to manufacture and supply the buyer with cushions. After the buyer had failed to pay at the due date,[53] the seller continued the production and the tribunal held that doing so was unreasonable on the ground that the materials used in the production of contract goods were not specialised ones[54] and therefore could have been put to some other valuable use. The tribunal stated that the seller had increased its own loss, which could have been prevented if the seller had stopped the production and used the production materials for some other valuable purpose.

contract in question, in some other direction and any benefits thus received will have to be taken into consideration so long as they would not have been received had the buyer performed the contract.

[49] White and Summers (n 47) 297.

[50] See *ibid*.

[51] See *ibid*.

[52] CIETAC Arbitration proceeding 29 September 2000 (Cushion case) <http://cisgw3.law.pace.edu/cases/000929c1.html>.

[53] The case is relevant here as the seller could have found itself in the same position as the one that arose in this case had the buyer committed an anticipatory, and not actual, breach.

[54] 'The PVC materials are not specially manufactured for the [contract] goods, but are generally used for the same kind of products.'

3. LONG-TERM CONTRACTS

3.1 General

If the basis for claiming damages is a breach of a long-term contract, the calculation of damages may be complicated by a number of factors stemming from the nature of such contracts. Performance of these contracts takes place over a long period of time and because of the uncertainty regarding the parties' needs and the price for the goods at a particular time in the future, the terms (such as price and quantity of the goods to be delivered) which are usually fixed in 'simpler' contracts will often be variable. Suppose that a buyer has breached the contract for the 10-year supply of oil. It is most unlikely that the contract in such a case will have a fixed price for the entire contract duration and the parties may have agreed that the price would be calculated as a percentage added to the market price (as listed, for example, on a particular exchange), current at the date when each particular instalment is due. There may be some other variables affecting the price such as where the price may increase or decrease depending on the quantity to be ordered. Similarly, the contract may not provide a fixed quantity to be delivered: for example, this may depend, as the case may be, on the seller's ability to deliver from a particular reservoir, the buyer's needs, the minimum or maximum quantities fixed by the contract. Since quantity and price are vital components in calculating damages, uncertainty inherent in their determination requires that certain methods of overcoming this uncertainty be developed. Calculating damages may be further complicated by some other contingencies such as the presence of an option to terminate the contract upon the occurrence of a particular event. The potential implications of such alternatives for calculating damages may include the need to make predictions as to the likelihood of such events occurring as well as of the parties' exercising that option. The question may also arise as to whether or not an actual occurrence of the event needs to be taken into consideration in quantifying damages where the contract had been avoided before the event but where the proceedings take place thereafter. Another problem is where a party has been given an option, say, to buy or sell a particular quantity at a fixed price and a breach of the contract leads to the loss of that option. Yet another difficulty stems from the need to project lost profits into the future and then to determine their present value. A list of these examples is by no means exhaustive and this section simply aims to highlight only some of the problems arising from the uncertainty inherent in long-term contracts. It also needs to be stressed that the given problems are not peculiar to long-term contracts as some of them can equally arise in contracts with a shorter duration. The reason that they are considered in the context of long-term contracts is that here these problems are most evident and pressing.

3.2 Uncertain price

As has been seen, determining the contract price is necessary for both the instruments' 'concrete' and 'abstract' formulae.[55] It will also be remembered that, in anticipatory breach cases, it is preferable that both the price in a replacement transaction and the current/market price are prices for a future date of delivery, as fixed in the original contract. Long-term contracts may often contain a mechanism for determining the price. If the price is defined as a certain percentage added to the market price, as listed on a particular exchange for the future due date of delivery, it has been suggested that the contract price can be determined, for the purposes of calculating damages, as the market price plus the specified percentage.[56] This approach can, of course, provide a solution in some cases. For example, suppose that the buyer breached the contract for the supply of oil in August 2009 and the seller avoided the contract in August 2007. The contract price was defined as the price listed at a specified exchange plus 5 per cent. Assuming that both the price in a replacement contract in August 2007 for the delivery in August 2009 and the current price at the time of the seller's avoidance are very similar, the seller will get a compensation under both the 'concrete' and 'abstract' formulae since the contract price is likely to be higher (as it includes a 5 per cent addition to the price) than the price in the actual or hypothetical transaction. However, if it is the seller who is in breach, the buyer will get no compensation[57] as, in the eyes of the 'concrete' and 'abstract' formulae, the buyer is in a better position now than it would have been had the seller performed the contract.[58] The essential point here is that if the contract price is determined at the time of avoidance for future delivery as fixed in the original contract, it becomes identical to the current price (under the 'abstract' formula)[59] and, at least, very similar to the price in a replacement transaction (assuming it has been concluded at the price current at the time of avoidance or shortly thereafter). The reason the seller gets damages in the given example is only because there is a percentage to be added to that price. Therefore, it is doubtful whether determining the contract price in the same way as the current price is always appropriate.

One solution could be to apply the provisions (of the CISG and UPICC) on fixing the price where the contract 'does not expressly or implicitly fix or make provision for determining the price',[60] with reference to the price generally

[55] It may be the case that in a long-term contract, the 'abstract' formula would often be more appropriate as it can be difficult for the innocent party to find a replacement for the entire amount and for the same contract period.

[56] See Schlechtriem (n 14).

[57] Apart from certain additional costs that may arise such as costs in procuring a substitute.

[58] Since the buyer can make a replacement (or if it has actually made a replacement) at a lower price than the contract price determined at the time of avoidance of the contract.

[59] As it is determined in the same way.

[60] Article 55 CISG. Similar provisions can be found in art 5.7 UPICC while the PECL provides that, in such cases, 'the parties are to be treated as having agreed on a reasonable price' (art 6:104).

charged for the goods in question under comparable circumstances at *the time of the conclusion of the contract*. This is a workable and appropriate solution in certain cases because it may provide a rough estimation of the parties' true expectations. However, this may not always be possible because no price for the future date of delivery may be available at the time of concluding the contract. Another solution could then be to rely on the price for future delivery at the time of proceedings and the assessment of damages. The contract price determined as of that date would not necessarily be the same as the current price at the time of avoidance because the proceedings will usually take place *after* the contract was avoided.[61] Yet another solution altogether is to issue an award or decision allowing the calculation of damages *after* the passage of the due date of delivery.[62] Under this approach, the contract price will be fixed by reference to the *actual* price at the due date. Damages can then be calculated as the difference between the contract price thus fixed and the price in the replacement contract or the current price at the time of avoidance (whichever is relevant).[63] Damages can also be calculated on a 'lost profit' basis. This measure is primarily relevant to the buyer as the 'concrete' and 'abstract' formulae generally compensate the seller for the lost profit margin. Once the contract price is known, it is clear what the buyer would have paid for the goods and, to calculate damages, that amount would have to be subtracted from the profits the buyer would have made (by reselling the goods or using them in its manufacture).[64] This solution, however, may often be of limited use because the award postponing the final calculation of damages may not be available under the applicable procedural rules.[65] It can also be argued that this method may not always be a satisfactory solution since, in a long-term contract, the innocent party is essentially required to wait a long time before it might be awarded damages. Considering the substantial amounts often involved in such contracts and the contracts' complex structure, this method may not provide the necessary legal protection to the innocent party

[61] If there is a substantial time gap between the two dates accompanied by a substantial price movement, it can be argued that the contract and the current price need to be assessed as of the same date since, to take the case of the innocent seller for example, splitting the dates at which these two prices are measured 'magnifies any distortions that otherwise occur in the contract market differential because allows one (contract) to escalate while the other (market) is held steady' (White and Summers (n 47) 247). This argument, it is submitted, is not well founded. The conditions in which the contract is concluded and the contractual expectations regarding the price are formed, do not have to be the same as those in which a hypothetical (or, for that matter, a replacement) transaction ought to be (or has been) concluded. The 'abstract' and 'concrete' formulae themselves recognise that there may be a difference between the replacement/current prices and the contract price, and that they are fixed at different points in time.

[62] See further note 72.

[63] It will be remembered that the mitigation rule should dictate the moment when the contract *ought* to have been avoided.

[64] This method may often be difficult to apply in practice as it will require inquiry into the hypothetical future, which in turn will require examining at what prices the buyer would have been able to resell the goods or how much the buyer would have earned had it used the goods in its manufacture. The latter situation will add further complications of determining both the future costs of manufacture and future prices at which a finished product will be sold.

[65] See Schlechtriem (n 14).

who might not only need capital to be able to proceed with substitute arrangements,[66] but also certainty regarding its legal position.

In some cases, the contract will contain a rather vague mechanism for determining the price and arbitrators have been prepared to predict what the contract price would have been had the contract been performed. In doing so, they have drawn assumptions about the parties' future conduct and have taken into account events occurring subsequent to the conclusion of the contract. In one case under the CISG involving two long-term contracts for the supply of raw aluminium,[67] the tribunal faced the task of determining the contract prices for the remaining eight-year period. The contract provided that the parties were to fix the price 'every three months' on the basis of 'the competitive world market price'. The buyer argued that because the seller had sold the goods at preferential price levels in the past, the price for the remaining contract period should be fixed on the same preferential basis. This argument was rejected on several grounds. First, the contract expressly referred to 'competitive market prices'. Second, the ownership and directorate of the seller had changed shortly before the seller breached the contract and the tribunal stated that it could be 'safely assumed that the new owners and the new directorate . . . would have requested the seller's management (sooner rather than later) to raise their export prices to the agreed "competitive world market" level during the next or following price negotiation rounds'. Third, 'the seller was created to accumulate hard currency trading profit outside Russia [and] [if the] seller wanted to make such hard currency trading profit in the future, this inevitably would have eroded [the] buyer's "preferential pricing" margin'. Finally, the seller was to receive a commission which would, at least in part, have been charged to the buyer. For these reasons, the price was fixed at 'world price' levels determined by reference to those listed at the London Metal Exchange and adjusted to the terms of the contract.[68]

3.3 Uncertain quantity

Contracts often fix the maximum and/or minimum quantities that can be delivered at the seller's or buyer's option. Where it is not possible to determine whether and how this option would have been exercised, a presumption could be raised that the party would have exercised an option which would have been the least burdensome or the most beneficial to it. The question then arises as to what can be considered to be such a conduct. For example, where the buyer has

[66] In a rising market it may be essential for the buyer, whose financial resources are limited, to receive the difference between the contract price and the current price to proceed with procuring a substitute (the mitigation rule in such circumstances should not be interpreted as requiring the party to procure a substitute).

[67] *Soinco v NKAP* Zurich Arbitration proceeding (Switzerland) 31 May 1996 <http://cisgw3.law.pace.edu/cases/960531s1.html>.

[68] '[T]o reflect transportation and other costs free Hungarian border' (*ibid*).

the option of selecting the quantity within the specified range, a court/tribunal may decide that the buyer would have ordered the maximum level on a market which is expected to rise. However, if the buyer suffered financial difficulties and/or the market was falling, a court/tribunal may hold that the buyer would have bought the minimum quantity. It should then be up to the innocent party to bring evidence to the contrary in order to rebut the presumption.[69]

Where no maximum or minimum quantities are fixed, and where the seller agrees to sell any quantity ordered by the buyer or the buyer agrees to buy any quantity delivered by the seller (output contract), the innocent parties take a risk that the 'abstract' and 'concrete' formulae might not be applicable.[70] Where the contract made in May 2008 provides that the farmer will sell its entire harvest in May 2010 to the buyer, it may be impossible for this farmer to find or prove a replacement contract since the amount of harvest in May 2010 will not be known at the time of avoidance (say, August 2008). Therefore, the 'concrete' formula is unlikely to be applicable unless the farmer manages to reasonably procure a similar (forward) output contract. For the same reason of uncertainty regarding the amount of harvest in 2010, the 'abstract' formula may be inapplicable unless, once again, there exists a current price for output contracts on similar terms. Subject to the mitigation rule, the farmer's only hope might be for either a reasonable profit margin in the light of its previous activities and relevant contingencies (as determined by a court/tribunal) or, if lost profits are too speculative, for loss of a chance to profit.[71]

3.4 Contractual rights and options

Besides providing for an option to deliver or order a particular quantity of goods, the contract may also confer various other rights or options and the question of whether or not a particular right would have been exercised in a hypothetical past or future is of great importance in assessing damages. Once again, this section does not aim to be exhaustive and the intention is to address two specific situations.

The first situation is where the contract provides that upon the occurrence of a particular event, one or both parties will have the right to terminate the contract. Suppose that a seven-year textile supply contract contains a clause providing that if, in the seller's country, legislation is adopted requiring all domestic exporters to sell hard currency, obtained from export transactions, to the state in return for a weak domestic currency, the seller has an option to terminate the contract. If the buyer breaks the contract one year after it was concluded with the proceedings taking place shortly afterwards, how should the seller's

[69] For a more detailed discussion, see ch 8.

[70] See Schlechtriem (n 14).

[71] There may also be a possibility of damages being awarded solely on the basis of judicial discretion (see art 7.4.3(3) UPICC and ch 7).

damages be assessed? Subject to the rules of foreseeability and mitigation, can the seller claim profits for the remaining six-year period assuming no such legislation would be adopted? One answer is to postpone the assessment of damages until a later date if the applicable procedural rules so permit.[72] As noted earlier, however, this may not always be the best solution since the seller will have to wait six years before there is certainty regarding its legal position and the amount of damages to be awarded. Assuming that this solution is either inapplicable or undesirable, it is suggested that the purpose of putting the party in the position in which it would have been had the contract been performed requires judges and arbitrators to do their best to incorporate the probability of the occurrence of the relevant events into an award of damages. This would mean that they would have to determine the degree of likelihood of such legislation being adopted, the point in time where such legislation might be enforced and the likelihood that the seller would have avoided the contract. The amount of damages would need to be reduced by the degree of probability of the occurrence of such events.

The situation becomes very different, however, where the assessment of damages takes place *after* the occurrence of the relevant event.[73] Suppose that, although the buyer had breached the contract one year after it was made, the proceedings and the assessment of damages take place three years after the making of the contract. Then, during the proceedings but before the assessment of damages, the entry of the aforementioned legislation is announced. It is sometimes argued that in the interests of certainty, finality, and consistency,[74] it is preferable to ignore the actual occurrence of such events. This position is also supported by the argument that if the subsequent events *are* taken into account, this would create an incentive for the breaching parties to delay a dispute resolution process[75] and discourage them from reaching a settlement[76] in the hope that subsequent events triggering the reduction of damages will occur.[77] While these are strong arguments, it is submitted that the acquired knowledge of the actual events cannot be ignored and must be incorporated into the damages award. This result is necessitated by the instruments' compensatory principle of damages and the strict adherence to the principle of putting the party in the

[72] For the discussion of this possibility in the context of some domestic legal systems, see, eg, Waddams (n 18); also Note, 'Damages for Loss of Prospective Crops' (1920–1921) 34 Harv L Rev 662, 664.

[73] See the recent English case *Golden Strait Corp v Nippon Yusen Kubishika Kaisha* [2007] 2 WLR 691, where this matter has been addressed.

[74] '[C]ertainty ("generally important in commercial affairs"), finality ("the alternative being a running assessment of the state of play so far as the likelihood of some interruption to the contract concerned"), . . . consistency ("the idea that a party's accrued rights can be changed by subsequent events is objectionable in principle") . . .)' (Lord Bingham of Cornhill in *ibid*, 703).

[75] *Ibid*.

[76] E Peel, *Treitel on the Law of Contract*, 12th edn, (London, Thomson–Sweet & Maxwell, 2007) 1036.

[77] For further critical discussion of *Golden Strait Corp v Nippon Yusen Kubishika Kaisha* (n 73), see, eg, GH Treitel, 'Assessment of Damages for Wrongful Repudiation' (2007) 123 LQR 9.

position in which it would have been had the contract been performed.[78] Thus, if, in our example, it is established that the seller would have terminated the contract as soon as the legislation was enforced, damages for the six-year period would put the seller into a better position than it would have been had there been no breach, since after three years the contract would have ceased to exist. Damages will have to be awarded only up to the point when the seller would have terminated the contract.

Another situation to be addressed is where the contract contains an option permitting (but not requiring) the seller to sell the goods ('put option') and the buyer to purchase the goods ('call option') at a price fixed in the contract.[79] Suppose that a long-term contract stipulates a procedure by fixing a 'quotation period' during which a buyer can exercise an option to buy aluminium at the price of $50 per ton.[80] If this contract requires that every three months the parties are to agree on a price by reference to the 'competitive world prices'[81] which at a particular time fall below $50, the buyer has no incentive to invoke the option since the parties' agreement on the price is likely to be in the range below $50. Where 'world prices' are above $50 and the parties' agreement would have led to a price higher than $50, the buyer will benefit from this option. Calculating damages under such a contract would have to incorporate the possibility of the buyer's exercising that option. If the assessment of damages takes place after the period when the exercise of the option was possible, the actual market movements during that time are certain and it can be ascertained whether damages are due for the loss of the buyer's right to exercise the option.

The assessment of damages becomes more complicated where the relevant period is in the future. One way to approach this situation is to say that the question of whether the buyer is to be awarded damages depends on future price movements and it is only if the price is predicted to rise that the buyer will suffer loss. If the court/tribunal takes the view that at the relevant time, prices will remain at the level below $50, no damages for loss of an option would be due. This approach, however, has been criticised on the ground that it ignores the nature of an option which, just like an insurance policy, guards against uncertain future events. Yang has suggested that by denying damages, even where it is predicted that future prices will be lower than that the price underlying an option, courts disregard 'the fact that when a party purchases an option, it is paying for the certainty that it will be protected from any market

[78] 'Certainty is a desideratum and a very important one, particularly in commercial contracts. But it is not a principle and must give way to principle . . . The achievement of certainty in relation to commercial contracts depends . . . on firm and settled principles of the law of contract rather than on the tailoring of principle in order to frustrate tactics of delay to which many litigants in many areas of litigation are wont to resort' (Lord Scott of Foscote in *ibid*, 709).

[79] For a detailed discussion, see E Yang, 'Assessment of Damages for Breach of an Option' [2004] JBL 437.

[80] This seems to have been the case in Zurich Arbitration proceeding 31 May 1996 (n 67).

[81] See *ibid*.

fluctuations, whether this could be predicted by the courts or not'.[82] This position is based on the view that an option has an *intrinsic* value and therefore, where the assessment takes place before the actual market price at the relevant date is known, damages need to be assessed on the basis that a party, by being deprived of its right to exercise an option, has in fact lost an asset.[83] Just like with the non-delivery of goods, damages need to be based on the replacement value of a similar asset, that is, of a similar option. Recognising the possible difficulty of determining a value of a replacement option, Yang points to the availability of a relevant formula for calculating that value which 'dispels the common misconception that the future value of an option can be accurately predicted using the present value as a benchmark' and tackles more accurately the problem of uncertainty of future price movement by taking account of 'the variance of the underlying asset's returns, the time remaining until the option's exercise and the option's exercise price'.[84] In comparison with the former approach, this approach certainly provides greater security to the injured party and it would also seem to be more in line with the function performed by an option in commercial contracts. For these reasons, it is tentatively suggested that this approach might be a better way to rationalise loss of an option and if the proposed mathematical formula[85] is able to provide an accurate assessment of an option's replacement value, there is no reason why it cannot be used under the international instruments.

3.5 Future losses

In long-term contracts, damages will often be awarded for the future losses the innocent party is predicted to suffer. Although claims for future losses may involve different types of loss, it would seem that it is profits that would have been made in the hypothetical future which will be claimed in most cases.[86] It is widely recognised that when awarding damages for future losses, their value needs to be discounted to their present value.[87] Discounting requires, first of all, the determination of the amount of compensable future losses which, in the case of lost profits, means that the amount of 'net' profits needs to be

[82] Yang (n 79) 442–3.
[83] *Ibid*, 443–4.
[84] Yang (n 79) 444.
[85] For the proposed formula, see *ibid*, n 14.
[86] This is likely to be so because losses such as reliance losses will, in any event, enter into the computation for the purposes of determining the amount of net profit. In other words, a proper determination of future net profits will take account of future reliance losses. Therefore, it is only losses other than reliance losses (often termed as 'incidental' and 'consequential' (excluding lost profits) losses), which can be claimed in addition to lost profits.
[87] This has been done by some arbitral courts and tribunals applying the CISG (see *Mansonville Plastics (BC) Ltd v Kurtz GmbH* 2003 BCSC 1298; Zurich Arbitration proceeding 31 May 1996 (n 67)).

ascertained.[88] This amount then needs to be discounted to its present value by using an appropriate discount rate which has been defined as the 'interest rate used to calculate future receipts or payments at their present value'.[89] Although it is easy to formulate this principle, its implementation is far more difficult. The main reason stems from the difficulty of determining an appropriate discount rate as there is no agreement as to what elements it should consist of. In general terms, however, it can be safely said that a discount rate should take into account multiple factors such as the expected currency depreciation rate,[90] the risks associated with making profits by the business in question,[91] and the safe rate of return[92] a business is expected to make.[93] Determining a discount rate is a question of fact and it needs to be fixed in the light of all relevant circumstances of the case.[94] In one case under the CISG,[95] where a Canadian buyer claimed that due to delay in delivery it was unable to sell the product to a customer ('Korolite') in the United States and thereby expand its market in that country. According to the decision:

> . . . the experts differed with respect to the appropriate discount rate. [The buyer's expert] chose a risk-free rate of 2.5% per annum, while [the seller's expert] chose a risk-based rate of 30%. [The latter] testified that a discount rate of 30% is basically a standard rate for startup businesses. In my opinion, an appropriate discount rate is between 20% and 25%. Although Korolite could be viewed as a startup company, its business is essentially an extension of [the buyer's] business and I believe that a discount rate of 30% is too high in the circumstances.

[88] The following formula is said to be commonly used to calculate the present value of future loss: $X/(1 + d)^n$ '[w]here X equals the amount of money to be discount, d is the discount rate and N equals the number of years' (White and Summers (n 47) 250).

[89] RL Dunn and EP Harry, 'Modeling and Discounting Future Damages' (2002) 193 J Accountancy 49, 50 ('For example, $1 put in the bank today at 5% interest will be worth $1.63 in 10 years. Therefore, the present value of $1.63 to be received in 10 years is $1 today at a 5% discount rate' (*ibid*)).

[90] 'The time value of money should also be taken into account in respect of future loss' *Mansonville Plastics BC Ltd v Kurtz GmbH* (n 87).

[91] See, eg, H Weisburg and C Ryan, 'Means to Be Made Whole: Damages in the Context of International Investment Arbitration' in Y Derains and RH Kreindler, *Evaluation of Damages in International Arbitration* (Dossiers of the ICC Institute of World Business Law, 2006) 165, 174; J Gotanda, 'Damages in Lieu of Performance Because of Breach of Contract' (Villanova University School of Law Working Paper No 2006-8, 2006) 73.

[92] See Dunn and Harry (n 89) 50.

[93] See further White and Summers (n 47) 251–53, who discuss the possibility of relying on several specific discount rates such as a 'risk-free' rate, lending rates based on the breaching party's credit rating and the injured party's rate of return. The commentators correctly reject a 'risk-free' rate since earning profits is always accompanied by taking business risks and, for this reason, this rate is likely to over-compensate the injured party. The second rate is criticised because the present value of the injured party's losses is dependent on the credit rating of the breaching party and 'the legitimacy' of doing so is correctly doubted. The reliance on the latter rate is also put in doubt because it results in 'the lucky and efficient' being penalised since the more efficient the claimant, the higher is the discount rate.

[94] See RL Dunn, *Recovery of Damages for Lost Profits,* 6th edn (Alameda CA, Lawpress, 2006) 545.

[95] *Mansonville Plastics BC Ltd v Kurtz GmbH* (n 87).

As soon as an appropriate rate is found, the next question is whether the amount of future loss needs to be discounted as of the date of judgment or of the date of breach. The question is clearly important as the discount rate may be different at these two dates, particularly if there is a substantial period of time between them. It is argued that the time of judgment is more appropriate since it is in line with the rationale underlying the need for discounting—that is, that the innocent party is able to invest the amount of a discounted award to receive, after the passage of time between judgment and the occurrence of future loss, the amount of future loss before discounting. Because the time of breach will always precede the time of judgment, the innocent party will not be able to go back in time in order to make an investment at the date of the breach.[96] Once a discount rate at the time of judgment is determined, it can be used to discount the amount of future losses, thereby fixing the final award of damages.

4. CURRENCY LOSSES[97]

4.1 Loss flowing from the change in the 'internal value' of currency

A change in the 'internal' value or purchasing power of the currency can cause loss to the innocent party. Suppose that the currency of payment is also the currency in which the aggrieved party operates. This is the case where, for example, a Finnish buyer delays payment to a German seller, and the currency (euro) depreciates (ie, its purchasing power has decreased) during the period when the payment was due and when it was actually made. In such a case, the seller may suffer loss by getting the same nominal amount, but the internal value or purchasing power of which is less than what it would have received on the due date. Provided that the requirements of limiting damages are met, the seller may be entitled to compensation for this loss. However, an important question is whether to be entitled to compensation, the seller must show that it would have used the money for a purpose which was adversely affected by the late payment. For example, it can be argued that the seller has not suffered loss unless it is shown that it would have purchased goods or services (or in fact bought, as intended, goods or services) and, thereby, would have paid (or has already paid) more than it would have if the payment had been received on time. It may be that the seller's intention was to exchange the euros for Uzbek 'sums' and it may well be the case that the depreciation of the euro did not have an impact on the exchange rate between the euro and the 'sum'.[98]

[96] For a similar view and more detailed discussion of this issue, see P Schulman, 'Economic Damages: Discounting Concepts and Alternatives' [1999] Colorado Lawyer 41, 44. See also KM Kolaski and M Kuga, 'Measuring Commercial Damages via Lost Profits or Loss of Business Value: Are these Measures Redundant or Distinguishable?' (1998–1999) 18 J L Commerce 1, 6–7.

[97] For the discussion of the issue of the recoverability of these losses, see ch 3.

[98] As discussed earlier, there is no necessary connection between the internal and external values of a currency (see ch 3 with further references).

Answering this question raises conflicting arguments. On the one hand, the logic underlying damage to the 'performance interest' may be interpreted as not requiring the seller to demonstrate that it would have used (or has used) the money for a particular purpose: it received less than it was entitled to receive under the contract, and that is all that matters.[99] On the other hand, it can be argued that this approach is unfair as it over-compensates the seller. No problem arises if the German seller can prove that it was going to use euros to purchase goods or services. The depreciation of the euro is likely to affect its purchasing power and the seller is likely to need more euros to acquire identical goods or services than it would have needed on the due date or shortly thereafter.[100] The problem of over-compensation does arise, however, in the example above where it was seller's intention to exchange the euros for Uzbek 'sums' because the decline in the purchasing power of the euro did not affect its plans to purchase Uzbek 'sums'. It is argued that the innocent party's actual circumstances cannot be ignored and over-compensation should be avoided. Thus, it is submitted that the question of whether damages for loss in the 'internal value' of the currency should be awarded must be resolved by having regard for the purpose for which the money was intended to be used.

4.1.1 Interest as a tool for compensating for loss flowing from a change in the 'internal' value of currency

It can be argued that when the aggrieved party suffers currency depreciation loss as a result of delay in payment, the appropriate compensation should be made not by means of damages, but by means of the award of interest.[101] The instruments provide for the injured party's entitlement to interest on the sum of money, the payment of which was delayed.[102] According to this argument, the interest rate takes account of the inflationary rate and therefore, the award of interest will serve as proper compensation for the currency depreciation loss.[103] Since under

[99] For the argument that the role of 'performance interest' should only be confined to cases where the injured party places some kind of subjective or non-economic value on the performance, see chs 3, 8. Currency losses clearly do not fall within this category of cases.

[100] Another factor that the seller may have to demonstrate is the date or period of time when it planned to use the money. Suppose that the seller could not or would not have used the money earlier than the date when it received a late payment. In such a case, the seller cannot be considered to have suffered loss because had it been paid on time, it would not have used the money earlier than the date of actual payment, which is the date when the currency depreciated. Therefore, had the contract been performed the seller would have had to deal with the depreciated currency anyway.

[101] This was the position of a German court in a case governed by the ULIS. The court stated that 'a debtor in default must compensate for his delayed payment by paying interest, but not by balancing the currency devaluation' (Case No O 116/81 District Court Heidelberg (Germany) 27 January 1981 <http://cisgw3.law.pace.edu/cases/810127g1.html>).

[102] Article 78 CISG, art 7.4.9 UPICC, art 9:508 PECL.

[103] 'A higher interest rate is generally an expression of inflationary value of the money' (District Court Heidelberg 27 January 1981 (n 89)).

the instruments, interest is distinct from damages,[104] the question is whether or not it is proper to regard the party's entitlement to interest as a solution to the problem of currency depreciation loss.

It is submitted that interest and damages are not in opposition with each other and what is crucial is that there be no double recovery. In some cases, an award of interest may solve the problem of compensating for the inflationary loss, thereby eliminating the necessity of awarding damages for this loss. An award of interest has been said to perform a number of different functions,[105] one of which is compensating the party for inflationary loss.[106] In particular, it has been pointed out that '[c]ommercial rates, such as the deposit rate . . ., account for inflation by adjusting to economic conditions . . . [T]he effects of inflation are already factored in the rate itself'.[107] Therefore, in cases where the rate of interest reflects the inflationary rate, the award of interest will fully compensate the party for the currency depreciation loss.[108] This, however, may not always be the case. In certain situations, the applicable interest rate may not fully reflect the rate of currency depreciation[109] and as a result, an award of interest will not fully compensate the party for its loss. Where this is the case, the party may claim damages for that part of the loss which was not compensated by interest. Full compensation will then be achieved, partly by interest and partly by awarding damages.

[104] In relation to the CISG, see, eg, B Nicholas, 'Art. 78 CISG' in CM Bianca and MJ Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Milan, Giuffrè, 1987) 569; UPICC: 'the harm resulting from delay in payment of a sum of money is subject to a special regime' (Comment 1 to art 7.4.9 UPICC); PECL: 'Interest is not a species of ordinary damages. Therefore, the general rules on damages do not apply' (O Lando and H Beale (eds), *Principles of European Contract Law: Parts I and II* prepared by the Commission on European Contract Law (The Hague, Kluwer Law International, 2000) 450).

[105] It has been said that interest can serve as compensation for the loss of use of money (see AF Zoccolillo, Jr, 'Determination of the Interest Rate under the 1980 United Nations Convention on Contracts for the International Sale of Goods: General Principles vs. National Law' (1997) 1 Vindobona J Int'l Commercial L Arbitration 3, also at <http://www.cisg.law.pace.edu/cisg/biblio/zoccolillo.html>), as a preventive mechanism against undue enrichment of a debtor, or against a debtor's use of money to which the creditor is entitled (see C Thiele, 'Interest on Damages and Rate of Interest under Article 78 of the United Nations Convention for the International Sale of Goods' (1998) 2 Vindobona J Int'l Commercial L Arbitration 3, also at <http://www.cisg.law.pace.edu/cisg/biblio/thiele.html>).

[106] '[I]nterest rates are in large part a function of anticipated inflation rates' (see K Rosenn, *Law and Inflation* (Philadelphia, University of Pennsylvania Press, 1982) 231); see also E Mackaay and C Fabien, 'Civil Law and the Fight Against Inflation—A Legal and Economic Analysis of the Quebec Case' (1983–1984) 44 Louisiana L Rev 723.

[107] JY Gotanda, 'Awarding Interest in International Arbitration' (1996) 90 AJIL 58.

[108] Interest rates can be even higher than the inflationary rates. See *Tessile 21 Srl v Ixela SA* District Court Pavia (Italy) 29 December 1999 <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/991229i3.html> where the court, applying the CISG, stated that '[n]othing [was] due by right of greater damages from monetary [depreciation] because . . . the legal annual interest rates have always been greater than the rate of inflation'.

[109] See V Behr, 'The Sales Convention in Europe: From Problems in Drafting to Problems in Practice' <http://www.cisg.law.pace.edu/cisg/biblio/behr.html>; Lando and Beale (n 104) 450; J Dach, 'Conversion of Foreign Money: A Comparative Study of Changing Rules' (1954) 3 AJCL 170–1.

The injured party always has a choice of not exercising its right to interest and resorting exclusively to the remedy of damages.[110] If the party chooses not to exercise its right to interest and to claim damages instead, then damages will have to be calculated in such a manner as to fully compensate the party for the currency depreciation loss.

4.2 Loss flowing from a change in the 'external' value of currency

The next type of loss to be considered is the loss caused by a change in the 'external' or international value of currency, that is, a change in the value of one currency against another currency. Such a change may occur when one currency devalues[111] (ie, its value declines) or when one currency's value increases in relation to another currency.[112] Since international transactions often involve more than one currency, changes in the exchange rate can often result in a loss to the aggrieved party.[113] To identify cases where a change in the external value of the currency may result in a loss, it needs to be borne in mind that currencies can be used in different capacities. The first capacity in which a currency can be used is that of representing the currency of account or the currency of contract ('contract currency'). The contract currency is the currency in which an obligation is expressed and measured and it tells the debtor how much it has to pay.[114] A currency can also be used as a currency of payment, that is, the currency 'which must be used as a means of performing the obligation'.[115] Thus, the difference between the two is that the contract currency 'establishes the quantum of the obligation ("how much") while the [currency] of payment determines the

[110] It can be argued that it is better for the injured party to claim interest when it amounts to or almost fully reflects the currency depreciation loss because in contrast with damages, in a claim for interest, neither the fact of the loss must be proved nor any other requirement of limiting damages needs to be met.

[111] It seems proper to use the term 'devaluation', rather than 'depreciation', in relation to decrease in a currency's value against another (see Mackaay and Fabien (n 106) 720 stating that '[t]he decline in the purchasing power of a currency is generally called depreciation. This term is not to be confused with devaluation, which is the decrease in the value of one currency in relation to another'; see also Rosenn (n 106) 3).

[112] 'Where a unit of account is devalued or depreciates, the rate of exchange is modified, but none of these other currencies can be said to be revalued or to appreciate. Conversely, where a unit of account is revalued or appreciates, in relation to other currencies, none of the latter is devalued or depreciates. Their value in terms of the particular unit of account affected by the change differs, but their value amongst themselves and their domestic values remain the same. In other words, the difference is relative, rather than absolute.' (C Proctor, *Mann on the Legal Aspect of Money,* 6th edn (Oxford, OUP, 2005) 75).

[113] See M Saldana, 'Cross Border Transactions', Practising Law Institute, Corporate Law and Practice Course Handbook Series (PLI Order N B0-003A, 1998) 369–70 (recommending that in advising clients about a cross-border transaction, the international value of the currency to be used is to be taken into account as a potential devaluation may expose the clients to losses).

[114] See Proctor (n 112) 107, 109; J Dach, 'Money of Reference and Conversion of Money' (1956) 5 AJCL 517.

[115] Proctor (n 112) 190; Dach (n 114) 517.

mode of payment ("how", in what currency)'.[116] The distinction is important for only if the two are clearly differentiated will it be possible to measure the value of the obligation, to determine the proper means of its execution and to properly assess the amount of compensation for its breach.[117]

One situation where exchange rate losses can be suffered is where, between the due date for payment and the date of actual payment, the contract currency has devalued against the payment currency or the latter has strengthened against the former resulting in the seller getting less in the currency of payment than it would have received had the payment been made on time. Another situation which frequently arises is where the seller intends to exchange, or has in fact exchanged, the currency of payment for another currency. The latter will often, but not necessarily,[118] be the seller's domestic currency. Thus, the seller may suffer loss where the value of its domestic currency changes in relation to the contract/payment currency (where it is the same currency) or against the payment currency (where the contract and payment currencies are different currencies), or even where there has been a change in the exchange rate between the contract and payment currencies. If the buyer makes a late payment and the contract and payment currencies are the same currency,[119] the seller may suffer loss if the contract/payment currency has devalued against the creditor's currency, or if the latter has strengthened against the former during the period when the payment was due and when it was actually made.[120] The UPICC and PECL contain a specific mechanism outside the remedy of damages, which will, in many cases, compensate the party for this loss. The UPICC provide that in cases where the contract and payment currency(ies) is/are different from the currency of the place of payment (which will often be the creditor's domestic currency) and where it is impossible for the debtor to make a payment in the agreed currency, the creditor may require the debtor to pay in the currency of the place of payment.[121] If, then, the debtor has not paid on time, the creditor 'may require

[116] Dach (n 114) 517; see ICC Arbitration Case No 7660 of 23 August 1994 (Battery Machinery case) where '[a]s a remedy against currency fluctuations, the contract price was valued in lira, but payment was due in DM' <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/947660i1.html>.

[117] The distinction between the currency payment and the contract payment appears to have been important in *Celli SpA v Agrolang BV* Appellate Court Arnhem (Netherlands) 15 April 1997 <http://www.cisg.law.pace.edu/cisg/wais/db/cases2/970415n1.html>.

[118] See, eg, the English case *Société Française Bunge S.A. v Belcan N.V.* (*The 'Federal Huron'*) [1985] 3 All ER 378, where it was established that a French company, a trader of soya beans, conducted its financial affairs and operations in US dollars because soya beans were 'a dollar commodity'.

[119] Or if they are different currencies but there has been no change in the value of these currencies in relation to each other.

[120] 'S in London agrees to sell goods to B in Hamburg at a price of US$100,000 payable in London 28 days after shipment. The goods are duly shipped to B, who is three months late in paying the price. During this period the value of the US dollar in relation to the pound sterling (the currency in which S normally conducts his business) depreciates by 20 per cent. Assuming that these consequences of delay in payment could reasonably have been foreseen by B at the time of the contract, S is entitled to recover US$20,000 damages from B, in addition to interest, for the loss on exchange' (Lando and Beale (n 104) 451).

[121] See art 6.1.9(1), (2) UPICC and Comment thereon.

payment according to the applicable rate of exchange prevailing either when payment is due or at the time of actual payment'.[122] In a similar vein, the PECL provide that where the currency of payment is not specified and the contract currency is different from the currency of the place of payment, payment may be made in the currency of the place of payment.[123] If the debtor, in this case, has not paid on time 'the creditor may require payment in the currency of the place where payment is due according to the rate of exchange prevailing there either at the time when payment is due or at the time of actual payment'.[124] These provisions may serve the creditor well,[125] particularly if it intended to exchange the currency of payment for its domestic currency. Indeed, in such cases, creditors may well prefer to rely on these provisions rather than to claim damages because by doing so no additional requirements, such as those that need to be met in claiming damages, will be imposed.

Since no similar provision is contained in the CISG, compensation for this loss is only possible by means of damages.[126] Unfortunately, in several cases, losses caused by a change in the external value of the creditor's domestic currency in relation to the contract/payment currency were held not to be recoverable under the CISG. In one case,[127] the claimant demanded damages for the difference in the exchange rate caused by the government of its country substantially raising the rate of the national currency against the US dollar which was the contract currency. As a result, the return of an advance payment in US dollars by the respondent to the claimant caused the claimant loss in its domestic currency. The tribunal held that the change in the internal rate of a national currency against the US dollar is a creditor's 'domestic affair' and rejected the claim. Similarly in another case,[128] the tribunal rejected the claim for damages flowing from the change in the exchange rate between the Finnish mark (which appears to have been the creditor's currency) and the US dollar which was both the contract and payment currency. The reasoning underlying these decisions seems to be this: where the creditor suffers loss in a situation where its domestic currency was not that of payment or contract, this loss should be regarded as a creditor's 'domestic affair' and should not lead to a shifting of this risk onto the other party.

It is argued, with respect, that this approach should not be followed. The fact that the creditor's domestic currency, which is neither the currency of payment nor of contract, is involved, cannot in itself preclude the exchange rate loss from being recoverable. As argued earlier,[129] this loss should be recoverable as a

[122] Article 6.1.9(4) UPICC.
[123] Article 7:108(2) PECL.
[124] Article 7:108(3) PECL.
[125] See also Comment 1 on art 6.1.9 UPICC.
[126] The same point has been made in CISG Advisory Council (CISG-AC) No. 6, 'Calculation of Damages under CISG Article 74' <http://www.cisg.law.pace.edu/cisg/CISG-AC-op6.html>.
[127] ICAC Case 61/1993, decision dated 21 April 1994 <http://cisgw3.law.pace.edu/cases/940421r1.html>.
[128] ICAC Case 442/1996, decision dated 26 February 1998.
[129] See ch 3.

matter of law.[130] At the same time, however, the question whether the party has suffered loss should be decided with regard for the purpose for which the creditor's currency was intended to be used (or was used). As argued in relation to losses caused by a change in the 'internal' value of currency, it is submitted that the purpose for which the currency was intended to be used should be ascertained to prevent over-compensation.[131] For instance, the creditor may have intended to exchange its domestic currency for a foreign currency. If the exchange rate between the creditor's currency and foreign currency is such that the creditor has received a lower amount in the foreign currency than it would have received had the payment been made on time, it can be said to have suffered loss. If, however, between the due date and the date of the actual payment, the exchange rate between the creditor's currency and foreign currency has changed in a way causing the party to receive the same or a greater amount in the foreign currency as/than it would have received had it been paid on time, it cannot be said to have suffered any loss (eg, if the creditor's currency strengthened against the foreign currency). The foreseeability rule is of particular importance here and in awarding damages, judges and arbitrators need to ensure that the breaching party foresaw or was in the position to foresee that the injured party would exchange its domestic currency for a foreign one and this may often not be the case.[132] In one case under the CISG, the court stated that '[u]sually, the creditor's currency [was] not converted into a different currency' and damages for this loss could be awarded 'if the creditor usually conduct[ed] his money transfers in a third currency and therefore always convert[ed] other currencies immediately after their receipt'.[133] Similarly, the creditor may have intended to

[130] See Commercial Court Zürich (Switzerland) 5 February 1997 (n 42), where the court recognised that the German buyer who brought an action to recover the advance payment could in principle be compensated for losses suffered due to the change in the exchange rate between the US dollar (the currency of payment) and the DM, calculated as the difference between the exchange rate on the date of making an advance payment and the date on which it is returned <http://cisgw3.law.pace.edu/cases/970205s1.html>.

[131] See Case No 2 U 28/80 Appellate Court Hamm (Germany) 26 June 1980 (Shoes and bags case) <http://cisgw3.law.pace.edu/cases/800626g1.html>, where the court stated that 'the loss can only be affirmed if it is certain that the creditor—had he received the open payment timely—would have used it in a particular way and that the unfavourable exchange rate there has a direct impact on him. This would be the case, i.e., if the creditor would have used the amount receivable in his own currency to repay his own debts in a different currency, which is now valued as a higher rate'.

[132] But see *DT Ltd v B AG* Commercial Court St Gallen (Switzerland) 3 December 2002 <http://cisgw3.law.pace.edu/cases/021203s1.html>, where the court stated that '[w]ith regard to debtor's default, there is a valid factual assumption that the relevant creditor of a foreign debt might have immediately exchanged that amount into Swiss francs when it had received this payment at maturity'. See further C Proctor, 'Changes in Monetary Value and the Assessment of Damages' in D Saidov and R Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (Oxford, Hart Publishing, 2008) 486–7, 495 for the discussion of the foreseeability test, in the context of English law, in cases where the creditor is obliged to surrender foreign currency receipts in exchange for its domestic currency.

[133] Case No 17 U 146/93 Appellate Court Düsseldorf (Germany) 14 January 1994 (Shoes case) <http://cisgw3.law.pace.edu/cases/940114g1.html>. It seems that the court's statement was intended to go beyond the foreseeability rule and to address the issue of the recoverability of the loss flowing from the party's intention to convert its domestic currency into a foreign one. However, the

use its domestic currency to purchase goods or services. It may be that between the due date for payment and the date of actual payment, the price for those goods and services has fallen to such a level as to make the amount of domestic currency actually received perfectly sufficient for the intended purchase.

The position advocated here of having regard for the purpose for which a currency is to be used, is open to objection in that it makes the calculation of damages a complex, cumbersome and costly exercise. It can be argued that a simpler, more predictable and less costly approach is simply to focus on whether the creditor received less (after the conversion of the currency of payment) in its domestic currency or some third currency as the case may be and, if so, to award the difference thus ascertained. At this point, we, in some ways, seem to be entering the realm of the debate surrounding the dilemma between the 'concrete' and 'abstract' approaches to calculating damages as well as the role of the 'performance interest'. As is clear by now, the preference expressed in this work lies with the 'concrete' approach to calculation which, despite its drawbacks, *truly* aims to place the party in the position in which it would have been had the contract been properly performed and as explained above, the instruments also give primacy to the 'concrete' approach.

5. LOSS OF A CHANCE

Loss of a chance is recoverable under the UPICC[134] and it has been argued that the same should be the case for the CISG and PECL. It has been further suggested that for this loss to be recoverable, the chance must a 'real' or a 'substantial' one.[135] As explained, there are two categories of contract cases in which damages for loss of a chance can be claimed: (1) where a chance *itself* is the subject-matter of the contract[136]; and (2) where the subject-matter of the contract is not a chance but an ordinary supply of goods (but where the innocent party is unable to prove its lost profits flowing from the breach of contract). In this case, loss of a chance is a tool whereby the law deals with the uncertainty flowing from speculative losses and implements a liberal policy of avoiding an 'all-or-nothing' result in awarding damages. It is the second category of cases which is usually relevant in sale of goods cases and for this reason the issue of quantifying loss of a chance will be considered in the context of this type of case.

The quantification of loss of a chance is inevitably speculative and, in general, involves two stages: (1) the evaluation of the value of a possible benefit; and (2) the likelihood of obtaining it.[137] Clearly, the greater the number of

court's arguments seem more relevant for the issue of foreseeability than for the issue of the recoverability of this loss as their force in the context of the recoverability seems doubtful.

[134] See art 7.4.3(2).

[135] See ch 3.

[136] See *Chaplin v Hicks* [1911] 2 KB 786.

[137] See Peel (n 76) 1026–27.

contingencies on which this likelihood depends, the lower the value of loss will be[138] and vice versa. So far as specific formula is concerned, damages for this loss are to be calculated 'in proportion to the probability of its occurrence'.[139] Evaluating hypothetical actions of third parties, particularly in cases where a number of contingencies are involved, can be difficult. Where several contingencies are involved, the relative weight of each contingency needs to be determined. It has also been suggested that it needs to be ascertained whether contingencies are dependent on one another or are separate (independent).[140] In the former case, damages need to be assessed 'as a percentage of a percentage'.[141] Suppose that the buyer asserts that due to the seller's breach, it has lost an opportunity of entering into a contract with a construction company which, in turn, intended to make a bid on the construction of a high-profile building.[142] Suppose also that the buyer claims damages for loss of a chance to earn profit for the entire expected period of constructing the building. The success of this claim is subject to a number of contingencies all of which are dependent on one another: a chance of making a contract with the construction company (in the first place), a chance of the company winning a bid, a chance of the buyer being retained as a supplier for the entire duration of the project. If a chance of earning the said profit is 'real or substantial', damages need to be calculated by reference to the percentages representing the likelihood of the occurrence of each of the contingencies. Thus, if the amount of profit is £10,000,000 and the chances of each of the events occurring are 50 per cent, 30 per cent, and 25 per cent, respectively, damages should amount to £375,000.[143]

The problems of valuing loss of a chance become more complicated where the innocent party claims that as a result of the breach, it has lost multiple chances, all of which are independent of one another and are mutually exclusive (alternative chances). Suppose that because of the seller's breach the buyer has lost a 30 per cent chance of winning a bid which would have led to the buyer concluding a contract with a resulting profit of £1,000,000. In the case of unsuccessful bidding, the buyer would have had a 50 per cent chance of securing a supply contract resulting in the profit margin of £500,000. Suppose also that the buyer would not have been in the position to perform both contracts and chances are, therefore, mutually exclusive. It is suggested that, in such cases, damages need to be calculated on the basis that both *chances* were available to the injured party. In the given example, had there been no breach the buyer would have had *both* a 30 per cent chance of earning £1,000,000 (ie, £300,000) *and* a 70 per cent chance of having a 50 per cent chance of earning £500,000

[138] See *ibid*.
[139] Article 7.4.3(2) UPICC.
[140] J Poole, 'Loss of Chance and the Evaluation of Hypotheticals in Contractual Claims' [2007] LMCLQ 63, 77.
[141] *Ibid*.
[142] See *Mansonville Plastics BC Ltd v Kurtz GmbH* (n 87).
[143] That is, 50% of 30% of 25%.

(ie, £175,000). Therefore, the buyer needs to be awarded damages in the amount of £475,000.[144]

6. DAMAGE TO BUSINESS REPUTATION AND GOODWILL[145]

6.1 General

It is usually assumed that the most that can be done with respect to the assessment of damage to business reputation and goodwill is fixing a fair and reasonable sum.[146] It has also been suggested that great care needs to be exercised in awarding such damages and therefore, the sums awarded should be modest.[147] What is often stressed is that some degree of uniformity of awards be maintained as this is essential for preventing arbitrary awards, for maintaining a degree of predictability and more broadly, for a legal system to be credible and just.[148] With these concerns in mind, it has been suggested that setting a maximum amount of damages could be a way of introducing some order into the award of damages for intangible losses.[149] How do these points fare in the context of the international instruments? It is certainly crucial for their future that a uniform treatment of claims be achieved and maintained. At the same time, in the absence of some international institution responsible for monitoring their application, fixing a maximum amount would not be a workable means of maintaining uniformity. Moreover, it can also be argued that this solution is arbitrary and possibly unfair as in any particular case, it may be felt that the loss in question goes beyond the fixed maximum amount. So far as the argument in favour of fixing a fair and reasonable sum is concerned, it seems that this is precisely what judges/arbitrators have done in cases where damages for this have been awarded.[150] While maintaining some degree of uniformity of awards made on that basis may be possible in the context of a domestic legal system, it is much more difficult, if not impossible, to achieve even something remotely reminiscent of uniformity

[144] For an English case dealing with this situation, see *Inter-Leisure Ltd v Lamberts (a firm)* (1997) NPC 49.

[145] This section is based on D Saidov, 'Damage to Business Reputation and Goodwill under the Vienna Sales Convention' in Saidov and Cunnington (n 132).

[146] See, eg, A Burrows, *Remedies for Torts and Breach of Contract,* 3rd edn (Oxford, OUP, 2004) 319.

[147] See McKendrick and Worthington, 'Damages for Non-Pecuniary Loss' in N Cohen and E McKendrick (eds), *Comparative Remedies for Breach of Contract* (Oxford, Hart Publishing, 2005) 321 (in the context of non-pecuniary losses in English law).

[148] '[J]ustice is not justice if it is arbitrary or whimsical, if that is awarded to one plaintiff for an injury bears no relation at all to what is awarded to another plaintiff for an injury of the same kind . . .' (*McCarey v Associated Newspapers Ltd and Others* (No 2) [1965] 2 QB 86, 108).

[149] See M Bridge, 'Contractual Damages for Intangible Loss: A Comprehensive Analysis' (1984) 62 Can Bar Rev 367.

[150] See, eg, ICC Arbitration Case No 3880 of 27 September 1983 in S Jarvin and Y Derains, *Collection of ICC Arbitral Awards, 1974–1985: Recueil Des Sentences Arbitrales de la CCI* (The Hague, Kluwer Law International, 1990) 161.

under the instruments, particularly given the multiplicity of courts and tribunals applying them. The question arises, therefore, whether there are some other, more rational, and reliable means of quantification? It would seem that if damage to reputation and goodwill is a 'true' loss, then surely in the light of developments in modern science and technology,[151] there must be some method of quantifying such damages with greater accuracy than the fixation of a reasonable sum. The discussion below will summarise some of the methods that could potentially be used to quantify this loss.

6.2 General measure

A general measure of damages is *the difference between the value of present and former reputations/goodwill*.[152] One general difficulty here relates to determining these two items of value. It should also be noted that the precise moment at which the valuation takes place may have an impact on the amount of the award. It may therefore be important to decide to which moments in time the words 'present and former' reputation/goodwill refer. One possibility is that they mean reputation/goodwill as they were *before* and *after* the breach. However, the reference to the time 'after the breach' may not always be appropriate since damage to reputation/goodwill can only occur when the relevant stakeholders become aware of the breach and its consequences, and when that awareness makes a negative impact on their perception of a company in question. Thus, the reference to reputation/goodwill after the breach may only be appropriate, for example, in cases where the stakeholders' perceptions are being damaged as the breach occurs.[153] Conversely, in some other cases, there may be a substantial gap between the time of breach and the time when a negative impact on the perceptions of stakeholders occurs. For instance, a wholesaler may keep a large quantity of goods delivered by the breaching seller at its warehouse for several months before putting them on sale. In this case, damage to its reputation/goodwill is likely to occur long after the breach when a certain number of customers become aware of the defects in the purchased products. In such a case, the reference to the time of breach is inappropriate and a later point in time at which injury to reputation/goodwill can be said to have occurred will

[151] See *AM/PM Franchise Association v Atlantic Richfield Company* 526 Pa. 110, 128 (Pa., 1990) (where it has been stated that those earlier decisions where recovery of goodwill had been disallowed were made at the time when 'market studies and economic forecasting were unexplored sciences' whereas '[w]e are now in an era in which computers, economic forecasting, sophisticated marketing studies and demographic studies are widely used and accepted').

[152] See Burrows (n 146) 319.

[153] This seems to have happened in an English case *Aerial Advertising Co v Batchelors Peas Ltd* [1938] 2 All ER 788, where the injured party hired the breaching party to advertise its goods by flying over various towns and trailing behind the aeroplane the words advertising the products. The latter, in breach of contract, flew over the crowded square during the Armistice service and the two minutes' silence, and it is likely that the damage to the innocent party's reputation largely occurred during that time.

have to be selected. Thus, the general measure should be the difference between the value of reputation/goodwill *before and after the loss*.[154] However, it is not easy to determine a specific moment in time at which damage to reputation/goodwill occurs and ultimately, such a determination will depend on the particular circumstances of the case. Nevertheless, a workable solution would need to be based on the tangible manifestations of such a loss. Since in the vast majority of cases customers will be regarded as relevant stakeholders, the moment or period at which the injured party can be said to have lost custom could perhaps provide a rough guideline in this respect.

6.3 'Cost' approach

One way to measure damage to reputation/goodwill is to estimate the costs incurred to repair the damaged reputation/goodwill. This measure was used in one case under the CISG where the buyer had taken measures and incurred expenses to regain its reputation as a supplier of canned food and to create 'new customer networks'.[155] In principle, this method can be used not only where an injured party has *actually* incurred costs to repair its reputation/goodwill but also where no such expenses have been made.[156] In both cases, the mitigation rule will require that a claimant demonstrate that the costs of cure are reasonable[157] and further, the causation requirement may require that these costs be truly necessary for and directed at, curing damage to reputation/goodwill.[158]

This method becomes more complicated if costs are understood as including 'opportunity costs',[159] that is, lost opportunity to earn profit during the period of repairing reputation/goodwill. If so, and if a claimant also claims loss of profit, the duplication of recovery for lost profits must be prevented. Therefore, either 'costs' should not include lost opportunity to profit, or the recovery of lost profit for the period of repairing the damaged reputation/goodwill should be denied.

[154] In theory, 'before the loss' would probably mean the moment immediately preceding the loss and, if no reasonable estimation at that time is possible for practical reasons (due, eg, to the lack of information), the moment which is the closest in time to the loss and which affords a reasonable opportunity for the estimation could be taken as the basis for valuation. The words 'after the loss' should probably mean the time immediately after the loss and, in any event, not later than a reasonable time thereafter.

[155] Tampere Court of First Instance (Finland) 17 January 1997 (Canned food case) <http://cisgw3.law.pace.edu/cases/970117f5.html>.

[156] See RF Reilly and RP Schweihs, *Valuing Intangible Assets* (New York, McGraw-Hill, 1999) 387.

[157] See the discussion on reasonableness of cost of cure and related in issues in the previous chapter.

[158] It is not entirely clear whether such costs should be recovered as costs caused by the breach, in which case, the suggestion in the main text would be correct. However, it can also be argued that costs of curing damage to reputation/goodwill should not be recovered as costs caused by the breach but should be regarded as a method of calculating damage to reputation/goodwill and, in this case, the causal requirement will not apply to costs of cure but will only require that there be a causal connection between a breach and damage to reputation/goodwill (as opposed to a causal connection between a breach and costs of cure).

[159] See Reilly and Schweihs (n 156).

6.4 'Royalty'

Another method which could be used is to ask how much a third party would pay to lease a corporate name. Although this method has been mostly used in the context of the valuation of brands, it has been suggested that it is possible to use this method to value reputation/goodwill.[160] If this is correct, the present value of all expected royalty payments under such licensing/leasing arrangements could represent another estimate of a company's reputation.[161] This method would seem to dispense with the need of defining reputation/goodwill as it refers to royalty rates insofar as the particular marketplace is concerned,[162] and market valuation has been said to correspond 'roughly to overall regard in which the company is held by its constituents'.[163] Quantifying damages would require the ascertainment of the difference between the present value of all royalty payments that would be payable *before* and *after* the loss. One potential difficulty relates to the availability of information regarding royalty rates. For example, because royalty data may be confined to a specific market or sector, it may not be easily extrapolated outside those boundaries.[164]

What is the relationship between this valuation method and a claim for future lost profits? As noted, the royalty method aims to arrive at a value of reputation/goodwill so far as the market is concerned,[165] and market value is generally regarded as reflecting a market's guess regarding the profits a company will make from a particular asset. Therefore, awarding damages for lost profits which can be attributed to reputation/goodwill along with damages calculated under the 'royalty' method will constitute a double recovery.[166]

6.5 Market value

Another well-known method of valuing business reputation/goodwill which is based on market valuation requires a calculation of the difference between the

[160] M Sussdorff, 'The Value to be Found in Corporate Reputation' at <http://intranet.csreurope.org/news/csr/one-entry?entry%5fid=114278>.

[161] *Ibid*.

[162] See Reilly and Schweihs (n 156) 147, 152–53, 194 (treating the royalty relief method as a specific type of valuation based on the 'market approach' the purpose of which is to provide an estimate of a market value of an asset (see *ibid*, 147)).

[163] C Fombrun, *Reputation: Realizing Value from the Corporate Image* (Harvard Business School Press, Boston MA 1996) 91.

[164] R Shaw, 'Brand Valuation' (2004) <http://www.mbpi.biz/Brand_Valuation.PDF> (in the context of brand valuation).

[165] See, eg, Waddams (n 18) 82–83; *R.E.B. Inc v Ralston Purina Co*. 525 F.2d 749, 754–5 (C.A.Wyo. 1975); Dunn (n 94) 566.

[166] Because royalty rates are often calculated as a percentage of *profits* (see Reilly and Schweihs (n 156), Fombrun (n 154) 152–3, 194), the amount arrived at from applying the royalty method would be precisely the amount which needs to be subtracted from the lost profit claim to avoid a double recovery.

market value of a business[167] and the value of all its tangible and identifiable intangible assets. It has been suggested that the difference resulting from this calculation will represent the value of business reputation/goodwill.[168] To calculate damages using this method, the value of reputation/goodwill will have to be determined *before* and *after* the loss and then the value after the loss will need to be subtracted from the value before the loss. So far as the relationship of this calculation method with a lost profits claim is concerned, a possible overlap between them must be avoided. Damages to reputation/goodwill are calculated as a residual derived from market value and market value is understood as taking into consideration the market's expectation of profits a business will make.[169] Therefore, that part of future lost profits which can be attributed to reputation/goodwill cannot be awarded together with damages calculated under the 'market value' method.[170]

6.6 Income approach

Yet another approach to valuing reputation/goodwill as well as damage thereto is based on the future profits a company would have been expected to earn *but for the breach*.[171] One specific method of calculating damages for lost reputation/goodwill based on future lost profits has been used in some US cases[172] where it has been suggested that in cases of defective delivery, damage to reputation/goodwill should be measured by future lost profits which the injured buyer would have made *not* from profits lost due to the sale of, or a failed attempt to sell defective goods, but due to the inability to provide *other* goods or services in the future. For example, if the buyer had purchased the goods to

[167] Market value of a company can be determined either on the basis of an actual sale of business or of a constructed value (see Reilly and Schweihs (n 156) 387).

[168] See, eg, Reilly and Schweihs (n 156) 387. For further discussion and the proposal of a more complex formula, see R Bowd and L Bowd, 'Assessing a Financial Value for Corporate Entity's Reputation: A Proposed Formula' <http://www.ribm.mmu.ac.uk/wps/papers/02-01.pdf>.

[169] See, eg, Waddams (n 18) 82–83; *REB Inc v Ralston Purina Co* 525 F.2d 749 [10th Cir. 1975], 754–5 (C.A.Wyo. 1975); RL Dunn (n 156) 566; see also *Hydraform Products Corp v American and Aluminum Corp* 498 A.2d 339, 347 (N.H., 1985).

[170] It can be very difficult to determine the part of lost profits attributable to reputation/goodwill. Nevertheless, it seems that it can be determined in the following way. Under the 'market value' method, the value of reputation/goodwill is determined as a residual from market value. It seems possible therefore to determine the percentage of market value which can be attributed to the value of reputation/goodwill and then to discount the amount of future lost profits claimed by the same percentage. In other words, the amount of future profits is reduced in proportion to the percentage that the value of reputation/goodwill occupies within the overall market value of a business. It is the amount by which future lost profits are reduced which cannot be claimed together with damage to reputation/goodwill under the 'market value' method.

[171] See Reilly and Schweihs (n 156) 388; CISG-AC (n 126) para 7.4.

[172] See *AM/PM Franchise Association v Atlantic Richfield Company* (n 151) ('goodwill damages refer to profits lost on future sales rather than on sales of the defective goods themselves'); *Sol-O-Lite Laminating Corp v Allen* 223 Or. 80, 353 P.2d 843, 849 (where goodwill was regarded as referring to 'the profits [the buyer] might have made on similar plastic he would have sold in the future or loss of profits on other items he would have sold had his customers not become disgusted with him').

fulfil its sub-sales which were either rejected or bought at reduced prices, the award of damages for lost profits caused by such rejection or resale at reduced price will not, under this approach, be an award for injury to reputation/goodwill. Rather, it will be the profits the buyer was unable to make when it was in the position to provide conforming goods in *other future transactions unrelated to the initial sub-sales* that will be the basis for calculating damages to goodwill/reputation. The buyer will, of course, have to prove that had the seller performed the contract, the buyer would have made those *future* sales. This calculation method is based on the assumption that if the buyer's sales continue to decrease despite its ability to provide proper performance, this may be an indication of negative perceptions of its business held by existing and potential customers. Provided that a judge/arbitrator is satisfied that loss of future sales was caused by damage to reputation/goodwill, this method is sound and can be used for the purposes of quantifying this loss.

If a lost profit claim is brought along with a claim for lost reputation/goodwill calculated under this method, care needs to be taken to avoid double compensation. If a lost profit claim is for damage suffered directly as a result of the buyer's resale of or attempt to sell defective goods, no overlap occurs between this claim and a claim calculated under the 'income approach' method. If, however, a claim for lost profit relates to future sales which the buyer could have made had the contract been performed, an overlap will occur.

7. CURRENCY OF DAMAGES

Because an international sales transaction may involve several different currencies, a question will often arise as to the currency in which an award of damages is to be expressed. This question is also integrally linked with the issue of the date by reference to which damages need to be assessed. To understand the significance of these questions, the distinction between internal and external values of currency needs to be recalled. The heart of the problem of the currency in which damages are to be expressed lies in the fact that both internal and external values of currency will often change between the date of the breach and the date of judgment (award). Suppose that, at the time of breach, a loss is estimated, at the then existing exchange rate, either as 1,000 US dollars or as 30,000 Russian rubles. It may matter to the innocent party whether the loss is awarded in dollars or rubles at a later point in time because the rate of depreciation (that is, fall in purchasing power) of each currency may be different. More specifically, if the innocent party intends to purchase goods or services which can be bought with either currency, the innocent party would prefer an award in a currency which has depreciated less between the breach date and a later point in time.[173]

[173] 1,000 US dollars may still be sufficient to make a purchase as planned, but an amount higher than 30,000 rubles may be needed to make the same purchase.

It would appear, however, that the problem of the currency of an award most frequently arises where the relationship of currencies with one another is concerned.[174] Suppose that the seller fails to deliver the goods and damages are measured 'abstractly' by reference to the market price. As of the date of avoidance, the market price loss could be expressed either as 1,000 US dollars or as 30,000 Russian rubles (at the then existing exchange rate). By the time of judgment, however, the dollar has strengthened against the ruble, and 1,000 dollars is now equivalent to 40,000 rubles. Should the buyer be awarded 1,000 dollars, 30,000 rubles, or 40,000 rubles? The first two sums represent the loss at an earlier date of avoidance and the issue here is merely that of a choice between the two currencies. The third sum reflects not merely a choice in favour of a particular currency (ruble), but also a choice in favour of the date of assessment, that is, the date of judgment (award) as opposed to an earlier date of avoidance. It can be argued, however, that if 40,000 rubles are awarded, the issue of currency of damages becomes much less important because the buyer receives the current equivalent of 1,000 dollars in rubles and, in this way, the award probably eliminates a potentially adverse change in the exchange rate.

The UPICC and PECL contain specific provisions regarding the currency in which to assess damages. The UPICC provide that 'damages are to be assessed either in the currency in which the monetary obligation was expressed or in the currency in which the harm was suffered, whichever is more appropriate'.[175] The PECL contain a similar, but not identical, provision to the effect that 'damages are to be measured by the currency which most appropriately reflects the aggrieved party's loss'.[176] The CISG, in contrast, does not expressly address this issue and there remains some uncertainty surrounding it. The position in cases has been far from uniform. One approach has been to award damages in the currency in which loss was suffered.[177] According to another line of cases, damages ought to be awarded in the currency in which the contractual obligations were expressed[178] while in some other cases it was considered appropriate to award damages in the currency of payment.[179] Finally, on occasions, currency of damages was treated as a matter of domestic law.[180]

It is submitted that currency of damages should be regarded as a matter which is governed by the Convention. The provisions of the CISG, as far as the exercise of the right to compensatory damages is concerned, should be regarded as exhaustive, thereby precluding recourse to domestic law. Arguing otherwise

[174] See, eg, Lando and Beale (n 104) 456 (viewing the issue of the currency of damages solely on the basis of the problem exchange rate fluctuations).

[175] Article 7.4.12.

[176] Article 9:510.

[177] See ICC Arbitration Case No 9187 of June 1999 (Coke case) <http://cisgw3.law.pace.edu/cases/999187i1.html>.

[178] See *Downs Investments Pty Ltd v Perwaja Steel SDN BHD* (n 19); most probably, ICAC Case 97/2004, dated 23 December 2004 <http://cisgw3.law.pace.edu/cases/041223r1.html>.

[179] District Court Berlin 30 September 1992 (n 19).

[180] *Delchi Carrier SpA v Rotorex Corp* 1994 WL 495787.

would lead to an important aspect of the right to damages being left to the vagaries of domestic legal systems thereby undermining the Convention's aspiration for uniformity. Recognising this matter as an issue within the Convention's scope would not require embarking on a long journey in search of a relevant general principle.[181] General principles of full compensation and/or reasonableness, for example, could easily provide a basis for formulating a position that damages are to be awarded in the currency which truly expresses and reflects the loss or in which the injured party has 'felt' its loss. This approach, which is well known to many legal systems[182] and which reflects a well-established principle in international arbitration,[183] is no doubt sensible, fair and the most appropriate in the light of the compensatory purpose of damages.[184] The UPICC can be helpful here by adding precision in formulating this principle under the CISG.

The real challenge, however, lies not with the justification of this principle but with its practical application. One difficulty is that the principle contains only a general guideline which will often turn its application into an exercise of weighing and balancing various relevant factors. How should the currency in which loss was truly felt be determined? The answer is relatively easy if the parties have expressed, either explicitly or implicitly, their intention as regards the currency in which they wanted to settle damages claims.[185] It needs to be stressed that while the contract currency may be a factor in establishing the parties' intention to settle damages claims in that currency, there is no necessary connection between that currency and the one in which loss has been suffered.[186] Where no intention, be it express or implied, can be identified, the question of the currency in which loss has been suffered will have to be answered in the light of the particular circumstances and will depend on a number of factors.

[181] See art 7(2) CISG.

[182] See Lando and Beale (n 104) 457.

[183] ICC Arbitration Case No 6955 of 1993 in JJ Arnaldez, Y Derains and D Hascher, *Collection of ICC Arbitral Awards, 1991–1995: Recueil des Sentences Arbitrales de la CCI* (The Hague, Kluwer Law International, 1997) 267, 295.

[184] For a similar view, see H Stoll and G Gruber, 'Arts. 74–77 CISG' in P Schlechtriem and I Schwenzer, *Commentary on the UN Convention on the International Sale of Goods*, 2nd English edn (Oxford, OUP, 2005) 761.

[185] For a similar view, see S Eiselen, 'Unresolved Damages Issues of the CISG: A Comparative Analysis' (2005) 38 Comparative Int'l L J Southern Africa 32, 41. See, in this regard, Case No 11 O 4261/94 District Court Kassel (Germany) 21 September 1995 (Wooden poles case) <http://cisgw3.law.pace.edu/cases/950921g1.html>. In this case, a German buyer claimed damages for the loss of the profit margin on its sub-sale contract from a US seller. The court denied the buyer's request for damages in DM and awarded damages in US dollars on the ground that the contract currency in both the buyer's contract with the seller and its contract with its sub-buyer was the US dollar: 'Any profit or corresponding damage from non-performance could only accrue in [US dollars] in the first place. Giving further consideration to the principle of full compensation which applies under the CISG and the fact that [the Seller] has not objected to compensation in US dollars, the assumption is thus justified that the parties at least impliedly agreed on an execution of their relationship solely on the basis of that currency.'

[186] See Proctor (n 132).

One relevant factor could be the currency in which the injured party usually operates or, in other words, the party's 'normal trading currency'.[187] Some English cases have shown that identifying this currency may be difficult, particularly where a multinational company is involved. Where this is the case, it may be relevant to enquire as to what is the currency in which the goods in question are traded. For example, in one case,[188] a French trader of soya beans (amongst other commodities) was held to have suffered loss in US dollars, primarily because it treated soya beans 'as a dollar commodity'.[189] Where the party has actually incurred costs in a particular currency, that currency may often be decisive. In one case under the CISG,[190] where due to delay of payment by the German buyer the French seller had to resort to credit, the court held that because the seller incurred costs in French francs, damages had to be awarded in that currency. For the same reason, in some other cases[191] where as a result of defective delivery the buyer had to incur additional costs arising from storage, inspection, and liability to third parties in its domestic currency, damages were awarded in that currency. However, the currency in which the expenditure was incurred may not always be the currency in which loss has been suffered if the injured party's normal business currency is different from that in which loss was incurred and where the former is used to purchase the latter. For instance, in one well-known English case,[192] although a French company incurred liability to third persons in Brazilian cruzeiros, French francs were found to be the company's normal business currency and were used to purchase cruzeiros.[193]

As noted above, the question of whether the party is adequately compensated may depend not only on the identification of a proper currency in which to award damages but also on the date by reference to which a loss in that currency is assessed. Suppose that after the seller's breach, a Russian buyer used 300,000 rubles to purchase 10,000 US dollars to pay damages to its customer. At the time of the legal proceedings 350,000 rubles would be required to purchase 10,000 US

[187] See *ibid*.

[188] *The Federal Huron* (n 118).

[189] '[T]he evidence is overwhelming that the cargo receivers treated soya beans as a dollar commodity. In purchases of raw beans the dollar was always the money of account . . . [I]f the currency of any onward sale were not dollars, the proceeds of sale would be immediately converted into dollars and, if it were a forward sale, the cargo receivers would buy dollars forward as a hedge against depreciation of the foreign currency against the dollar' (*ibid*, 192).

[190] Case No 2 U 1230/91 Appellate Court Koblenz (Germany) 17 September 1993 (Computer Chip case) <http://cisgw3.law.pace.edu/cases/930917g1.html>.

[191] See CIETAC Arbitration proceeding 10 March 1995 (Polyethylene film case) <http://cisgw3.law.pace.edu/cases/950310c2.html>; CIETAC Arbitration proceeding (Copperized steel tubes case) 5 July 1993 <http://cisgw3.law.pace.edu/cases/930705c1.html>.

[192] *Services Europe Atlantique Sud (Seas) v Stockholms Rederiaktiebolag Svea (The 'Folias')* [1979] AC 685.

[193] See also ICAC Case 97/2004 (n 178) where the Russian buyer paid a penalty to its customers in rubles as a result of the seller's delay in delivery but damages were nevertheless awarded in US dollars because the dollar was the currency of the contract. It is, however, not entirely clear whether the tribunal viewed the contract currency as evidencing the parties' intention to settle damages claims in US dollars.

dollars. If the ruble is held to be the currency in which the buyer suffered its loss because it is its normal trading currency, the question is whether to award the buyer 300,000 or 350,000 rubles. The question reflects the difficulty of making a choice between the date of breach (or shortly thereafter)[194] or the date of judgment (or some other later date).[195] It is argued that it is the date of judgment which is most appropriate under the international instruments.[196] The date of judgment is more in line with the instruments' preference for the 'concrete' approach, as opposed to the 'abstract' approach, to calculating damages as it takes account of the developments which have taken place from the moment of breach and which have affected the injured party's *actual* position. This approach also ensures that the principle of full compensation is implemented more accurately.[197] The reliance on the date of judgment may create an incentive for the injured party to cause delays in order to postpone the date of the award[198]: if, in our example, the Russian buyer correctly predicts that the value of the ruble will continue to fall against the dollar, it will certainly benefit from damages at a later point in time as an award then will give it a higher amount in rubles. It is suggested, however, that the danger of speculation and delay may be countered by the proper application of the mitigation rule which will require that the injured party bring a claim in good time to avoid the increase in the amount of loss.

[194] In some other cases such as those involving the calculation of damages under the instruments' 'concrete' and 'abstract' formulae, the relevant date is that of the avoidance of the contract, or, under art 76 CISG where the goods were taken over, at the time of such taking over.

[195] An appropriate later date is the date when the payment of damages is actually made.

[196] The reason this date is preferred as opposed to the date of payment of damages (see n 195) is that it has shown to be a workable date in practice (see the statement by Lord Wilberforce in *Miliangos v George Frank (Textiles) Ltd* [1976] AC 443, 469) and seems to be more widely accepted that the date of payment.

[197] The reliance on the date of judgment can, of course, lead to the innocent party getting less than it would have received had damages been assessed by reference to the time of breach or shortly thereafter. Suppose that, in our example, the buyer paid 350,000 rubles to purchase 10,000 US dollars but at the time of judgment, due to the strengthening of the ruble against the dollar, it will now have to spend 300,000 rubles to purchase the said amount in US dollars. It is suggested that the 'concrete' approach to calculating damages and the accompanying reliance on the date of judgment would require that only 300,000 rubles be awarded as damages.

[198] For the discussion of incentives, see J Knott, 'A Quarter of a Century of Foreign Currency Judgments: The Wealth-Time Continuum in Perspective' [1994] LMCLQ 325, 344; R Bowles and C Whelan, 'Judgments in Foreign Currencies: Extension of the Miliangos Rule' (1979) 42 MLR 452, 455–8.

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