9

Remedies

The CISG allows the injured party to choose among a set of remedies. The party may avoid the contract, recover damages, obtain specific relief, or suspend its own performance.[1] In addition, Article 50 permits the buyer to reduce the contract price. Articles 44 and 61 list these remedies for the buyer and seller, respectively. Both Article 45(2) and 61(2) make explicit that certain damages remain recoverable even when the injured party obtains a remedy other than damages. A remedy not included in Article 44 and 61's list is restitution, available under Article 81. The following is an index that collects the CISG's remedies:

TABLE 9.1: *Remedies*

	Seller (Article 61)	Buyer (Article 45)
1. Avoidance	Article 64(1)	Article 49(1)
2. Specific relief	Article 62	Article 46
3. Price reduction	Inapplicable	Article 50
4. Damages:		
General rule	Article 74	Article 74
Substitute transaction	Article 75	Article 75
Market price measure	Article 76	Article 76
5. Restitution	Article 81(2)	Article 81(2)

Some of the CISG's remedies can be obtained without judicial intervention while others require judicial recognition. Suspension of performance, avoidance of the contract, and reduction of the contract price do not require a judicial order. The non-breaching party can obtain these remedies, where applicable, unilaterally. We have therefore discussed avoidance in Chapter 5 as part of the rights and

obligations of parties with respect to performance of the contract. Recall from that chapter that avoidance means that the contractual obligations of both parties come to an end, and that avoidance in international sales transactions is disfavored.[2] On the other hand, damages or specific relief requires judicial determination. Some remedies are available only if the non-breaching party avoids the contract. Others are available only if the contract is not avoided. Finally, several remedies remain available whether or not the non-breaching party avoids the contract.

I. NON-AVOIDANCE-BASED REMEDIES

As we explain in Chapter 5, the injured party may not have a right to avoid the contract unless the breach is fundamental and other requirements of avoidance have been satisfied.[3] Even if it has a right to do so, the party may prefer a remedy other than avoidance. In this case the CISG makes available both substitutional and specific relief. The injured party who either cannot or has not avoided the contract can recover damages, reduce the contract price, or (subject to limitation) compel the breaching party to perform. Although the calculation and elements of damages mostly track recoverable damages under the Uniform Commercial Code ("UCC") and common law principles for remedies, price reduction and specific relief do not.

A. *Article 74's general rule for recoverable loss*

Article 74 states the general rule for recovering damages for breach. It provides that damages "consist of a sum equal to the loss, including the loss of profit, suffered by the other party as a consequence of breach." The Article initially appears to provide for full compensation to the aggrieved party, including consequential and incidental damages. Because the Article includes lost profits among "loss," it aims to put the injured party in the position that it would have been in had there been full performance. Thus, Article 74's rule protects the injured party's expectation interest.[4]

Article 74 does not state a formula for calculating damages. Nor does it state the conditions under which an injured party can rely on its rule. Other Articles do. Article 45(1)(b) allows the buyer to recover damages under Article 74 if the seller "fails to perform any of his obligations" under the contract or the CISG, while Article 61(1)(a) does the same for the seller if the buyer "fails to perform any of his obligations" under the contract or the CISG. Article 74 is best thought of as prescribing a general rule or principle of compensation by which damages are to be awarded. The general rule does

[2] See Chapter 5.IV.A. [3] See Chapter 5.IV.B.1.

[4] See *Profi-Parkiet Sp. Zoo* v. *Seneca Hardwoods LLC*, 2014 U.S. Dist. LEXIS 71289 (E.D.N.Y.-May 23, 2014); Court of Appeals St. Gallen (Switzerland), 13 May 2008, available at http://cisgw3.law.pace.edu/cases/080513s1.html; CISG Advisory Council Opinion No. 6: Calculation

not state a trivial requirement. It requires that damages be calculated to protect the injured party's expectancy ("lost profit") rather than its reliance or restitution interests. For the same reason, Article 74's general rule does not allow the award of punitive damages. Punitive damages, if available, may be awarded only under applicable domestic law. By awarding damages "as a consequence of breach," Article 74 also signals that damages are available for breach even if the breaching party is not at fault in breaching. Thus, Article 74 deviates from some domestic law that awards damages only when there is fault or does not allow damage awards to reflect lost profits.[5]

An injured party who has not avoided the contract can recover damages only under Article 74. Although Articles 75 and 76 have their own calculations of damages, these Articles are available to calculate damages only if the contract has been avoided. In determining damages recoverable under Article 74's general rule, two other Articles must be taken into account. Article 77 requires damages to be reduced to the extent that the injured party has not mitigated its loss. Article 78 allows the award of interest, increasing the damages recoverable under Article 74.

1. The limitation of foreseeability

Although it initially appears to provide for full compensation to the aggrieved party, Article 74's second sentence limits recoverable damages according to their foreseeability. Damages may not exceed the loss the breaching party "foresaw or ought to have foreseen at the time of the conclusion of the contract, in light of facts and matter of which he then knew or ought to have known, as a possible consequence of the breach." Although stated in slightly different terms, this limitation essentially embodies the *Hadley* v. *Baxendale* foreseeability requirement for recoverable consequential damages. As with the *Hadley* rule, facts that the breaching party knew or ought to have known at the conclusion limit its liability. Facts it discovers or ought to have discovered after the contract's conclusion have no effect on recoverable damages.

The foreseeability limitation, which is common in domestic law – even if stated in somewhat different terms than Article 74 – makes sense. Parties cannot easily price into their contracts risks that they did not foresee. The result is that without a limitation unforeseen risks will expose breaching parties to a risk of liability for which they have not been compensated and that they may be ill-equipped to bear. Parties exposed to unforeseen damages might avoid entering into what would otherwise be mutually valuable contracts, because they would risk liability for loss that they were not paid to bear and that the other party was better able to avoid.

Nevertheless, Article 74 leaves open some vital issues concerning the scope of the limitation. Article 74 does not say whether the requirement of foreseeability applies

[5] See, e.g., Burgerliches Gesetzbuch [BGB] [Civil Code] § 280(1) (Ger.); Reinhard Zimmer-

to both the type and extent of loss.[6] It might be that it was unforeseeable that a buyer intended to resell the goods that it contracted to purchase from a breaching seller, so that lost profit (a type of loss) was unforeseeable. But it might also be foreseeable to the seller that the goods that cost $10 would be resold, but unforeseeable that they would be used in a product that would be so successful as to generate many millions of dollars of profits (the extent of loss). Article 74 seems to preclude recovery in the first case. It is unclear whether the Article precludes recovery in the latter.

There is some argument that Article 74's foreseeability limitation differs from the traditional test of *Hadley* and related domestic law in one respect.[7] As a matter of technical formulation, Article 74 excludes loss that the breaching party did not or could not reasonably foresee, in the light of the facts and matters of which he then knew or ought to have known, as a "possible consequence" of its breach. American law concerning contracts other than for sales of goods excludes recovery of losses the breaching party did not have reason to foresee as a "probable result" of the breach.[8] Fewer types of loss are excluded by Article 74's language than under domestic law doctrine, because loss can be foreseeable as a possible consequence of breach, even if not a probable consequence of it. But the UCC, rather than general contract principles, provides the closest analogue to the CISG, and the relevant UCC provision, § 2–715(2)(a), permits recovery of consequential damages resulting from the seller's breach for any loss resulting from general or particular requirements and needs of which the seller has "reason to know" at the time of contracting. That limitation appears far closer to the "possible" loss standard of the CISG than to the "probable" one in general contract law. If there is a substantial difference between the CISG and the UCC on this score, it lies in the fact that the UCC appears to permit recovery of consequential damages only for the buyer,[9] while Article 74 applies to both parties.

Two American cases that have focused on Article 74's foreseeability limitation both understand it as stating the foreseeability limitation in terms of "probable" consequences,[10] while a third case adheres to the "possible" language.[11] We believe

[6] The Austrian Supreme Court requires foreseeability with regard to both the type and extent of loss, see Supreme Court (Austria), 14 January 2005, available at http://cisgw3.law.pace.edu/cases/020114a3.html; see also Ingeborg Schwenzer, *Article 74*, in Schlectriem & Schwenzer: Commentary on the UN Convention on the International Sale of Goods (CISG) 999, 1020 (Ingeborg Schwenzer ed., 3d ed. 2010) [hereinafter "Schlechtriem & Schwenzer"].

[7] See Franco Ferrari, Hadley v Baxendale *v Foreseeability Under Article 74 CISG*, in Contract Damages: Domestic and International Perspectives 305 (Djakhongir Saidov & Ralph Cunnington eds., 2008).

[8] See Restatement (Second) of Contracts § 351(1) (1981).

[9] See U.C.C. § 2–715(2); cf. U.C.C. § 2–710.

[10] See *Delchi Carrier SpA* v. *Rotorex Corp.*, 71 F.3d 1024, 1029 (2d Cir. 1995) ("The CISG requires that damages be limited by the familiar principle of foreseeability established by *Hadley* v. *Baxendale*"); *TeeVee Toons, Inc.* v. *Gerhard Schubert GmbH*, 2006 U.S. Dist. LEXIS 59455, at *40 (S.D.N.Y. August 12, 2006). Cf. Supreme Court (Switzerland), 28 October 1998, available at http://cisgw3.law.pace.edu/cases/981028s1.html (limitation traceable to Anglo-

that these verbal formulations do not translate into significant differences in result. Taken literally, a "possible" consequences formulation imposes something close to strict liability rather than a limitation, because an even moderately informed breaching party can forecast a huge range of possible losses that can result from its breach. In short, virtually anything is "possible" from the ex ante perspective that Article 74 embraces. The very fact that a result materialized indicates that it was "possible" that it could materialize, and given sufficient time and effort, a party could have foreseen that such a result could possibly materialize. Thus understood, the foreseeability requirement of Article 74 does not foreclose recovery for any damage suffered. While the requirement that the breaching party is only charged with what was foreseeable in the light of the facts and matters of which he knew or ought to have known at the time of contracting, the flexible characterization of those facts and circumstances limits the effect of that constraint. That result becomes more likely as one expands the description of the consequence. The loss of downstream contracts from breach that lead the aggrieved party to declare bankruptcy may be described as either foreseeable lost revenues or as less readily foreseeable insolvency. Neither the CISG's drafters nor the delegates who approved the CISG likely intended this result. Nor do the cases that apply the "possible consequences" test appear to allow such a broad standard of foreseeability. At the same time, a probability test arguably demands too much if it means a greater than 50 percent probability that the consequence complained of would materialize. Certainly the current cases make no inquiry into whether foreseeability transcends some probabilistic threshold. The court in *Delchi Carrier SpA* v. *Rotorex Corp.*[12] concluded that the transactions for which the buyer sought consequential damages were "objectively foreseeable" at the time the contract was concluded. Similarly, the court in *TeeVee Toons, Inc.* v. *Gerhard Schubert GmbH*[13] inferred foreseeability from evidence that the buyers intended to resell the goods that defendant agreed to manufacture and made no inquiry into probability.

We conclude, therefore, that notwithstanding differences in technical formulations, in practice the Article 74 test and the "probable consequences" test converge on something like a "reasonably foreseeable consequences" test. Consequences that are remote, although possible, should be excluded because the likelihood that they would materialize has not been priced into the contract. The breaching party, that is, would not have been paid to take the risk that the aggrieved party would suffer the loss complained of. On the other hand, the breaching party would have had an opportunity to price a risk of a reasonably foreseeable loss, even if that risk did not rise above a 50 percent threshold. We conclude that this interpretation is consistent with the practice of courts as well as with a theory of consequential damages that places loss on the party best positioned to avoid or insure against them.

[13] 71 F.3d 1024 (2d Cir. 1995).

Al Hewar Environmental & Public Health Establishment v. *Southeast Ranch, LLC*[14] illustrates the convergence. There a buyer contracted with its seller for a large quantity of hay. The buyer in turn arranged to sell a portion of the hay to a sub-buyer. As part of the arrangement, the buyer posted a forfeitable bond to assure delivery. The buyer had entered into the same arrangement with the sub-buyer over the previous several years. When the seller breached by failing to deliver the hay, the buyer had to cancel its contract with the sub-buyer and forfeited its bond. The court awarded the buyer consequential damages, including the amount of the bond. In doing so it relied on Article 74's "ought to have known" language, finding that these damages were foreseeable to the seller at the time of the conclusion of the contract. Given the quantities of hay the buyer was purchasing and the buyer's past contracting practices, the seller could have reasonably foreseen that the buyer would resell some of it. The seller therefore also could have reasonably foreseen that its breach might result in a loss to the buyer in those resale transactions. Although the court makes no specific findings as to why the seller ought to have known that this loss was a foreseeable result of breach, the facts it recites suggest that the result was reasonably foreseeable to the seller. The court did not decide (and did not need to decide) whether the loss was a probable result of breach.

But the court in *CITGO Petroleum Corp.* v. *Odfjell Seachem*[15] reached what is arguably an alternative conclusion, and did so in a manner that demonstrates, perhaps to a fault, the ineffectiveness of Article 74's language of the "possible." Tricon had contracted for the purchase of cyclohexane from YPF. It then contracted to resell the cyclohexane to CITGO, and CITGO in turn contracted to resell to BASF. Each of the resale contracts would generate significant profit for the reseller. But those resales were negated when delivery of the cyclohexane to Tricon was delayed. Through a series of intermediate transactions, CITGO brought a claim for damages on behalf of both Tricon and itself, and contended that lost profits were recoverable as a foreseeable consequence of the delay in delivery because YPF had reason to know that Tricon was merely a reseller. The court, arguably ignoring the language of Article 74, applied a version of *Hadley* that permitted recovery of lost profits only if YPF could foresee that Tricon would suffer a delay in reselling as a consequence of the breach. To satisfy this standard, the court concluded, YPF would have needed to understand that Tricon was a reseller, not a company that purchased and used cyclohexane itself, and that Tricon had a short-term deal to resell the product. Moreover, the burden was on CITGO to demonstrate that YPF had the requisite understanding, even though YPF and Tricon's prior dealings indicated that Tricon was a trader, not a user, of cyclohexane. The lack of evidence on foreseeability was fatal to CITGO's efforts to attempt to demonstrate that Article 74 was or could be satisfied. As the court concluded, "[w]hile certainly YPF *may*

[14] 356 U.S. Dist. LEXIS [illegible]

have known [that Tricon was a reseller], such supposition does not rise to the level necessary to survive summary judgment."[16] That inquiry, however, misunderstands a literal reading of Article 74. Under that reading, the relevant issue was not whether YPF may have known that Tricon would resell the goods, but whether, given what YPF did or ought to have known, YPF could foresee the possibility that Tricon would resell the goods.

The Austrian Supreme Court's application of Article 74's foreseeability limitation is consistent with the "reasonable foreseeable consequences" test.[17] According to the court, consequential damages are recoverable if at the conclusion of the contract a reasonable person in the breaching party's position could view the loss as a "sufficiently probable consequence" of breach. It concluded that Article 74 therefore requires determining the degree to which a reasonable person in the breaching party's position at the conclusion of the contract could foresee the loss from its breach. The court remanded the case to the lower court for it to make this determination. A "probable consequences" test for foreseeability requires that the loss be probable, not merely sufficiently probable as the court requires. The court's concern with the degree to which the loss is foreseeable suggests that the loss must be reasonably foreseeable at the conclusion of the contract. A Russian arbitral tribunal, in denying the buyer lost profits on a sale to its sub-purchaser, reached a similar conclusion.[18] It concluded that the breaching seller had "no obligation" to foresee the buyer's lost profits when it was not informed of the buyer's sale to the sub-purchaser.

There is one additional technical distinction between the foreseeability limitation expressed in *Hadley* and in Article 74. Traditionally, *Hadley* speaks in terms of what was foreseeable to both parties at the time the contract was concluded,[19] while Article 74 speaks only in terms of what the party in breach foresaw. As a practical matter, the difference is likely to be immaterial because it is highly improbable that the party in breach would foresee a consequence that might befall the aggrieved

16 Id. at *20 (emphasis in original).

17 See Supreme Court (Austria), 14 January 2002, available at http://cisgw3.law.pace.edu/cases/020114a3.html.; cf. Tribunal of International Commercial Arbitration (Russia), 6 June 2000, available at http://cisg3.law.pace.edu/cases/000606r1.html (buyer denied consequential damages when breaching seller was not informed of buyer's sale to a sub-purchaser).

18 See Tribunal of International Commercial Arbitration (Russia), 6 June 2000, available at http://cisg3.law.pace.edu/cases/000606r1.html.

19 According to the *Hadley* court, "[w]here two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made contract, as the probable result of the breach of it." *Hadley* v. *Baxendale*, 156 Eng. Rep. 145, 151 (Ex. 1854). Only the second of *Hadley's* two "rules" refers to what was foreseeable to both parties ("in the contemplation of both parties"). The Restatement (Second) of Contract's statement of the *Hadley* rule refers only to what was reasonably foreseeable to the breaching party when the contract was made; see Restatement (Second) of Contracts § 351

party and that the aggrieved party itself did not foresee. More likely is the circumstance in which the breaching party, with limited information available to it, would not foresee a consequence that is foreseeable to the aggrieved party.

2. Calculation of loss under Article 74

According to Article 74, recoverable damages are equal to the loss resulting from breach. The aggrieved party does not have to rely on Article 75's cover measure or Article 76's market price measure to calculate damages, even when available.[20] In fact, sometimes the aggrieved party can only rely on Article 74 to recover damages. This will be so when it has not avoided the contract under either Article 75 or Article 76. Since Article 74 does not require avoidance, it will be the primary source of damage recoveries under Article 36 when the buyer retains goods that fail to conform to the contract.

Notwithstanding its broad applicability, Article 74 does not state how loss from breach is to be calculated. Nonetheless, its reference to "loss . . . as a consequence of breach" suggests that damages are to be calculated to protect the aggrieved party's expectation interest. This is because awarding damages for loss from breach puts the victim in the position it would be in had the contract been performed. Protecting the aggrieved party's expectancy interest requires determining two positions. One is the aggrieved party's position as a result of the breach. The other is the position that party would have been in had the contract been performed. A damage calculation that gives a monetary award ("a sum") equal to the difference between these two positions measures the aggrieved party's loss from breach. For example, in one case the seller delivered nonconforming goods and sued the buyer to recover the remaining portion of the contract price.[21] The court calculated the buyer's damages under Article 74 as equal to this portion of the price and denied the seller recovery. In effect it measured these damages as the difference between the value that conforming goods would have had at the time of delivery and the value of the delivered goods at that time.

That measure of damages appears to be correct in light of the objective of retaining the aggrieved party's benefit of the bargain. Assume, for example, that a buyer enters into a contract with a seller for the purchase of Grade A sawdust at a price of $100,000, with delivery to occur in six months. Assume that at the time of delivery, Grade A sawdust in the quantity required by the contract has a market value of $110,000. Finally, assume that the seller instead delivers the same quantity of Grade B sawdust, which has a value at the time of delivery of $90,000. The buyer has suffered a loss measured by the difference between the value of what it expected

20 See Articles 45(1)(b), 61(1)(b).

21 See District Court Trier (Germany), 12 October 1995, available at http://

to receive (sawdust worth $110,000) and what it did receive (sawdust worth $90,000), or $20,000. If the buyer receives $20,000 in damages, it will be in the same position it would have occupied had there been performance, because it will have $90,000 in sawdust and $20,000 in damages for a total value of $110,000 – the value it would have received had there been performance.

Although the reference to the aggrieved party's loss suggests that there is a single amount that satisfies Article 74, there are different ways of measuring loss, and they could give rise to different amounts. The cost of repair measures the buyer's loss from the seller's nonconforming tender, unless the buyer suffers loss not compensated by repair.[22] If nonconforming goods have a prevailing market price at the time delivery is due, the market price differential can measure loss from breach.[23] Likewise, the cost of funds measures the seller's loss as a result of the buyer's delay in paying the contract price. All these measures calculate damages consistent with Article 74's general rule for recoverable loss. Occasionally, establishing loss directly can be difficult. Loss is not directly observable, and the party bearing the burden of proving loss might not have the evidence needed to establish it directly. In this event the party might prefer to rely on repair costs or the market differential to prove its loss.

3. Consequential and incidental damages

Under Article 74 loss from breach includes incidental loss and consequential damages. Article 74's reference to "loss ... as a consequence of breach," because unqualified, covers both sorts of loss. Incidental loss is out of pocket expense incurred as a result of breach. Storage and transportation costs that would not have been incurred had the contract been properly performed are incidental expenses. Consequential damages include liability to third parties as well as opportunity costs incurred as a result of breach. Although domestic law sometimes makes the distinction between incidental loss and consequential damages important,[24] the CISG does not. Both are recoverable under Article 74. As types of recoverable damages, both incidental loss and consequential damages are subject to Article 74's limitation of foreseeability. Finally, they are recoverable under Article 74 even when the

[22] See District Court Stuttgart (Germany), 29 October 2009, available at http://cisgw3. law.pace .edu/cases/091029g1.html; CIETA Arbitration Award (China), 31 May 2006, available at http:// cisgw3.law.pace.edu/cases/060531c1.html; ICC Case 8740 (1996), available at http://cisgw3.law .pace.edu/cases/968740i1.html; Court of Appeals Köln (Germany), 8 January 1997, available at http://cisgw3.law.pace.edu/cases/970108g2.html.

[23] See Secretariat Commentary on the 1978 Draft, in Documentary History of the Uniform Law for International Sales 449 (para. 7) (John O. Honnold ed., 1989) [hereinafter "Documentary History"]; Court of Appeals Zweibrucken (Germany), 2 February 2004, available at http:// cisgw3.law.pace.edu/cases/040202g1.html.

[24] For instance, Article 2 of the UCC allows the seller to recover only incidental loss, not consequential damages; see U.C.C. §§ 2–710, 2–715. The buyer may recover both sorts of loss;

aggrieved party measures its damages under Articles 75 or 76, as both Articles make explicit. In a Spanish case the aggrieved seller sought to measure its damages for wheat it resold under Article 75's resale measure, and for unsold wheat under Article 76's market measure.[25] The Spanish Supreme Court upheld the trial court's damage award under Article 74, which included the warehousing costs the seller incurred before it resold the wheat the breaching buyer had refused. The Court, however, also upheld the lower court's refusal to include in the damage award under Article 74 additional financing costs the seller allegedly incurred while arranging resale. It found that the seller had not sufficiently proven these costs. Financing costs incurred as a result of breach, if proven, easily are recoverable as "loss...as a consequence of the breach."

4. Burden of proof

The CISG is unclear about the assignment of the burden of proving damages. There are two issues here. One is whether the CISG or the forum's law governs burden of proof. The second issue is the assignment made by applicable law, either by the CISG or the forum's law. Courts and commentators tend[26] to conclude that the CISG assigns the burden of proving loss from breach and that the party claiming damages under Article 74 bears that burden.[27] Although both parts of the conclusion are reasonable, the case for it is far from compelling. Article 74 does not deal with burdens of proof. In fact, apart from Article 79(1), none of the CISG's provisions expressly address the question. Thus, the CISG must deal with burdens of proof, if at all, implicitly.

Commentators find that Article 7 implicitly addresses the matter. We are not so sure. By its terms, Article 7(1) requires the CISG to be interpreted to promote uniformity in its application. Uniformity in interpretation only demands that tribunals interpret the CISG's provisions in the same way.[28] As far as the instruction goes, they may interpret the CISG to assign or not to assign the burden of proving

[25] See Supreme Court (Spain), 1 July 2013, unpublished translation by Santiago J. Teran.

[26] See *Delchi Carrier SpA* v. *Rotorex, Corp.*, 71 F.3d 1024 (2d Cir. 1995); Court of Appeals Helsinki (Finland), 26 October 2000, available at http://cisgw3.law.pace.edu/cases/001026f5.html; District Court Saan (Switzerland), 20 February 1997, available at http://cisgw3.law.pace.edu/cases/ 970220s1.html.

[27] See Peter Huber & Alastair Mullis, The CISG 36, 281 (2007); CISG Advisory Council Opinion No. 6: Calculation of Damages Under CISG Article 74 ¶ 2 (2006), available at http://cisgw3 .law. pace.edu/cisg/CISG-AC-op6.html; Schwenzer, *Article 74*, in Schlechtriem & Schwenzer, supra note 6, at 1025; Franco Ferrari, *Burden of Proof Under the United Nations Convention on Contracts for the International Sale of Goods*, 2000 Int'l Bus. L. J. 665, 666; *Chicago Prime Packers, Inc.* v. *Northam Trading Food Co.*, 408 F.3d 494, 899 (7th Cir. 2005); Supreme Court (Austria), 12 September 2006, available at http://cisgw3.law.pace.edu/cases/ 060912a3.html; Court of Appeals Hamm (Germany), 31 March 1998, available at http:// cisgw3.law.pace.edu/cases/980331g1.html; District Court Vigevano (Italy), 12 July 2000, available at http://cisgw3.law.pace.edu/cases/000712i3.html.

[28] Cf. CISG Advisory Council Opinion No. 6, Calculation of Damages Under

damages. Tribunals follow Article 7(1)'s instruction as long as they converge on the interpretation of the relevant provision. Thus, Article 7(1)'s requirement of uniformity in interpretation does not implicitly deal with burden of proof. According to Article 7(2), matters not expressly settled by the CISG are to be settled according to general principles underlying it. The trouble is that it is hard to identify these principles. Although some commentators have found a large number of underlying principles,[29] it is difficult to see how principles bearing on burden of proof are embedded in the CISG. For instance, the principle is sometimes offered to the effect that a party wanting to benefit from a provision bears the burden of proving the provision's factual requirements.[30] Article 74 gives the aggrieved party a right to recover its loss and places limits on the loss it may recover. However, it suggests nothing about whether the aggrieved party must introduce evidence to establish that loss. Although the principle might be a good one, it has no basis in a provision that merely grants remedial rights.

Ultimately, the question as to whether the CISG assigns burdens of proof with respect to damages is not of major importance. This is because, according to those who find that it does so, the party claiming damages under Article 74 bears the burden of proving its loss.[31] Domestic law tends to assign the burden in the same way.[32] We would expect that to be the case, since the aggrieved party has better access to the relevant information than the breaching party.

5. Lost profits and the standard for recovery

Article 74 expressly includes lost profits as an element of recoverable damages. The express inclusion probably is intended to signal that the Article counts lost profits as recoverable "loss;" it does not under some domestic laws. Article 74 does not state how lost profits are to be calculated. Unsurprisingly, courts calculate it as they would under applicable domestic law. Unfortunately, this tendency provides more potential for divergence between the CISG and domestic law than one finds with respect to standards of proof. National laws differ concerning the required likelihood of loss

[29] See, e.g., Ulrich Magnus, *The General Principles of UN Sales Law*, 3 Int'l Trade & Bus. L. 33 (1997) (26 general principles); Camilla B. Anderson, *General Principles of the CISG—General Impenetrable?*, in Sharing International Commercial Law Across National Boundaries 13, 28 (Camilla B. Anderson & Ulrich B. Schroeter eds., 2008) (reporting 14 general principles identified by the CISG Digest).

[30] See, e.g., Magnus, supra note 32, at 33, 52; Ferrari, supra note 28, at 667–68.

[31] See, e.g., Huber & Mullis, supra note 27, at 36, 281; Ingeborg Schwenzer, *Article 74*, in Schlechtriem & Schwenzer, supra note 6, at 1025; Victor Knapp, *Damages in General*, in Commentary on the International Sales Law 541 (Cesare M. Bianca & Michael J. Bonell eds., 1987) [hereinafter "Bianca & Bonell"].

[32] See Ingeborg Schwenzer, Pascal Hachem & Christopher Kee, Global Sales and Contract Law

supported by the evidence.[33] For instance, they differ about whether the aggrieved party must prove its damages with reasonable certainty, clear and convincing evidence, or some other standard of proof. An unfortunate example of reverting to domestic standards can be found in *Orica Australia Pty Ltd* v. *Aston Evaporative Services, LLC*.[34] The court concluded that Article 74 allowed lost profits, but – considering only American decisions – then observed that "[c]ourts applying this have often imported lost-profits standards similar to [the standard of the relevant state in the United States]."[35] That standard, which requires proof of the fact that damages will accrue in the future and sufficient admissible evidence to compute a fair approximation of the loss, may be perfectly appropriate. But the inference that domestic principles should be imported into the CISG simply proves too much. If courts from jurisdictions with different standards each import their own standards, no autonomous CISG standard can evolve. Perhaps the best one can say of the approach in *Orica Australia Pty Ltd* is that the party seeking lost profits did not argue for a different standard, leaving the court with an unquestioned assumption.

The CISG Advisory Council advocates a standard of reasonable certainty: The evidence must allow a reasonable estimate of damages.[36] It bases its recommendation on the CISG's international character and Article 74's policy of full compensation. Although selection of a standard of proof is complicated, it is not clear that a reasonable certainty standard is efficient. This is because a standard of proof has two opposite effects on the contracting parties. One occurs at the point of breach, when the aggrieved party must decide to litigate. Lower standards of proof increase the incentive of the aggrieved party to sue, because they make it more likely that evidence will show loss from breach. The other effect occurs prior to breach, at the point of contracting. At this point lower standards of proof increase the expected liability of a party, because they increase the likelihood that loss will be found in the event it breaches. By increasing the likelihood that the aggrieved party can recover its loss, the reasonable certainty standard increases the value of the contract to that party. At the same time, the standard increases the expected cost of the contract by increasing the expected liability from breach. By contrast, higher standards of proof decrease the contract value because the loss on breach is harder to establish. However, these standards also decrease the cost of the contract by reducing the expected liability from breach. Thus, in general, the two effects point in different directions. Their respective sizes are unknown and hard to estimate. Without a basis

[33] See, e.g., Kevin M. Clermont, *Standards of Proof in Japan and the United States*, 37 Cornell J. Int'l Law 263 (2004); Kevin M. Clermont & Emily Sherwin, *A Comparative View of Standards of Proof*, 50 Am. J. Comp. L. 243 (2002).

[34] 2015 U.S. Dist. LEXIS 98248 (D. Colo. July 28, 2015). [35] Id. at *23.

[36] See CISG Advisory Council Opinion No. 6, Calculation of Damages Under Article 74 ¶ 2.6

for estimating their size, a reasonable certainty standard (or any other standard) seems difficult to support as an optimal basis for proving damages.

The buyer's profit is the difference between the value to it of the seller's performance and the contract price. For the seller, profit is the difference between the contract price and its cost of performance. Rational buyers and sellers expect a profit from performance, so that the difference between value and price (buyer) and price and cost (seller) is positive. To date both German and American courts calculate lost profits under Article 74 in the same way.[37] Costs that the aggrieved party would incur in performance are variable costs. Variable costs that the victim saves by breach are deducted from the value of performance (buyer) or the price (seller) to arrive at its lost profit. Costs that the aggrieved party incurs whether or not the contract was entered into are fixed costs. In calculating lost profits, fixed costs are not deducted from the value of performance.[38]

The aggrieved party sometimes will prefer to recover lost profits directly under Article 74. This can occur when proving the prevailing market price at the time of delivery or the resale price is difficult. To establish its lost profits under Article 74, the aggrieved party must prove the value of performance to it and its performance costs. The burden of doing so can be easier than proving market or resale price, even when Articles 75 or 76 are available to measure damages.

Al Hewar Env. & Public Health Est. v. *Southeast Ranch, LLC*[39] is likely an example. There the buyer contracted with the seller to purchase bales of hay for a total price of $5,166,000. The contract called for a $787,500 down payment, which the buyer paid the seller. The buyer in turn contracted to sell the hay to a downstream buyer for $6,806,000. This contract required the buyer to post a forfeitable performance bond in the amount of $452,000. When the seller failed to deliver the hay to the buyer, the buyer avoided the contract. The buyer in turn cancelled its contract with the downstream buyer, who, in turn, called on the buyer's performance bond. Although the buyer could have measured its damages under Articles 75 or 76, it elected to recover its lost profit under Article 74.

The court calculated the lost profit at $2,427,500 as follows: The value of the seller's performance to the buyer was the $6,806,000 contract price due from the downstream buyer. The buyer's variable costs were the $5,166,000 breached contract price. Because the buyer had made a $787,500 down payment on the price, the seller's breach saved it $4,378,500 ($5,166,000 - $787,500 = $4,378,500). Thus, the buyer's lost profit under Article 74 equaled the difference between $6,806,000 and

[37] See Court of Appeals Hamburg (Germany), 26 November 1999, available at http://cisgw3.law.pace.edu/cases/991126g1.html; *Delchi Carrier SpA* v. *Rotorex Corp.*, 71 F.3d 1024 (2d Cir. 1995); *TeeVee Toons, Inc.* v. *Gerhard Schubert GmbH*, 2006 U.S. Dist. LEXIS 59455 (S.D.N.Y. August 12, 2006).

[38] See *Profi-Parkiet Sp. Zoo* v. *Seneca Hardwoods LLC*, 2014 U.S. Dist. LEXIS 71289 (E.D.N.Y.

$4,378,500 or $2,427,500. In addition, the $452,000 performance bond that the buyer forfeited on canceling its contract with the downstream buyer was a foreseeable consequential damage resulting from the seller's breach. Article 74 therefore includes it in the buyer's recoverable loss. Thus, the buyer's total recoverable loss under the Article is $2,879,500. The court noted that the same calculation would be made under United States domestic law.

6. Lost volume sellers

Article 74 does not directly address whether a "lost volume" seller can recover its lost profit on the breached contract. A seller loses volume when its available supply of the goods exceeds its available customers at any time. If the buyer breaches and the seller resells the same goods to another buyer at the breached contract price, Article 76's market measure gives the seller no damages. This is because the market price of the second sale will equal the contract price. Thus, the contract price- market price differential is zero. Nevertheless, the seller may have suffered damages that should be compensated: Given that the seller had sufficient goods to serve all available customers, the seller may claim that it would have made the second sale even if the first buyer had performed. Thus, the second sale was an additional sale, not a substitute sale. The seller will have lost a profit on the breached contract and should be entitled to recovery of that profit as a "sum equal to the loss . . . suffered by the other party as a consequence of breach."

The Austrian Supreme Court has accepted this reasoning and allowed a lost volume seller to recover its lost profit under Article 74.[40] The CISG Advisory Council takes the same position.[41] Although supported by some domestic case law, their reasoning is questionable. Both accept the traditional notion of a "lost volume" seller as one who has the capacity to supply all its customers. According to the Austrian Supreme Court: "[B]usinesspersons, who regularly trade with goods as the ones involved in the avoided contract, will—as a general rule—always be in a position to replace the failed transaction by a substitute transaction selling the goods of the avoided contract or different goods on the basis of the current market price."[42]

Although a seller who loses a sale due a breach should receive its lost profit, the availability of sufficient goods to make sales to additional customers notwithstanding the breach should not, of itself, constitute lost volume. To lose volume, it must be the case that the seller not only could have made the additional, sale; it must also be true that the seller would have made the additional sale.[43] There are at

[40] See Supreme Court (Austria), 28 April 2000, available at http://cisgw3.pace.law.edu/cases/000428a3.html.

[41] See CISG Advisory Council Opinion No. 6, Calculation of Damages Under CISG Article 74 ¶ 3.20 (2006), available at http://cisgw3.law.pace.edu/cisg/CISG-ACop6.html.

[42] Id.

[43] See District Court Gelderland (Neth.),

least two reasons why a seller who has the capacity to make an additional sale would not do so. First, the effort to make the additional sale might require incurring costs that render the additional sale unprofitable. To earn a profit from making a sale in addition to the breached contract, the seller's marginal costs in supplying the additional good must equal its marginal revenue from the sale. The seller maximizes its profit by making sales up to the point where the marginal cost of the sale equals its marginal revenue. In a relatively competitive market, sellers will occupy that position. For this reason, unless the market is noncompetitive or the seller has a peculiar reason for not operating at its profit-maximizing capacity, any sale the seller makes with the breached goods is a substitute sale, not an additional one. As a result, the seller does not lose volume from the breached sale.[44]

In addition, by its breach, the buyer has indicated that it no longer has productive use for the goods. As a result, if it had performed the contract and accepted the goods, the buyer presumably would have attempted to resell them. Arguably, any such resale would have occurred within the seller's market, since the buyer purchased the goods in that market. As a result, the seller would have been deprived of the sale made to the party who purchased the goods from the performing buyer. On that logic, resale of the breached goods only occurred because of the breach; it was, therefore, a substitute for the breached contract, not an additional sale. As a consequence, the seller did not lose volume when the buyer failed to accept the goods and the seller resold them to a party that the buyer otherwise would have serviced.[45]

7. Litigation costs

Article 74 does not say whether attorney's fees and other litigation costs are recoverable as damages. Unsurprisingly, courts and commentators divide over the issue,[46] although in some cases it is unclear whether an award of attorney's fees has been made under Article 74 or under some domestic law principle.[47] Both sides

[44] American domestic case law shows a similar divide over the definition of the lost volume seller; compare *Neri* v. *Retail Marine Corp.*, 285 N.E.2d (N.Y. 1972) with *R.E. Davis Chemical Corp.* v. *Diasonics, Inc.*, 826 F.2d 678 (7th Cir. 1987). Indeed, *R.E. Davis Chemical* imposes on the seller the burden of proving that it would have lost volume.

[45] See *A. Lenobel, Inc.* v. *Senif*, 252 App. Div. 533 (N.Y. 1938).

[46] Compare *San Lucio S.r.l.* v. *Import & Storage Services LLC*, 2009 U.S. Dist. LEXIS 31681 (D.N.J.); *Hermanos Succesores* v. *Hearthside Baking Co.*, 315 F.3d 385 (7th Cir. 2002); Harry Flechtner & Joseph Lookofsky, *Viva Zapata! American Procedure and CISG Substance in a U.S. Circuit Court of Appeals*, 7 Vindobona J. Int'l L. & Comm. Arb. 93 (2003) (CISG silent on attorney's fees), with Court of Appeals Turku (Finland), 12 April 2002, available at http://cisgw3.law.pace.edu/cases/020412f5.html; Lower Court Augsburg (Germany), 29 January 1996, available at http://cisgw3.law.pace.edu/cases/960129g1.html; Fritz Enderlein & Dietrich Maskow, International Sales Law 298–99 (1992) (Article 74's compensation principle allows recovery of attorney's fees).

[47] See Court of Appeals Turku (Finland), 12 April 2002, available at http://cisgw3.law.pace.edu/

have respectable arguments in their favor. According to one position, Article 74 allows the aggrieved party to recover damages equal to its "loss," and litigation costs are a type of incidental expense resulting from breach. If the aggrieved party cannot recover its litigation expenses, damages do not put it in the same position as performance would have. Article 74 therefore would not protect its full expectancy interest. Although Article 74 does not expressly address litigation costs, Article 7(2) directs that general principles underlying the CISG settle matters that the CISG implicitly addresses. A relevant underlying principle, supported by Article 74, is one of full compensation: the principle that a damage award fully protects the aggrieved party's expectancy interest. The principle of full compensation argues for construing Article 74 to allow recovery of litigation costs.

The opposing position relies on Article 74's language to the effect that damages equal the "loss . . . as a consequence of breach." Loss that results from events other than breach therefore is not recoverable under the Article. Arguably, litigation costs are the consequence of litigation, not breach.[48] If the breaching party had posted a forfeitable bond equal to the loss breach caused the aggrieved party, the victim would not have to litigate. It could call on the bond instead. Or the breaching party might have fully compensated the aggrieved party without litigation. These possibilities arguably show that litigation costs are the result of the victim having to sue to get paid, not the breach itself.

American courts have systematically refused to award attorney's fees in litigation governed by the CISG.[49] *Zapata Hermanos Succesores* v. *Hearthside Baking Co.*[50] remains the best judicial discussion of the matter. There, Judge Posner concluded that attorney's fees are unavailable under the CISG; they are recoverable, if at all, only under the procedural law of the forum. Posner notes an odd consequence of interpreting damages under Article 74 to cover litigation costs. Article 74 allows recovery for loss resulting from breach. Thus, although litigation costs would be recoverable by the prevailing plaintiff (the aggrieved party), the prevailing defendant could not recover its litigation costs in the event it is found not to have breached.[51] True, the law of a forum that has a "loser pays" rule would award the prevailing defendant its litigation costs. But the prevailing defendant would not be made whole in a forum that adopts the American rule ("each side bears its own litigation costs"). Judge Posner conjectured that the United States, with its American rule, would not likely have signed the CISG had Article 74 allowed for the recovery of litigation costs.[52] Contracting States with a "loser pays" rule, he speculated, likely did not

[48] See John Gotanda, *Article 74*, in UN Convention on Contracts for the International Sale of Goods (CISG): Commentary 1010 (Stefan Kröll, Loukas Mistelis & Pilar Perales Viscasillas eds., 2011) [hereinafter "Kröll et al."].

[49] See, e.g., *Profi-Parkiet Sp. Zoo* v. *Seneca Hardwoods LLC*, 2014 U.S. Dist. LEXIS 71289 (E.D.N.Y. May 23, 2014); *Chicago Prime Packers, Inc.* v. *Northam Food Trading Co.*, 320

think about the matter at all. His first conjecture seems plausible to us, given the reservations that the United States expressed with respect to other proposed provisions. The second seems less certain. Because Article 74 only awards damages for loss resulting from breach, even Contracting States with a "loser pays" rule could not construe the Article to allow a prevailing defendant to recover its litigation costs. They plausibly also concluded that litigation costs are recoverable, if at all, by the prevailing party only under the law of the forum.

Nothing in the recent case of *Stemcor USA, Inc.* v. *Miracero, S.A. de C.V.*,[53] changes the American view of attorney's fees, even though their award in an arbitration was upheld under Article 74. Stemcor sold steel coils to Miracero, a Mexican steel importer and distributor. When Stemcor failed to provide Mexican authorities with documentation that would have permitted preferential tax treatment of the sales, Miracero was assessed an additional $2.6 million in taxes and fees, and Miracero incurred $340,000 in costs to overturn those assessments. Miracero was ultimately awarded $819,437.86 for its attorneys' fees and costs in both the Mexican legal proceedings and the New York arbitration. Stemcor sought to vacate the arbitration award on several bases, including the non-arbitrability of the dispute and the allegedly *ultra vires* award of attorneys' fees.

On the issue of fees, the court noted that the relevant arbitration rules allowed the arbitral panel to award the costs of the arbitration to a prevailing party. But Stemcor contended that the CISG provided the substantive law applicable to the arbitration, and that damages under Article 74 are limited to the loss suffered as a consequence of the breach. Implicitly, Stemcor was contending that attorneys' fees are a consequence of the decision to bring an arbitration proceeding or litigation, not a consequence of the breach itself, and thus were unrecoverable under Article 74. The court, however, rejected the contention that the applicability of the CISG to the dispute meant that attorneys' fees were disallowed. The court concluded that choice of law provisions do not override arbitrators' ability to award fees otherwise available under the relevant arbitration rules.[54] In essence, therefore, the court appears to have been agreeing with Judge Posner's position that the issue of attorneys' fees fits more comfortably within the realm of procedural rules that fall outside the CISG than substantive rules that are created by it. But the court also confirmed the award of attorneys' fees in the case because the CISG itself does not "unambiguously" bar recovery of fees and costs.[55] One might initially read this claim as inconsistent with the holding in *Zapata*. But context matters. The court in *Stemcor* did not decide whether Article 74 either allowed or disallowed attorneys' fees. Instead, it recognized that *Zapata* had found attorneys' fees to fall outside of Article 74, that other courts included such fees within Article 74, and that commentators deemed the matter unresolved. As a result, the legal status of attorneys' fees under the CISG remained open. In that context, the court concluded that the

decision of the arbitral panel to permit attorneys' fees had a "colorable" basis in law. This is the deferential standard that the court deemed necessary to surmount in order to overturn the arbitral award.[56]

Essentially, the court was simply deciding that an arbitral panel that either awarded or disallowed attorney's fees could be said to be acting reasonably. Neither decision would satisfy the standard for reversal. Viewed from that perspective, *Stemcor* detracts only minimally from *Zapata*. Assume, for example, that the arbitral panel in *Stemcor* had decided not to award attorneys' fees and that the disappointed plaintiff sought judicial reversal of the arbitral decision on the grounds that such costs were required by Article 74. Presumably, the court in *Stemcor* also would have denied that claim, again because it was only deciding that, given the disputed status of attorneys' fees under Article 74, an arbitrator picking either position will not have committed the degree of error necessary to overturn the arbitral award. Thus, the deferential standard of review of arbitral awards, not a construction of Article 74, was decisive in *Stemcor*. *Stemcor* does, however, vary from *Zapata* in one interesting respect. Judge Posner's decision has been criticized for its inattention to what commentators have viewed as contrary case law from other jurisdictions on the availability of attorneys' fees under Article 74.[57] The *Stemcor* court's recognition of the division in opinion is worthy of attention and approval insofar as it takes seriously the admonition to interpret the CISG in light of its international character and to consider opinions and commentary from outside the forum. To the extent that the ambiguity about the issue arises from conflicting views of courts from different jurisdictions, the court successfully avoided any accusation of a homeward trend in deciding CISG cases.

8. Interest

Article 74 clearly allows the recovery of interest on damages for breach of an obligation to pay the contract price or other sums of money. Breach deprives the injured party of the use of the money owed, and damages therefore compensate for this loss. Bearing the burden of proving its damages, the injured party must establish the amount of interest due on sums owed. The cost of capital to the party over the relevant period accurately measures interest owed.[58]

[56] Id. ("At most, then, Stemcor has identified an ambiguity in the law, which the arbitrators here resolved in favor of granting fees. Since that decision was at least reasonable, and certainly 'barely colorable,' this Court will not disturb it.").

[57] See, e.g., David B. Dixon, *Que Lastima Zapata—Bad CISG Ruling on Attorneys' Fees Still Haunts U.S. Courts*, 38 U. Miami Inter-Amer. L. Rev. 405, 422–24 (2007); John Felemegas, *An Interpretation of Article 74 CISG by the U.S. Circuit Court of Appeals*, 15 Pace Int'l L. Rev. 91, 119–21 (2003); cf. Harry Flechtner & Joseph Lookofsky, *Viva Zapata! American Procedure and CISG Substance in a U.S. Circuit Court of Appeals*, supra note 46, at 103 (endorsing result but criticizing opinion for failure to refer to relevant foreign case law).

[58] See, e.g., Court of Appeals Ditzell of (Germany)

Interest can be recovered under Article 78 independently of interest on damages. Article 78 provides: "If a party fails to pay the price or any other sum that is in arrears, the other party is entitled to interest on it, without prejudice to any claim for damages recoverable under Article 74." The provision's vagueness or incomplete character has divided courts and commentators. Clearly interest is recoverable under Article 78 without proof of loss under Article 74, as the last clause in Article 78 expressly allows. More generally, interest awardable under Article 78 is not awarded as damages.[59] It is not compensation for the loss of the use value of money or other sum due. Article 78 appears in Section III ("Interest") of Chapter V of the CISG, while the CISG's damages appear in Section II ("Damages") of the same chapter. The separation by different sections reinforces the different bases on which interest is awarded.

This difference between interest and damages has a practical consequence. Interest is not recoverable under Article 74 when the parties' contract effectively excludes damages. That would be the situation, for example, when the contract contains an exclusive liquidated damages clause. Even when the contract does not exclude damages, Article 79(5) does not allow recovery of interest as damages when the party's liability for nonperformance is exempted under Article 79. Nonetheless, in both cases the injured party still is entitled to interest under Article 78. Interest is not recoverable under that Article only when a contractual provision effectively excludes Article 78's application to the contract.

The distinction between interest and damages means that the injured party can recover interest as damages under Article 74 in addition to interest recovered under Article 78.[60] Further, the availability of interest under Articles 78 and 74 allows the injured party to choose the Article under which to recover interest. This is because Article 78 allows interest on the price or other sum that is "in arrears." Although we think that allowing interest as damages under Article 78 stretches the meaning of the phrase "in arrears" too far, adjudicators and some commentators disagree.[61] So, for example, the damage award obtained by a buyer who receives nonconforming goods apparently represents a sum "in arrears." Accordingly, Article 78 allows interest on the award.

To recover interest as damages under Article 74, the injured party must prove its loss from the breaching party's failure to pay obligated sums. Such proof is unnecessary under Article 78, because the Article awards interest independently of loss. On the other hand, although Article 78 does not specify the interest rate applicable to interest awarded under the Article, the interest rate recoverable under Article 74 is measured by the injured party's loss of the use of obligated sums. Thus, the interest rate used to calculate recoverable interest under Article 74 in principle can be higher than the benchmark rate used to calculate interest awarded under Article 78. A Swiss court concluded that an injured seller could recover interest calculated at a higher interest rate under Article 74 than at the legal rate of interest allowable under applicable domestic law.[62] A German appellate court awarded the injured seller interest under Article 74 calculated by the interest rate payable on the bank loan it used to finance the sale.[63] The award is consistent with allowing interest recoverable under Article 78 to be calculated using a different interest rate. A tribunal in an early ICC Arbitration concluded that the interest rate awarded under Article 78 was independent of any claim for damages under Article 74 CISG, and could be higher than the legal rate applicable to Article 74 losses.[64] The tribunal awarded the non-breaching seller interest based on its borrowing costs. On the other hand, an Austrian arbitral tribunal used the interest rate due on the seller's bank loan to calculate interest under Article 78.[65] This is the same benchmark used to award interest under Article 74.

As noted, Article 78 does not set the interest rate applicable under the Article. It could be the LIBOR, the EURIBOR, the Fed Funds rate or another official discount rate, the prime rate, or some other benchmark.[66] One United States federal court applied a federal interest rate based on the average rate of return on one-year Treasury bills for the relevant time period between the time the plaintiff's claims arose and the entry of judgment.[67] The omission of an interest rate reflects the inability of the

[59] See ICC Case No. 7585 (1992), available at http://cisgw3.law.pace.edu/cases/927585i1.html (Article 78's purpose is to distinguish between interest and damages).

[60] See District Court Padova (Italy), 31 March 2004, available at http://cisgw3.law.pace.edu/cases/040331i3.html; Lower Court Oldenburg (Germany), 24 April 1990, available at www.cisg.law.pace.edu/cases/900424g1.html.

[61] See, e.g., Supreme Court of Western Australia, (Australia) (*Ginza Pte Ltd* v. *Vista Corporation Pty Ltd.*), 17 January 2003, available at http://cisgw3.law.pace.edu/cases/030117a2.html; Court of Appeals (Finland), 26 October 2000 available at http://cisgw3.law.pace.edu/cases/001026f5.html; District Court Landshut (Germany), 5 April 1995, available at http://cisgw3.law.pace.edu/cases/950405g1.html. For commentary maintaining that Article 78 allows interest on any damage claim, see Klaus Bacher, *Article 78*, in Schlechtriem & Schwenzer, supra note 6, at 1052; for commentary expressing some doubts, see John O. Honnold, Uniform Law for International Sales Under the 1980 United Nations Convention 608 (Harry M. Flechtner ed., 4th ed. 2009) [hereinafter "Honnold/Flechtner"]; Francesca G. Mazzotta, CISG Article 78: Endless Disagreement Among Commentators, Much Less Among the Courts, available at

[62] See Commercial Court Zurich (Switzerland), 10 July 1996, available at http://cisgw3.law.pace.edu/cases/960710s1.html.

[63] See Court of Appeals Düsseldorf (Germany), 14 January 1994, available at http://cisgw3.law.pace.edu/cases/940114g1.html.

[64] See ICC Court of Arbitration–Paris, 7197 (1992), available at http://cisgw3.law.pace.edu/cases/927197i1.html.

[65] See Arbitral Tribunal (Austria), 15 June 1994, available at http://cisgw3.law.pace.edu/cases/940615a4.html.

[66] See e.g., District Court Gelderland (Netherlands), 30 July 2014, available at http://cisgw3.law.pace.edu/cases/140730n1.html (assigning the statutory interest rate in accordance with Dutch law).

[67] [illegible]

CISG's drafters to reach a consensus on a uniform rate.[68] Although some adjudicators find that the matter is addressed by the CISG's underlying principles, a significant majority of courts and arbitral tribunals deem the applicable interest rate to be outside the CISG's scope.[69] In their view, under Article 7(2) the rate is determined instead by the applicable national law selected by the forum's conflict of laws principles. There is much less agreement about the national law selected by these principles. Adjudicators have selected the law of the breaching party's place of business, the injured party's place of business, the place where payment was to be made, and the place of the forum.[70] Several courts even select the law of the injured party's place of business without relying on conflict of laws principles.[71] Given the uncertainty about the interest rate applicable under Article 78 in the case law, the parties do well to provide for one in their contract.

Article 78 says little about elements of calculations that will determine whether interest payments are fully compensatory. It says nothing about the date from which interest begins to accrue either on the contract price due or on any amount owing ("any other sum that is in arrears"). With respect to price, the date from which interest begins to run seems clear: the date on which the price is due. The date from which interest on other amounts due accrues, such as carriage costs or an insurance policy taken for the breaching party's benefit, is harder to determine. Where the amount due is damages,[72] different dates are plausible. Does interest on damages run from the date of the breach, the date the cause of action accrues (if different), the entry of a judgment, or some other point? An American appellate court faced

[68] See 11th Plenary Meeting, April 8, 1980, in Documentary History, supra note 23, at 761 (para. 3).

[69] See, e.g., *Chicago Prime Packers, Inc.* v. *Northam Trading Co.*, 320 F. Supp.2d 702, 716 (N.D.Ill. 2004); ICC Case No. 10274 (1999), available at http://cisgw3.law.pace.edu/cases/990274i1.html; Francesco G. Mazzotta, CISG Article 78: Endless Disagreement Among Commentators, Much Less Among the Courts, available at www.cisg.law.pace.edu/cisg/biblio/massotta78.html (appendices collecting cases from different national or arbitral fora as of 2004); 2012 UNCITRAL Digest of Case Law on the United Nations Convention on the International Sale of Goods 377 (at para. 13), available at http://uncitral.org/pdf/english/clout/CISG-digest-2012-e.pdf. For cases finding that the interest rate is within the CISG's scope, see, e.g., *Zapata Hermanos Sucesores, S.A.* v. *Hearthside Baking Co., Inc.*, 2001 U.S. Dist. LEXIS 15191 (N.D.Ill. August 28, 2001), *partially rev'd* 313 F.3d 385 (7th Cir. 2002); Arbitral Tribunal (Austria), 15 June 1994, available at http://cisgw3.law.pace.edu/cases/94061524.html.

[70] See 2012 UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods 377 nn. 46–50, available at http://uncitral.org/pdf/english/clout/CISG-digest-2012-e.pdf (collecting cases).

[71] See, e.g., Commercial Court Koophandel (Belgium), 20 September 2005, available at http://cisgw3.law.pace.edu/cases/050920b1.html; District Court Arbon (Switzerland), 9 December 1994, available at http://cisgw3.law.pace.edu/cases/94120981.html 1994; District Court Frankfurt (Germany), 16 September 1991, available at http://cisgw3.law.pace.edu/cases/910916g1.html.

[72] For the view that Article 78 covers interest on recoverable damages, see District Court Zug (Switzerland), 21 October 1999, available at http://cisgw3.law.pace.edu/cases/99102181.html; John Gotanda, *Article 78*, in Kroll et al., supra note 48, at 1044. For the distinction between

with the issue of whether prejudgment interest was governed by domestic law or the CISG concluded that it did not have to decide the question, because the trial court's award of such interest was permitted by each.[73] But in doing so, the court made the unfortunate leap that the CISG's status as a treaty permitted it to decide the issue as matter of domestic federal law rather than to discern an answer from within the CISG itself.

Finally, the CISG does not determine whether the interest that is payable is calculated as simple or compound interest. These gaps have led to conflicting decisions. For example, courts have concluded that compound interest is available if granted under domestic law,[74] unavailable under the CISG (with an analogy to domestic law),[75] and available if the claimant can prove that it had to make additional interest payments because of the other party's default.[76]

B. *Reduction of the price*

Article 50 allows the buyer a form of substitutional relief that has no counterpart in common law systems. It gives a money allowance by way of a reduction in the contract price owed the seller. Article 50's measurement of recovery is familiar in civil law systems.[77] The term "price reduction" suggests to a common lawyer an offset or counterclaim to the contract price, where the offset or counterclaim is in the amount of damages. This is its meaning under the UCC.[78] "Price reduction" has a different meaning under Article 50. The reduction in price is stated in terms of a proportion, rather than an amount that reflects the difference between the monetary value of expected performance and actual performance. Moreover, the CISG does not consider a reduction in price a form of damages. Articles 74 through 76 give damage measures, and these measurements differ from the measurement given by Article 50. In addition, the CISG throughout carefully distinguishes between damages and a reduction in price. For instance, Articles 45(1) makes available to the aggrieved buyer as alternatives damages under Articles 74–77 and

[73] See *ECEM European Chem. Mktg. B.V.* v. *Purolite Co.*, 451 Fed. Appx. 73 (3d Cir. 2011).

[74] See Commercial Court Versailles (France), 12 March 2010, available at www.cisg.fr/decision.html?lang=fr&date=10-03-12.

[75] See Court of Appeals Brandenburg(Germany), 18 November 2008, available at http://cisgw3.law.pace.edu/cases/081118g1.html.

[76] See Court of Appeals Antwerp (Belgium), 24 April 2006, available at http://cisgw3.law.pace.edu/cases/060424b1.html.

[77] See, e.g., Code civil [C. civ.] art. 1644 (Fr.); Burgerliches Gesetzbuch [BGB] [Civil Code] § 441 (3) (Ger.). For background, see Reinhard Zimmerman, The Law of Obligations: Roman Foundations of the Civilian Tradition 318, 327–29 (1990); A.M. Honore, *The History of the Aedilitian Actions from Roman to Roman-Dutch Law*, in Studies in the Roman Law of Sale 132 (David Daube ed., 1959). The place of the remedy in the CISG is described in Eric E. Bengston & Anthony J. Miller, *The Remedy of Price Reduction*, 27 Am. J. Comp. L. 275

a price reduction under Article 50.[79] For its part, Article 44 allows an aggrieved party who has a reasonable excuse for failing to give the requisite notice of breach to reduce the price or claim damages (except for lost profits). This choice among remedies reflects the difference between damages and a reduction in price.

Three consequences follow from Article 50's remedy not being a form of damages. First, because the CISG does not consider a reduction in price to be damages, limits on recoverable damages do not apply to Article 50's remedy. Article 77 states a mitigation requirement: The breaching party may "claim a reduction in the damages" to the extent the aggrieved party could have mitigated them. As price reduction under Article 50 is not "damages," a buyer relying on the Article is not subject to a mitigation requirement. Likewise, Article 74 limits the loss recoverable as damages to loss that the breaching party foresaw or could reasonably have foreseen at the conclusion of the contract as a result of the breach. Again, as Article 50's price reduction is not damages, its recovery is not restricted by a foreseeability limitation.

Second, restrictions on the occasions in which damages may be recovered do not apply to Article 50. In particular, Article 79's exemption from liability, when it applies, exempts the breaching party only from liability for damages. An aggrieved buyer can still reduce the price in accordance with Article 50. This is because, according to Article 79(5), "[n]othing in this article prevents either party from exercising any right other than to claim damages under this Convention." A buyer is prevented from claiming damages against a seller whose liability for nonperformance is exempted by Article 79. However, Article 79(5) expressly preserves the buyer's right to exercise its non-damages remedies, such as reducing the price in accordance with Article 50.

Third, recovery under Article 50 can be combined with a recovery of damages. Article 45(2) provides that the buyer is not deprived of a right to claim damages by exercising his right to other remedies. Consequential damages are recoverable by the buyer under Article 74, as loss resulting from breach. Although a price reduction is not damages, the buyer relying on Article 50 may also recover consequential damages (subject to Article 74's foreseeability limitation). Article 50's remedy therefore is cumulative with Article 74's damage remedy. Of course, the injured buyer cannot claim both damages and a price reduction for the same portion of loss, as this would result in a duplicative recovery. Thus, the buyer cannot rely on both remedies for loss representing a nonconformity in the goods. However, consequential damages are not recoverable directly under Article 50, because the Article's remedy reduces price based on the nonconformity in the goods, not on loss resulting from the nonconformity.[80] Consequential damages therefore compensate for loss not recoverable under Article 50. For this reason, a price reduction along with consequential damages is not duplicative.

[79] See Article 45(1)(a) ("exercise the right provided in Articles 46 to 52"), (b) ("claim damages as provided in Article 74 to 77").

[80] See Article 50 ("If the goods do not conform with the contract . . . the buyer may reduce the price in the same proportion as the value that the goods delivered had at the time of the delivery

1. Conditions of price reduction

Article 50 gives the buyer the right to reduce the price when the seller breaches by delivering nonconforming goods. The breach need not be fundamental under Article 25 and, even if fundamental, the buyer may choose to reduce the price rather than avoid the contract. If the buyer has already paid the contract price, Article 50 entitles him to recover the amount of the reduction in price.[81] As a prerequisite of any remedy, the buyer must give the seller timely and proper notice of breach.[82] The right to a price reduction is made subject to the seller's right to cure the nonconformity in the goods, according to the Article's second sentence ("the seller . . . remedies any failure to perform his obligations in accordance with article 37 or article 48 . . ."). Thus, the buyer loses the right to reduce the price if the seller either cures the nonconformity or the buyer refuses to allow the seller to do so.

According to the majority of commentators, the buyer must declare a reduction in price.[83] This requires the buyer to state its intention to reduce the price. Both German and Swiss courts have required a declaration as a condition of exercising the remedy, with the German court relying on commentary to this effect.[84] There is no basis in Article 50 for the requirement,[85] and no good reason to impose one.

[81] The buyers' right to restitution of the price paid derived from Article 50 itself, not Article 81. Article 81 allows restitution only in the case of avoidance. See Article 81(2) and "Section V: Effects of Avoidance." A buyer who reduces the price in accordance with Article 50 has not avoided the contract.

[82] See Article 39(1). Article 44 allows the buyer to reduce the price even when it has not given the requisite notice, if it has a reasonable excuse for not doing.

[83] See Huber & Mullis, supra note 27, at 250; Markus Muller-Chen, *Article* 50, in Schlechtriem & Schwenzer, supra note 6, at 772; Ivo Bach, *Article* 50, in Kröll et al., supra note 48, at 756; UNCITRAL Digest 243 (para. 6) (2012).

[84] See Court of Appeals Munich (Germany), 2 March 1994, available at http://cisgw3.law.pace.edu/cases/940302g1.html; Court of Appeals Geneva (Switzerland), 15 November 2002, available at http://cisgw3.law.pace.edu/cases/02111. The German court relied on Peter Huber, *Article* 50, in Commentary on the UN Convention on the International Sale of Goods (CISG) 439 (Peter Schlechtriem ed., 2d (English) ed. 1998).

[85] The available diplomatic history relevant to the matter is inconclusive. At one point the British delegate to the Vienna Conference proposed that the phrase "the buyer may declare the price to be reduced" in an earlier version of Article 50 be eliminated because it seemed too weak. "May," according to the delegate, suggested that the buyer's entitlement was conditional rather than a unilateral right. See First Committee Deliberations, 23rd Meeting, 26 March 1980, in Documentary History, supra note 23, at 580 (para. 56). In response the delegates agreed that Article 50 gave the buyer the unilateral right to declare the price reduced. Id. at 581 (para. 62). This response is ambiguous. The delegates could have agreed that the buyer had the unilateral right which it may, but need not, exercise by a declaration. Or the consensus could have been that the buyer had the unilateral right which is exercised by a declaration of a reduction in price. The only safe inference from the incident is that the delegates

The CISG is careful to require a declaration, as Articles 49(1) and 61(1) do with respect to avoidance of the contract. The absence of a similar condition from Article 50 suggests that the buyer can reduce the price without declaring in advance its intention to do so. As important, there is no purpose served by requiring a declaration. To rely on any remedy, the buyer must give the seller notice of the fact and basis of its breach.[86] This breach-related information puts the seller in a position to cure the nonconformity in the goods, if it chooses do so. The seller does not benefit from the buyer's declaration that it intends to reduce the price. It has all the information it needs to decide whether or not to cure. Rather than give a good reason for the demand of a declaration, the commentary and slight case law simply assert the requirement. Nonetheless, it is a good bet that developing case law will follow the German and Swiss courts.

A more difficult question concerns the meaning of "nonconformity in the goods." Article 50's remedy applies only if the goods do not conform to the contract. Clearly goods that do not fit the description, packaging, quality, or quantity required by the contract are nonconforming.[87] Equally clear, a delay in delivery or defects in documents required by the contract constitute defects in performance, not in the goods. The performance is defective, even if the goods conform to the contract. Accordingly, the buyer can reduce the price for goods that do not meet the standards required by the contract but not for delay in delivery or defective documents.[88] The difficult case involves delivery of goods with defective title or that are subject to claims by third parties. The seller's delivery breaches its obligations imposed by Article 41 or Article 42. Are goods with defective title or subject to competing claims nonconforming? Or does their delivery constitute another sort of defective performance?

The diplomatic history reveals that delegates were aware of the problem of characterizing the breach. Rather than resolve it, they decided to leave its resolution to courts.[89] To date no court has done so. Most commentators take the position that goods subject to third party claims are not goods that "do not conform to the contract."[90] They construe "conformity" narrowly, limiting its reference to matters the CISG refers to by the term. Articles 35 and 36 refer to the respects in which the goods must conform to the contract, while Article 41 and Article 42 deal with third parties' claims to or concerning the buyer's right to use the goods. The narrow construction of "conformity" has support in the CISG's Section titles. Section II to Chapter II, Part III's heading reads: "Conformity of the goods and third party

[86] See Article 39(1). [87] See Article 35(1).

[88] See District Court Düsseldorf (Germany), 5 March 1996, available at http://cisgw3.law.pace.edu/cases/960305g1.html (price reduction not available for late delivery).

[89] See Documentary History, supra note 23, at 582; Michael Will, *Reduction of Price*, in Bianca & Bonell, supra note 31, at 373 (para. 3.4).

[90] See, e.g., Markus Muller-Chen, *Article 50*, in Schlechtriem & Schwenzer, supra note 6, at 771;

claims." The heading recognizes the distinction between a breach of Articles 35 and 36 ("conformity") and a breach of Article 41 or Article 42 ("third party claims").

The predominant view of commentators has textual support. Articles 35 and 36 refer to "conformity," and it therefore seems reasonable to limit "conformity" to standards for the goods set by those Articles. By giving the term a narrow meaning, the CISG's drafters might have made price reduction available only when delivered goods do not conform under Articles 35 and 36. True, Article 50's remedy is unavailable in other instances of defective performance, even though the breach can be as serious as the delivery of nonconforming goods. But this arguably is a restriction on the remedy made by the CISG's drafters.

One consideration, however, does not support the predominant view: legal certainty.[91] Delivered goods subject to third party claims are nonconforming in a nontechnical but recognizable sense. They fail to meet a standard of quality as clearly as when the goods fail to satisfy the contract description, for instance. This failure is unlike late delivery or tender of defective documents covering the goods, which clearly do not make the goods nonconforming. Finally, this failure is just as easy (or difficult) to verify as other standards with respect to the goods. For these reasons, legal certainty is not jeopardized by allowing third party claims to the goods to count as a "nonconformity" for purposes of Article 50's remedy.

2. Calculation of price reduction

Article 50 allows the buyer to reduce the contract price in the same proportion that the value of the nonconforming goods on the date of the delivery bears to the value that the goods would have had on the same date if they conformed to the contract. The proportional reduction in price allows the calculation of the reduced price the buyer owes. A simple formula calculates the reduced price directly, as follows:

Reduced price/Contract price = Value of the nonconforming goods delivered/Value of conforming goods

Rearranging terms:

Reduced price = Value of nonconforming goods delivered/Value of conforming goods x Contract price

Article 50's remedy is stated in terms of the proportion by which the contract price may be reduced. This last formula calculates the reduced price the buyer owes. The difference between the contract price and the reduced price is the amount by which the buyer may reduce the contract price under Article 50.

An example may clarify the application of the formula. Assume that the seller and buyer agree to a sale of goods at a contract price of $60. At the time of delivery, the market price of the goods has decreased, so that conforming goods would only be

worth $40. The seller delivers goods that are nonconforming. As a result, at the time of delivery, they are only worth $30. Thus, they are worth only $30/$40, or ¾ of what they would have been worth had they been conforming. Assume the buyer needs the goods even in their defective state and therefore does not avoid the contract even though the nonconformity amounts to a fundamental breach. The buyer does not have to pay the full contract price or pay the contract price less damages for breach. Instead, it may invoke Article 50 to pay that part of the contract price that represents the fractional value of the goods relative to what they would have had if the delivery had conformed to the contract. Since that fractional value here is ¾, the buyer need only pay ¾ of the contract price or ¾ of $60, or $45. Thus, the buyer may reduce the price by $15.

To calculate the price reduced under Article 50, the date at which delivery occurs must be determined. Article 31 states the seller's obligations of delivery, and presumably the delivery occurs when the seller fulfills its obligations.[92] Under Article 31(a), when the sales contract involves carriage, the seller completes its delivery obligation when it hands the goods over to the first carrier for transmission to the buyer. In this case, therefore, delivery occurs before the buyer takes possession of the goods. Under Articles 31(b) and (c), when the sales contract does not involve carriage, the seller fulfills its delivery obligation when it places the goods at the buyer's disposal. Delivery here too can and usually will occur before the buyer takes possession of the goods.

3. Price reduction to zero: worthless goods

Assume that the seller delivers nonconforming goods that have no value at all. Courts that have considered the question have allowed the buyer to whom worthless goods have been delivered to reduce the price to zero.[93] Presumably, use of the price reduction formula would be unnecessary in such a case. The buyer could achieve the same result by simply avoiding the contract. A seller who has delivered worthless goods fundamentally breaches the contract in all but the most atypical cases. As a result, the buyer can avoid the contract, which relieves the buyer of the obligation to pay the contract price.

Given the relative ease of avoidance, the use of Article 50 in a "zero value" case suggests that the buyer is invoking the remedy because it has failed to comply with the requirements of avoidance. This may be, for example, because the buyer failed

[92] See Ivo Bach, in Kröll et al, supra note 48, at 760–61 for a summary of different points of delivery advocated by scholars.

[93] See, e.g., Federal Court (Australia) (*Castel Electronics Pty. Ltd.* v. *Toshiba Singapore Pte. Ltd.*), 28 September 2010, available at http://cisgw3.law.pace.edu/cases/100928a2.html; Federal Supreme Court (Germany), 2 March 2005, available at http://cisgw3.law.pace.edu/cases/050302g1.html; Supreme Court (Austria), 23 May 2005, available at http://cisgw3.law.pace.edu/

to give timely notice and is barred from avoiding the contract under Article 49(2). Some scholars are bothered by this result. They believe that allowing the buyer to reduce the price to zero permits an aggrieved party to circumvent the requirements of avoidance.[94] For instance, a buyer who fails to provide a timely notice of avoidance may be precluded from avoiding the contract and thus from recovering damages under Article 75 or 76. But that same buyer would, under the more liberal view of Article 50, still be entitled to pay a reduced price under Article 50. Nevertheless, the antipathy of some commentators to this result does not have much going for it. To begin with, Article 50's language does not limit the remedy to the delivery of nonconforming goods having some value. Its stated formula refers to the "value" of nonconforming goods, which can be zero. Article 50's terms aside, the limitation produces an arbitrary result without good reason. Suppose goods with a contract price of $100 are delivered at the time the market price of conforming goods remains at $100. Suppose too that Article 50's remedy applies only when nonconforming goods delivered have some value. If the nonconforming goods have a market value of 1 cent, the reduced price is 1 cent (1 cent/$100 x $100 = 1 cent), so that the buyer can reduce the $100 contract price by $99.99. However, if the nonconforming goods have no value, the buyer cannot reduce the price at all. The difference between nonconforming goods having no value and their having a value of one cent is negligible. The buyer is harmed in both cases. It is arbitrary to allow price reduction in the "some value" case but not in the "zero value" case. Allowing price reduction only in the former case introduces a discontinuity in remedy without justification. There is no good reason to deny the buyer in the zero value case the right to reduce the $100 contract price by $100, so that the reduced price is zero.

Finally, the charge that reliance on Article 50 in a zero value case "circumvents" the CISG's requirements for avoidance begs the question. The buyer circumvents these requirements only if the CISG does not allow the buyer access to Article 50. Avoidance requires the buyer to give notice of avoidance within a reasonable time.[95] Although Article 50 does not state a time limit within which the buyer must exercise its right to reduce the price, the right arguably must be exercised within a reasonable time too. However, the two periods need not be the same. Thus, it is possible that the buyer is too late to avoid the contract while not too late to timely exercise its right to reduce the price. Article 45's index of remedies suggests that Article 50's remedy is an alternative to avoidance. The different time periods for avoidance and the exercise of price reduction plausibly correspond to these alternatives. An argument therefore is needed to show that the appearance is deceptive and that Article 50's remedy is unavailable in zero value cases. The argument will be hard to make. If avoidance somehow displaces the

remedy of price reduction in a zero value case, the same likely is true in an "almost zero value" case. Put another way, if allowing price reduction in a zero value case circumvents the requirements for avoidance, the same is true in an "almost zero value" case.

To be sure, avoidance and price reduction give nominally different results in a zero value case. If the buyer avoids the contract, Article 81(1) requires it to return the goods. If the buyer reduces the price, it retains them. However, this difference in outcome is unimportant because in a zero value case the goods are worthless. Neither party therefore can benefit from the goods, so that it does not matter who ultimately retains them. Thus, even if price reduction allows the buyer to circumvent avoidance in a zero value case, the possibility is harmless.

4. Damages versus price reduction

Article 74's damage measure calculates the loss to the aggrieved buyer who has retained the goods as the difference between the value of the conforming goods and the value of the nonconforming goods. The measure is sometimes described as "linear": damages are equal to loss from breach, so that damages increase directly with loss. By contrast, Article 50's reduction in price is a "proportional" measure. It reduces the contract price by the proportion of the value of the nonconforming goods delivered to value of hypothetical conforming goods to the contract price. Because the value of goods may deviate from the contract price, Article 50 may reduce the price by a different amount than a damage measure.

When would an aggrieved buyer prefer to reduce the price under Article 50 rather than recover damages? As Article 50's formula suggests, the desirability of price reduction depends on the value of the goods as compared to the contract price. Measuring value by market price, three cases are possible: (1) the market price remains stable and equal to the contract price, (2) the market price increases above the contract price, and (3) the market price declines below the contract price.

(1) *Stable market price.* When the market price at the time of delivery remains equal to the contract price, Article 50 gives the same recovery as damages under Article 74. For example, if the contract price is $100, the market price of conforming goods at the time of delivery remains $100 and the value of nonconforming delivered goods is $95, Article 74 gives $5 in damages ($100 - $95 = $5). Article 50 reduces the contract price by $5, so that the reduced price the buyer must pay also calculates to $95 ($95/$100 x $100 = $95).

(2) *Increased market price.* When the market price at the time of delivery has increased above the contract price, Article 74 gives a higher recovery in damages than Article 50's remedy. Assume again that the contract price is $100, but now assume that the market price of conforming goods on delivery increases to $105 and the market price of the nonconforming goods delivered is $100. Now, damages under Article 74 again would be $10 ($105 value as expected - $100 value as delivered = $5). The aggrieved buyer would pay the contract price of $100, less Article 74 damages of $5 for a net price of $95. However, Article 50 reduces the contract price by only $4.77, so that the reduced price the buyer must pay is $95.23 ($100/$105 x $100 = $95.23). As a result, the buyer in the increasing market will choose Article 74 over Article 50.

(3) *Decline in market price.* When the market price of the goods at the time of delivery has declined below the contract price, the buyer's remedy under Article 50 is greater than the amount of recoverable damages under Article 74.[96] Assume again that the contract price is $100, but that the market price of conforming goods on delivery is $95 while the market price of the nonconforming goods delivered is $90. The buyer's damages under Article 74 are $5 ($95 - $90 = $5). It would be required to pay the contract price of $100, but is entitled to Article 74 damages of $5 for a net price of $95. By comparison, Article 50 allows the buyer to pay a reduced price of $94.73 ($90/$95 x $100 = $94.73) for the nonconforming goods. Accordingly, while Article 74 allows the buyer to deduct $5 in damages from the $100 contract price, Article 50 allows it to reduce the contract price by $5.27 ($100 - $94.73 = $5.27) – a greater amount.

Article 50 does not measure the buyer's expectation interest in either case (2) or case (3). In case (3) the buyer of course would most prefer to get out of the contract, because the market price is below contract price. By keeping the contract in place and reducing the price according to Article 50, the buyer still pays $94.73 for goods worth $90. The buyer is better off avoiding the contract and purchasing conforming goods at the now-prevailing market price of $95 (or nonconforming goods at the now-prevailing price of $90). Avoidance allows the buyer to shift back to the seller the risk of the decline in market price. However, the buyer will not always be able to avoid the contract or want to do so. Avoidance is not possible if the nonconformity is not serious enough to constitute a fundamental breach. Even if the breach is fundamental, the buyer may fail effectively to declare the contract avoided. Finally, the buyer might need the goods immediately even if they are substantially nonconforming Rather than avoiding the contract and having to return the goods,[97] it will want to retain them and rely on a non-avoidance-based remedy. In these instances, the buyer will prefer to reduce the price in accordance with Article 50 rather than obtain damages.

[96] A decline in market price is not necessary for Article 50 to give a greater recovery than damages. The same result follows if market price remains constant but the contract price is above it.

[97] See Article 81(1).

5. Evaluation

It is worth asking whether the remedy of price reduction is defensible. Although the remedy has long been available in civil law systems, we are dubious about its justification. A reduction in price does not always protect the buyer's expectation interest. Where the market price on delivery and the contract price are equal, Article 50's measure gives the same recovery as damages under Article 74. These damages assure the buyer its expectation. However, where market price goes above the contract price, Article 50 gives the buyer less than its expectation. For instance, in the example where the market price of conforming goods on delivery increases to $105, the contract price is $100 and the value of the nonconforming goods on delivery is $100, Article 50 reduces the price by $4.77, so that the buyer pays $95.23. The buyer's recoverable damage under Article 74 is $5, so that it pays $95 ($100 - $5) for nonconforming goods with a market value of $100. And where the market price on delivery declines below the contract price, as when the market price declines to $95, contract price is $100, and the value of the nonconforming goods is $90, Article 50 reduces the price by $5.27, while the buyer's damages under Article 74 are $5.00. Price reduction in this case therefore awards the buyer more than its expectation. In this way the remedy gives the seller an inefficient incentive to breach or perform. Where the reduction in price awards the buyer less than its expectation, the seller is encouraged to inefficiently breach the sales contract; where the remedy awards the buyer more than more its expectation, the remedy encourages the seller to inefficiently perform the contract.

Article 50's measure might be defended as a way of allocating the risk of fluctuations in market price ex post. The measure forces the buyer to share part of the risk of an increase in market price and the seller to share part of the risk of a market decline. This defense based on risk sharing is unconvincing. For one thing, the way in which Article 50 shares risk seems arbitrary. In the case of the above-market price increase, the seller obtains 4.6 percent of the market increase ($ .23 divided by $5 = 4.6 percent). However, the seller bears 5.4 percent of the market decrease in the case of the market decline above ($.27 divided by $5 = 5.4 percent). The asymmetric character of the sharing of gains and losses appears ad hoc.

In addition, the seller does not share any of the benefit of an increase in the market price of the goods. This is because Article 50 does not operate alone. The buyer also has the option of electing to recover damages. It will do so when damages give a greater recovery than is provided by Article 50's reduction in price. Article 45 (2) allows the buyer to recover damages rather than rely on Article 50's remedy. Thus, in the case of the example of a market price increase, damages give the buyer the entire $5 increase in market price. The seller does not get a share of the increase. When the buyer's other available remedies are taken into account, the risk sharing

Finally, and most important, a fixed contract price allocates the risk of market price fluctuations: The seller bears the cost of market price increases and the buyer bears the cost of declines in price. It is unclear what therefore justifies Article 50's reallocation of risks already allocated by a fixed contract price. Because there is no reason to believe that most parties prefer to reallocate market risk ex post, reallocation is not a majoritarian default. If atypical parties want to shift the risk of changes in market price, their contract easily can provide for a different price term. In any case, Article 79 insulates the buyer from liability when its performance is exempted. The exemption, when it applies, already reallocates the risk of intervening events on contract performance. There is no justification for a further ex post reallocation of the risk of changes in market price when the buyer's performance is not exempted from liability.

Sometimes it is said that Article 50's reduction in price is a restitutionary measure. Restitution is noncontractual in nature. The measure's purpose is to eliminate the amount by which the breaching seller has been enriched by delivering nonconforming goods.[98] If so, a reduction in price does not achieve this restitutionary aim. This is because in a market decline Article 50 gives the buyer more than the seller benefitted by its breach. In the earlier example, the seller gained $5 by delivering nonconforming goods: the difference between the $95 market price for conforming goods on delivery and the $90 market price for the nonconforming goods. However, Article 50 allows the buyer to reduce the price by $5.27– $.27 more than the seller was enriched by its breach. The measure therefore, at best, only approximates a restitutionary measure.

C. *Specific relief*

The CISG gives the aggrieved party a right to require performance of the contract. Article 46(1) provides that "[t]he buyer may require performance by the seller of his obligations, unless [it] has resorted to a remedy which is inconsistent with this requirement." Article 62 gives the seller the same right to the buyer's performance of the contract. It provides that the seller may require the buyer to pay the contract price, unless the seller has resorted to a remedy inconsistent with this requirement.

In several respects the right to specific relief is broad. The relief is available at the request of the aggrieved party. Subject to the Article 28 proviso that we discuss later, a tribunal to which the request is directed does not have the discretion to refuse specific relief and award damages instead. Articles 46(1) and 62 give the aggrieved party the right to compel the breaching party to perform its obligations ("his obligations"). The breaching party therefore can be required to perform all of its obligations under the contract, not just obligations of delivery or payment. For example, Article 62 entitles the seller to compel the buyer to have established a

[98] See, e.g., Gunter H. Treitel, Remedies for Breach of Contract: A

letter of credit naming the seller as beneficiary, as required by the contract.[99] Article 46(3) even entitles the injured buyer to require the seller to repair nonconforming goods, unless repair is unreasonable in the circumstances.

Finally, Articles 46(1) and 62 impose only one restriction on specific relief: The aggrieved party cannot have already resorted to a remedy inconsistent with obtaining the relief. The operative terms in the restriction are "resorted" and "inconsistent." Avoidance of the contract is inconsistent with specific relief, because avoidance ends the contract while specific relief enforces it. Likewise, a buyer who has reduced the price under Article 50 is compensated for the seller's breach. Specific performance would force the seller to perform an obligation, even though it already has compensated the buyer for the failure to perform. On the other hand, an injured buyer who has not acted to avoid the contract or reduce the price has not "resorted" to a remedy at all. Accordingly, Article 46(1) does not prevent the buyer from requesting specific performance as an alternative to avoidance or a price reduction. Damages can compensate the injured party for loss from breach even when the breaching party is later forced to perform its contractual obligations. A request for damages therefore is consistent with a request for specific relief.[100] Damages can be sought either as an alternative to specific relief or in addition to it. Of course, a party who already has recovered damages for loss from breach cannot obtain specific relief to avoid the loss.

It is worth noticing a requirement that does *not* apply to specific relief: mitigation. Although Article 77 requires the injured party to mitigate its loss, the requirement by its own terms applies only to "damages." Accordingly, if the injured party fails to take reasonable measures to reduce its loss from breach, Article 77 entitles the breaching party to "claim a reduction in the damages . . ." Because specific relief under Articles 46(1) and 62 does not constitute "damages," Article 77's mitigation requirement does not apply to it. The inapplicability of mitigation to specific relief is not an oversight. Article 45 and 61's respective lists of remedies both carefully distinguish between "damages" and "rights." The latter include the right to specific relief given by Articles 46 and 62. Applying a mitigation requirement to specific relief ignores the CISG's articulated divide between substitutional relief ("damages") and non-substitutional relief ("rights"), which includes specific relief. Both the relevant diplomatic history and commentary support the inapplicability of mitigation to specific relief.[101]

[99] See ICC Case No. 7197 (1992), available at www.cisg.law.pace.edu/cases/927197i1.html.

[100] See ICC Case No. 12173 (2004) (para. 53), available at http://cisgw3.law.pace.edu/cases/04121731.html; Secretariat Commentary on the 1978 Draft, in Documentary History, supra note 23, at 426 (paras. 4, 6).

[101] See Steven Walt, *For Specific Performance Under the United Nations Sales Convention*, 16 Texas Int'l L. J. 211, 227–28 (1991); cf. Honnold/Flechtner, supra note 61, at 598 (applying the mitigation requirement to specific performance as not making a "serious inroad" to the rule

1. Article 28's limitation on specific relief

The CISG makes specific relief generally available to the injured party. This reflects its routine availability in civil law systems, at least as a matter of formal law.[102] By contrast, common law systems and UCC § 2–709 and § 2–716 treat specific relief as an exceptional remedy.[103] The remedy is awarded in the discretion of the court only when damages are inadequate to compensate for the injured party's loss, perhaps because the unique nature of the goods or a thin market for cover renders damages difficult to ascertain. The difference in the approaches to specific relief among legal systems reflects in part differences in judgment about the nature of contractual obligation. Some legal systems implicitly view the contractual obligation of performance as sufficiently sacrosanct as to permit its enforcement, even against an unwilling trading partner. Hence, the maxim *pacta sunt servanda*. Other legal systems reject the notion that unwilling parties should be judicially coerced to perform if they are willing to compensate the injured actors, or construe the "promise" as one to perform or to pay, rather than only to perform.

The division among legal systems with respect to specific performance also implicitly reflects the degree of concern about the effect of the remedy on efficient breach. Requiring a party specifically to perform discourages breaches that may be socially desirable. If a breaching seller, for example, is willing fully to compensate the aggrieved buyer for its losses, including any lost profits, reputational injury from losing downstream contracts, or any other losses imaginable, then presumably the seller is breaching because it can provide the same goods to an alternative buyer who is willing to pay an amount that allows the seller to compensate the first buyer fully and still profit from fulfilling the second contract. That scenario suggests a social gain if the seller fulfills the second contract, not the first. Under these circumstances, it is unclear why we would want to require the seller to perform the first contract. One might contend that the second buyer should be required to obtain the goods from the first buyer or from alternative seller. But if the second buyer is offering an idiosyncratically high price to the seller, presumably each of those alternative avenues would require it to incur additional transaction costs. If the first buyer is in a better position than the breaching seller or the second buyer to enter into a replacement for the breached contract, then costs are saved by denying specific performance and granting compensatory damages. That result places the first buyer in the same position as performance after it enters the cover contract that it is best situated to conclude.

[102] See, e.g., Burgerliches Gesetzbuch [BGB] [Civil Code] § 241 (Ger.); Code civil [C.c.] art. 1142 (Fr.); Schweizerisches Obligationenrecht [OR] [Code of Obligations] art. 97 (Switz.); Codigo Civil [C.C.] art. 475 (Braz.).

[103] For the discrepancy between doctrine and

For example, a buyer of mass produced goods may readily enter into a cover contract for fungible goods if the original seller fails to perform. Requiring the seller either to perform or to find another seller of the same goods may simply impose additional costs that could be avoided by an award of damages. Some legal systems, particularly common law systems, appear to take this view and award specific performance only where the aggrieved party is poorly positioned to enter a replacement contract. A contract for unique goods is the standard example of a contract in which the aggrieved party cannot easily enter a replacement contract. Other legal systems, particularly civil law systems, take a different view. They allow more liberal use of specific performance, perhaps based on the belief that promises should be performed and that damages are not an appropriate substitute for promise-keeping.

That is not to say, however, that an award of specific performance necessarily produces an inefficient result. Damages can induce inefficient breach if the loss from breach is measured inaccurately, so that the injured party is undercompensated. In this case a party might breach even when performance yields greater gains than breach. Whether specific relief or damages is the preferred default remedy depends on whether the risk of inefficient performance is greater than the risk of inefficient breach. This ultimately is an empirical matter. There is almost no relevant data collected to decide the question.[104]

As a compromise between civil and common law approaches to specific relief, Article 28 limits its availability under the CISG. The Article provides:

> If, in accordance with the provisions of this Convention, one party is entitled to require performance of any obligation by the other party, a court is not bound to enter a judgment for specific performance unless the court would do so under its own law in respect of similar contracts of sale not governed by this Convention.

The limitation stated in the Article is that the forum court is not required to order specific relief, unless it would order the relief in like contracts governed by its own law. To apply Article 28's limitation on specific relief, the forum court must ask two questions. First, is the specific relief sought by the party available under the CISG? Second, if the relief is available, would the court order it for like contracts ("similar contracts") otherwise governed by its own law? If affirmative answers are given to both questions, the forum court must order specific relief. Otherwise, Article 28 permits, but does not require, the court to refuse.

The English language version of Article 28 refers only to "specific performance." Specific performance is the buyer's right to obtain performance from the seller. The

[104] For an event study measuring the effects of specific relief on share price, see Yair Listokin, *The Empirical Case for Specific Performance: Evidence from the IBP-Tyson Litigation*, 2 J. Emp. Legal Stud. 469 (2005); for experimental evidence on the effect of specific relief as a default remedy, see Ben Depoorter & Stephan Tontrup, *How the Law Frames Moral Intuitions: The*

Article does not refer to "specific relief," which includes the seller's right to the buyer's performance, such as paying the contract price. Nonetheless, there is no reason to think that the phrase limits only the buyer's right to obtain performance from the seller.[105] Such a limitation is arbitrary, because there is no principled reason why Article 28 would limit only one sort of specific relief. After all, the Article responds to the concerns of delegates from common law systems who opposed the free availability of all types of specific relief under the CISG.[106] The few tribunals that have mentioned the Article appear to believe that it applies to the seller's right to obtain performance from the buyer as well.[107]

The phrases, "its [i.e., the court's] own law" and "similar contracts of sale not governed by this Convention," are a bit opaque. "Its own law" likely refers to the substantive domestic law of the judicial forum. Not only do other interpretations strain the plausible meaning of the phrase. They also frustrate the purpose served by Article 28: to allow the forum court not to order specific performance when doing so would not be required under its own domestic law with respect to a like contract. For instance, suppose that "its own law" refers to the law selected by the forum court's conflict of laws rules applicable to sales contracts not governed by the CISG. Because the law selected varies depending on the particular sales contract and the circumstances of the transaction, "its own law" is indeterminate in reference. The phrase might pick out the law of a civil law system that makes specific relief routinely available or the law of a common law system which restricts its availability. Unless "its own law" refers to the substantive domestic law of the judicial forum, Article 28's limitation cannot guarantee that a common law court will not have to order specific relief when it would not do so under its own domestic law. The few courts that have applied Article 28 understand the phrase to refer to the judicial forum's substantive domestic law.[108]

"Similar contracts of sale not governed by this Convention" is harder to interpret. The phrase is ambiguous, giving different possible results. "Similar contracts of sale" might refer to contracts for the sale of goods governed by the forum court's substantive domestic law. Specific aspects of these sales contracts, or the circumstances in which they are concluded, need not be "similar" to the sales contracts governed by the CISG. For instance, suppose the forum court's substantive domestic sales law is Article 2 of the UCC. Article 2 governs a range of sales of goods contracts, some of

[105] For the suggestion that it might, see E. Allan Farnsworth, *Specific Relief and Damages*, 27 Am. J. Comp. L. 247, 249 (1979). Farnsworth does not explain why Article 28's drafters might have intended to limit its application to specific performance.

[106] See First Committee Deliberation, 19 March 1980, in Documentary History, supra note 23, at 525–26 (paras. 43–44).

[107] See Commercial Court Bern (Switzerland), 22 December 2004, available at http://cisgw3.law.pace.edu/cases/041222s1.html.

[108] See, e.g., Commercial Court Bern (Switzerland), 22 December 2004, available at http://cisgw3

which do not have features similar to sales contracts governed by the CISG. Specific relief with respect to these contracts might not be permitted by UCC § 2–716(1) or § 2–709(1)(a). Alternatively, "similar contracts of sale" might refer to sale of goods contracts governed by the forum's substantive domestic law that share specific aspects of sales contracts governed by the CISG. Such aspects might include sales of goods with few close local substitutes and high transportation costs. The lack of close substitutes or the presence of high transportation costs makes cover or resale difficult. Given these facts, UCC § 2–716(1) or § 2–709(1)(a) might require specific relief (if requested) in the circumstances. To date no tribunal has focused on the ambiguity in the phrase "similar contracts of sale not governed by this Convention."

Magellan International Corp. v. *Salzgitter Handel GmbH*[109] illustrates Article 28's application. There, an American buyer ordered steel bars according to its specifications from a German seller. When the parties disputed the terms of the contract and the seller refused to deliver, the buyer sued in an Illinois federal district court asking for specific performance of the contract. The seller moved to dismiss for failure to state a claim. The court denied the motion. It noted that the forum court's own law is § 2–716(1) of the UCC. Under § 2–716(1) a court may order specific performance if the goods are unique or "in other proper circumstances." Official Comment 1 to § 2–716 states that the inability to cover is "strong evidence" of "other proper circumstances." Relying on the Comment, the court concluded that the buyer had sufficiently pled its complaint for specific performance.[110]

The procedural posture of the case limits the lessons that can be drawn from the *Magellan* court's application of Article 28. The court was considering the Article only in connection with a motion to dismiss the complaint. Thus, it did not have to decide whether the buyer in fact was unable to obtain from other suppliers the specially manufactured steel bars it had ordered from the seller. The court only had to determine whether the buyer had alleged facts which, if true, entitled it to specific performance: "Given the centrality of the replaceability issue in determining the availability of specific relief under the UCC, a pleader need allege only the difficulty of cover to state a claim under that section [§ 2–716(1)]. Magellan [the buyer] did that."[111] The case therefore does not stand for the proposition that specific performance is routinely available in American courts to enforce contracts governed by the CISG. A more straightforward application of Article 28 is provided by a Swiss case.[112] Swiss law gives the seller the unqualified right to recover the contract price from the buyer. Relying on this law, the Swiss court concluded that Article 28's restriction "can be disregarded in the case at hand." It awarded the seller the price under Article 62.

One plausible effect of the compromise struck by the interaction of Articles 28, 46 (1), and 62 is to generate a race to the courthouse or forum shopping to enforce

[110] Id. at 926. [111] Id. at 926.

contracts without forum selection clauses. Assume that an American buyer and a German seller are in a dispute concerning a breach of a contract for the sale of goods governed by the CISG. If the German seller desires to avoid a decree of specific performance, it might rush to file a lawsuit in the United States before the American buyer is able to file a lawsuit in Germany, on the theory that American law is more restrictive on the issue than German courts. One can also imagine the opposite preference operating: The buyer, anticipating the seller's breach, might file suit in Germany seeking to order the seller to deliver according to the contract. The contractual response to this prospect is to include a forum selection clause and a governing law clause in the sales agreement to prevent forum shopping for a remedy. Parties will select a forum selection clause, taking into account the effect of specific relief on the cost of performance and therefore on the contract price. Specific relief increases the cost of performance because it allows the aggrieved party to require performance even when the gains from breach exceed that party's loss. At the same time, the remedy avoids the risk that a damage award undercompensates the aggrieved party for its loss from breach. If the parties value specific relief by an amount more than the increase in the contract price associated with the remedy, the contract will contain forum selection clause designating a forum that makes specific relief routinely available. If they value specific relief by an amount less than this increase in the contract price, the forum selection clause will designate a forum that makes specific relief available only as an extraordinary remedy or not at all.

2. Specific relief in arbitration

Article 28's limitation does not apply to arbitration. According to the Article, "a court" is not required to order specific performance if its own law would not require it do so with respect to like contracts not governed by the CISG. Arbitral tribunals are not courts. Thus, Article 28 does not restrict the availability of specific relief in arbitration. The only limits on the relief imposed by the CISG are those stated in Articles 46(1) and 62. This reflects the predominant preference of parties to international sales contracts for arbitration. In addition, few disappointed buyers seek specific performance, and relatively few sellers pursue an action for the price.[113] Most injured parties do better making other arrangements and recovering damages from the breaching party. Given the frequency of arbitration under the CISG and

[113] See Alan Schwartz, *The Myth that Promisees Prefer Supercompensatory Remedies: An Analysis of Contracted for Damage Measures*, 100 Yale L. J. 468, 488 (1990); for the sparse use of specific performance even when the remedy is available by right, see Heinrik Lando & Caspar Rose, *On the Enforcement of Specific Performance in Civil Law Countries*, 24 Int'l Rev. L. & Econ. 473 (2004); Treitel, supra note 96, at Remedies for Breach of Contract: A Comparative Account 53. For the same observation with respect to arbitral awards, see Sigvard Jarvin, *Non-Pecuniary Remedies: The Practices of Declaratory Relief and Specific Performance in International Com-*

infrequency of actions for specific relief, the dearth of decisions applying Article 28 is unsurprising. UNCITRAL cites six court cases that discuss Article 28 in its 2012 Digest of CISG case law. By comparison, the 2012 Digest cites thirty-one cases that discuss Article 46 and 132 cases that discuss Article 62.

Arbitral tribunals occasionally (but without being required to) invoke Article 28. The arbitral tribunal in *ICC Case 12173* had to decide whether a liquidated damages clause and a clause calling for specific performance in a contract were mutually exclusive remedies.[114] In determining that the buyer could rely on both remedies, the tribunal mentioned but did not rely on Article 28. Similarly, a 2006 Russian arbitral tribunal denied the buyer's request for specific performance.[115] In reaching its conclusion that the seller was not obligated to deliver when the buyer failed to pay on an unrelated contract, the tribunal found that its result "corresponds with" Article 28. Apparently the arbitral tribunal determined that a Russian court would not be required to order specific performance in a similar contract governed by Russian domestic law. Article 28 is an irrelevant legal limitation in both arbitrations, because the tribunals are not courts. The invocation of the Article therefore is dictum.

Rules outside the CISG do not limit the authority of arbitrators to order specific relief. The rules of arbitral institutions rarely deal with the remedies an arbitral award may provide.[116] The prevailing view is that arbitrators may award specific relief if the remedy is within the scope of the arbitration agreement and not prohibited by applicable law. Awards issued in arbitrations conducted under the major arbitral institutions have included specific relief.[117] For instance, *ICC Case 7453* included an award of specific performance when the arbitration agreement called for all disputes arising in connection with the contract to be "finally settled" by the arbitrator.[118] In *ICC Case 7197*, a sales contract governed by the CISG called for the buyer to have established a letter of credit.[119] The buyer failed to do so. Noting that Article 62 gave the seller the right to require the buyer to perform its contractual obligations, the arbitral tribunal's award ordered the buyer to establish the letter of

[114] See ICC Arbitration Case No. 12173 (2004), available at http://cisgw3.law.pace.edu/cases/041217311.html.

[115] See Tribunal of International Commercial Arbitration (Russia), 30 June 2006, available at http://cisgw3.law.pace.edu/cases/060630r1.html.

[116] An exception is the American Arbitration Association Commercial Arbitration Rule 43(a), which expressly allows for specific performance; cf. 1996 English Arbitration Act § 48(5)(b) (arbitrator has power to order specific performance of a contract other than a contract relating to land); Ontario Arbitration Act § 31 (1991) (power to order specific relief).

[117] See Performance as a Remedy: Non-Monetary Relief in International Arbitration (Michael E. Schneider & Joachim Kröll eds., 2011) (case studies of awards under major arbitral institutions); cf. 2 Gary B. Born, International Commercial Arbitration 2480 (2009) (courts routinely uphold arbitral awards of specific performance).

[118] See ICC Case No. 7453 (1994), Collection of ICC Awards: 1996–2000 109 (Jean-Jacques Arnaldez, Yves Derains & Dominique Hascher eds., 2003).

credit provided in the contract. The tribunal (properly) did not mention Article 28's limitation on specific relief.

Unsurprisingly, arbitral tribunals will not order specific relief if the remedy is impractical or impossible to enforce. A Zurich Chamber of Commerce arbitral award refusing specific performance relies on the constraint of practicality.[120] The arbitration involved the Russian seller's failure to deliver under a series of long-term contracts for the sale of aluminum governed by the CISG. The arbitral tribunal gave two reasons for refusing the buyers' request that the seller be required to deliver shipments under the contracts. One was that the CISG does not provide for specific performance in the circumstances. This is clearly mistaken; Article 46(1) provides for the relief. The tribunal's second reason was that specific performance is an impractical remedy even if the CISG provides for it: The buyers cannot expect "to have an award enforced in Russia providing the [seller] must specifically perform its obligations under the various contracts for the next eight to ten years . . ."[121] The difficulty of supervising long-term contracts, not Article 28's limitation, restricts the availability of an award of specific performance.

II. AVOIDANCE-BASED REMEDIES

If the injured party can avoid the contract and chooses to do so, it can recover damages. The CISG allows the injured party to choose among three options for measuring damages. It can recover damages for its loss from breach under Article 74. Alternatively, it can obtain substitute performance and recover damages under Article 75. Substitute performance for the buyer is the purchase of replacement goods, and for the seller the resale of the breached goods. The injured party's third option is to forgo substitute performance and recover damages under Article 76 measured by the market price ("current price") of the contract goods. Article 74 gives the injured party damages equal to its foreseeable loss. Article 75 gives damages equal to the difference between the contract price and the price of the substitute transaction. Article 76 gives damages equal to the difference between the contract price and the "current" price of the goods. Articles 75 and 76's damages measures have close counterparts under some domestic sales laws. Article 75 corresponds to a cover measure of damages, and Article 76 to a "market price" measure.[122]

[120] See Zurich Chamber of Commerce (Switzerland), 31 May 1996, available at http://cisgw3.law.pace.edu/cases/960531s1.html.

[121] For another instance of the constraint of practicality, see ICC Case 8032 (1995), 21 Yr. Bk. Comm. Arb. 113 (A.J. van der Berg ed., 1996) (specific performance rejected because practically impossible to enforce); see also Jarvin, supra note 106, at 180–81.

[122] See, e.g., §§ U.C.C. 2–712, 2–713; Nieuw Burgerlijk Wetboek [NBW] arts. 7.36, 7.37 (Nether.); Burgerliches Gesetzburch [BGB] [Civil Code] §§ 249, 252, Handelgesetzbuch [HGB] [Commercial Code] § 376(1), (2) (Ger.); Schweizerisches Obligationenrecht [OR]

In principle the CISG's damage measures all protect the injured party's expectation interest. Article 74 measures damages directly according to loss from breach, so that damages put the injured party in the position it would be have been in had the contract been performed. Articles 75 and 76 measure loss from breach indirectly, as the difference between the price of a substitute transaction or market price, respectively, and the contract price. In practice these damage measures can yield different recoveries. The remedies in Articles 74–76 use different formulae to measure damages. For instance, Article 75's substitute performance formula uses the price of the substitute transaction, while Article 76's current price differential uses (as a general matter) the market price at the place of delivery and at the time of avoidance. Because these formulae measure the price of goods at different times, they may not give the same damages. Assume, for example, that the seller breaches a contract for the sale of goods at a contract price of $100. Assume that on the day of the breach, the current price of the goods is $105 and that the next day the buyer reasonably purchases goods in substitution at the reasonable price of $106. The Article 75 measure would give damages of $5, while the Article 76 measure would give damages of $6. In addition, the remedies provided by Articles 74–76 require proof of different elements and therefore have different proof costs associated with their use. For this reason, the injured party who bears the burden of proving these elements may not be indifferent between damage measures.

A. *Substitute performance measure: Article 75*

Article 75 measures the injured party's damages as the difference between the price of a substitute transaction and the contract price. If the injured party is the seller, the price of the substitute transaction is the price at which it has resold the contract goods. For the injured buyer, it is the price at which it has covered by making an alternative purchase of comparable goods. Article 75's last clause ("as well as . . .") allows the injured party to recover additional damages under Article 74. The most common sort of additional damages will be incidental expenses associated with making a substitute transaction, such as negotiation costs and transportation expenses, and consequential damages.

The CISG does not allow the non-breaching party to elect between measuring its damages under Article 75 or under Article 76. Although some domestic law is unclear about the election of remedies,[123] the CISG clearly bars an election between Article 75's substitute performance formula and Article 76's market price formula. According to Article 76, the injured party who has avoided the contract

[123] Compare U.C.C. §§ 2–703, 2–711 with §§ 2–712 comm. 3 (first paragraph), 2–703 comm. 1. See John A. Sebert, *Remedies Under Article 2 of the Uniform Commercial Code: An Agenda for Review*, 130 U. Pa. L. Rev. 360, 380–83 (1981); Ellen Peters, *Remedies for Breach of Contract Relating to the Sale of Goods Under the Uniform Commercial Code: A Roadmap for Article 2*, 73

may recover damages according to its market price formula "if he has not made a purchase or resale under Article 75." Thus, an injured party who has obtained substitute performance that meets Article 75's requirements may not use Article 76 to calculate its damages. Because Article 76's exclusion is limited to substitute performance under Article 75, the aggrieved party still has the option of measuring its damages by Article 74, in accordance with its general rule.[124] Of course, before the injured party obtains substitute performance it retains the option of obtaining substitute performance and calculating its damages by Article 75 or not doing so and calculating its damages by Article 76.

To apply the bar against election of remedy, the party bearing the burden of proving damages must establish that the injured party did not obtain substitute performance under Article 75. Courts and commentators maintain that the injured party bears the burden of proving its damages under Articles 74–76.[125] This means an injured party relying on Article 76's market price formula must establish that it has not obtained substitute performance in accordance with Article 75. For the same reason, the injured party calculating its damages under Article 75 must prove the elements needed to calculate them. Thus, the injured party must show that the transaction it entered into was a substitute for the breach contract. For example, the injured seller is required to show the goods it resells are those identified to the breached contract.[126] Similarly, the injured buyer must establish that the purchase it makes is a cover purchase for the breached contract.

B. *Article 75's requirements*

Article 75 requires that the substitute performance be obtained "in a reasonable manner" and "within a reasonable time." The former requirement sometimes is

[124] See Court of Appeals Graz (Austria), 29 July 2004, available at http://cisgw3.law.pace.edu/cases/040729a3.html; Rechtbank Limburg (Netherlands) 16 April 2014, available at http://cisgw3.law.pace.edu/cases/140416n1.html.

[125] See CISG Advisory Council Opinion No. 6, Calculation of Damages Under CISG Article 74 ¶ 2 (2006), available at www.cisg.law.pace.edu/cisg/CISG-AC-op6.html; Federal Supreme Court (Germany), 9 January 2002, available at http://cisgw3.law.pace.edu/cases/020109g1.html; District Court Vigevano (Italy), 12 February 2000, available at http://cisgw3.law.pace.edu/cases/000712i3.html; Court of Appeals Zweibrucken (Germany), 31 March 1998, available at http://cisgw3.law.pace.edu/cases/980331g1.html. It is unclear whether the CISG or applicable domestic law allocates the burden of proving damages to the injured party. Most commentators assert that the CISG governs the burden of proving damages. See Ingeborg Schwenzer, *Article 74*, in Schlechtriem & Schwenzer, supra note 6, at 1025 ("nearly undisputed" that burden of proof allocation governed by the CISG); Franco Ferrari, *Burden of Proof Under the CISG*, Review of the Convention on Contracts for the International Sale of Goods (CISG) 1 (2000–2001), available at www.cisg.law.pace.edu/cisg/biblio/ferrari5.html; Magnus, supra note 30, at 51–2 (1997). For a critical assessment of this view, see infra IX.

[126] See, e.g., CIETAC Arbitration Award (China), 27 April 2000, available at http://cisgw3.law.pace.edu/cases/000427c1.html; CIETAC Arbitration Award (China),

particularly difficult to apply. Article 75 does not even provide measures of reasonable cover purchase or resale found in UCC § 2–706, such as requirements of notice of an intent to resell or reasonable identification to the broken contract. Nor does it distinguish between private sales and public sales as does UCC § 2–706.

A "reasonable manner" connotes the means by which a substitute performance is obtained. As one arbitral tribunal a bit unhelpfully put it, acting in a reasonable manner requires acting as a "prudent and reasonable" party would act.[127] Presumably "reasonableness" provides sufficient latitude that the aggrieved party does not have to resell or cover on the exact terms as the original contract. Article 75 requires only that the substitute goods be purchased "in replacement" for the original goods. If the repurchased goods are of somewhat higher quality, and thus of higher cost than the original goods, a buyer who can demonstrate a need to obtain the replacement goods in a timely manner and the relative unavailability of identical goods should be able to recover the difference between the contract price and the price of the substitute transaction.

Importantly, reasonableness allows some flexibility in the price of the substitute transaction. In principle goods can be resold in a reasonable manner at a low price or replacement goods can be purchased in a reasonable manner at a high price. As far as Article 75's language goes, the high or low price of substitute performance does not by itself affect the reasonableness of the performance.

Courts nonetheless have relied on the price of a substitute transaction to determine its reasonableness. In an early case a German appellate court found that a resale price about a quarter of the contract price made the resale unreasonable.[128] A more recent French case concluded that the manner of the buyer's cover was unreasonable when the buyer paid close to double the price the breaching seller offered.[129] The results in these cases can be understood in two different ways. The courts could be assuming that the reasonableness of a substitute transaction includes price, so that a price significantly above or below contract price makes the transaction unreasonable. Article 75's "reasonable manner" requirement does not allow price to figure in the way in which a substitute transaction is obtained. Alternatively, price can be circumstantial evidence that bears on the reasonableness of the manner of the substitute transaction. A very high or very low price, without countervailing evidence, makes it likely that the substitute transaction was unreasonable. Using price merely as evidence of the reasonableness of a transaction does not go beyond Article 75's "reasonable manner" requirement. *ICC Award 8128*[130] appears to use

[127] See ICC Case No. 10274 (1999), available at http://cisgw3.law.pace.edu/cases/990274i1.html.

[128] See Court of Appeals Hamm (Germany), 22 September 1992, available at http://cisgw3.law.pace.edu/cases/920922g1.html.

[129] See Court of Appeals Rennes (France), 27 May 2008, available at http://cisgw3.law.pace.edu/cases/080022g1.html.

price in this way. There the injured buyer made a cover purchase at a much higher price than could have been paid with a more leisurely purchase. Noting that the buyer had to cover quickly in order to meet a deadline with its sub-buyer, the arbitral tribunal concluded that the higher price did not make the cover unreasonable. The tribunal relied on the circumstances in which the buyer covered to determine the reasonableness of the cover transaction. Price was only one piece of evidence bearing on the reasonableness of the cover.[131]

The "reasonable time" requirement obviously limits the discretion of the aggrieved party to play the market in response to the other party's breach. If, for example, a buyer believes that market prices will decline after the breach, the buyer may wait before entering into a cover transaction in the expectation that it will be able to obtain the same goods at a price lower than the contract price. If prices do in fact decline, the buyer will be quite pleased that the seller breached. If prices increase, however, the buyer bears no risk because it is entitled to recover the difference between the contract price and the cover price from the breaching seller. In effect, the buyer is gambling with the seller's money. The "reasonable time" requirement constrains the ability of the buyer (or the seller) to act in that manner. The concept of "reasonable time," therefore, should be construed in light of its objective of reducing strategic behavior by the aggrieved party. That is, what constitutes a reasonable time in any case should depend at least in part on the volatility of prices in the relevant market.

One clear condition of "reasonable time," however, is that it is measured from the time "after avoidance." In *Profi-Parkiet Sp. Zoo* v. *Seneca Hardwoods LLC*,[132] a purchaser of wood flooring claimed damages for a substitute transaction at a price in excess of the contract price. The court noted that the invoice submitted by the buyer was dated prior to the time when the breach was discovered by the buyer. The court concluded, quite logically, that "plaintiff could not have replaced goods that it was unaware were deficient," and denied recovery for that alleged replacement. The court did, however, allow the same buyer to recover Article 75 damages for the difference between the price paid to the breaching seller and the price paid to another seller from whom the buyer made a replacement purchase three months after discovering the breach.

In calculating damages under Articles 74–76, the injured party's duty to mitigate must be taken into account. Article 77 requires the party to take reasonable measures to mitigate its loss. The breaching party may reduce damages for which it is liable by

[131] To the same effect is ICC Case 10274 in which the seller resold breached goods for 20 percent less than the contract price after unsuccessfully trying to resell them at a higher price. The tribunal found that in the circumstances the seller had acted in a reasonable manner and awarded damages calculated according to Article 75. See ICC Case No. 10274 (1999), available at http://cisgw3.law.pace.edu/cases/990274i1.html. Cf. Supreme Court (Spain), 28 January 2000, available at http://cisgw3.law.pace.edu/cases/000128s4.html (inferior price obtained

the amount of mitigable loss if the injured party fails to mitigate. Accordingly, mitigable loss is deducted from damages calculated under Articles 74–76 to arrive at the damage award. This creates a problem, because Article 77's application here assumes that a substitute transaction can meet Article 75's requirements when the injured party fails to mitigate. Arguably the circumstance is rare. It is unlikely to occur in the typical range of cases.

To see this, notice that to measure its damages under Article 75 the injured party must have acted in a reasonable manner and time in obtaining substitute performance. If the party has not acted reasonably, it must calculate its damages by either Article 74 or 76, not Article 75. However, a party who fails to mitigate its loss has not acted reasonably in the circumstances according to Article 77 ("... must take such measures as are reasonable in the circumstances to mitigate ..."). For this reason, the injured party does not obtain a substitute transaction in a reasonable manner. There might be cases in which the failure to mitigate is unrelated to the substitute transaction, so that the non-breaching party acts unreasonably in not avoiding loss while acting reasonably in effecting substitute performance. But such cases will be rare. More typically the failure to mitigate takes the form of failing to make a reasonable and timely substitute transaction. In these cases the failure to mitigate prevents the injured party from measuring its damages under Article 75. Although the party can recover damages under Articles 74 or 76, with a deduction of mitigable loss from damages calculated under those Articles, Article 75 is unavailable to it.

A simple numerical example illustrates this point. Assume that Buyer breaches a sales contract with a contract price of $80 before Seller delivers the contract goods. After Seller effectively avoids the contract, it waits an unreasonably long period of time to resell them. It receives $60 for the goods, the stable market price, when it eventually resells the goods. Had Seller resold in a reasonable and timely manner, it would have gotten $75 for the goods. Under these facts, Seller's mitigable loss is $15, the difference between the $75 it would have received on a reasonable and timely resale and the $60 it received on actual resale. Thus, Article 77 allows Buyer to deduct $15 from a damage award against its damages calculated under Articles 74 or 76. Seller's recoverable damages under both Articles is $20 ($80 - $60 = $20), assuming that its loss is measured by market price and that the market price was $60 at the time of avoidance. Deducting the $15 mitigable loss from these damages gives Seller a net recovery of $5. However, on the facts Seller cannot calculate its damages under Article 75's formula, because its resale was not made in a timely manner.

The facts in the example essentially are those presented in a case decided by the Spanish Supreme Court in 2000.[133] There, the buyer breached and the seller avoided the contract, according to the Court. The seller then quickly resold the goods "for a very inferior price." Because the seller had previously rejected an offer

from the buyer for the goods at a higher price, the Court deemed it to have failed to mitigate under Article 77. Nonetheless, the Court allowed the seller to measure its damages by Article 75 while ordering that the damages be reduced by the amount of mitigable loss. Although the Court's finding of net damages is correct on the facts, its reliance on Article 75 is mistaken. The seller's failure to accept the earlier, higher priced offer for resale made the later, lower-priced resale unreasonable. (We might disagree with the court's conclusion on that point, since a once-disappointed seller's refusal to deal with a breaching buyer might not be unreasonable.) Thus, the seller cannot calculate its damages under Article 75 as the difference between the resale price and the higher contract price. Put simply, given the facts in the case, Article 75 and 77 cannot both apply.

The Spanish Supreme Court's reliance on Article 75 probably is harmless on the facts of the case. After all, forcing the seller to measure its damages under either Article 74 or Article 76 while deducting mitigable loss yields the same net damage award. But in other cases the calculation of damages under Articles 74 or 76 might give different damages. This is because the facts that need to be proven under these Articles are different and might have different proof costs associated with them. For instance, Article 76 requires proof of the market price ("current price") at the time of avoidance if the seller has not delivered the goods. The market price at that time might be higher than the price at which the seller resells. In addition, the seller might have difficulty proving this price or incur higher proof costs than are incurred in proving a reasonable resale. For a similar reason, it might have difficulty proving the amount of its loss directly under Article 74, particularly if it values the goods above their market price. In such cases the Article under which damages are measured can matter.

C. *Market price measure: Article 76*

An injured party who has avoided the contract need not calculate its damages by reference to Article 75's formula. If it has not obtained a substitute transaction that satisfies Article 75, the injured party may measure its damages by Article 76's market price formula. Under Article 76, damages are equal to the difference between the "current price" for the goods and the contract price. The "current price" is the prevailing price – the market price. It is determined under Article 76(2) by reference to the price prevailing at the place where delivery of the goods should have been made. If there is no current price at that place, the price at such other place as serves as a reasonable substitute may be used, but due allowance must be made for differences in the cost of transporting the goods from the original and the substitute place. Article 76's formula obviously is available to the injured party only if the contract goods have a market price.[134] If the goods of the kind are not traded with sufficient regularity to establish a prevailing price, the non-breaching party cannot

use Article 76 but must rely instead on either Articles 74 or 75 to measure its damages. An injured party using Article 76's market price measure can recover additional damages, such as incidental expenses or consequential damages, under Article 74.

ICC Case 8740[135] conveniently illustrates the application of Article 74–76's damage remedies. The arbitration involved a contract for the sale of a quantity of coal. The seller breached its obligations under Article 35 by delivering nonconforming coal and failing to deliver the required quantity. In response the buyer avoided the contract and covered by making a substitute purchase for part of the undelivered coal. When the buyer tried to set-off its damages from the contract price, the arbitral tribunal had to determine how those damages were properly measured. The tribunal found that the buyer could calculate its damages under Article 75 only for the portion of undelivered coal it covered. There was no "substitute transaction" with respect to the remaining portion. In addition, the tribunal found that the buyer's damages could not be measured under Article 76 because there was no current price for the contracted coal. Given attributes of coal and diverse needs of its buyers, together with the absence of a coal exchange, no market price existed. Finally, the tribunal found that Article 74's measure also could not be used to measure the buyer's damages with respect to the portion of undelivered coal for which it had not covered.

The tribunal's first two findings are unobjectionable. They appear to be fairly straightforward applications of Articles 75 and 76, given the stated facts. However, the tribunal's last finding is questionable. Article 74 allows the injured party to recover of damages equal to the foreseeable loss from breach. The Article is silent about the evidence of loss and therefore does not prevent the use of cover price in calculating loss. The buyer made a partial cover of the undelivered quantity of coal, and the price of this cover could be extrapolated as the price at which the entire quantity of undelivered coal could be purchased.[136] Thus, the buyer's loss from breach under Article 74 is equal to the difference between the cover price for the entire quantity of undelivered coal and the contract price. For this reason, the buyer should have been able to calculate its damages under Article 74 even if Article 76 was unavailable to it. Any other result fails to satisfy the objective of compensating the buyer for its loss.

[135] Id.

[136] It is hard to see how cover price does not meet the tribunal's standards of proof with respect to loss under Article 74. Article 75's formula uses a substitute transaction to calculate damages, and there is no reason why the same measure cannot be used under Article 74. Commentators disagree about whether standards of proof are governed by the CISG or by applicable domestic law. Compare CISG Advisory Council Opinion No. 6, Calculation of Damages Under CISG Article 74 ¶ 2 (2006), available at http://cisgw3.law.pace.edu/disg/CISG-AC-op6.html. (CISG

1. "Taking over" the goods

For purposes of Article 76's formula, the price is current as of the time of avoidance if avoidance occurs before the goods have been delivered. If, on the other hand, the injured party avoids the contract after taking over the goods, the current price is as of the time of "such taking over."[137] The CISG does not define "taking over." One might define it as the time of delivery, especially in light of the fact that Article 60 defines the buyer's obligation to take delivery as including "taking over the goods." We reject that conclusion. When the drafters of the CISG meant "delivery," they knew how to say it (e.g., Articles 30, 31, and 33). Thus, we conclude that when they used the term "taking over" the goods, they intended it to have independent meaning. The difficulty lies in defining that meaning. We conclude that, in the context of Article 76 at least, "taking over" is best understood as the receipt of actual possession of the goods by the buyer or the buyer's agent under circumstances that permit the buyer to examine them. We believe that this understanding is most consistent with the reasons for Article 76's distinction between measuring damages at the time of avoidance in non-delivery cases and at some alternative time in other cases. Presumably, we want to fix the buyer's market-price damages at the time when the buyer can determine whether the goods conformed to the contract. This induces the buyer to make a prompt examination under Article 38 and a prompt decision whether to avoid or not, because the buyer would bear the risk of subsequent market price movements. Any alternative time permits the buyer to play the market between the time that it discovers the defect and the time it is allowed to fix its damages. Under our reading, the buyer who delays declaring avoidance will only be able to recover an amount equal to the difference between contract price and the current price at the time it was able to examine the goods, even if the market price of the goods subsequently increased and the buyer would be able to obtain higher damages if it avoided at that later time. Thus, there is no strategic reason for the buyer to delay the avoidance decision and speculate about market prices.

We conclude that this is an appropriate result because we interpret the requirement that current price be set as of the time of "taking over" as an effort to constrain buyers' strategic behavior. Flexibility is built into the decision to avoid. In the event of a late or defective delivery, Article 49 permits a buyer a reasonable time to avoid. Assume that the buyer purchases goods at a contract price of $100 and receives goods sufficiently defective to constitute a fundamental breach. Assume further that at the time of the defective delivery, conforming goods have a market price of $105. The buyer who recognizes the defect can immediately avoid and recover Article 76 damages of $5. But the buyer can delay avoidance for a reasonable time to "play the market." If the market price continues to increase and damages are fixed as of the time of avoidance, the buyer suffers no harm, because it can avoid at a later point

within the reasonable period and recover the difference between market price and contract price when it does avoid. If the market price declines, for example to $95, the buyer can simply avoid the contract and purchase the goods at the lower price, pleased that the seller breached. In effect, and as we discussed with respect to the "reasonable time" requirement under Article 75, the buyer is gambling with the seller's money. Some domestic law deals with this problem by fixing market price damages at the time of tender in the case of an aggrieved seller[138], or at the time when the buyer learned of the breach in the case of an aggrieved buyer.[139] If the buyer who receives defective goods were able to fix damages as of the time of avoidance, the greater discretion that benchmark provides would increase the risk that the buyer would make the substance and timing of the avoidance decision based on predicted market price movements rather than on satisfaction with the goods or capacity to fix damages at an earlier point. Of course, the breaching party could make a claim that the aggrieved party had failed to mitigate damages under Article 77, but that claim comes replete with its own difficulties of proof.

A reading of "taking over" that equates it with delivery may avoid strategic behavior, but it fails to induce efficient decision making, because it includes no requirement that the aggrieved party be able to detect the nonconformity at the time its damages are fixed. Assume, for instance, a shipment contract in which the seller is required to deliver the goods to a carrier for transportation to the buyer. The goods are handed over the first carrier in accordance with Article 31(a) on March 1. They reach the buyer one month later, but are sufficiently defective to justify avoidance. Assume that the contract price for the goods is $100, that the current price at the time they were handed over to the first carrier was $105 and that the current price at the time that the buyer receives possession of the goods is $110. Even if the buyer avoids the contract immediately on receipt of the nonconforming goods, equating "taking over" with delivery limits the buyer to damages of $5 ($5 = $105 - $100). That is the case even though at the time that the buyer had an opportunity to examine the goods and avoid the contract, the market price of the goods was $110. Thus, defining "taking over" as referring to a time prior to when the buyer could know of the fundamental breach permits the breaching party to impose some breach costs onto the aggrieved party. We recognize that the buyer could simply make a cover purchase at $110 and invoke Article 75 to be made whole. But aggrieved parties may have reasons not to enter into cover purchases, and the ambiguities of Article 75 that we discussed above may force use of Article 76. As we noted in Chapter 6, the inclusion of "taking over" within Article 60's definition of "delivery" does not necessary make the two periods coterminous.

Consistent with our definition of "taking over," we read the buyer's obligation to take delivery under Article 60 as including the taking over of the goods, but not as defining the time of taking over as the time of delivery. Assume that the contract calls for shipment by carrier from the seller's place of business. Delivery occurs at that point under Article 31(a). On our reading, the buyer does not "take over" the goods at that point. The buyer nonetheless has an "obligation" to take delivery under Article 60. If the buyer refuses to receive the goods when the carrier arrives, the buyer has, at that point, violated its obligation. That is different from defining the taking over as of the time of the delivery. We also recognize that one argument against our position is that if the drafters intended a "receipt" term, which may be more consistent with our concerns, they knew how to say so, since they use that term in Articles 65, 79, and 97. Nevertheless, we conclude that defining "taking over" in terms of the time when examination becomes plausible as the best fit with the policies of Article 76.

As this discussion suggests, Article 76's damage measure can give different damages than under Article 75, whether current price is set as of time of avoidance or the time of delivery. This is because current price can differ from the price at which the injured party obtains substitute performance. Article 76 gives the party a reasonable period in which to effect the substitute performance. This period, even when short, ends after the avoidance or delivery of the goods. During this time market price can fluctuate.

Finally, notwithstanding that the "taking over" exception in the second sentence of Article 76(1) is written in terms of "the party," there is reason to believe that it applies only to buyers. As a practical matter, circumstances will rarely permit such a claim by a seller. Perhaps a seller who, for example, recovers goods from a breaching buyer would be considered to have "taken over" the goods for purposes of Article 76 and would have to fix its damages as of that time rather than at the time of avoidance.[140]

2. Establishing current price

By its terms, Article 76's measure requires determination of the current price of goods of the kind at the time of avoidance of the contract or taking over the goods. While Article 76(2) establishes the relevant market for fixing the price (the place of delivery, even though that might vary from the place of avoidance or of taking over), establishing market price at these times can be difficult, particularly in highly volatile markets. An injured party unable to prove market price at these times cannot rely on Article 76 to measure damages.[141] Nonetheless, several Chinese arbitral awards are particularly forgiving in their determination of market price and its timing. One award allowed the international market price of the goods of the kind to serve as the current price rather than the domestic market price at the place the

[140] See Honnold/Flechtner, supra note 61, at 588–89.

[141] U.C.C. § 2–723(2) allows for evidence of prevailing market price within reasonable times before prescribed times when evidence of market price is not readily available for the

goods were to be delivered.[142] Another award considered an offer to sell, although not accepted, sufficient to establish current price when the offer came within six days of the buyer's avoidance.[143] A third award allowed the price of resold goods to serve as a "reasonable reference of" the market price at the time of avoidance.[144] The tribunal nonetheless also acknowledged that Article 75's resale-contract differential would yield lower damages than Article 76's market price-contract differential. Another award used the contract price in the modified agreement as the market price when the current price at the time of avoidance was otherwise unavailable.[145] The tribunal apparently assumed that the market price at the time of avoidance remained the same as when the modified contract was concluded earlier.

D. *Restitution following avoidance*

After the contract has been avoided, the CISG gives a party the right to restitution of the goods it supplied or payment made under the contract. Restitution is not listed among the buyer and seller's respective remedies appearing in Articles 45 and 61. Instead its availability and restrictions on the relief are treated separately, in Articles 81–84. Labels aside, restitution gives a party a remedy: the right to recover goods it supplied or payments it made. The separate treatment of restitution makes the remedy available independently of a right to recover damages or specific relief. Restitution is useful when the injured party cannot or prefers not to prove its damages or establish its entitlement to specific relief. It is also helpful when Article 79 exempts a party from liability for breach. In this case Article 79(5) does not allow the recovery of damages. Restitution is not damages. Thus, if the breach permits avoidance of the contract, the right to restitution allows the non-breaching party to recover goods it supplied or payment made.

Under Article 81(2) a party who has wholly or partly performed the contract may claim restitution from the other party for what it has supplied or paid under the contract. Article 81(2)'s second sentence requires that the restitution be concurrent. This requirement in effect gives a contracting party a security interest in the other party's obligation to make restitution. Thus, a buyer who has prepaid the contract price and taken delivery of the goods is not obligated to redeliver the goods to the

[142] See CIETAC Arbitration Award (China), 2 May 1996, available at http://cisgw3.law.pace.edu/cases/960502c1.html; but cf. CIETAC Arbitration Award (China), 12 September 1994, available at http://cisgw3.law.pace.edu/cases/940919c1.html; CIETAC Arbitration Award (China), 20 January 1994, available at http://cisgw3.law.pace.edu/cases/940220c1.html (market price at place goods should have been delivered).

[143] See CIETAC Arbitration Award (China), 20 January 1993, available at http://cisgw3.law.pace.edu/cases/930120c1.html.

[144] See CIETAC Arbitration Award (China), October 2007, available at http://cisgw3.law.pace.edu/cases/071000c1.html.

[145] See CIETAC Arbitration Award (China), 30 June 1999, available at http://cisgw3.law.pace.edu/

seller if the seller refuses or is unable to remit the contract price. In this case the goods can serve as a source of repayment of the contract price. The concurrent requirement for restitution also in effect secures other obligations the seller owes the buyer. Avoidance of the contract leaves unaffected a party's liability for damages, as Article 81(1) makes explicit. Accordingly, the goods the buyer retains can also serve as a source of payment of any damage award the buyer may obtain against the seller.

Article 81(2)'s right of restitution is limited by the CISG's scope. The Article only gives a party the right against its counterparty. Two limitations restrict the restitution right. First, Article 81(2) does not give the seller or buyer title in the goods or payment that can be recovered by restitution. Because Article 4(b) excludes from the CISG's scope issues of the effect of the sales contract on title ("property") in the goods, the right to restitution says nothing about title to the goods or payment recovered. Thus, applicable domestic law, not the CISG, determines whether their recovery reinvests title in the seller or buyer. Second, the right to restitution provides no right against third parties. Article 4 limits the CISG's scope to the formation of the sales contract and the rights and obligations of the contracting parties arising from it. An unpaid seller has no rights under the CISG, for example, to recover goods that the buyer has resold to third parties. A prepaying buyer who never received goods has no rights under the CISG to recover the payment from a bankrupt seller's estate. Instead applicable domestic law, including bankruptcy law, governs the rights of the creditors and the buyer's bankruptcy trustee to the contract goods or payment.[146] Thus, applicable domestic law may restrict or eliminate the contracting parties' rights to restitution when third parties have claims to them.

Even with its limitations, Article 81(2)'s right to restitution is broader than similar rights given under some domestic law. By comparison, UCC § 2–507(2) and § 2–702 (1) impose greater restrictions on the seller's right to reclaim goods delivered under the contract. Section 2–507(2) allows the seller to reclaim the goods only when the buyer fails to make payment on delivery,[147] and § 2–702(1) allows reclamation from buyers who have received the goods on credit while insolvent. Neither of these limitations applies under Article 81(2). Under Article 81(2), after avoidance of the contract the seller may demand restitution of goods delivered whether or not payment is due on delivery or the buyer received the goods on credit. The parties' rights to restitution displace domestic law rules that affect restitution, unless the parties have opted out of Article 81(2) or the CISG entirely.

[146] See 11 U.S.C. § 546(c); *Usinor Industeel* v. *Leeco Steel Products, Inc.*, 209 F. Supp.2d 880 (N.D.Ill. 2005); Federal District Court (*Roder Zelt-und Hallenkonstruktionen GmbH* v. *Rosedown Park Pty Ltd. et al.*) (Australia), 28 April 1995, available at http://cisgw3.law.pace.edu/cases/950428a2.html.

[147] See Comment 2 to U.C.C. § 2–507.

1. The place and costs of restitution

The CISG does not expressly provide for the place of restitution of the goods, or for the price or costs of restitution. Almost all courts and commentators maintain that they are determined under Article 7(2), which incorporates general principles underlying the CISG.[148] There is some disagreement over the general principles that select the place of restitution as well as the place selected. Three different positions appear in the case law or commentary.

(1) *The reverse role rule.* One position views the restitution transaction as the reverse of the original transaction. Accordingly, the seller in the original transaction who is to recover the goods is in the position of the buyer in the restitution transaction, and the buyer in the original transaction who is to recover the contract price paid is in the seller's position in the restitution transaction.[149] The reverse role rule therefore deems the buyer's place of redelivery of the goods in the restitution transaction to be at the place of delivery in the original transaction. Likewise, the seller's place of repayment of the price in the restitution transaction, according to the rule, is the place of payment in the original transaction. Under Article 31(c)'s default rule, the place of delivery of the goods is the seller's place of business, and under Article 57(1)(a)'s default the place of payment also is the seller's place of business. Accordingly, in the restitution transaction the goods are redelivered and the price repaid at the buyer's place of business. If the contract governing the original transaction requires different places of delivery or payment, the reverse role rule requires redelivery and repayment in the restitution transaction at those places.

Although courts and commentators tend to favor the reverse role rule (also called the "mirror image" rule), the rule and its consequences can be questioned. For one thing, it is unclear which of the CISG's underlying principles supports the rule. Rather than being backed by these principles, the rule rests on an

[148] See Supreme Court (Austria), 29 June 1999, available at http://cisgw3.law.pace.edu/cases/990629a3.html; CISG Advisory Council Opinion No. 9, Consequences of Avoidance of the Contract ¶¶ 3.12, 3.16 (2008), available at www.cisg.law.pace.edu/cisg/CISG-AC-op9.html; Rainer Horning, *Article 81*, in Commentary on the UN Convention on Contracts for the International Sale of Goods (CISG) 860 (Peter Schlechtriem & Ingeborg Schwenzer eds., 2d (English) ed. 2005). For application of domestic law to the place of restitution, see Court of Appeal Paris (France), 14 January 1998, available at http://cisgw3.law.pace.edu/cases/980114f1.html.

[149] See Supreme Court (Austria), 29 June 1999, available at http://cisgw3.law.pace.edu/cases/990629a3.html (restitution obligations "mirror image" of obligations under the original transaction); Court of Appeals Karlruhe (Germany), 19 December 2002, available at http://cisgw3.law.pace.edu/cases/021219g1.html; Court of Appeals Valais (Switzerland), 21 February 2005, available at http://cisgw3.law.pace.edu/cases/050221s1.html; Christiana Fountoulakis, *Article 81*,

analogy, as one court acknowledges.[150] The buyer in the restitution transaction is in a similar position to the seller in the original transaction (it is obligated to deliver the goods), and the seller in the restitution transaction is in a similar position to the buyer in the original transaction (it is obligated to pay the price). Thus, by analogy the buyer has the delivery obligations of the original seller, and the seller has the repayment obligations of the original buyer.

As applied, the reverse role rule can inefficiently allocate costs in the restitution transaction. This is because, if Article 58(1)(a)'s place of delivery default applies to the original transaction, the rule requires redelivery of the goods to the seller at the buyer's place of business. However, between the date the goods are delivered and date the contract is avoided, the buyer might have moved them elsewhere for storage or processing. The reverse role rule therefore requires the buyer to bear the costs of having the goods shipped back to its place of business. These costs are wasted, because the seller likely does not benefit from retrieving them there. It can resell the goods in a local market where they are located initially as high a price. The more general point is that the efficient allocation of delivery costs as part of the original transaction may not be efficient with respect to the restitution transaction.

(2) *Delivery and payment at the innocent party's place of business.* Several European commentators find that the CISG's underlying general principle of good faith determines the place of delivery of payment in restitution.[151] Apparently a party acts in bad faith or at least is at fault by breaching the contract; fault obligates it to redeliver the goods or repay the price at the non-breaching party's place of business. If the buyer breaches and the contract is avoided, it must redeliver the goods at the seller's place of business and the seller must make repayment there. If the seller breached, it must retrieve the goods at the buyer's place of business and be repaid there too.

This position is weak and no courts have adopted it. Although some commentators find a principle of good faith in the performance of contracts among the CISG's underlying principles,[152] breach need not be in bad faith or the result of fault. For instance, Article 35 makes warranty liability strict, and Article 74 gives damages even when the breaching party is not at fault in breaching. Even where

[150] See District Court Giessen (Germany), 17 December 2002, available at http://cisgw3.law.pace.edu/cases/021217g1.html. ("... one may look at Art. 57(1)(a) by analogy"). It is worth emphasizing that the reverse role rule is based only on an analogy. The parties' performance under the original transaction is called for by the sales contract; the restitution obligations in the reverse transaction are not. They instead are imposed to unwind certain obligations created by the contract. The buyer in the restitution transaction is not really selling the restitution goods, and the seller in the transaction is not really buying the goods. The analogy by itself does not convincingly select the place of performance of the restitution obligations.

[151] See Christiana Fountoulakis, *Article 81*, in Schlechtriem & Schwenzer, supra note 6, at 1112 n.78.

breach is the result of fault, determining the place of restitution by fault can inefficiently allocate the costs of reversing the original transaction. This is because the party at fault might be in an inferior position to the innocent party with respect to redelivery or repayment. For example, the innocent seller might face lower carriage costs in reshipping the goods or be able to resell the goods in the at-fault buyer's local market. The costs of redelivering the goods are lower when the seller retrieves them from the buyer's place of business. Somewhat more unusual, an innocent buyer who is a beneficiary on the seller's standby letter of credit might be able to draw on the letter for repayment of the contract price rather than obtain payment from the seller at its place of business. Setting the place of repayment at the at-fault seller's place of business is the more expensive route.

(3) *The locus on avoidance rule.* A third position is that the place of delivery of the goods in the restitution transaction is their location at the time the contract is avoided.[153] If the goods are at the buyer's place of business when the contract is avoided, the buyer must make them available to the seller there. If they are stored or being fabricated elsewhere at the time of avoidance, the buyer must make them available to the seller at the place of storage or fabrication. If the goods are in transit at the time the contract is avoided, the buyer must make any documents covering them available to the seller to allow it to take delivery of the goods. This "locus on avoidance" rule is more or less the one recommended by the CISG Advisory Council.[154] The rule is attractive because it efficiently allocates the costs of redelivering the goods. The costs of retrieving the goods from locations other than the buyer's place of business do not favor the buyer. In addition, the seller might prefer to resell the goods in a market near to the location of the goods. For this reason, requiring the buyer to incur costs in returning the goods to its place of business is wasteful. Because the locus on avoidance rule efficiently allocates the costs of delivering restitution goods (and the CISG is otherwise silent), we favor it over its two competitors.

The locus on avoidance rule with respect to repayment of the contract price is more difficult to apply. The CISG Advisory Council recommends that repayment be at the buyer's place of business, subject to an exception. The exception applies when payment under the original transaction was made at a different place, such as at a bank. In that case the Advisory Council recommends that the place of repayment in the restitution transaction be at the same place.[155] This exception to the locus rule should not be recognized. At the time the contract is avoided the seller has received payment, even if the payment initially was made to a bank or other payment intermediary. The fact that payment under the original contract was made

[153] See CISG Advisory Council Opinion No. 9, Consequences of Avoidance of the Contract ¶¶ 2.13–2.17 (2008), available at http://cisg-law.pace.edu/cisg/CISG-AG-opo.html.

through an intermediary is irrelevant to the preferred location for repayment after the contract is avoided.

The remaining question is whether the locus of repayment should be at the seller's or the buyer's place of business. We have no views that lead us to favor one repayment locus rather than the other. As far as we can see, the choice is a coin toss. The locus rule could select the buyer's place of business, as courts do,[156] or the seller's place of business. There seems nothing objectionable about requiring repayment at the seller's place of business while requiring redelivery of the goods at their location. Article 81(2)'s concurrence requirement only obligates the seller and buyer to perform their respective obligations of restitution at the same time. It does not require that their obligations be performed at the same place.

Where the goods are redelivered to the seller at the buyer's premises or other proper location, the seller often will incur costs in retrieving and disposing of them. These include the expense of transporting, meeting applicable regulatory requirements and reselling the goods. Although the CISG does not expressly allocate the costs of restitution between the seller and buyer, its damages provisions apply to allocate them.

If the buyer's breach is exempted by Article 79 after the goods have been delivered, Article 79(5) does not allow the seller to recover damages. The seller nonetheless retains the right to avoid the contract (if avoidance is permitted) and restitution of the goods delivered. Costs that the seller incurs in retrieving them are the consequence of the buyer's breach and therefore damages under Article 74. Retrieval costs therefore are damages; however they are labeled. Because Article 79(5) limits the buyer's liability to remedies other than damages, the seller cannot recover its retrieval costs. A French court exempted the seller's delivery of nonconforming goods under Article 79 while awarding the buyer customs fees it incurred in importing them.[157] Customs fees are among the buyer's (foreseeable) loss resulting from the seller's breach and therefore damages in everything but name. They are not recoverable from the exempted seller.

Where a party's liability for breach is not exempted by Article 79, the costs of restitution are borne by the breaching party. If the buyer breaches and the seller retrieves the goods after avoiding the contract, the seller's retrieval costs are loss resulting from the breach. As such they are recoverable damages. If the seller breaches and retrieves the goods after the buyer avoids the contract, the seller's retrieval costs result from its own breach. They are not damages and the breaching seller therefore cannot recover the retrieval costs. Finally, as recoverable loss, the

[156] See District Court Giessen (Germany), 17 December 2002, available at http://cisgw3.law.pace.edu/ases/012117g1.html; cf. Supreme Court (Austria), 28 June 1999, available at http://cisgw3.law.pace.edu/cases/990629a3.html ("The place of performance for the obligations concerning restitution should mirror the place of performance for the primary contractual obligations").

[157] See District Court Besancon (France), 10 January 1998, available

expenses of retrieving and disposing of the goods are subject to Article 77's mitigation requirement. Thus, if the non-breaching seller chooses to ship the goods back to its premises when it could have more cheaply sold them in the buyer's local market, the costs of shipment are not recoverable to the extent they exceed the costs of making a local sale.

2. The benefits of restitution of goods

Article 81(2) gives the party the right to restitution of what it supplied or paid the other party. Article 84(2)(b) goes further and obligates the buyer to account to the seller for all benefits which it derived from the goods if it is impossible for the buyer to make restitution of them. If the buyer resells delivered goods before the seller makes a claim for restitution, it is impossible for the buyer to return the goods. The buyer nonetheless has "benefitted" from the goods to the extent that the sub-buyer has no claims against it arising from the sale.[158] In this case the Article 84(2)(b) entitles the seller to what a Finnish court calls a "monetary surrogate":[159] the resale price.

Article 84(2) enables the seller sometimes to recover more in restitution than it could in damages. This is because Article 84(2)(b) allows the seller to recover the price at which the buyer resold contract goods even if the seller was not in a position to resell them for that price. For example, assume that Buyer contracts with Seller for goods at a price of $100, which Seller delivers. Payment is due a month after delivery. Two weeks later Buyer resells the goods for $175 at no additional cost to itself. Seller could not have sold the goods for more than $100. When Buyer later refuses to pay the purchase price, Seller avoids the contract. On these facts, Seller's damages under Article 74 are $100; it suffers no other loss from Buyer's breach. Buyer's $175 resale price represents a "benefit derived from the goods." In addition, the resale makes restitution of the contract goods impossible. Thus, under Article 84(2)(b) Seller is entitled to $175 in restitution from Buyer. This gives Seller $75 more than it would have received had Buyer performed the contract. On similar facts, a German court allowed a seller to recover the resale price from its breaching buyer.[160]

Calculating the "benefits derived from the goods" is easy in the previous example, because the example assumes that Buyer incurs no additional costs in reselling the contract goods. Buyer's benefit from the goods is the resale price it receives from its

[158] Cf. Court of Appeals Oldenburg (Germany), 1 February 1995, available at http://cisgw3.law.pace.edu/cases/950201g1.html (buyer received no benefit from subsale when furniture sold was defective and seller unsuccessfully repaired it).

[159] See Court of Appeals (Finland), 31 May 2004, available at http://cisgw3.law.pace.edu/cases/040531f5.html.

[160] See Court of Appeals Karlsruhe (Germany), 14 February 2004, available at http://cisgw3.law

buyer. The buyer's use of the goods before they are returned to the seller is a relatively easy case too. The benefits the buyer derived from the goods are the use value to the buyer between delivery and their return. The rental price for similar goods for this period might reliably measure this value. In more realistic cases in which the buyer incurs costs in reselling the goods, establishing the "benefits derived from the goods" is harder. The resale price incorporates both the cost of the goods and the buyer's other variable costs in reselling them. The part of the price attributed to other variable costs is a benefit that derives from the buyer's resources other than the goods. To calculate the benefit from the goods, these costs must be deducted from the price. This deduction from the resale price allows the seller restitution of the resale price in the amount of the net benefit derived from the goods, as one court has found.[161] It is not much of a stretch to read "benefits" in Article 84(2) as referring to the buyer's net benefits from the goods.

III. REMEDY STIPULATIONS, REMEDY LIMITATIONS, AND DAMAGE EXCLUSIONS

The CISG's remedies are default terms only. This is because Article 6 allows the contracting parties to opt out of them by agreement. Under Article 6 the parties may derogate from most of the CISG's provisions, including its damages measures and other remedies. One way in which they can do so is to fix the amount of damages recoverable in the event of breach. Another way is to limit available remedies, restricting the non-breaching party's remedy on breach to repair or replacement of the goods or recovery of the contract price or stated portion of it, as applicable. Finally, the recovery of certain sorts of damages can be excluded. Article 74 allows the recovery of lost profits and consequential damages. The parties' contract can provide that these damages are not recoverable in the event of breach. Whether the agreement fixes damages, limits remedies, or excludes certain sorts of damages is a matter of contract interpretation.

The CISG does not regulate contractually stipulated damages, remedy limitations, and damage exclusions. It instead leaves their regulation to applicable domestic law. Article 6 merely allows the parties to make inapplicable to their contract the allocation of risk of liability and damages made by the CISG's provisions. However, the CISG does not address the enforceability of the parties' own allocation of the risk through stipulations of damages, remedy limitations or damage exclusions. As ordinarily understood, the enforceability of contractual provisions allocating these risks is a matter of their "validity." These provisions have no legal effect if they are invalid. Article 4(a) excludes from the CISG's scope issues of "validity" (unless expressly provided for), leaving them to applicable domestic law. Thus, the question is whether the CISG tracks the ordinary understanding of the term "validity."

Although the CISG does not define the term,[162] case law and commentary overwhelmingly considers the regulation of damage stipulations, remedy limitations and damage exclusions to be issues of validity under Article 4(a).[163] The Secretariat Commentary to the CISG supports this view, describing the issue of the enforceability of penalty clauses as one of "validity."[164] Applicable domestic law, not the CISG, therefore regulates damage stipulations, remedy limitations, and damage exclusions.

The decision of the CISG's drafters to leave the enforceability of these provisions to domestic law reflects their inability to reach consensus on a uniform rule regulating the provisions. Their failure is understandable given the difficulty of determining the optimal regulation of damage stipulations, remedy limitations, and damage exclusions. Consider the enforceability of damage stipulations. Penalty clauses affect the choice of contracting partner, investment in the contract's performance, and the decision to breach. This makes it difficult to evaluate the aggregate impact of enforcing or refusing to enforce them. When parties have limited information about the quality of their contracting partners, a party that agrees to a penalty clause risks having to pay the penalty if breaches the contract. For this reason, agreeing to the clause signals to the counterparty a willingness and ability to perform.

On the other hand, a penalty clause may or may not induce inefficient performance. It can induce efficient breach when the parties more accurately measure loss from breach than courts or arbitrators. In this case the damages stipulated are fully compensatory on an expectancy basis and not a "penalty." However, where courts or arbitrators forecast loss from breach more accurately than the parties, a penalty clause can induce inefficient performance. This is because the party subject to the penalty will perform when the penalty sum is greater than its performance cost, even when the non-breaching party's loss from breach is less than that sum.

Finally, a penalty clause can encourage efficient investment in the contract's performance. To see this, recognize that default remedies such as expectation damages induce the aggrieved party to make inefficiently high investments in the contract. This is because the aggrieved party recovers its investment whether or not the contract is performed. If the contract is breached, expectation damages give the aggrieved party the return on its investment had the contract been performed. If the contract is performed, the aggrieved party will get the value from its performance. Because the aggrieved party recovers its investment whether or not the contract is breached, it does not discount the value of its investment by the probability of breach. Thus, it will make an inefficiently high investment in its performance of the contract. A penalty clause decouples investment and damages by fixing damages without regard to investment. This makes the aggrieved party take into account the

[162] See Chapter 2.V.B.

[163] See, e.g., Foreign Trade Court of Arbitration attached to the Serbian Chamber of Commerce, Serbia, 15 July 2008, available at http://cisgw3.law.pace.edu/cases/080715sb.html.

[164] See Secretariat Commentary to the 1978 Draft, in Documentary History, supra note 23, at 428

likelihood of breach, because a dollar invested in the contract reduces its net recovery on breach by a dollar. The aggrieved party therefore is forced to calibrate the investment's cost with the discounted value of the investment. As a result, the victim will efficiently invest in its performance of the contract. The trouble is that the conditions required for penalties to assure efficient investment are demanding.[165] For example, in the simple case where only one of the contracting parties can invest in the contract's performance, the contract price must be set below the investing party's marginal cost of performance. Otherwise, the non-investing party might breach and the investing party will not be guaranteed the value of its investment. At the same time, to induce the investing party to enter into the contract, the non-investing party must pay or guarantee a large, non-recoverable payment (the penalty) to the investing party. This payment assures that the contract is profitable for the investing party. If the non-investing party can recover the payment or cancel the payment obligation by convincing a court that it is an unenforceable penalty, the design of the contract is infeasible. It is hard to guarantee that a court ex post will not find that the payment or payment obligation is an unenforceable penalty.

For the penalty to assure efficient investment, the investment also must have a particular feature. It must not benefit only the non-investing party by increasing the contract's value to it while leaving the investing party's cost of contractual performance unaffected. Otherwise, the investing party receives the same return whether or not it invests. As a result, it will not invest in the contract when doing so benefits only the non-investing party. The assumption that investment does not benefit only the non-investing party limits the use of penalties to assure efficient investment in the contract. More generally, it is hard to gauge the efficiency of stipulated damages when its effects on the choice of contracting partner, investment and decision to breach are taken into account. Legal systems can reach different conclusions about the matter and the drafters of a uniform sales law are unlikely to agree on a uniform rule to regulate damage stipulations. It probably is not therefore surprising that Article 4(a) leaves the enforceability of damage stipulations to applicable domestic law.

Accordingly, a court or arbitral tribunal considering a contract containing damage stipulations, remedy limitations or damage exclusions must engage in a two-step inquiry. First, the forum must determine, based on its conflict of law rules, the country whose law regulates the provisions. Second, it must determine whether that country's applicable law enforces them in the circumstances of the contract and its performance.

The regulation of damage stipulations can illustrate the second step. Suppose a contract governed by the CISG contains a penalty clause that is not "manifestly excessive" but still super-compensatory. Legal systems take one of three approaches

[165] See Steven Walt, *Penalty Clauses and Liquidated Damages*, in Contract Law and Economics 178, 187–92 (Gerrit De Geest ed., 2011); Aaron S. Edlin & Alan Schwartz, *Optimal Penalties*

to penalty clauses. A few civil law systems enforce stipulations of damages even if they are penalties.[166] Other civil law systems enforce penalties for breach if they are not "manifestly excessive" in relation to the actual loss from breach. A court can reduce the penalty sum so that it is no longer excessive.[167] Some countries put an upper limit on the enforceable penalty sum, determined by the value of the principle obligation or a percentage of the contract price.[168] Common law systems adopt a third approach, enforcing damage stipulations only when the stipulated sum does not exceed the actual or reasonably anticipated loss from breach.[169] Penalty clauses are unenforceable. If the forum's conflicts rules select the law of a country that adopts either the first or second approach, the penalty clause in the contract is enforceable. The penalty clause is unenforceable if the country's law selected adopts the third approach. There is no reason to believe that the analysis would be different if the enforceability of a remedy limitation or damage exclusion were at issue.

Case law has been consistent in making the enforceability of damage stipulations turn on applicable domestic law. In an early case, *ICC Case 7197*,[170] the arbitral tribunal had to determine whether a penalty clause in a sales contract governed by the CISG was enforceable. The penalty clause limited damages to *x* percent of the contract price. The buyer breached and argued that its liability was limited to this amount. For its part, the seller argued that it was entitled to recover damages under Article 74 notwithstanding the limit fixed by the penalty clause. Thus, the question was whether the contract's penalty clause was enforceable. Finding that the CISG does not regulate penalty clauses, the court concluded that Article 7(2) left their enforceability to applicable domestic law.[171] The tribunal determined that Austrian law, the applicable law, would not enforce the penalty clause in the contract. Thus, the clause did not displace the damages available under Article 74 and the tribunal awarded the seller damages according to that Article.

ICC Case 9978[172] adopts follows the same reasoning, making explicit that the enforceability of a penalty clause is a matter of validity. The contract in dispute governed by the CISG contained a penalty clause, referred to by the court as a "penalty/liquidated damages (PLD) clause." The PLD clause limited damages to 2 percent of the contract price. When the seller breached, the buyer argued that it had a right to recover damages under Article 74. In response the seller maintained

[166] See, e.g., Polgari Torvenykonyv [PTK] [Civil Code] art. 346 (Hung).

[167] See Code civil [C.civ.] art. 1152 (Fr.); Burgerliches Gesetbuch [BGB] [Civil Code] § 343(1) (Ger.); Schwenzer, Hachem & Kee, supra note 32, at 639 n.579 (listing legal system allowing reduction; cf. The Principles of European Contract Law 9.509 (at 453) (1999).

[168] See, e.g., Codigo Civil para el Distrito Federal [C.C.D.F.] art. 1843 (Mex.); Codigo Civil [C.C.] art. 412 (Braz.); Codigo Civil [C.C.] art. 935 (Port.).

[169] See, e.g., U.C.C. § 2–718(1).

[170] 1 UNILEX D.1992–3 (Michael J. Bonell ed., 2008).

[171] Accord Court of Appeals Arnhem (Netherlands), (*Diepeveen-Drison B.V. v. Nieuenhoven Vichandel GmbH*), 22 August 1995, available at http://cisgw3.law.pace.edu/cases/950822n1 .html

that its liability for breach was exempted under Article 79. The tribunal rejected both the buyer and the seller's respective arguments. While finding that the seller's nonperformance was not exempt under Article 79, it noted that the PLD clause, if enforceable, applied even if the seller were exempt. Article 79(5) insulates the exempted party only from "damages," and the PLD clause is not damages. The clause, if enforceable, instead displaces damages otherwise available under Articles 74–76. Against the buyer, the tribunal noted that the enforceability of the PLD clause is a matter of validity under Article 4(a) and therefore not governed by the CISG. Finding that the clause was valid under applicable domestic law (German law), the tribunal limited the buyer's recovery to 2 percent of the contract price. Courts and arbitrators in more recent cases involving penalty clauses analyze the issue of their enforceability in the same way.[173]

Several commentators argue that the CISG continues to govern the enforceability of stipulated damages even though Article 4(a) delegates their validity to applicable domestic law.[174] They reason that Article 7(2) makes applicable to damage stipulations in the contract the "general principles" underlying the CISG. These principles, they conclude, regulate damages stipulations whose validity is governed by applicable domestic law. We find this reasoning unpersuasive. Once the parties have opted out of the CISG damage provisions with a damage stipulation in the contract, the CISG no longer governs the enforceability of the stipulation. Domestic law alone regulates its validity.

To illustrate this position, assume that a clause in a contract governed by the CISG expressly bars the injured party from any remedy in the event of breach. The clause underestimates damages, giving the injured party nothing, without regard to the seriousness of the counterparty's breach. Article 4(a) considers the enforceability of the clause a matter of validity not addressed by the CISG. Thus, according to the last phrase in Article 7(2) ("in conformity with ..."), applicable domestic law determines the clause's validity. Applicable domestic law likely deems a clause depriving the injured party of any remedy to be invalid: Either the agreement containing it is not a contract at all[175] or the clause, while part of a contract, is unconscionable.[176] However, the argument just described maintains that under Article 7(2)'s first clause the general principles underlying the CISG continue to

[173] See, e.g., Foreign Court of Arbitration (Serbia), 15 July 2008, available at http://cisgw3.law.pace .edu/cases/080715sb.html; *American Mint LLC* v. *Gosoftware*, 2006 U.S. Dist. LEXIS 1569, at *19 (M.D. Pa. January 6, 2006); cf. ICC Case No. 12173 (2004), available at http://cisgw3.law .pace.edu/cases/041217311.html (interpreting a liquidated damages clause in accordance with Swiss law).

[174] See Ingeborg Schwenzer & Pascal Hashem, *Article 4*, in Schlechtriem & Schwenzer, supra note 6, at 93; Pascal Hashem, *Fixed Sums in CISG Contracts*, 13 Vindobona J. Int'l Comm. L. & Arb. 217 (2009); Ingeborg Schwenzer & Pascal Hashem, *CISG—Successes and Pitfalls*, 57 Am. J. Comp. L. 457, 474 (2009).

[175] Cf. Restatement (Second) of Contracts § 1 (1981) ("A contract is a promise or set of promises for

apply. Those general principles in turn can invalidate the "no remedy" clause, even if applicable domestic law were to declare it valid.

One problem with this argument is that it relies heavily on general principles underlying the CISG. As we have argued throughout this text, identifying among these principles the standards that continue to regulate damage stipulations or other legal doctrines is problematic. Commentators taking the line described offer a principle to the effect that a damage stipulation must preserve some adequate remedy.[177] The CISG's damages provisions supposedly evince the principle. We are not so sure. The CISG's damage provisions could evince the more limited principle to the effect that parties have adequate remedies when their contract does not make these provisions inapplicable to it. After all, the CISG's remedial provisions are default rules only. This more limited principle does not apply when the parties' agreement displaces the CISG's damage provisions. Even if the relevant principle requires adequate remedies for parties, it conflicts with another underlying principle: freedom of contract. Article 6 reflects the principle that favors the parties' agreement over the CISG's provisions.[178] This pro-contract principle supports enforcement of damage stipulations that do not provide the protection given by the CISG's remedial provisions.

The more serious problem with the argument is that it badly misreads Article 7 (2)'s first clause. This clause in relevant part makes general principles underlying the CISG applicable only to "matters governed by this Convention which are not expressly settled in it." Article 6 allows parties to derogate from most of the CISG's provisions, including its remedial provisions. If the parties have effectively made inapplicable to their contract the CISG's remedies through an appropriately drafted damage stipulation, the CISG no longer governs the parties' remedies on breach. In Article 7(2)'s terms, "the matter" is no longer governed by "this Convention." The damage stipulation instead controls. Thus, Article 7(2)'s general principles underlying the CISG also no longer apply. How parties displace the CISG's remedial provisions is a matter governed by the CISG.[179] But the substance of the provision that supplants the CISG's remedies is regulated by applicable domestic law, not the CISG.

[177] See Ingeborg Schwenzer & Pascal Hachem, *The CISG—Successes and Pitfalls*, 57 Am. J. Comp. L. 457, 474 (2009).

[178] See Magnus, supra note 30, at 42; UNCITRAL Digest 45 (para. 31) (2012); cf. Supreme Court (Austria), 23 May 2005, available at http://cisgw3.law.pace.edu/cases/050523a3.html; Supreme Court (Austria), 7 September 2000, available at http://cisgw3.law.pace.edu/cases/000907a3.html (parties generally free to modify rights provided by the CISG).

[179] See Chapter 2.IV.A.

APPENDIX 1

The United Nations Convention on Contracts for the International Sale of Goods

The States Parties to this Convention,

Bearing in mind 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,

Considering that the development of international trade on the basis of equality and mutual benefit is an important element in promoting friendly relations among States,

Being of the opinion 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,

Have agreed as follows:

PART I. SPHERE OF APPLICATION AND GENERAL PROVISIONS

Chapter I. *Sphere of Application*

Article 1

(1) This 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.

(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed