

Pacta Sunt Servanda: Contrasting Disgorgement Damages with Efficient Breaches under Article 74 CISG

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ABSTRACT

The contractual remedy of disgorgement damages has increasingly gained acceptance in international legal practice. Disgorgement of profits can result from a situation in which contractual breach is incentivised due to its financial superiority, ie profitability, over the proper fulfilment of the initial contract. In this situation, the aggrieved party can raise a claim for disgorgement damages, meaning it can claim the profits that the breaching party has made as a result of the breach. This differs from compensatory damages focusing solely on the loss of the aggrieved party. The calls for acceptance of disgorgement damages as an acceptable remedy under the United Nations Convention on Contracts for the International Sale of Goods ('CISG') specifically do not only stem from emerging international case law, but disgorgement as an applicable remedy under Article 74 CISG is also supported by leading CISG scholars such as Ingeborg Schwenzer and Pascal Hachem. This paper analyses the recoverability of disgorgement damages under Article 74 CISG, including an assessment of possible additional requirements a prima facie case needs to fulfil for the remedy to apply. The affirmative view to the applicability of disgorgement damages will be contrasted with the opposing concept of efficient breach.

INTRODUCTION

The contractual remedy of disgorgement damages has increasingly gained acceptance in international legal practice.¹ Disgorgement of profits can result from a situation in which a contractual breach is incentivised due to its financial superiority, ie profitability, over the proper fulfilment of the initial contract. In

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¹ See 'International Legal Practice via Article 7(1) CISG' below.

this situation, the aggrieved party can raise a claim for disgorgement damages, meaning it can claim the profits that the breaching party has made as a result of the breach. This practice is, however, vulnerable to the criticism that it overcompensates victims.²

Although the PACE database³ does not contain a single case in which disgorgement damages have been granted under the United Nations Convention on Contracts for the International Sale of Goods ('CISG' or 'Convention'),⁴ the rise of disgorgement is reflected in international legal practice and supported by leading CISG scholars such as Peter Schlechtriem and Ingeborg Schwenzer.⁵ CISG, as a living instrument adapting to challenges resulting from globalisation,⁶ must be interpreted with regard to its international character.⁷ There is no provision in the CISG explicitly addressing the remedy of disgorgement damages, and it is unclear whether Article 74, its damages clause, can be interpreted so as to encompass said remedy. This provision, in its literal meaning, states that damages equal to the loss, including loss of profit, are recoverable. Disgorgement, which would allow for the profits the breaching party has made to be part of the damages, seemingly exceeds this scope. However, international legal practice could potentially lead to an interpretation allowing the award of disgorgement damages under Article 74 CISG. An important focus of the following analysis will therefore lie on the existing case law of successful claims for disgorgement damages and courts' reasoning behind such awards.

This paper will analyse how the remedy of restitutionary disgorgement damages could be granted under Article 74 CISG in cases of gain-seeking

² Elaine Buckberg and Frederick G Dunbar, 'Disgorgement: Punitive Demands and Remedial Offers' (2008) 63 *The Business Lawyer* 347.

³ The PACE database is the database of PACE University, containing the CISG database which is a comprehensive global collection of legal materials, most importantly case law, on the CISG. See <<http://iicl.law.pace.edu/cisg/cisg>> accessed 21 February 2018.

⁴ Nils Schmidt-Ahrendts, 'Disgorgement of Profits under the CISG' in Ingeborg Schwenzer and Lisa Spagnolo (eds), *State of Play: The 3rd Annual MAA Schlechtriem CISG Conference* (Eleven International Publishing 2012).

⁵ Peter Schlechtriem and Ingeborg Schwenzer, *Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, OUP 2010).

⁶ Bruno Zeller, *CISG and the Unification of International Trade Law* (Routledge-Cavendish 2007) 2; André Janssen and Olaf Meyer, *CISG Methodology* (European Law Publishers 2009) 138.

⁷ United Nations Convention on Contracts for the International Sale of Goods (adopted 11 April 1980, entered into force 1 January 1988) 1489 UNTS 3 (CISG) art 7(1).

breaches of commercial contracts. The novelty of this research can be found in the inclusion of an analysis of potential additional conditions that need to be fulfilled under Article 74 in order for a disgorgement damages claim based on that provision to be successful. First, the paper provides an overview of the functioning of Article 74 CISG. Second, an assessment of the provision in light of relevant legal interpretive methods follows. Herein, the main focus lies on the analysis of international legal practice, concluding from which additional criteria for disgorgement, stemming from case law, can be established. Third, a distinction is made between disgorgement being restitutionary and punitive in nature. As punitive damages are explicitly excluded in CISG Advisory Council Opinion No 6 ('Opinion'),⁸ the present research addresses disgorgement damages as a solely restitutionary remedy. Last, the concept of efficient breach and its position in the CISG is analysed and juxtaposed with the concept of disgorgement.

I. CLAIMING DAMAGES UNDER ARTICLE 74 CISG

Requirements for the Award of Damages under Article 74 CISG

The Convention's residual damages clause, Article 74, provides a basis for the recovery of any loss, encompassing both the indemnity interest, meaning actual losses, and the expectation interest, meaning loss of profit.⁹ A claim for damages under Article 74 must meet four requirements. First, there must have been a contractual breach. Second, this breach must have resulted in consequential damages. Third, the risk of those losses must have been known by the breaching party, which is assessed by reference to the knowledge of the circumstances and consequences an experienced merchant would have had.¹⁰ Generally, this requirement is assumed to be fulfilled.¹¹ Fourth, it must have been foreseeable at the moment of conclusion of the contract that as a consequence of a breach, the other party would suffer losses. Whether the loss was foreseeable at the moment

⁸ CISG Advisory Council, 'CISG-AC Opinion No 6, Calculation of Damages under CISG Article 74, Rapporteur John Y Gotanda' (Spring 2006).

⁹ Djakhongir Saidov, 'Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods' (2002) 14 Pace Int'l L Rev 307.

¹⁰ Victor Knapp, 'Article 74' in Cesare M Bianca and Michael J Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Fred B Rothman & Co 1987) 541.

¹¹ *ibid.*

of the conclusion of the contract is assessed by the reference to what a reasonable person in the same circumstances ought to have foreseen.¹²

Interestingly, there is no prescribed method of calculation under Article 74 CISG, leaving the quantification of damages to the relevant court. Generally, the aggrieved party must be placed in as good a position as they would have been in had the contract been properly performed by the breaching party.¹³ Furthermore, in accordance with the principle of full compensation, the breaching party owes the aggrieved party damages consisting of the loss the aggrieved party incurred by relying on proper fulfilment of the contract and the profits that the aggrieved party would have made had the contract been fulfilled.¹⁴

Interpretation of Article 74 CISG

Article 74 CISG is phrased in a way that does not leave any uncertainty about the literal meaning of the words: the aggrieved party must be compensated for the losses it incurred as a result from the breach of contract. Therefore, a claim for damages under this provision seems to focus on the loss of the victim only, not the possible gain or loss of the breaching party. However, the CISG does not provide for a method by which to quantify damages under Article 74. Therefore, it is unclear whether compensating the victim for its losses is the only aim of the provision or whether the purpose of Article 74 CISG extends so far as to include deterrent considerations to protect contractual interests, thereby providing grounds for the remedy of disgorgement.

Although under CISG, the starting point for an analysis of the provision would be the literal interpretation,¹⁵ it is a living instrument¹⁶ that should be interpreted in accordance with its international character, as required by Article 7(1). Therefore, all possible interpretation methods should be taken into

¹² *Magnesium Case* [1995] ICC Arbitration Paris 8324; *Downs Investment v Pervaja Steel* [2000] Supreme Court of Queensland 10680, UNCITRAL (CLOUT) Abstract No 631; Schlechtriem and Schwenzer (n 5).

¹³ Secretariat Commentary on the 1978 Draft of the CISG, *Guide to CISG Art. 74* <<http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-74.html>> accessed 21 February 2018.

¹⁴ *Cooling system case* [2002] OGH Linz 7 Ob 301/01t; Saidov (n 9).

¹⁵ Robert Koch, 'The CISG as the Law Applicable to Arbitration Agreements?' in Camilla B Andersen and Ulrich G Schroeter (eds), *Sharing International Commercial Law across National Boundaries* (Simmons & Hill Publishing 2008).

¹⁶ Janssen and Meyer (n 6) 138.

account.¹⁷ Below, contextual and purposive interpretations will be applied, followed by an analysis of international legal practice.

Principles Underlying the CISG

In applying the contextual interpretation method, the general principles of the CISG as well as the application of other provisions must be considered, thereby establishing the spirit of the CISG as a whole.¹⁸ It must be interpreted with regard to its international character, to the need to promote uniformity in its application, and the need to observe good faith in international trade, in line with Article 7(1). Article 7(2) states that matters governed by CISG, but not expressly settled in it, are to be settled in conformity with its general principles. If this is not possible, resort to national law via the rules of private international law is allowed.¹⁹ Additionally, the concept of disgorgement is not alien to the CISG and is allowed for restitution of goods under Article 84(2) CISG. This provision states that the buyer must account to the seller for all benefits which he has derived from the goods or part of them; the aggrieved party is then allowed to claim all profits the breaching party has made with the concerned goods.²⁰

Legal doctrine and case law stemming from the CISG do not provide sufficiently clear answers to the debate on disgorgement damages. However, it is clear that the Convention must be read to provide an incentive to parties to keep their promises. It is commonly accepted that the CISG is based on the principle of full compensation, which internalises the underlying basic principle *pacta sunt servanda*.²¹ Seen in conjunction, these notions aim to encourage parties to keep their promises.²² This is also reflected through Article 84(2), allowing restitution

¹⁷ *Condensate crude oil mix* [2002] Netherlands Arbitration Institute 2319, UNCITRAL (CLOUT) Abstract No 720; Cesare M Bianca and Michael J Bonell (eds), *Commentary on the International Sales Law: The 1980 Vienna Sales Convention* (Fred B Rothman & Co 1987) 78.

¹⁸ Franco Ferrari and Marco Torsello, *International Sales Law (CISG) in a Nutshell* (West Academic 2014) 15; Larry A DiMatteo, *International Sales Law: A Global Challenge* (CUP 2014) 96.

¹⁹ CISG, art 7(2).

²⁰ *ibid* art 84(2).

²¹ Ulrich Magnus, 'CISG Art. 74' in Ulrich Magnus (ed), *Kommentar zum Bürgerlichen Gesetzbuch mit Einführungsgesetz und Nebengesetzen – Wiener UN-Kaufrecht (CISG)* (de Gruyter 2013); DiMatteo (n 18) 96.

²² Peter Huber and Alastair Mullis, *The CISG: A New Textbook for Students and Practitioners* (European Law Publishers 2007); Magnus (n 21).

including all gains derived from possession of the goods concerned. Furthermore, scholars have argued that ‘a breach of contract must not pay’ is a general idea underlying the Convention.²³ In the view of Nils Schmidt-Ahrendts, Peter Schlechtriem, Ingeborg Schwenzer, and Lisa Spagnolo, the Convention’s damages provisions should be interpreted according to their purpose and should therefore have deterrent effect so as to prevent deliberate breaches of contract.²⁴ Following this argumentation, they do not only suggest disgorgement damages but also to award the profits of the breaching party to the aggrieved party as a calculation method of the latter’s loss as defined under Article 74 CISG.²⁵

Article 74 CISG incorporates the principle of full compensation, which aims to place the party in breach in the same economic position it would have been in had the contract been duly performed. Nonetheless, it does not allow for overcompensation of the aggrieved party, and the profits of the breaching party can only be disgorged to the aggrieved if they do not exceed the amount of loss the victim has suffered as a result from the contractual breach under consideration.²⁶

In this light, Article 74 CISG should be understood as deterring parties from breaching their contractual obligations rather than encouraging them to do so for their own profit at the expense of their counterparty. An interpretation to the contrary would damage reasonable reliance, leading to a situation in which business practice building upon long-term relationships in particular would be distorted.²⁷

Purposive Interpretation

A purposive approach to interpretation looks at how the article is intended to function.²⁸ According to the Secretariat Commentary to Article 74 CISG, the provision’s draft counterpart, draft Article 70, was clearly intended to convey the notion ‘that the basic philosophy of the action for damages is to place the injured

²³ Schlechtriem and Schwenzer (n 5) 1017.

²⁴ Schmidt-Ahrendts (n 4).

²⁵ *ibid.*

²⁶ CISG-AC Opinion No 6 (n 8); Peter Huber, ‘CISG Art. 45-101’ in Harm P Westermann (ed), *Münchener Kommentar zum Bürgerlichen Gesetzbuch* (vol 3, 7th edn, CH Beck 2016).

²⁷ John Fitzgerald, ‘CISG, Specific Performance, and the Civil Law of Louisiana and Quebec’ (1997) 16 *J L & Com* 291.

²⁸ DiMatteo (n 18) 87.

party in the same economic position he would have been in if the contract had been performed.²⁹ Therefore, damages should be assessed according to the expectation interest.³⁰ It is suggested that discouraging parties from a deliberate breach of contract is, aside from the financial protection of the aggrieved party, the main motivation behind a damages clause.³¹ Article 74 CISG reflects the fact that *pacta sunt servanda* is one of the principles underlying the CISG, as it upholds a party's right to performance and protects this right with the principle of full compensation.³² An adverse interpretation of Article 74 CISG would lead to an encouragement of the concept of efficient breach, which is adverse to and in direct conflict with both *pacta sunt servanda* and the principle of good faith enshrined in Article 7(1) CISG.³³ Lastly, the article must be interpreted in light of contemporary legal practice, reflecting the need for and the practicality of disgorgement as a private law remedy. The following section will elaborate upon this.

International Legal Practice via Article 7(1) CISG

Legislation Supporting Disgorgement Damages

Although the CISG requires uniform and autonomous application,³⁴ national law can serve as an aid in informing international legal practice and development.³⁵ Examples of states allowing for disgorgement include the civil law systems of Germany, under §285 BGB, France, under Article 1303 of the *Code Civil*, Austria, under §1447 ABGB, and the Netherlands, under Article 6:104 BW. Furthermore, English and Welsh law recognised the remedy in cases such as *Blake* and *Esso Petroleum*, which are assessed below.

²⁹ Secretariat Commentary (n 13).

³⁰ Edward A Farnsworth, 'Damages and Specific Relief' (1979) 27 Am J Comp L 249.

³¹ Arthur L Corbin, *Corbin on Contracts: A Comprehensive Treatise on the Rules of Contract Law* (Vol I, West Publishing Company 1963) para 998. See also Nils Schmidt-Ahrendts, 'CISG and Arbitration' (2011) 3 Belgrade L Rev 211.

³² CISG-AC Opinion No 6 (n 8); *Jewelry Case* [2000] OLG Innsbruck 1 Ob 292/99v; *Rolled metal sheets case* [1994] Arbitral Tribunal Vienna SCH-4366.

³³ cf section III below.

³⁴ CISG, prmb1, para 13.

³⁵ Pilar Perales Viscillas, 'General Provisions - Article 7' in Stefan Kröll and Loukas Mistelis (eds), *United Nations Convention on Contracts for the International Sale of Goods (CISG)* (CH Beck Publishing 2011); *Feinbäckerei Otten GmbH & Co. Kg and HDI-Gerling Industrie Versicherung AG v Rhumveld Winter & Konijn B.V.* [2014] 200.127.516-01 Gerechtshof Den Haag.

Case Law

The CISG is a living instrument, wherefore it is imperative to consider international legal practice when interpreting its provisions. As mentioned before, the CISG should be interpreted in a way that promotes uniformity as required by Article 7(1) CISG. This is to be done by looking at the law of signatory States.³⁶ Numerous courts across various jurisdictions have allowed the remedy of disgorgement for deliberate contractual breaches, as in the cases of *Hickey v Roches Stores* in Ireland,³⁷ *Esso Petroleum v Mardon* in England and Wales,³⁸ and *Snepp v US*³⁹ in the United States.

In *Chinn v Collins*, the House of Lords awarded disgorgement in a case of constructive trust concerning shares.⁴⁰ The House did not accept the breaching party's argument that the contract specified only 'the number of shares, and not (...) specific shares.'⁴¹ In *Cincinnati*⁴² and *Experience Hendrix*,⁴³ an American and an English court, respectively, granted disgorgement for breach of contract that concerned intellectual property. Interestingly, those cases reflect situations in which disgorgement was awarded for incorporeal goods. In both, the grant of disgorgement damages was based on the nature and object of the underlying contract in its specific circumstances. *Cincinnati* concerned the disclosure of a trade secret. In *Experience Hendrix*, the breaching party knowingly acted contrary to what had been contractually agreed upon to protect the intellectual property right to song recordings of the party in breach, and thus the commercial value of its right.⁴⁴

Notably, the disgorgement remedy granted in the *Adras* case was decided by the Supreme Court of Israel under the CISG relating to a Uniform Law on the International Sale of Goods ('ULIS'), the predecessor of CISG.⁴⁵ Case law and

³⁶ *Sport d'Hiver di Genevieve Culet v. Ets. Louys et Fils* [1996] District Court Cuneo 45/96; Schmidt-Ahrendts, 'CISG and Arbitration' (n 31); DiMatteo (n 18) 60.

³⁷ *Hickey v Roches Stores* [1993] RLR 196.

³⁸ *Esso Petroleum Co Ltd v Mardon* [1976] EWCA Civ 4.

³⁹ *Snepp v United States* [1980] 444 US 507.

⁴⁰ *Chinn v Collins* [1981] 1 All ER 189, [1981] AC 533.

⁴¹ *ibid* [548]. See also Nicholas W Sage, 'Disgorgement: From Property to Contract' (2016) 66 UTLJ 244, 253.

⁴² *E.I. du Pont de Nemours & Co. v Cincinnati Printers Co., Inc.* [2010] Ohio 1631.

⁴³ *Experience Hendrix LLC v PPX Enterprises Inc* [2003] EWCA Civ 323.

⁴⁴ *ibid* [39].

⁴⁵ *Adras Chmorey Binyan v Harlow & Jones GmbH* [1988] Israeli Supreme Court 20/82.

interpretation of the CISG's predecessor is relevant because Article 70 ULIS, the provision the case was decided under, and Article 74 CISG are substantially equal.⁴⁶ The breaching party did not perform the contract because another company had offered more money for the same amount of steel contracted for. The goods contracted for, namely steel, were generic, wherefore they could easily have been found elsewhere on the market. Nevertheless, disgorgement was granted. The Court reasoned that the interests a party has in performance stemming from a contractual agreement should be protected – *pacta sunt servanda*.⁴⁷

One of the most important precedents concerning disgorgement under English law is *Attorney General v Blake and Another*, which allowed disgorgement as a generally applicable contractual remedy for the first time under English law.⁴⁸ The House of Lords noted that '[t]he main argument against the availability of an account of profits as a remedy for breach of contract is that the circumstances where this remedy may be granted will be uncertain' and emphasised that '[a]n account of profits will be appropriate only in exceptional circumstances'.⁴⁹ However, it granted the remedy because it considered the circumstances to be exceptional: the case concerned a former member of the security and intelligence services. The intelligence officer, Blake, deliberately breached his contract by divulging confidential information to the public, thereby causing 'untold and immeasurable damage to the public interest he had committed himself to serve'.⁵⁰ The House of Lords held that, in context, those were circumstances in which the breaching party cannot be permitted to profit from a contractual breach, and that specific performance and injunction would be insufficient to remedy the wrong and compensate the aggrieved party.⁵¹

The foregoing case law reflects the rise of disgorgement damages as a generally applicable contractual remedy. The argument can therefore be made that the CISG, as a living instrument,⁵² should be interpreted in a way that takes this development into account, which means a broadening of the scope of Article 74 CISG.

⁴⁶ Secretariat Commentary (n 13).

⁴⁷ *Adras* (n 45).

⁴⁸ *Attorney General v Blake and Another* [2000] UKHL 45.

⁴⁹ *ibid.*

⁵⁰ *ibid.*

⁵¹ *ibid.*

⁵² Janssen and Meyer (n 6) 138.

Additional Requirements for Disgorgement?

This article has argued that calculation of damages under Article 74 CISG should be permissible, allowing for a calculation method depending on the assessment of the circumstances in each particular case.⁵³ The US *Restatement of Restitution and Unjust Enrichment, the Restatement (Third)* states that any profit resulting from investment of the goods promised to the claimant should be paid to the latter as disgorgement damages as ‘there would [otherwise] be an incentive to embezzlement if the defendant were permitted to retain the profits.’⁵⁴ Nonetheless, profits should not be disgorged if this would be ‘unacceptably punitive, being unnecessary to accomplish the objective of the disgorgement remedy.’⁵⁵

An analysis of the case law in the foregoing section reflects the following recurring characteristics of the contracts for breach of which disgorgement was granted. Looking at the different sets of facts of the cases where the profits have been disgorged, no distinction can be made between cases concerning generic goods and unique goods.⁵⁶ Further, the remedy seems to qualify for both, cases concerning tangible goods and cases concerning intangible goods.⁵⁷ However, there is an ascertainable recurring trend which can be formally split into three cumulative conditions. In all cases addressed, there was a unilateral breach of contract. Secondly, the breaching party made a tangible profit. Last, the profit to be disgorged was causally related to the loss the victim of the breach suffered, meaning the profit could not have been made, but for the breach.

II. DISGORGEMENT DAMAGES AS RESTITUTIONARY REMEDY

Scholars disagree as to whether disgorgement is either: (1) a remedy of unjust enrichment, ie an independent cause of action for restitution; or (2) a tort claim run as an alternative or in addition to compensatory damages.⁵⁸ It is disputed

⁵³ Schmidt-Ahrendts, ‘Disgorgement of Profits’ (n 4).

⁵⁴ US Restatement of Restitution and Unjust Enrichment, the Restatement (Third) para 51.

⁵⁵ *ibid.*

⁵⁶ *Adras* (n 45).

⁵⁷ *Blake* (n 48).

⁵⁸ Ronald L Israel and Brian P O’Neill, ‘Disgorgement as a Viable Theory of Restitution Damages’ (2014) *Commercial Damages Reporter*

whether disgorgement damages should be considered restitutionary or punitive in nature.

Restitution is aimed at reimbursing the aggrieved party for its losses by assessing the expectation interest, thereby putting it into the position it would have been in had the contract been duly performed.⁵⁹ However, the risk of overcompensating the aggrieved party remains. In such a case, the aggrieved party could receive damages greater than the loss it actually incurred; that is to say, where the amount disgorged is beyond what could have possibly been gained had the contract been performed.⁶⁰ Therefore, some authors argue that the remedy is punitive in nature and should not be applied under CISG, as punitive damages are explicitly excluded through the Opinion.⁶¹ Nevertheless, Richard Posner, a strong advocate for the concept of efficient breach, has implied that such overcompensation would result from disgorgement for contractual breach in cases concerning unique goods only.⁶² Further, in cases where it would be considered punitive, Schwenzer stated that Article 74 CISG could entail 'penal elements (...) despite the fact that the Convention does not allow punitive damages.'⁶³

Claims for restitution are intended to 'prevent the defendant's unjust enrichment by recapturing the gains the defendant secured in a transaction.'⁶⁴ According to the Opinion, the focus of a damages claim under Article 74 CISG is the loss suffered by the aggrieved party.⁶⁵ In contrast, restitution is a gain-based approach focusing on the gain of the breaching party. They are, therefore, at odds as the Opinion expresses a victim-based approach.⁶⁶ Concerning Article 84 CISG,

<http://www.csglaw.com/B8D11B/assets/files/News/israel_oneill_commercial_damages_reporter_jan_2014_lead_article.pdf> accessed 21 February 2018.

⁵⁹ *ibid.*

⁶⁰ Richard Posner, *Economic Analysis of Law* (7th edn, Wolters Kluwer 2007) 118-126, 130-131; Steve Thel and Peter Siegelman, 'You Do Have to Keep Promises: A Disgorgement Theory of Contract Remedies' (2011) 52 *Wm & Mary L Rev* 1181.

⁶¹ Ernest J Weinrib, 'Punishment and Disgorgement as Contract Remedies' (2003) 78 *Chi-Kent L Rev* 55; CISG-AC Opinion No 6 (n 8).

⁶² *ibid.*

⁶³ Schlechtriem and Schwenzer (n 5) 1002.

⁶⁴ Dan B Dobbs, *Law of Remedies: Damages, Equity, Restitution* (2nd edn, Thomson West 1993) 551. See also Israel and O'Neill (n 58).

⁶⁵ CISG-AC Opinion No 6 (n 8).

⁶⁶ Daniel Markovits and Alan Schwartz, 'The Myth of Efficient Breach: New Defenses of the Expectation Interest' (2011) 97 *Va L Rev* 1939.

it applies ‘a corollary to the restitutionary principle which is generally accepted in domestic systems of law: to avoid unjust enrichment, a party who is required to make restitution must also account for the benefits received.’⁶⁷ As such, it is arguable that the general spirit of the CISG points towards restitution, as reflected by the remedy of restitution of goods under Article 84 CISG. Disgorgement damages, as considered in this paper, are addressed as a restitutionary rather than a punitive remedy, since it does not put the breaching party in a position worse than it would have been in if the initial contract never would have been concluded.⁶⁸ As this paper posits, where a case-by-case assessment reveals that specific circumstances require disgorgement to adequately compensate the aggrieved party for the losses it has incurred as a result of the contractual breach, the result cannot lead to overcompensation. While a punitive remedy may at the same time be restitutionary, the award of restitutionary disgorgement damages under Article 74 CISG can, following the foregoing line of reasoning and the proposed additional requirement for the award of disgorgement damages, never be of a punitive nature.

III. DISGORGEMENT AND EFFICIENT BREACH AS OPPOSING CONCEPTS

A man who bespeaks a coat of his tailor will scarcely be persuaded that he is only betting with the tailor that such a coat will not be made and delivered to him within a certain time. What he wants and means to have is the coat, not an insurance against not having the coat.⁶⁹

Efficient breach builds upon the dual performance hypothesis, and operates under the premise that, in a contract, parties can choose to either fulfil their primary contractual obligations or pay damages.⁷⁰ Thereafter, having compensated the aggrieved party for the breach, the surplus left can be kept by

⁶⁷ Joseph Lookofsky, ‘Article 84 - Accounting for Interest and Other Benefits Received’, *International Encyclopaedia of Laws – Contracts* (Suppl 29, 2000) 170.

⁶⁸ For a different view, consult Buckberg and Dunbar (n 2).

⁶⁹ Frederick Pollock, *Principles of Contract* (3rd edn, Stevens & Sons 1881) XIX.

⁷⁰ Markovits and Schwartz (n 66); Gregory Klass, ‘To Perform or Pay Damages’ (2012) 98 Va L Rev 143.

the breaching party.⁷¹ Advocates of this concept argue that it allows both parties to gain – the aggrieved party is put in the position it would have been in had the contract been duly performed, while the breaching party was able to make a larger profit.⁷² The opposing view highlights the importance of remedies such as specific performance and restitution in cases of contractual breach.⁷³

One of the main purposes of disgorgement damages is to provide an incentive for parties to fulfil their contractual obligations by precluding the possibility for parties to make larger profits through contractual breach – *pacta sunt servanda*.⁷⁴ This is reflected through Article 74 CISG, which inherently protects contractual interests.⁷⁵ It is apparent why the remedy of disgorgement is in direct conflict with the concept of efficient breach: when electing efficient breach, the breaching party acts contrary to its contractual obligations because doing so makes it a larger profit. This incentive would be taken away if the aggrieved party could claim those profits as disgorgement damages. The moral criticism of the efficient breach concept is that a party deliberately acting contrary to the obligations it undertook cannot keep the gains resulting from this breach.⁷⁶

Article 74 CISG is premised on the expectation interest. By stating that '[d]amages for breach of contract by one party consist of a sum equal to the loss, including loss of profit (...)', it seeks to place the aggrieved party in a position it would have been in had the contract been duly performed.⁷⁷ Allowing for efficient breach would jeopardise 'the regime of exchange', leading to a situation in which no party could 'occupy a sufficiently stable position to know what he had to offer or what he could count on receiving from another.'⁷⁸ It is therefore reasonable to conclude that efficient breach is not a concept supported by the Convention,

⁷¹ Thel and Siegelman (n 60).

⁷² *ibid*.

⁷³ Alan Schwartz, 'The Case for Specific Performance' (1979) 89 *Yale L J* 271, 271; Ian R Macneil, 'Efficient Breach of Contract: Circles in the Sky' (1982) 68 *Va L Rev* 947, 947; Fitzgerald (n 27) 300.

⁷⁴ Schmidt-Ahrendts, 'CISG and Arbitration' (n 31) para 3.2.

⁷⁵ *ibid*.

⁷⁶ Thel and Siegelman (n 60).

⁷⁷ Joseph Lookofsky, 'Article 74 - Damages for Breach', *International Encyclopaedia of Laws – Contracts* (Suppl 29, 2000) 152-153 (emphasis added).

⁷⁸ Lon L Fuller, *The Morality of Law* (rev edn, YUP 1969) as cited in Robert A Hillman, 'Applying the United Nations Convention on Contracts for the International Sale of Goods' (1995) 21 *Cornell Review of the Convention on Contracts for the International Sale of Goods* 21.

which leaves open the possibility of awarding disgorgement under certain circumstances.

CONCLUSION

Article 74 CISG is governed by the principle of full compensation, and aims to place the victim of contractual breach in the same economic position as it would have been in had the contract been duly performed.⁷⁹ Premised on the expectation interest, Article 74 CISG seeks to provide an incentive for parties to keep their promises – *pacta sunt servanda* – wherefore it has been argued in the foregoing that the CISG does not support the concept of efficient breach. In light of the principle of full compensation, a provision of damages under Article 74 focuses on the loss incurred by the aggrieved party. Disgorgement damages exceed this scope. As it does not relate to the losses that might be incurred by the party demanding damages, it does not intend to compensate the party requesting damages for the alleged loss,⁸⁰ but rather for the unwarranted gain of the other party. Considered as a supra-compensatory concept of damages, it would be incompatible with the overall purpose of the CISG, where the party claiming damages can only be compensated for the loss it actually incurred. Arguably, the principle of full compensation aims to secure remedial certainty under the CISG, which the inclusion of disgorgement damages, as a general contractual remedy under the scope of Article 74, would jeopardise. However, it has been demonstrated that in specific cases, disgorgement is appropriate. Recurring in the case law are three cumulative conditions necessary, in addition to the general requirements for a damages claim, in order for the disgorgement remedy to be available. First, one party must have breached a contract. Second, this party must have made a profit which it could not have made, had it properly performed its contractual obligations towards the claimant. Third, there must be an economic link between the gain resulting from the breach of contract incurred by the breaching party and the loss incurred by the party in breach, which serves as an additional requirement where a successful damages claim includes the disgorgement of profits. This way, the restitutionary nature of the remedy under

⁷⁹ CISG-AC Opinion No 6 (n 8).

⁸⁰ cf formulation of Article 74 CISG: ‘sum equal to the loss’.

Article 74 CISG can be ensured, in line with the principle of full compensation governing the CISG.