REDUCTION IN DAMAGES ACCORDING TO ARTICLE 77 CISG

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I. A RUSSIAN AND A SPANISH CASE

My starting point is the Russian Case No. 54/1999 of 24 January 2000 of the Arbitration Tribunal of the Russian Federation Chamber of Commerce and Industry.[1] I quote the abstract prepared by Alexander Komarov:

> The action was brought by an American firm, the buyer, against a Russian company, the seller, in connection with a contract concluded by the parties in January 1998. The contract involved the delivery of two consignments on an FCA (free carrier) basis, in accordance with Incoterms under the contract. The seller was obliged to check the quality of the goods before dispatch and submit confirmatory documents with the cargo to the buyer. According to the statement by the seller, the check on the first consignment was conducted, for technical reasons, in the country of destination. The check revealed material deviations from the contract requirements, as a result of which the first consignment reached the end user substantially reduced in value. On the first consignment, the buyer sought a price reduction equal to the sum that remained unpaid by the end users. On the second consignment, the buyer sought damages for lost profit, on the grounds that the delivery of inferior goods under the first consignment had damaged its reputation on the market, with a consequent substantial slowdown in sales. The seller asserted that, firstly, the buyer had not proven that the goods were defective, and, second, that the buyer's claim had been lodged after the deadline established by the contract.
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> The tribunal found that the buyer's inspection of the first consignment had used methods not provided for by the contract. With regard to the breach by the buyer of the agreed claim period, the tribunal ruled that the buyer, by sending the seller a letter with an inquiry about replacing the defective goods, had acted in conformity with the provisions of article 46 CISG. The tribunal did not, however, agree with the buyer's contention that the seller had wrongfully failed to indicate in the documentation accompanying the shipment the existence of defects, since it was impossible to draw such a conclusion from the nature and extent of the defects and the evaluation made by each side. The tribunal found that the inspection of the goods in the loading port had been economically and technically inadequate. The postponement of the quality check until its arrival in the port of destination was, therefore, considered reasonable by the tribunal.
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> With regard to the amount of the payment that should be made by the seller to the buyer, the court concluded that it was impossible to establish precisely from the documents submitted by the buyer whether all the defective goods checked had defects

1. CLOUT Case No. 474 [Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry, 24 Jan. 2000], *available at* http://cisgw3.law.pace.edu/cases/000124r1.html.

characterized as such under the terms of the contract. In addition, the tribunal concluded that claims relating to the consignment could be considered only in relation to the goods that were actually checked, since the method of checking by sampling was not in accordance with the provisions of the contract (despite the fact that such a method of checking is generally recognized in world trade). Furthermore, the tribunal noted that the buyer could not base its claim on articles 75 and 76 CISG, which applied to situations where a contract was avoided, whereas the buyer had exercised its right under article 50 CISG to claim a price reduction. The buyer could not, therefore, also claim compensation for loss and it had made no claim for including customs costs in the calculation of the price reduction. Moreover, the buyer had not proved that it could use the goods only for the purposes indicated by it (sale to specified users). The tribunal applied article 77 CISG, since the buyer had taken no action to mitigate the loss arising out of the breach of contract. With regard to the first consignment of goods, the tribunal determined that the price reduction should be fixed at 50 percent of the difference between the price of the disputed goods under the contract and the price agreed between the buyer and the end consumers. With regard to the second consignment of goods, the tribunal determined that the buyer had not proven the damage caused to its reputation by the goods in question. The tribunal noted that the seller's breach of contract could not have resulted in serious harm to the reputation of the goods or difficulties in selling the second consignment.

On the basis of the above and of article 74 CISG, the tribunal concluded that the buyer's claims with regard to the second consignment of goods should be dismissed. With regard to the first consignment, the tribunal ordered the seller to pay the buyer 50 percent of the difference between the price of the goods under the contract and the price agreed between the respondent and the end users.[2]

The part concerning Article 77 of the Synopsis and Commentary by Mikhail G. Rozenberg reads as follows:

In accordance with Article 77 of the Vienna Convention 1980, if the party relying on the breach of the contract does not take measures reasonable in the circumstances to mitigate the loss, the party in breach is entitled to demand the reduction of damages in the amount by which they could have been reduced. In his reply to the claim and in the proceedings of the ICCA, the seller alleged that the buyer had not taken such measures. In this regard, the seller asked the Court to dismiss the buyer's claim. As follows from the materials of the case, the buyer did not provide the seller with documents confirming the validity of the claims in time and, accordingly, did not receive necessary information from the seller which could be used at negotiations with the consumers of the goods and conduce to solving the issue of decreasing the amount of reduction of the price.

In particular, such a conclusion is also confirmed by the fact that, as has been pointed out in paragraph 3.1., the issue of incorrectness of the applied method of the inspection of the quality of the goods was of decisive importance. The position set forth by the seller gives the ICCA grounds to conclude that Article 77 of the Vienna Convention 1980 is applicable to the present case.

With regard for all the above said considerations, the ICCA has come to a conclusion that it would be fair to fix the reduction of the price with respect to the quantity of the goods which had been, in fact, examined in the amount of 50% of the difference between

2. *Id.*

> the price of the goods under the contract in dispute and the price agreed to in the relations between the buyer and his customers. Thus, the seller must pay the buyer the above indicated discount under the claim related to the first instalment of the goods.[3]

Now the Spanish Case No. 454/2000 of 28 January 2000 of the Tribunal Supremo.[4] The seller (Internationale Jute Maatschappij, BV) sought to have the Spanish Tribunal declare that the buyer committed a breach of contract on the basis that it did not take delivery of 724,800 bags of jute (the agreed total amount was 800,000 bags).[5] The Tribunal's decision was favourable to the seller, as it declared that a contract existed because the fax of 25 January 1993 sent by the buyer was an acceptance; a pure, unconditional and unequivocal acceptance, as it specified the amount of 800,000 bags of jute at the price of $55.90 per hundred. Moreover, the Tribunal understood that a subsequent fax sent to the seller was a confirmation of the acceptance and that the third fax the buyer sent to the seller was an attempt to alter the terms of the contract, as it included a renegotiation of the price.

Regarding damages, the seller sought to receive the difference between the agreed contract price and the price it obtained when it sold the goods to a third company pursuant to Article 75 CISG. The Court held, however, that the amount had to be reduced on the basis that the seller did not comply with its obligation to mitigate damages under Article 77 CISG.

I quote the part of the decision which concerns Article 77 CISG in full:

> It was proved that the buyer offered to purchase the 724,800 sacks of jute at a price of 70 pesetas per unit, a price which included the stamping of the buyer's anagram. Upon being informed by the seller of the existence of a substitute buyer who would pay US $0.30 per new and printed unit, the rejection by the seller of the buyer's offer to purchase the jute at 70 pesetas per unit is not justified based on the seller's attempt to condition the buyer's payment on the issuance of a letter of credit drawn on a prestigious Dutch bank to cover the purchase price that the buyer offered. This is so considering the fact that the commercial relationship that had existed between the parties since 1988 was without incidents concerning the payment of the supplied merchandise. We further observe that in the substitute sale no special guarantees of the payment of the price were demanded; the seller simply made payment conditional "after receipt of the invoice." Consequently, we cannot affirm that in rejecting the buyer's offer to acquire the 724,800 sacks of jute at a price of 70 pesetas per unit, the seller had adopted "measures that are reasonable under the circumstances, in order to reduce the loss." Instead, the seller resold the sacks to a third party for a very inferior price after only a few days. The damages the seller has requested should therefore be reduced to US $17,865.48 whose

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3. *Id.*

4. CLOUT Case No. 395 [Tribunal Supremo, Spain, 28 Jan. 2000], *available at* http://cisgw3.law.pace.edu/cases/000128s4.html.

5. *Id.*

> value in Spanish currency is 2,340,379 pesetas. We direct the buyer to pay this amount plus the legal interest under art. 921 of the Civil Procedures Code from the date of this award.[6]

II. THE INTERPRETATION OF ARTICLE 77 SENTENCE 2 CISG

As we have seen, the Russian court of arbitration arrived at the conclusion that the damage, which should have been mitigated, has to be apportioned between the creditor and the debtor.[7] This result is in accordance with the wide and generally accepted principle on contributory negligence, which is accepted not only under tort law but also in the area of contractual liability.[8] Nevertheless, it seems to contradict Article 77 sentence 2 CISG. The first sentence provides that a party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss. The second sentence reads: "If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated."[9] The Spanish decision, on the other hand, obviously is in accordance with the wording of Article 77.

It is true, some scholars[10] are of the opinion that Article 77 is in accordance with the generally accepted rule on contributory negligence. But the overwhelming doctrine[11] takes the opposite view: the reduction in damages has to be equal to the amount by which the loss should have been

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6. *Id.*

7. But I have to point out that the reasoning of the decision is not very clear.

8. *See* Ulrich Magnus & Miquel Martín-Casals, *Comparative Conclusion no. 2*, *in* UNIFICATION OF TORT LAW: CONTRIBUTORY NEGLIGENCE 259 (Ulrich Magnus & Miquel Martín-Casals eds., 2004).

9. United Nations Convention on Contracts for the International Sale of Goods art. 77, U.N. Doc. A/CONF.97/18, Annex 1 (Apr. 11, 1980).

10. JAN HEILMANN, MÄNGELGEWÄHRLEISTUNG IM UN-KAUFRECHT 610 (1994); ROLF HERBER & BEATE CZERWENKA, INTERNATIONALES KAUFRECHT art. 77, no. 2 (1991); Willibald Posch, *Pflichten des Käufers, Rechtsbehelfe des Verkäufers, Gefahrenübergang und Schadenersatz*, *in* DAS UNCITRAL-KAUFRECHT IM VERGLEICH ZUM ÖSTERREICHISCHEN RECHT 181 (Peter Doralt ed., 1985); PETER SCHLECHTRIEM, EINHEITLICHES UN-KAUFRECHT 92 (1981); PETER SCHLECHTRIEM, UNIFORM SALES LAW 99 (1986).

11. STEFANO CORVAGLIA, DAS EINHEITLICHE UN-KAUFRECHT—CISG 120 (1998); Fritz Enderlein, *in* INTERNATIONALES KAUFRECHT 243 (Fritz Enderlein et al eds., 1991); MARTIN KAROLLUS, UN-KAUFRECHT 225 (1991); Victoria Knapp, *in* COMMENTARY ON THE INTERNATIONAL SALES LAW: THE 1980 VIENNA SALES CONVENTION 562, art. 77, no. 2.11 (C.M. Bianca & M.J. Bonell eds., 1987); Ulrich Magnus, *in* KOMMENTAR ZUM UN-KAUFRECHT art. 77, no. 13 (Heinrich Honsell ed., 1997); Peter Rummel, *Schadenersatz, höhere Gewalt und Fortfall der Geschäftsgrundlage*, *in* DAS EINHEITLICHE WIENER KAUFRECHT 183 (Hans Hoyer & Willibald Posch eds., 1992); Hans Stoll, *in* KOMMENTAR ZUM EINHEITLICHEN UN-KAUFRECHT art. 77, no. 3 (Ernst von Caemmerer & Peter Schlechtriem eds., 2d ed. 1995).

mitigated. Thus, the amount owed by the liable party has to be established as follows. First, the full damage has to be calculated and then the amount by which the loss should have been mitigated has to be deducted from the former.[12] Therefore, the contributory negligence of the party relying on the breach of contract does not lead to the result that the damage to which he has contributed has to be apportioned, but to the outcome that he has to bear the whole damage negligently caused by him. Only this interpretation seems to be in accordance with the clear wording of Article 77 sentence 2.

III. A JUST AND PROPER SOLUTION?

Article 77 sentence 2 CISG, therefore, seems to be in accordance with the Roman law;[13] but this theory of the so-called Culpa-Compensation, which generally denied any compensation in cases of contributory negligence, is antiquated.[14] This concept has long since been set aside;[15] even the common law countries have accepted the flexible system of contributory negligence, under English law by the Law Reform (Contributory Negligence) Act 1945 and in the U.S.A. in the 1970's.[16] The modern concept is considered to be just and reasonable, above all because it treats the tortfeasor and the victim equally.[17]

Therefore, at first glance the continental lawyer may come to the conclusion that, unfortunately, Article 77 CISG has adopted an archaic concept which no longer can be qualified as just and reasonable. Nevertheless, a common lawyer will immediately contradict and point out that Article 77 is based on the principle that a party "may not recover damages that he could reasonably have avoided."[18] Under common law, except in Ireland,[19]

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12. Knapp, *supra* note 11, at 562.

13. *See* REINHARD ZIMMERMANN, THE LAW OF OBLIGATIONS: ROMAN FOUNDATIONS OF THE CIVILIAN TRADITION 1047 (1990).

14. *Cf.* Jörg Fedtke & Ulrich Magnus, *Contributory Negligence Under German Law*, *in* UNIFICATION OF TORT LAW: CONTRIBUTORY NEGLIGENCE 76 (Ulrich Magnus & Miquel Martín-Casals eds., 2004).

15. *See* Magnus & Martín-Casals, *supra* note 8, at 260.

16. *Cf.* G.T. Schwartz, *Contributory Negligence Under United States Law*, *in* UNIFICATION OF TORT LAW: CONTRIBUTORY NEGLIGENCE 223 (Ulrich Magnus & Miquel Martín-Casals eds., 2004).

17. As to further justifications see Magnus & Martín-Casals, *supra* note 8, at 261.

18. HENRY GABRIEL, PRACTITIONERS GUIDE TO THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG) AND THE UNIFORM COMMERCIAL CODE (UCC) 237 (1994); JOHN O. HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION no. 417 (1982); Stoll, *supra* note 11, at art. 77, no. 3.

19. Civil Liability Act, 1961 (Act No. 41/1961) (Ir.) ch. 3, § 34(2)(b). *Cf.* Curley v. Dublin

it seems broadly accepted that in a case of negligent failure to *mitigate loss* the damaged person does not receive compensation for the whole avoidable loss.[20] Some other legal systems stick to this concept.[21] The same is true for Articles 9.504 and 9.505 of the Principles on European Contract Law by the "Lando Comission" and for Article 7.4.8. of the UNIDROIT Principles on International Trade Law.

But I feel that in general the avoidable loss rule is not reasonable and one should follow the Irish example and the opinion of the majority of the civil law countries[22] which apply the rule on contributory negligence also in the cases of failure to mitigate damage. The counter argument against the avoidable loss rule is that in weighting all the relevant factors there is no difference between cases of contributory negligence and of failure to mitigate damage. In both cases the conduct of the damaged party is a conditio sine qua non for (part of) the damage and, therefore, in both times it could be said that the loss has been avoidable. Further, the avoidable loss rule treats the party who breaches the contract and the party who suffers damage quite differently, and there exists no convincing argument for doing so.[23] But I have to acknowledge that there may be an exception for one area, and that those who drafted Article 77 CISG perhaps had only in mind this area. This is indicated by Honnold[24] who states: "Under the Convention, a party is responsible for non-performance of the contract without regard to fault . . .; consequently, it is not surprising that the convention states, with some emphasis, that the other party 'must make' measures to 'mitigate the loss . . . resulting from the breach.'" If the non performing party is liable without being at fault, it may be justified[25] to argue that negligence on the side of the aggrieved party is prevailing to such an extent that he has to bear the whole loss. If Article 77

Corporation (Unreported) (9 July 2003) (H. Ct.) (Ir.); Curley v. Dublin Corporation (Unreported) (26 Nov. 2004) (S.C.) (Ir.); Kelly v. Hennessy, [1995] 1 I.L.R.M. 321 (S.C.) (Ir.); Bohan v. Finn (1994) Doyle's Personal Injury Journal: Trinity and Michaelmas Terms.

20. *Cf.* DAN DOBBS, LAW OF REMEDIES 270 (2d ed. 1993); JOHANN NEETHLING ET AL., LAW OF DELICT 234 (3d ed. 1999); W.V. Horton Rogers, *Contributory Negligence Under English Law*, *in* UNIFICATION OF TORT LAW: CONTRIBUTORY NEGLIGENCE 59 (Ulrich Magnus & Miquel Martín-Casals eds., 2004).

21. *Cf.* Magnus & Martín-Casals, *supra* note 8, at 263.

22. *See id.*

23. For more details see Helmut Koziol, *Rechtsfolgen der Verletzung einer Schadensminderungspflicht—Rückkehr der archaischen Kulpakompensation?*, ZEITSCHRIFT FÜR EUROPÄISCHES PRIVATRECHT [ZEUP] 599 *et seq.* (1998).

24. HONNOLD, *supra* note 18, at no. 417.

25. Although the author is skeptical as to whether it can be justified at all. Magnus & Martín-Casals, *supra* note 8, at 596.

would only cover such cases it would be acceptable. But I have to point out that Article 77 CISG is not restricted to cases where there is no fault on the side of the breaching party and that there is no such justification in cases of breach of contract by fault on the one side and negligent failure to mitigate the damage on the other side. The conduct of both parties is negligent and a conditio sine qua non for the loss. Furthermore, I think there is no reason at all to judge the negligence of the party who breaches the contract as being less culpable than the fault of the other party in mitigating the loss caused by the improperly behaving party. For example, if a seller negligently fails to buy the goods he has to deliver, why should the buyer bear the whole loss if he also neglects to mitigate the loss by purchasing goods in replacement? Is it not the seller who promised to get the purchaser the goods and who is put under an obligation to do whatever is necessary? And why should the buyer alone—who has promised nothing of this nature—bear all the negative consequences if he negligently does not assume the obligations the other party has undertaken? The result in applying Article 77 CISG seems particularly intolerable if the seller intently breaches the contract although he easily could purchase the goods and the buyer only negligently fails to mitigate the loss.

Therefore, I feel that the avoidable loss rule is—if at all—reasonable only if a party is responsible for non performance of the contract without fault and the aggrieved party negligently does not mitigate the loss. In all other cases only the flexible contributory negligence rule is reasonable. Thus, I would express the view that it understandably did not even occur to the Russian arbitration court that according to Article 77 CISG the case should be resolved differently.