

# Measuring Damages Under the United Nations Convention on the International Sale of Goods

## I. INTRODUCTION

The United Nations Convention on the International Sale of Goods (hereinafter Convention or CISG)<sup>1</sup> went into force on January 1, 1988<sup>2</sup> with the United States as one of nineteen countries that ratified the Convention.<sup>3</sup> The Convention received the requisite two-thirds advice and consent from the Senate and was subsequently ratified by President Reagan.<sup>4</sup> Therefore, under the supremacy clause of the United States Constitution,<sup>5</sup> the Convention now prevails over state sales laws, such as the Uniform Commercial Code (“U.C.C.”), in international transactions to which the Convention applies.<sup>6</sup> Because the Convention eliminates state competence to deal with these sales,<sup>7</sup> it represents a significant displacement of state law in the United States.<sup>8</sup>

In the wake of American ratification of the Convention, American sales lawyers must consider the Convention’s impact on their international sales contracts. Parties can no longer draft international sales contracts in the limited context of conflicts of law provisions and foreign sales law. Contracting parties from different countries that have adopted the Convention<sup>9</sup> must now consider the prospect, benign to some and worrisome to others, that the Convention may control their contract.<sup>10</sup>

This Note focuses on one important aspect of the Convention: how the Convention measures money damages. After briefly reviewing the drafting history of the Convention, the scope of its application, and general drafting considerations, the Note will compare the Convention’s damages provisions to those of Article 2 of the

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1. United Nations Convention on Contracts for the International Sale of Goods, U.N. Doc. A/CONF. .97/18, Annex I (1980) [hereinafter Convention or CISG], reprinted in *United Nations Conference on Contracts for the International Sale of Goods, Official Records* at 178, U.N. Doc. A/CONF. .97/19, U.N. Sales No. E.81.IV.3 (1981); ABA, *THE CONVENTION FOR THE INTERNATIONAL SALE OF GOODS: A HANDBOOK OF BASIC MATERIALS* 28–61 (1987); S. TREATY DOC. No. 9, 98th Cong., 1st Sess. 22–43 (1983); and 52 Fed. Reg. 6262 (1987). The text of the Convention has six official versions—English, Arabic, Chinese, French, Russian, and Spanish. *Final Act of the United Nations Conference on Contracts for the International Sale of Goods*, U.N. Doc. A/CONF. .97/18 (1980).

2. ABA, *supra* note 1, at 1.

3. *Id.* The Convention initially went into force between Argentina, China, Egypt, France, Hungary, Italy, Lesotho, Syria, United States, Yugoslavia, and Zambia. 52 Fed. Reg. 6262 (1987). As of September 8, 1989, eight other countries have joined the Convention—Australia, Austria, Denmark, East Germany, Finland, Mexico, Norway, and Sweden. Current information about which countries have ratified the Convention can be obtained through the United Nations, Treaty Section, New York, N.Y. 10017, (212) 963-7958/5048.

4. 52 Fed. Reg. 6262 (1987).

5. U.S. CONST. art. VI.

6. See *infra* notes 23–35 and accompanying text.

7. Rosett, *Critical Reflections on the United Nations Convention on Contracts for the International Sale of Goods*, 45 OHIO ST. L.J. 265, 295 (1984).

8. *Id.* at 265, 272.

9. See *supra* note 3.

10. CISG, *supra* note 1, art. 1(1)(a). The increasing interdependence of the world’s economy presages continued growth of international trade. The value of the world’s exchange of goods is one trillion dollars and growing. Honnold, *The United Nations Commission on International Trade Law: Mission and Methods*, 27 AM. J. COMP. L. 201, 202 (1979). These trends suggest that the Convention is likely to play a significant role in the future development of private international law. That countries from six continents and from diverse legal and economic traditions have already ratified the Convention suggests that the Convention will affect an increasingly large segment of international sales transactions. See *supra* note 3.

Uniform Commercial Code and will offer possible interpretations of the Convention's provisions in light of their drafting history. Prior research and scholarship concerning the Convention has focused on two areas: (1) the merits or criticisms of particular provisions and (2) arguments for and against American acceptance of the Convention.<sup>11</sup> Now that the Convention has been adopted, a more practical perspective should be considered—what is it that American drafters of international sales contracts need to know about the Convention? An analysis of the Convention's damages provisions will address one aspect of this broader question.

## II. BACKGROUND

### A. *Drafting History of the Convention*

The drafting history of the Convention lends perspective to its rules on damages and to the manner in which these rules will be interpreted. The Convention represents the culmination of over fifty years of negotiation.<sup>12</sup> This process of obtaining consensus on an international sales law proceeded in two stages. The first stage began in 1928 at the Sixth Session of the Hague Conference on Private International Law.<sup>13</sup> In the 1920s and 1930s, the participants in the effort came from the industrialized countries of Europe.<sup>14</sup> During this Eurocentric phase of the drafting, the primary disagreements centered on the differences between the common law and civil law traditions of the various participants.<sup>15</sup> The second stage of the Convention's drafting history began after World War II. In the years after the Second World War, the voices of a much more diverse group of countries—developed and undeveloped, socialist and capitalist, colonized and colonizing—contributed to what would become the final draft of the Convention.<sup>16</sup> In 1964, a conference of twenty-eight countries at the Hague Convention adopted (1) the Convention on the Formation of the Contract and (2) the Convention on the Sales Contract.<sup>17</sup> Negotiations focusing on these two conventions led to approval by the United Nations Commission on International Trade Law (UNCITRAL) in 1978 of a draft sales convention, which was finally adopted in 1980 in Vienna.<sup>18</sup> The 1980 Vienna Convention went into effect on January 1, 1988.<sup>19</sup>

The UNCITRAL body responsible for drafting the CISG was widely repre-

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11. For current bibliographies on the Convention, see ABA, *supra* note 1, at 152–68; J. HONNOLD, *UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION* 29–34 (1982).

12. J. HONNOLD, *supra* note 11, at 49; Rosett, *supra* note 7, at 266.

13. Honnold, *A Uniform Law for International Sales*, 107 U. PA. L. REV. 299, 302–03 (1959); Rosett, *supra* note 7, at 267.

14. Rosett, *supra* note 7, at 267.

15. *Id.* at 282.

16. *Id.*

17. J. HONNOLD, *supra* note 11, at 37, 49.

18. *Id.* at 37.

19. See ABA, *supra* note 1. For further discussion of the history of the Convention and its prior drafts, see J. HONNOLD, *supra* note 11, at 37–43, 49–56; Sono, *The Vienna Sales Convention: History and Perspective*, in *INTERNATIONAL SALE OF GOODS: DUBROVNIK LECTURES 1* (P. Sarcevic & P. Volken eds. 1986) [hereinafter *DUBROVNIK LECTURES*].

sented. It consisted of nine countries from Africa, seven from Asia, five from Eastern Europe, six from Latin America, and nine from Western Europe and "Others" (including the United States).<sup>20</sup> The final draft of the Convention reflects this diversity of legal traditions, as well as the world's "balance of affluence and need."<sup>21</sup> Although this diversity was necessary in order to create a truly international sales law, the Convention necessarily includes many areas of compromise that point to a lack of consensus.<sup>22</sup>

### B. *Scope of Application of the Convention*

The Convention applies to all contracts for the sale of goods between parties whose places of business lie in different contracting countries.<sup>23</sup> The sphere of application of the convention is controlled by 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."<sup>24</sup> Because the United States did not adopt article 1(1)(b) (as allowed under article 95),<sup>25</sup> the Convention will not apply to American sales contracts when international private law rules lead to the application of a contracting country's own law.<sup>26</sup>

The Convention also excludes several types of international sales contracts that would otherwise fall under article 1(1)(a).<sup>27</sup> Articles 2 through 5 list specific exclusions from the Convention. Among the more significant exclusions are the following. First, the Convention does not govern sales of consumer goods (for "personal, family or household use") or of stocks, money, investment securities, or negotiable instruments.<sup>28</sup> Second, it does not govern the validity of the contract, its provisions, or its usage,<sup>29</sup> which suggests that questions of duress, illegality, fraud,

20. Honnold, *supra* note 10, at 207.

21. *Id.* at 207-08.

22. See Eorsi, *A Propos the 1980 Vienna Convention on Contracts for the International Sale of Goods*, 31 AM. J. COMP. L. 333 (1983); Rosett, *supra* note 7; Note, *Unification and Certainty: The United Nations Convention on Contracts for the International Sale of Goods*, 97 HARV. L. REV. 1984 (1984). But see Dore & DeFranco, *A Comparison of the Non-Substantive Provisions of the UNCITRAL Convention on the International Sale of Goods and the Uniform Commercial Code*, 23 HARV. INT'L L.J. 49 (1982).

23. CISG, *supra* note 1, art. 1(1)(a); J. HONNOLD, *supra* note 11, at 77.

24. CISG, *supra* note 1, art. 1(1).

25. The Convention states: "Any State may declare at the time of the deposit of its instrument of ratification, acceptance, approval or accession that it will not be bound by subparagraph (1)(b) of article 1 of this Convention." CISG, *supra* note 1, art. 95.

26. *Status of the Conventions: Note by the Secretariat* at 5, U.N. Doc. A/CN.9/294 (1987), reprinted in ABA, *supra* note 1, at 68. For further discussion of this subject, see J. HONNOLD, *supra* note 11, at 77-84; Conetti, *Uniform Substantive and Conflicts Rules on the International Sale of Goods and Their Interaction*, in DUBROVNIK LECTURES, *supra* note 19, at 385-99; Dore, *Choice of Law Under the International Sales Convention: A U.S. Perspective*, 77 AM. J. INT'L L. 521 (1983); Reczei, *The Area of Operation of the International Sales Conventions*, 29 AM. J. COMP. L. 513 (1981).

27. See generally Winship, *The Scope of the Vienna Convention on International Sales Contracts*, in INTERNATIONAL SALES: THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS 1-1-1-53 (N. Golston & H. Smit eds. 1984) [hereinafter INTERNATIONAL SALES].

28. CISG, *supra* note 1, art. 2.

29. *Id.* at art. 4. Article 4 states:

This Convention governs only the formation of the contract of sale and the rights and obligations of the seller and the buyer arising from such a contract. In particular, except as otherwise expressly provided in this

unconscionability, and mistake are controlled by domestic law.<sup>30</sup> Third, the Convention does not control the seller's liability "for death or personal injury caused by the goods to any person."<sup>31</sup> Finally, and perhaps most importantly, contracting parties may alter the effect of the Convention or exclude altogether its application.<sup>32</sup> The freedom of parties "to draft their way out of any undesirable provisions"<sup>33</sup> demonstrates the Convention's emphasis on freedom of contract;<sup>34</sup> its "dominant theme . . . is the role of the contract made by the parties . . . ."<sup>35</sup>

### C. General Drafting Considerations

The Convention's emphasis on freedom of contract offers the prudent attorney myriad opportunities to draft around unfavorable provisions or to include those portions of the Convention favoring the client. The first question the drafting attorney faces is whether to exclude the Convention completely from the contract.<sup>36</sup> Most American attorneys presumably will opt to make their state's law, ordinarily the Uniform Commercial Code, the law of the contract if for no other reason than the predictability and certainty it offers. For attorneys who do not have the luxury of being able to dictate the choice of law or who see in the Convention certain favorable provisions, the Convention offers a viable source for the law of the contract. In those situations in which no agreement can be reached on the governing law, using the Convention offers a more simplified solution than relying on the law of conflicts or on foreign sales laws.<sup>37</sup> In weighing these options, attorneys need to consider the nature of the Convention and the method by which it will be interpreted.

Inherent in the Herculean task facing the drafters of the Convention was the need to fuse an array of legal traditions. In trying "to find the right combination of words that would not be too offensive to any participant in the negotiations,"<sup>38</sup> the drafters often accommodated diverse laws by straddling "two points of view" or by creating abstract provisions that masked an underlying disagreement.<sup>39</sup> The drafting attorney must consequently be aware of the "illusion of certainty"<sup>40</sup> suggested by the Convention and ensure that the deal is structured to protect the expectations of the

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Convention, it is not concerned with: a) the validity of the contract or any of its provisions or of any usage; b) the effect which the contract may have on the property in the goods sold.

*Id.* There has been little agreement concerning the application of this article to the validity of the contract. Rosett, *supra* note 7, at 303.

30. J. HONNOLD, *supra* note 11, at 47-48; Rosett, *supra* note 7, at 265 n.2.

31. CISG, *supra* note 1, art. 5.

32. *Id.* at art. 6. Under articles 12 and 92, states may exclude parts of the Convention or insist on a written contract. Rosett, *supra* note 7, at 265 n.2.

33. Rosett, *supra* note 7, at 303.

34. Note, *supra* note 22, at 1997.

35. J. HONNOLD, *supra* note 11, at 47.

36. If not excluded, the Convention governs the contract under article 1. CISG, *supra* note 1, art. 1.

37. Winship, *International Sales Contracts Under the 1980 Vienna Convention*, 17 U.C.C. L.J. 55, 71 (1984).

38. Rosett, *supra* note 7, at 286.

39. Eorsi, *supra* note 22, at 346.

40. Note, *supra* note 22, at 1998.

client. This caveat applies even though some commentators laud the Convention as being very similar to Article 2 of the Uniform Commercial Code.<sup>41</sup>

How courts will interpret the Convention remains to be seen. No federal courts in the United States, for instance, have yet had an opportunity to consider a case involving a contract controlled by the Convention. In promulgating the Convention, the United Nations did not create an international court to hear disputes concerning the Convention's provisions, nor does the Convention itself designate a pre-existing international court to adjudicate such disputes.<sup>42</sup> National courts, then, through conflicts of law rules, will hear cases disputing the provisions of the Convention.

One danger is that these tribunals will apply the Convention within the limited context of their own legal traditions, exposing in the process the lack of consensus and resulting ambiguity of certain provisions. This gloomy prospect may be mitigated to an undetermined extent by the stated obligation of the contracting countries to adhere to the precedents of other countries.<sup>43</sup> Article 7 requires that three general considerations govern interpretations of the Convention: the goal of promoting uniformity in the application of the Convention; the principles on which the Convention is based; and conformity with the rules of private international law.<sup>44</sup> Business customs and developed jurisprudence that serve to limit the application of the Uniform Commercial Code in the United States, for example, will not equally constrain interpretations of the Convention.<sup>45</sup> Until an international jurisprudence emerges concerning the interpretations of the convention, contracting parties must circumspectly consider its various possible interpretations.

### III. THE CONVENTION'S DAMAGES PROVISIONS

#### A. Introduction

The above considerations are particularly applicable to the Convention's provisions on damages, for "[n]o aspect of a system of contract law is more revealing of its underlying assumptions than is the law that prescribes the relief available for breach."<sup>46</sup> American drafters of sales agreements need to consider the extent to which the Convention's rules mirror American expectations formed by the Uniform Commercial Code, reflect the assumptions of a different legal system, or represent a compromise of several legal traditions. An explicit premise of the Convention is that both the buyer and seller must perform all obligations "required by the contract."<sup>47</sup>

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41. S. TREATY DOC. NO. 98-9, 98th Cong., 1st Sess. I (1983); Dore & DeFranco, *supra* note 22, at 49; Lansing & Hauserman, *A Comparison of the Uniform Commercial Code to UNCITRAL's Convention on Contracts for the International Sale of Goods*, 6 N.C. J. INT'L L. & COM. REG. 63 (1981).

42. Rosett, *supra* note 7, at 295.

43. J. HONNOLD, *supra* note 11, at 120. Many countries, however, do not report adequately their cases and do not give court precedents the same deference that common law countries do. Rosett, *supra* note 7, at 272.

44. CISG, *supra* note 1, art. 7.

45. Note, *supra* note 22, at 1999.

46. Farnsworth, *Damages and Specific Relief*, 27 AM. J. COMP. L. 247 (1979).

47. CISG, *supra* note 1, arts. 30, 53; J. HONNOLD, *supra* note 11, at 63.

One alternative that the injured party has upon breach of this obligation is money damages.

A subspecies of the many remedial provisions found in the Convention, the measurement of damages rules are located in articles 74–78. These sections address the following issues: (1) a general rule for the measurement of damages,<sup>48</sup> (2) the measurement of damages in contract avoidance situations by substitute transactions<sup>49</sup> or by current price,<sup>50</sup> (3) the mitigation of damages,<sup>51</sup> (4) and the interest on money damages.<sup>52</sup> These rules apply to both buyers and sellers and are available whenever a party to the contract “fails to perform any of his obligations under the contract or this convention.”<sup>53</sup> Other remedial provisions in the Convention, which are peripherally related to the measurement of damages,<sup>54</sup> such as specific performance,<sup>55</sup> seller’s obligations,<sup>56</sup> buyer’s obligations,<sup>57</sup> risk of loss,<sup>58</sup> and reduction of price,<sup>59</sup> are beyond the scope of this Note. No section of the Convention, however, should be analyzed independently of the other sections. The interpretation of each set of provisions is most accurately deciphered in the context of other relevant and applicable sets of provisions of the Convention.

## B. Damages

### 1. General Rule for Measuring Damages and Foreseeability

Article 74 states the general rule for measuring damages:

Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.<sup>60</sup>

This provision seeks to give the injured party the “benefit of the bargain,” as measured by expectation interests as well as reliance expenditures.<sup>61</sup> The reference to “loss of profit” in article 74 creates this inference. In addition, the Commentary to

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48. CISG, *supra* note 1, art. 74.

49. *Id.* at art. 75.

50. *Id.* at art. 76.

51. *Id.* at art. 77.

52. *Id.* at art. 78.

53. *Id.* at arts. 45(1)(b), 61(1)(b).

54. For a general treatment of the remedial provision of the Convention, see Ziegel, *The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives*, in INTERNATIONAL SALES, *supra* note 27, at 9-1-9-43.

55. See Farnsworth, *supra* note 46; Kostely, *The Right to Require Performance in International Sales: Towards an International Interpretation of the Vienna Convention*, 63 WASH. L. REV. 603 (1988).

56. See Schlechtriem, *The Seller's Obligations under the United Nations Convention on Contract for the International Sale of Goods*, in INTERNATIONAL SALES, *supra* note 27, at 6-1-6-35.

57. See Tallon, *The Buyer's Obligations under the Convention on Contracts for the International Sale of Goods*, in INTERNATIONAL SALES, *supra* note 27, at 7-1-7-19.

58. See Honnold, *Risk of Loss*, in INTERNATIONAL SALES *supra* note 27, at 7-1-8-15.

59. See Bergsten & Miller, *The Remedy of Reduction of Price*, 27 AM. J. COMP. L. 255 (1979).

60. CISG, *supra* note 1, art. 74.

61. Farnsworth, *supra* note 46, at 249.

article 70, an earlier version of article 74, of the 1978 Draft Convention (hereinafter 1978 Commentary) states the rule's goal of "plac[ing] the injured party in the same economic position he would have been in if the contract had been performed."<sup>62</sup> With the exception of the inclusion of the word "of" before "which" in the second sentence, which appears to be merely a grammatical alteration, the two articles are identical. Because the CISG does not have a commentary, the 1978 Commentary will be an important source concerning the intent of the drafters of the Convention, particularly as to those articles that did not undergo significant change in the final draft of the Convention. Although the 1978 Commentary does not control the CISG, it is authoritative to the extent it reveals the intent of the drafters of the Convention and to the extent it offers persuasive interpretations of the Convention's rules.

The first sentence of article 74 does not specify the time or place for measuring the loss suffered by the injured party. This issue is likely to arise in international transactions, particularly transactions involving goods which fluctuate significantly in price. A footnote to the 1978 Commentary of article 70 offers one plausible answer to this problem. The footnote states that the place for measurement should be where the seller delivered the goods, and adds that the point in time should be an "appropriate [one] . . . , such as the moment the goods were delivered, or the moment the buyer learned the non-conformity would not be remedied by the seller" under other articles of the Convention.<sup>63</sup> Parties can eliminate the potential ambiguity of this aspect of article 74 by including a clause in the contract that specifies time and place reference points for measuring damages.

The second sentence of article 74 closely resembles the common law foreseeability requirement derived from *Hadley v. Baxendale*.<sup>64</sup> Conceding that "[a]ny such formula is inevitably imprecise," Professor Farnsworth believes that this language "comes close to blending" Uniform Commercial Code section 2-715(2)(a) and Restatement (Second) of Contracts section 351(1) and is at least within the "scope of the Code [U.C.C.] language."<sup>65</sup> The only significant difference between the Restatement and Uniform Commercial Code view of foreseeability and that of article 74 is that the Convention includes a subjective as well as an objective test of foreseeability. The language of Uniform Commercial Code section 2-715(2)(a) is cast in objective terms, referring to a seller who "at the time of contracting had *reason to know*,"<sup>66</sup> as is the language of the Restatement, allowing recoveries for injuries that the defendant had "reason to foresee as a probable result of his breach when the

62. *Id.* at 249 n.4; See J. HONNOLD, *supra* note 11, at 408.

63. *Commentary on the Draft Convention on Contracts for the International Sale of Goods, Prepared by the Secretariat*, art. 70 n.2, U.N. Doc. A/CONF. .97/5 (1979) [hereinafter *Commentary on the Draft Convention*], reprinted in ABA, *supra* note 1, at 98-150.

64. 9 Ex. 341, 156 Eng. Rep. 145 (1854). See Farnsworth, *supra* note 46, at 253.

65. Farnsworth, *supra* note 46, at 253. Farnsworth discusses this issue in regards to Restatement of Contracts § 330 which is comparable to the current Restatement (Second) of Contracts § 351.

66. U.C.C. § 2-715(3)(a) (1978) (emphasis added). The full text of this section states: "Consequential damages resulting from the seller's breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise . . . ." *Id.*

contract was made . . . .”<sup>67</sup> Article 74, on the other hand, provides an objective and subjective foreseeability test: “[D]amages may not exceed the loss which the party in breach *foresaw or ought to have foreseen* . . . .”<sup>68</sup> Given this difference, a party to a contract that may lead to unusually large losses may want to make these dangers known to the other contracting party in order to implicate the subjective prong of the article 74 foreseeability test.<sup>69</sup> More likely than not, however, such notice would also create objective foreseeability today under the Uniform Commercial Code and Restatement,<sup>70</sup> thus minimizing the differences between the article 74 and American view of foreseeability.

## 2. Punitive Damages and Breach of Warranty

Article 74 also differs from the Uniform Commercial Code scheme for breach of warranty and punitive damages. Uniform Commercial Code section 2-715(2)(b) allows consequential damages arising from the seller’s breach due to “injury to person or property proximately resulting from any breach of warranty.”<sup>71</sup> Article 74 does not do this, and it is unlikely that the countries of the world will adopt the broader separate formula of the Uniform Commercial Code.<sup>72</sup> One reason for this difference is that article 5 of the Convention excludes claims concerning the “liability of the seller for death or personal injury caused by the goods to any person.”<sup>73</sup> The Uniform Commercial Code, on the other hand, authorizes personal injury awards in breach of warranty actions. Under the Convention, it seems unlikely that breach of warranty claims could escape the broad exclusion of article 5. In addition, the language of article 74 appears to authorize only commercial measures of damages.<sup>74</sup>

The Convention does not have a rule concerning punitive damages. As a result, sales attorneys may want to include a provision for punitive damages in the contract. Courts in many countries will enforce penalty clauses.<sup>75</sup> Common law courts, however, do not enforce penalty clauses, for public policy reasons, but do allow liquidated damages, as provided in Uniform Commercial Code section 2-718.<sup>76</sup> Under article 4 of the Convention, which says that the Convention does not consider “the validity of the contract or any of its provisions,”<sup>77</sup> the validity of a penalty clause will likely be determined by conflicts of law rules.<sup>78</sup> When considering whether to include a clause allowing punitive damages, attorneys need to ensure that what is included is indeed enforceable in the country whose laws will govern any claims arising under the contract.

67. RESTATEMENT (SECOND) OF CONTRACTS § 351(1) (1979) (emphasis added).

68. CISG, *supra* note 1, art. 74.

69. *Commentary on the Draft Convention*, *supra* note 63, art. 70 Comment 8.

70. J. WHITE & R. SUMMERS, UNIFORM COMMERCIAL CODE 514-18 (1988).

71. U.C.C. § 2-715(2)(b) (1988).

72. CISG, *supra* note 1, art. 74.

73. *Id.* at art. 5.

74. Farnsworth, *supra* note 46, at 253.

75. *Id.* at 248.

76. *Id.*

77. CISG, *supra* note 1, art. 4.

78. Farnsworth, *supra* note 46, at 248.



### 3. Measurement of Damages Through Substitute Transactions

Articles 75 and 76 provide two methods for measuring damages when a party avoids a contract due to a fundamental breach of the contract by the other party.<sup>79</sup> Both provisions represent specific applications of article 74 and should be read in conjunction with it. Article 74 establishes the rule for the measurement of damages “whenever and to the extent that articles [75] and [76] are not applicable.”<sup>80</sup>

Article 75 measures damages on the basis of a substitute transaction:

If the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods, the party claiming damages may recover the difference between the contract price and the price in the substitute transaction as well as any further damages recoverable under article 74.<sup>81</sup>

Damages under this provision are established by the action of the injured seller in reselling the goods and the action of the injured buyer in obtaining cover, that is, buying the goods elsewhere. The measure of damages is the difference between the price under the contract and the price of the substitute transaction, which allows the injured party to measure damages without having to show the market price for the goods.<sup>82</sup>

The substitute transaction may occur in a different location than that provided for in the contract. The amount of damages, however, will be altered to reflect any increased costs or expenses saved.<sup>83</sup> The injured party is obligated to obtain cover or seek resale in a “reasonable manner [and] within a reasonable time after avoidance.”<sup>84</sup> Thus, the terms of the substitute transaction do not have to be identical to those of the original transaction. The time limitation does not begin to run until the party in breach has actually avoided the contract.<sup>85</sup> In the event that the substitute transaction is not carried out in a reasonable manner, the injured party must resort to article 76—measurement of damages by current market price.<sup>86</sup> Uniform Commercial Code sections 2-706 (resale by the seller) and 2-712 (cover by the buyer) closely parallel article 75’s “concrete” method of establishing damages.<sup>87</sup> Professor Farnsworth notes that this article accomplishes the common law goal of having contract remedies lead to the “relief of the promisee” and not the “compulsion of the promisor.”<sup>88</sup>

79. For rules governing grounds for avoidance of the contract, see CISG, *supra* note 1, arts. 49, 64, 72, 73.

80. *Commentary on the Draft Convention*, *supra* note 63, art. 70.

81. CISG, *supra* note 1, art. 75.

82. J. HONNOLD, *supra* note 11, at 412–13 (quoting CISG, *supra* note 1, art. 75).

83. *Commentary on the Draft Convention*, *supra* note 63, art. 71.

84. *Id.*

85. *Id.*

86. *Id.*

87. J. HONNOLD, *supra* note 11, at 413; Ziegel, *supra* note 54, at 9–40.

88. Farnsworth, *supra* note 46, at 248.

#### 4. *Measurement of Damages Through Market Price*

Instead of gauging damages by the price differential of a substitute transaction, article 76 authorizes damages on the basis of the market price at the time of avoidance.<sup>89</sup> Article 76 states:

(1) If the contract is avoided and there is a current price for the goods, the party claiming damages may, if he has not made a purchase or resale under article 75, recover the difference between the price fixed by the contract and the current price at the time of avoidance as well as any further damages recoverable under article 74. If, however, the party claiming damages has avoided the contract after taking over the goods, the current price at the time of such taking over shall be applied instead of the current price at the time of avoidance.

(2) For the purposes of the preceding paragraph, the current price is the price prevailing at the place where delivery of the goods should have been made or, if there is no current price at that place, the price at such other place as serves as a reasonable substitute, making due allowance for differences in the cost of transporting the goods.<sup>90</sup>

The measurement of damages rule authorized by article 76 may be used when resale or purchase is not reasonable under article 75, when no resale or purchase occurs, or when it is impossible to tell "which was the resale or purchase contract in replacement of the contract which was breached."<sup>91</sup> The relevant date for determining the market price is the first date when the contract could have been avoided.<sup>92</sup>

Articles 76's counterparts in the U.C.C. are sections 2-708 (recovery by the seller) and 2-713 (recovery by the buyer).<sup>93</sup> Professor Honnold maintains that the "'place for tender' reference point" for determining the market price under each U.C.C. rule may be "awkward" for both buyer and seller if, in the case of anticipatory repudiation, the "place for tender" is not near the location where the substitute goods must be repurchased.<sup>94</sup> Article 76, likewise, refers to the market price "at the place where delivery of the goods should have been made."<sup>95</sup> In traditional international sales contracts, the place of delivery is the port of the first carrier for transportation to the buyer.<sup>96</sup> For the seller, this rule poses few problems, as the port is likely to be in his or her country, and the market information for the goods will normally be readily available. The buyer, on the other hand, often will be far removed both from the seller's country and from current information concerning the markets in the seller's country. In a destination contract, in which the seller is obligated to deliver the goods to a port in the buyer's country, the reverse problem arises; the buyer has easy access to the local market, but the seller is often far removed from it.

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89. CISG, *supra* note 1, art. 76.

90. *Id.*

91. *Commentary on the Draft Convention*, *supra* note 63, art. 72.

92. CISG, *supra* note 1, art. 76(1).

93. J. HONNOLD, *supra* note 11, at 415 n.9.

94. *Id.*

95. CISG, *supra* note 1, art. 76(2).

96. CISG, *supra* note 1, art. 31; J. HONNOLD, *supra* note 11, at 415.

One solution to these problems is to seek cover under article 75, which eliminates the burden on the buyer or seller of establishing the market price of the goods in what may be a distant country.<sup>97</sup> Another option is to include in the contract a more predictable reference point for measuring the current market price by, for example, establishing a specific locale as the determinative market. If no current market price exists at the destination point or at the location of the ship of first departure, article 76(2) states that the parties should look to another market that represents a "reasonable substitute."<sup>98</sup> If a reasonable substitute market cannot be found, then the parties will not be able to measure damages under article 76.

Articles 75 and 76 appear to supplement article 74. While articles 75 and 76 specify the types of damages measurements authorized by the Convention, they also include the residual phrase, "as well as any further damages recoverable under article 74."<sup>99</sup> The reach of this phrase is uncertain. For instance, does this language refer to the "loss of profits" language in article 74 and does it encompass a "lost volume" situation?

Consider a contract between an American seller, who has an unlimited supply of goods, and a French buyer. Upon breach of the contract by the French purchaser, the American resells the goods in the market at the identical contract price. Under the substitute transaction formula of article 75, the American has no damages, because the contract price and the price of the substituted transaction are the same. Because the American has an unlimited supply of goods to sell, however, she has lost the profits from the breached contract with the French purchaser. Both the market price formula of article 76 and the substituted transaction approach of article 75 fail to compensate the American seller for these lost profits.

American courts have interpreted Uniform Commercial Code section 2-708(2) to authorize lost volume damages.<sup>100</sup> Some scholars maintain that the damages provisions of the Convention also allow, albeit not explicitly, for lost volume damages;<sup>101</sup> others do not subscribe to this view.<sup>102</sup> The language of articles 74, 75, and 76 does not necessarily resolve the matter, because the words of the rules do not definitively authorize lost volume damages for a seller.

The broad language of article 74, which measures damages as the "loss, including loss of profit[s], suffered by the other party as a consequence of the breach,"<sup>103</sup> is susceptible to an interpretation authorizing lost volume damages. Given the language and juxtaposition of the three articles, a tribunal could view articles 75 and 76 as specific applications of the sweeping language of the first

97. J. HONNOLD, *supra* note 11, at 415.

98. CISG, *supra* note 1, art. 76(2).

99. CISG, *supra* note 1, arts. 75, 76.

100. *Neri v. Retail Marine Corp.*, 30 N.Y.2d 393, 285 N.E.2d 311 (1972). See A. FARNSWORTH, *CONTRACTS* 851-54, 857-58, 866-67 (1982); Farnsworth, *supra* note 46, at 249 n.4.

101. Professors Honnold, Ziegel, and Farnsworth point to the broad language of article 74, authorizing damages for "loss of profits," as justification for their view. J. HONNOLD, *supra* note 11, at 416; Farnsworth, *supra* note 46, at 252; Ziegel, *supra* note 54, at 9-41.

102. Ziegel, *supra* note 54, at 9-41 (citing Professor Hellner).

103. CISG, *supra* note 1, art. 74.

sentence of article 74 and not as limitations placed on it.<sup>104</sup> Moreover, article 74 could be read within the context of its previously stated purpose—to put the “injured party in the same economic position he would have been in if the contract had been performed.”<sup>105</sup> The 1978 Commentary to the predecessor of article 74 may also suggest a lost volume and lost overhead damage award.<sup>106</sup> Given the lack of cases interpreting the Convention and the lack of consensus on the part of the Convention’s negotiators, the drafter would be wise to avoid the plight of the hypothetical American seller by including a contract clause which specifies whether lost volume damages are recoverable and how they should be determined in the event of breach of the contract.

### 5. Duty to Mitigate

Article 77 of the Convention states the injured party’s duty to mitigate damages:

A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated.<sup>107</sup>

Failure to mitigate by the injured party does not eliminate the recovery but will reduce the amount of damages recovered.<sup>108</sup> This rule concerns an assumption which is fundamental to the American common law view of damages: Relief ought not to include damages for loss that could have been avoided.<sup>109</sup> This rule parallels section 347 of the Restatement (Second) of Contracts and section 2-715(2)(a) of the Uniform Commercial Code. The latter disallows recovery to the buyer for loss that could “reasonably be prevented by cover or otherwise.”<sup>110</sup> As in the Uniform Commercial Code, a buyer under the Convention must avoid the contract and seek cover once it is clear that the seller will materially breach the contract.<sup>111</sup> The buyer “must take such measures as are reasonable in the circumstances.”<sup>112</sup>

As to the seller, whether article 77 gives the seller the same flexibility that Uniform Commercial Code section 2-704 does in dealing with unfinished goods remains unclear. Section 2-704 allows the seller to mitigate in one of two ways: “[E]ither complete the manufacture and wholly identify the goods to the contract or

104. Ziegel, *supra* note 54, at 9–41.

105. *Commentary on the Draft Convention*, *supra* note 63, art. 70.

106. *See id.*

107. CISG, *supra* note 1, art. 77.

108. *See id.*

109. Farnsworth, *supra* note 46, at 251.

110. *Id.* Section 2-715(2)(a) of the Uniform Commercial Code states: “Consequential damages resulting from the seller’s breach include any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise . . . .” U.C.C. § 2-715 (1988). Under section 347 of the Restatement (Second) of Contracts, the injured party has a right to damages based on his expectation interest as measured by (a) the loss in the value to him of the other party’s performance caused by its failure or deficiency, plus (b) any other loss, including incidental or consequential loss, caused by the breach, less (c) any cost or other loss that he has avoided by not having to perform. RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981).

111. *Commentary on the Draft Convention*, *supra* note 63, art. 73.

112. CISG, *supra* note 1, art. 77.

cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner.”<sup>113</sup> It remains to be seen whether the “reasonable in the circumstances” language of article 77 will allow the seller to base damages on the cost of completion of a product that hindsight shows the seller could have avoided by stopping construction and selling the scrap upon notification of the breach.<sup>114</sup> As with many of the ambiguous provisions of the Convention, the legal backgrounds of the judges who interpret these provisions may determine the extent to which the American common law tradition on this subject is followed. Consequently, the attorney must draft a contract controlled by the Convention in a way that specifies how the mitigation provisions should be interpreted.

### 6. Interest

A party to a contract controlled by the Convention relies on article 78’s rule on interest at his own peril. The sweeping language of the provision states: “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.”<sup>115</sup> The meaning of this general rule is unclear;<sup>116</sup> its language gives few hints as to how interest is to be computed and under what circumstances it is appropriate.<sup>117</sup> More than any other provision in the Convention, article 78 was affected by the diverse traditions of its drafters. Interest is treated differently in countries with different economic systems—the distinction is greatest between capitalist and socialist countries—and is barred by religious rules existing in some countries.<sup>118</sup>

The history of the drafting of article 78 suggests its controversial nature. The prior two drafts of the Convention, the 1978 Draft and the 1977 UNCITRAL Sales Draft,<sup>119</sup> omitted a rule on interest. Article 58 of the 1976 UNCITRAL Working Group’s Draft Convention authorized interest awards, but only for the seller. It entitled the seller to interest when “the breach of contract consist[ed] of delay in the payment of the price . . . .”<sup>120</sup> Interest under article 58 was computed with reference to the higher of either the official discount rate plus one percent in the country of the seller’s principal place of business or the rate for “unsecured short-term commercial credits” in that country.<sup>121</sup>

Because article 78 provides neither a method for calculating interest nor a commentary for guidance, article 58 and its commentary will be a significant source for determining acceptable ways to calculate interest under the Convention. Although

113. U.C.C. § 2-704 (1988).

114. Farnsworth, *supra* note 46, at 252; Ziegel, *supra* note 54, at 9-41-42.

115. CISG, *supra* note 1, art. 78.

116. J. HONNOLD, *supra* note 11, at 422.

117. Rosett, *supra* note 7, at 298.

118. J. HONNOLD, *supra* note 11, at 422.

119. *Comments by Governments and International Organizations on the Draft Convention on the International Sale of Goods*, [1977] VIII Y.B. INT’L L. COMM’N 109, U.N. Doc. A/CN.9/125.

120. *Draft Convention on the International Sale of Goods*, art. 58, [1976] VII Y.B. INT’L L. COMM’N 89, 94, U.N. Doc. A/CN.9/116, annex. I.

121. *Id.*; *Commentary on the Draft Convention on the International Sale of Goods*, art. 58, [1976] VII Y.B. INT’L L. COMM’N 96, 136, U.N. Doc. A/CN.9/116, annex. II.

article 58 only authorizes interest for the seller, its methods of calculating interest could apply equally to a buyer. Article 58 compensates for the loss of the use of money with reference to the market in the injured party's principal place of business. Under the broader language of article 78, which allows interest when a party does not pay the price "or any other sum that is in arrears,"<sup>122</sup> the interest market of the injured party's principal place of business would normally be the most accurate reference point for determining the cost to the injured party of a delay in receiving funds. Likewise, the use of the discount rate or the interest rate on commercial paper, whichever is higher, in the injured party's country would be equally appropriate for determining interest for an injured buyer or seller.

In the event that a court does not view article 58 of the 1976 UNCITRAL Working Group's Draft Convention as a viable source for interpreting article 78, the court may resort to conflicts of law rules and determine the method for calculating interest with reference to the appropriate domestic law. This approach has two merits. First, article 58 was deleted from earlier drafts of the Convention and in theory has no binding force. Second, the purpose of article 78, as a result of its general language and the prior rejections of specific formulas for calculating damages, may be limited—simply to authorizing interest damages and to leaving to the courts the task of formulating a method of determining the rate of interest. On the other hand, such an approach ignores the stated goal of interpreting the Convention in order "to promote uniformity."<sup>123</sup> In either case, the drafter must consider the possibility that a court will orient itself in interpreting the interest provision of the Convention with reference either to an earlier version of article 78 or to conflicts of law rules.

In addition, the Convention gives little indication as to the circumstances in which an injured party may properly demand interest, except for the broad proviso that a party may seek interest upon a failure of the other party "to pay the price or any other sum . . . in arrears."<sup>124</sup> The failure to pay the price language mirrors that of article 58. The additional reference to "any . . . sum . . . in arrears," however, intimates that parties may seek interest in a broader spectrum of situations than under article 58 of the UNCITRAL Working Group's Draft Convention (1976). The interpretation of article 78 will be affected by whether a court focuses on the language "sums in arrears," an approach which would probably limit interest to delays in paying liquidated damages,<sup>125</sup> or considers its own traditions in awarding interest. If courts interpret article 78 in the context of their own legal traditions, then interest could conceivably be awarded under the Convention for liquidated as well as unliquidated damages, or for damages based on current price and substitute transactions.<sup>126</sup>

The above problems are not raised by statutory requirements for the payment of

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122. CISG, *supra* note 1, art. 78.

123. *Id.* at art. 7(1).

124. *Id.* at art. 78.

125. J. HONNOLD, *supra* note 11, at 424.

126. *See* CISG, *supra* note 1, arts. 75, 76.

interest after judgment has been entered.<sup>127</sup> In addition, the language of article 78 indicates that any interest awards will not affect damages recoveries under article 74.<sup>128</sup> Finally, article 78 must be read in conjunction with article 84(1) of the Convention, which allows the buyer to recover interest from a seller who is obligated "to refund the price."<sup>129</sup>

A contract clause that clearly spells out the method for calculating the rate of interest and those scenarios in which interest may be included in a damages award should eliminate much of the uncertainty surrounding this provision. Article 4 of the Convention, which leaves questions of contract validity to domestic law,<sup>130</sup> should not in theory "preserve rules of domestic law that are inconsistent with the Convention . . . ."<sup>131</sup> Thus, a court in a Moslem country that has joined the Convention,<sup>132</sup> but which proscribes interest payments, could not eliminate the applicability of article 78, although it could render invalid an interest clause in the contract.<sup>133</sup> The drafting attorney needs to investigate this matter in light of the principal place of business of the person with whom his client is doing business and the legal norms within that particular country.

#### IV. CONCLUSION

The above analysis considers how damages are measured when parties breach their obligations under a contract governed by the Convention. Because the United States is a party to the Convention, American negotiators of international sales contracts need to consider not only how the Convention measures damages but also how other areas of the law now controlled by the Convention may affect their clients. The remedial provisions are not limited to the measurement of damages. Other equally significant sections concern specific performance,<sup>134</sup> avoidance of the contract,<sup>135</sup> damages exemptions due to *force majeure*,<sup>136</sup> and risk of loss.<sup>137</sup>

The organization of the Convention creates the impression that each set of provisions is a rule unto itself. This organizational framework is deceptive. The Convention must be read as an organic whole and not in parts, because different rules are modified in a limiting or expansive fashion by other rules. For instance, an attempt to modify one of the damages provisions by contractual language may, under the authority of article 4, prove futile if it violates the contract validity rules of the domestic legal system given power to interpret the contract and the Convention.<sup>138</sup>

127. J. HONNOLD, *supra* note 11, at 423 n.5.

128. *See* CISG, *supra* note 1, art. 78.

129. *Id.* at art. 84(1).

130. CISG, *supra* note 1, art. 4.

131. J. HONNOLD, *supra* note 11, at 424 n.7.

132. Syria and Egypt, for instance, have ratified the Convention. *See supra* note 3.

133. J. HONNOLD, *supra* note 11, at 424 n.7.

134. *See supra* note 55.

135. *See supra* notes 54-57.

136. *See* Nicholas, *Force Majeure and Frustration*, 27 AM. J. COMP. L. 231 (1979); Nicholas, *Impracticability and Impossibility in the U.N. Convention on Contracts for the International Sale of Goods*, in INTERNATIONAL SALES.

137. *See supra* note 58.

138. *See* CISG, *supra* note 1, art. 4.

Furthermore, the drafter must ensure that the provisions have not been interpreted unfavorably by the courts of member countries. Those rules that are most vague will most likely be altered in the broadest manner by judicial interpretation, much of which is bound to take place in non-common law jurisdictions.

These caveats certainly apply to the following measurement of damages rules of the Convention: the general rule for the measurement of damages; the measurement of damages in contract avoidance situations by substitute transactions and market price; the mitigation of damages; and the rules for obtaining interest. Many of these provisions bear a facial resemblance to Uniform Commercial Code or common law tenets. Although these provisions of the Convention were certainly influenced by the common law participants in the drafting of the Convention, the rules contain the seeds of a wide variety of interpretations. The diverse representation of UNCITRAL forced many different legal traditions to be merged in the language of the Convention. The sales attorney needs to consider all of these factors—the provision's drafting history, its similarity to the Uniform Commercial Code, and its potentially diverse interpretations. Careful drafting ultimately can limit and, in some cases, eliminate these risks.

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