CIETAC's Calculations on Lost Profits under Article 74 of the CISG

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I. Introduction

In China, it is said, "[i]n death, avoid hell; in life, avoid the law courts."[1] The remarks, made by Thomas Klitgaard in his address to the Northern Californian International Arbitration Club in 2005, address the Chinese view toward litigation.[2] Given the rise of arbitration as a form of alternative dispute resolution in China and the prevailing reputation of its legal system, this paper concentrates on the work undertaken by the Chinese International Economic and Trade Arbitration Commission ("CIETAC"), and how it resolved the calculation of lost profits under Article 74 of the United Nations Convention on Contracts for the International Sale of Goods ("CISG").[3] This is particularly of interest because CIETAC, in one form or other, has existed since 1956, well before the CISG was ratified in 1980.

Furthermore, claiming lost profits from a breach of contract is not specifically recognized in Chinese contract law. Article 113 of the 1999 revision of the Chinese Contract Law provides that "the amount of damages payable shall be equivalent to the other party's loss resulting from the breach, including any benefit that may be accrued from performance of the contract, provided that the amount shall not exceed the likely loss resulting from the breach which was foreseen or should have been foreseen by the breaching party at the time of conclusion of the contract."[4] In other words, the amount of compensation for losses must be equal to the losses caused by the breach, including the interest receivable after the performance, provided that they do not exceed the probable losses caused by breach of contract.

In contrast, Article 74 of the CISG specifically states, "[d]amages for breach of contract by one party consist of a sum equal to the loss, including loss of

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[1] Thomas J. Klitgaard, Esq., Address to the Northern California International Arbitration Club, Arbitration in the Peoples Republic of China, May 11, 2005, outline *available at* http://www.wirepaladin.com/Arbitration%20in%20China.pdf.

[2] *See id.*

[3] At this stage up to 179 CIETAC case translations are available in translated form. However, very few were decided after 2000, when the new Chinese Contract Law was promulgated. Hence, this study relies only on pre-2000 cases. *See Article 74: CIETAC and PRC Case Annotations*, http://cisgw3.law.pace.edu/cisg/text/CIETAC-PRC-74.html (last visited Mar. 17, 2007). Al Kritzer, in correspondence with the authors, suggests that there are at least 200 cases subsequent to January 2000 that he has not seen yet.

[4] Contract Law of the People's Republic of China, Chapter 7, Article 113 (adopted and promulgated by the Second Session of the Ninth Nat'l Peoples Cong., Mar. 15, 1999, effective Oct. 1, 1999), Chinese Civil Law Forum, *available at* http://www.cclaw.net/download/contractlawPRC.asp.

profit, suffered by the other party as a consequence of the breach."[5] The CISG specifically envisions that lost profits are to be taken into consideration when calculating damages, whereas the Chinese Contract Law has not done so. However, this does not mean that the inclusion of lost profits is not possible under Chinese contract law. Lost profits may be included in the term "equal to the loss," found in the Chinese Contract Law. The CISG specifically included lost profits as an obligatory item in the calculation of loss under Article 74. The Secretariat's Commentary to the CISG states that this inclusion was deemed necessary "because in some legal systems the concept of loss standing alone does not include loss of profit."[6]

Scholars argue whether lost profits are, or should be, consistently part of the Chinese remedial scheme and how lost profits should be calculated. This article does not examine whether loss of profit is consistently applied in the calculation of losses, but instead aims to identify and examine the methods adopted by CIETAC to calculate lost profits under Article 74 of the CISG. To this end, this article evaluates the published decisions by CIETAC since the inception of the CISG in China, and also discusses whether or not CIETAC's decisions on lost profits under Article 74 are uniform and consistent with international interpretations.

CIETAC's methodology has not been readily apparent until recently. Previously, CIETAC decisions were either available only in Chinese or not at all. However, as translated decisions become more readily available, the methodology and analysis of the tribunal becomes clearer. A study of CIETAC decisions is important, as it serves as an illustration of the growing integration of international law into China's legal framework. Indeed, China's development into an economic superpower has led to trade liberalization, which, in turn, has brought an ever-increasing number of conflicts between parties to trade contracts. This article will attempt to reveal how Chinese arbitration is conducted by examining the important issue of how to calculate lost profits suffered by an aggrieved party.

Furthermore, this study is restricted to an investigation of Article 74 of the CISG, and specifically, the awarding of lost profits in cases where a contract has been breached. First, lost profits are an integral and important part of Article 74. Second, as stated earlier, Chinese contract law does not specifically recognize lost profits as an automatic right when claiming damages for breach of contract. If CIETAC correctly applies Article 74, one of the contentious issues in applying the CISG would be resolved, and further study could confidently move forward.

Part I of this article provides a brief history of CIETAC, which is necessary to appreciate the work completed by the Chinese Arbitration system. Part II discusses the issue of lost profits within the context of Article 74 of the CISG, describing the methodology of international jurisprudence and considering sev-

[5] United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, 19 I.L.M. 668, 1489 U.N.T.S. 3, *available at* http://www.cisg.law.pace.edu/cisg/text/treaty.html [hereinafter CISG].

[6] Secretariat Commentary, Guide to CISG Article 74, http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-74.html (last visited March 15, 2007).

eral academic works. Part III provides an overview of lost profits in general. Part IV analyzes specific CIETAC decisions on lost profits and how damages are calculated under Article 74. Part V draws together and discusses those inconsistencies found during examination of the CIETAC decisions. Parts VI and VII summarizes the trend in CIETAC decisions and draws together conclusions on how to strengthen the tribunal on the international stage.

II. A Brief History of CIETAC

The foundations of CIETAC date back to 1956. This half-century history of CIETAC sheds light on economic and political changes within China that have put the country into the forefront of economic growth. CIETAC began as the Foreign Trade Arbitration Commission ("FTAC") when the China Council for the Promotion of International Trade first inaugurated FTAC in the 1950s.[7] In 1979–1980, FTAC became known as the Foreign Economic and Trade Arbitration Commission ("FETAC") upon the inclusion of dispute settlement among Chinese and foreign joint ventures. Eight years later, in 1988, the Commission underwent another name change, this time from FETAC to its current name, CIETAC.[8] The cumulative role of CIETAC and its predecessors was to arbitrate disputes arising out of foreign trade by Chinese nationals.[9] Along with the name change to CIETAC in 1988, the arbitration rules were also revised,[10] which broadened the scope of CIETAC's jurisdiction and its pool of listed arbitrators. The aim was to create consistency between the Chinese arbitration system and those of other players in international arbitration, such as Switzerland.

The new 1988 CIETAC rules specifically permitted the appointment of foreign arbitrators, selected from a limited list that CIETAC first approved.[11] This was a significant step in trans-nationalizing CIETAC and the arbitration process, because prior to these changes, only Chinese nationals were allowed to arbitrate. In 1989, thirteen non-Chinese nationals were added to the CIETAC panel of arbitrators, eight from Hong Kong and five from various other countries.[12] Nonetheless, the overwhelming majority, ninety-six of the CIETAC arbitrators in total, were Chinese nationals.

In 1994, the CIETAC panel of arbitrators and the 1988 CIETAC rules underwent another significant reform. The number of foreign arbitrators on the panel was pushed to sixty, thereby increasing the perception of CIETAC neutrality in

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[7] Bonnie Hobbs, *CIETAC Arbitration Rules and Procedures: Recent Developments and Practical Guidelines*, 2, Apr. 1999, http://www.omm.com/webcode/webdata/content/publications/CIETAC.PDF.

[8] China International Economic and Trade Arbitration Commission, Arbitration Rules, (revised and adopted by the China Council for the Promotion of Int'l Trade/China Chamber of Int'l Commerce, Jan. 11, 2005, effective May 1, 2005), *available at* http://www.cietac.org.cn/english/rules/rules.htm. [hereinafter CIETAC 2005].

[9] Hobbs, *supra* note 7, at 2.

[10] Given effect from October 1, 2000, CIETAC also uses the name Arbitration Institute of China Chamber of International Commerce of the People's Republic of China ("IAC").

[11] CIETAC 2005, *supra* note 8, art. 4.

[12] Hobbs, *supra* note 7, at 2–3; Paulsson & Alastair Crawford, *1994 Revision of CIETAC Rules Promises Increased Neutrality in Arbitration in China*, 9(6) MEALEY'S INT'L ARB. REP. 17, June 1994.

international trade cases .[13] Furthermore, CIETAC adopted internationally accepted arbitration rules by modeling themselves after the United Nations Commission on International Trade Law Arbitration Rules ("UNCITRAL Model Law"), the International Chamber of Commerce ("ICC") rules, and the Stockholm Chamber of Commerce rules.[14]

Subsequent amendments in 1995, 1998, and most recently in 2005, have been structured to ensure that CIETAC continues to remain competitive in an increasingly global market.[15] One change allows parties to freely choose the language of arbitration, instead of automatically defaulting to Chinese.[16] Another significant change allows the parties, through mutual consent, to select arbitrators from outside CIETAC's panel of arbitrators, with the proviso that the chairman must approve the selection (thus, still allowing CIETAC to maintain some control over the conduction of proceedings).[17]

The expansion of external arbiters' involvement in tribunal proceedings has arguably resulted in an increase in arbiters who possess a greater breadth of knowledge and experience to adjudicate cases.[18] Currently, CIETAC has 206 foreign arbitrators out of 738 total arbitrators for foreign-related disputes.[19]

With the emergence of China as an economic power and the recent boom in trade, CIETAC has become one of the most active international commercial arbitration bodies in the world.[20] In 2000, CIETAC heard 543 arbitration cases, compared to 500, 541, and 294 cases heard by the American Arbitration Association, the International Arbitration Centre, and the Hong Kong International Arbitration Centre, respectively.[21] However, skepticism surrounding CIETAC since its inception has not completely subsided, and critical analysis of its decisions is still required. This skepticism mainly focuses on China's communist regime and the political considerations surrounding its state instrumentalities, including CIETAC. Consequently, some commentators argue that certain CIETAC decisions have the perception of partiality or prejudice—which negatively affects confidence in the global arbitration system as a whole.

13 Victor Perez, *CIETAC*, 12 FLA. J. INT'L L. 491, 494 (2000).

14 *See* Hobbs, *supra* note 7, at 3–5, for an explanation as to the depth of modeling.

15 *Id.*

16 CIETAC 2005, *supra* note 8, art. 67.

17 *Id.*, art. 21.

18 Edward Alder & Rosamund Cresswell, *CIETAC Arbitration Rules Revised*, Bird & Bird, May 2005, http://www.twobirds.com/English/publications/articles/CIETAC_arbitration_rules_revised.cfm (last visited Mar. 28, 2007).

19 China International Trade and Arbitration Commission, Panel of Arbitrators for Domestic Disputes, http://www.cietac.org.cn/english/arbitrators/arbitrators_n1.htm (last visited Mar. 15, 2007).

20 Li Zhang, *The Enforcement of CIETAC Arbitration Awards*, HONG KONG LAW., February 2002, *available at* http: //www.hk-lawyer.com/2002-2/Feb02-china.htm.

21 *International Arbitration Cases Received*, HONG KONG INT'L ARB. CENTRE (2006), http://www.hkiac.org/HKIAC/HKIAC_English/en_statistics.html#top (last visited March 15, 2007) (noting the following annual numbers of arbitrations have taken place with CIETAC from January 2000 until 2005, respectively: 543, 731, 684, 709, 850, and 979).

Keeping in mind that the CISG became effective on January 1, 1988,[22] CIETAC has been exposed to the international standard for quite some time, allowing it to observe international convention and jurisprudence in action.[23] However, CIETAC's interpretations of the CISG present a broad view of how key provisions should be interpreted to maintain the effectiveness of the Convention and avoid ethnocentric interpretations.[24] One of the issues addressed in the CISG is how to calculate damages and, specifically, loss of profits.[25] CIETAC, like its other international counterparts, will no doubt be tested on the methods it employs in determining this issue.

III. Lost Profits: A General Overview

The obligation, or right, to claim lost profits is contained within Article 74 of the CISG.[26] Article 74 covers both reliance[27] and expectation interests,[28] with expectation interests providing the limitation for recovery.[29] However, the CISG does not explicitly use the terms "reliance interest" and "expectation interest" when providing for compensation.[30] In this article, reference to these terms is only made because they are still in use (despite the terms' misleading and generally unhelpful character).[31]

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22 *See 1980—United Nations Convention on Contracts for the International Sale of Goods (CISG)*, UNCITRAL, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html (last visited Mar. 28, 2007).

23 *Id.* China exercised its right to opt out of Article 1(b) and 11 of the CISG. Note that Article 10 of the Chinese Contract Law no longer requires contracts to be concluded in writing and therefore the reservation is inconsistent with Article 10 of the CCL.

24 *See* CISG, *supra* note 5, art. 7(1) ("In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.").

25 Victor Knapp, *Article 74, in* BIANCA-BONELL COMMENTARY ON THE INTERNATIONAL SALES LAW 538–48, (Dott A. Giuffrè ed., 1987), *available at* http://www.cisg.law.pace.edu/cisg/biblio/knapp-bb74.html.

26 CISG, *supra* note 5, art. 74. Article 74 reads in full, "Damages for breach of contract by one party consists of the 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."

27 Reliance, in the realm of contract law, is the principle that an aggrieved party has the right to be put into the situation in which it would have been had the contract never been performed.

28 Expectation interests refer to the principle that a party has the right to be placed in the same economic position it would have been in had the contract been properly performed.

29 BRUNO ZELLER, DAMAGES UNDER THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS, 43–44 (2005); *see also* Joseph Lookofsky, *The 1980 United Nations Convention on Contracts for the International Sale of Goods, in* INTERNATIONAL ENCYCLOPAEDIA OF LAWS—CONTRACTS, Suppl. 29 (R. Blanpain & J. Herbots eds., 2000) *available at* http://www.cisg.law.pace.edu/cisg/biblio/lookofsky.html.

30 ZELLER, *supra* note 29, at 39.

31 For reasons why and further details of this view, *see* David W. McLaughlan, Reliance Damages for Breach of Contract (unpublished conference paper, on file with authors).

The first sentence of Article 74 clearly provides for two categories of losses: actual losses (*damnum emergens*) and loss of profit (*lucrum cessans*).[32] Despite this broad language, Article 74 does not define in detail which losses can be compensated or how they are to be calculated. Consequently, liability is determined by the general principle of full compensation, taking into account the particular purpose of the contract in question.[33] The principle of full compensation provides that the aggrieved party is entitled to full compensation for harm sustained as a result of the breach. The harm can include any loss suffered and any deprivations of gain. Put differently, "[A]rticle 74 aims to give an aggrieved party the right to put themselves back into the position they were in had the contract been properly performed."[34] Therefore, when the full compensation principle is properly applied it necessarily includes loss of profit.

Lost profits are differentiated from the actual loss category. Actual loss "generally means the diminution in the assets of an injured party at the time of the conclusion of the contract, loss of profit [on the other hand] means the loss of any increase in the assets caused by the breach."[35] Hence, a loss of profit represents the difference between the aggrieved party's assets if the contract had been adequately performed and the aggrieved party's assets absent the breach of contract.[36] It follows from the principle of full compensation that such compensation is to be made not only for lost profits prior to the date of judgment, but also for any foreseeable and calculable profit that would have been achieved after the judgment date.[37] Losses are not merely confined to actual losses, but include future losses and loss of chance as well.[38]

The CISG does not provide specific rules on how to calculate loss of profits. Consequently, some commentators have observed that there is an assumption that the injured party may recover lost profits suffered, or expected to suffer, without limitation on the period of time for which the injured party may recover.[39] Therefore, the aggrieved party under the CISG "should be able to demand compensation of any profit lost as a consequence of the breach of contract by the

[32] *See* Chengwei Liu, Remedies for Non-performance: Perspectives from CISG, UNIDROIT Principles & PECL (2003), *available at* http://www.cisg.law.pace.edu/cisg/biblio/chengwei.html.

[33] Knapp, *supra* note 25; Peter Schlechtriem & Ingeborg Schwenzer, Commentary on the UN Convention on the International Sale of Goods—CISG, art. 74, ¶¶ 12–14 (2nd ed. 2005).

[34] Zeller, *supra* note 29 at 117. It should also be noted that Article 74 also makes it clear that the contractual liability is not unlimited. Three rules are contained within the CISG that are pertinent in circumstances when damages are claimed: the foreseeability rules pursuant to Article 74 and the duty to mitigate damages as explained in Article 77 and Article 79, which set out the exemptions due to unexpected circumstances.

[35] Djakhongir Saidov, *Methods of Limiting Damages Under the Vienna Convention on Contracts for the International Sale of Goods*, 14 Pace Int'l L. Rev. 307, 317 (2002).

[36] Claude Witz, Hanns-Christian Salger, & Manuel Lorenz, International Einheitliches Kaufrecht. Praktiker-Kommentar und Vertragsgestaltung zum CISG, art. 74, ¶ 15 (2000).

[37] John Honnold, Uniform Law for International Sales under the 1980 United Nations Convention, art. 74, ¶ 404 (3d ed. 1999).

[38] Zeller, *supra* note 29 at 127–31.

[39] Knapp, *supra* note 25.

other party."[40] The amount is limited only by foreseeability and the full compensation rules as set out in Article 74.

However, the full compensation rule does not suggest that an award for profits is possible. The wording of Article 74 makes it clear that only *lost* profits are recoverable. The plaintiff must show that profits indeed were achievable and that the business was not taking on losses.[41] It follows, therefore, that compensation is only made for those losses that are a consequence of the breach, and the plaintiff would be limited in his recovery to the extent of the balance sheet analogy.[42]

IV. CIETAC Decisions Regarding the Calculation of Loss of Profits under Article 74

As pointed out above, Article 74 does not explicitly provide a loss of profit calculation. However, Article 74 does make it clear that damages cannot exceed full compensation.[43] In effect, damages under Article 74 are capped by the general principle of full compensation.

CIETAC's decisions since 1988 have adopted a variety of different methods to calculate lost profits under Article 74.[44] Hence, the appropriate method of calculating lost profits under the CISG is disparate and unclear. This in itself is not unusual in light of international practice and varying factual situations which parties face. An analysis of CIETAC decisions suggests that the awards which are made under the category of lost profits can be classified into eight broad categories:[45] (1) seller's lost profits calculated as the difference between the contract price and the actual production cost of the goods; (2) the difference between the contract price between the seller and the buyer and the contract price between the seller's supplier and the seller; (3) the price difference between the contract price and the price of actual resale; (4) the buyer's lost profits calculated as his anticipated net profits (anticipated gross profits minus fees payable); (5) the price difference between the contract price and the price of the intended resale to sub-buyer (minus costs of resale); (6) the difference between the prices of the intended resale to sub-buyer and the actual resale made; (7) the price difference according to the calculations set out in Article 76; and (8) the awarding loss

40 *Id.*

41 Saidov, *supra* note 35.

42 It is not within the scope of this paper to discuss types of losses. However, one must keep in mind that if a party would have suffered a loss in performing under a contract, that loss would diminish the actual recoverable damages. The ultimate aim is to put the claimant or plaintiff into a position as if the contract would have been performed. Hence a breach can actually amount to a profit for the plaintiff. In such a case, the plaintiff ought to compensate the respondent or defendant under the principle of good faith.

43 CISG, *supra* note 5, art. 74.

44 *See infra* Part IV for an in depth analysis of the varying methods used by CIETAC in calculating lost profits.

45 For further analysis on CIETAC awards, see Dong Wu, *CIETAC's Practices on the CISG*, NORDIC J. OF COM. L. (2005), *available at* http://www.njcl.fi/2_2005/article2.pdf.

profits as well as price difference under Article 75 or 76 and associated calculations to either party.[46]

By no means, however, are the calculations restricted to such categories. CIETAC's arbitration tribunals have been amiable to the methods of calculations as stipulated by the parties as well.[47] CIETAC has sought to adopt those methods as appropriate when suitable evidence is provided in support of the parties' method of calculation.[48] In order to fully understand the different approaches used by CIETAC in calculating lost profits, the brief facts and holdings of the decisions are discussed below. This analysis will assist in future understandings of the Chinese arbitral process.

A. Seller's Lost Profits Calculated as the Difference between the Contract Price and the Actual Production Cost of the Goods

In the *Semi-Automatic Weapons Case* (7 August 1993),[49] a United States buyer contracted with a Chinese seller to purchase 5000 guns per year for three years. The guns were to be manufactured according to the buyer's specifications. In preparation for the delivery of the first shipment of 5000 guns, the seller requested payment. The American buyer responded that it could not make payment, claiming that it could not obtain the necessary authorization to import the guns into the United States. The seller applied to arbitrate its claim, and together with other damages, submitted an amount of expected profits from the first shipment which were lost due to the buyer's breach of the contract. The basis for the calculation was the profit expected using Free on Board ("FOB")[50] pricing, as opposed to the Cost Insurance and Freight ("CIF")[51] pricing stipulated in the contract, per gun, minus the seller's cost per gun multiplied by the quantity to be delivered. The tribunal accepted this calculation, and provided an award accordingly. This method for reaching such a calculation is in line with the principles of the CISG. By providing FOB pricing as opposed to the CIF pricing under the contract, the tribunal avoided unduly enriching the seller for costs it had not yet incurred.

In the *Frozen Beef Case* (26 October 1993),[52] a United States buyer entered into a contract with a Chinese seller to purchase 200 tons of beef, payment of

46 *See infra* Part IV (outlining the different categories and calculations of lost profits awards).

47 *Id.*

48 *Id.*

49 Semi-Automatic Weapons (P.R.C. v. U.S.), CIETAC (1993), *available at* http://cisgw3.law.pace.edu/cases/930807c1.html.

50 Intercoms, http://www.ltdmgmt.com/incoterms.htm (last visited Feb. 27, 2007). FOB is used here as defined by the Incoterms 2000. A FOB term requires the seller to deliver goods on board a vessel designated by the buyer. The seller fulfils its obligations to deliver when the goods have passed over the ship's rail.

51 *Id.* CIF is used here as defined by the Incoterms 2000. A CIF term requires the seller to arrange for the carriage of goods by sea to a port of destination, and provide the buyer with the documents necessary to obtain the goods from the carrier.

52 Frozen Beef (P.R.C. v. U.S.), CIETAC (1993), *available at* http://cisgw3.law.pace.edu/cases/931026c1.html.

which was to be effectuated by a letter of credit. Upon the seller receiving the letter of credit, it noticed that additional terms not included in the original agreement were inserted. The seller asked the buyer to issue another letter of credit in line with the parties' agreement. When the buyer failed to alter the letter of credit and negotiations failed, the seller applied for arbitration. The seller provided two different methods of calculations for loss of profits. The first of which will be discussed in the fourth method.[53] The second calculation was based upon the contract price minus the seller's expected cost of the beef not yet produced. Such a calculation could not be based on actual costs but expected or anticipated ones. The arbitral tribunal implicitly agreed that such a calculation was appropriate; however, the tribunal failed to award the calculated amount due to lack of evidence. Almost certainly, the tribunal would have agreed to award the seller reimbursement of the bargain to which it was entitled under the contract, had the evidence been available.[54]

B. Seller's Lost Profits Calculated as the Difference between the Buyer's and Seller's Contract Price and the Contract Price of the Seller's Supplier and the Seller

This calculation arguably rests on the same methodology as described in the immediately preceding section above, except the manufacturer is now replaced by a seller who can also be a wholesaler. For example, in the *Hot-Rolled Steel Plates Case* (10 May 1996),[55] a Singaporean seller and a Chinese buyer entered into a contract for the supply of 10,000 tons of hot rolled steel plates. When the buyer failed to pay for 2000 tons of the product, the seller took its claim to arbitration seeking its lost profits, among other damages. The tribunal deemed that the loss of profits should be calculated according to the difference between the contract price with the buyer and the supplier respectively.[56] In the *Steel Coil Case (*31 December 1999)[57] the arbitral tribunal awarded a seller lost profits calculated using the same methods.[58]

C. Seller's Lost Profits Calculated as the Price Difference between the Contract Price and the Price of Resale Actually Made

The *Chrome-Plating Machines Production-Line Equipment Case* (12 July 1996)[59] involved a Swiss seller and a Chinese buyer who signed a contract providing for the sale of a set of chrome-plating production-line equipment at the

53 *See infra* Part IV.D.

54 Frozen Beef, *supra* note 52.

55 Hot-Rolled Steel Plates (Sing. v. P.R.C.), CIETAC (1996), *available at* http://cisgw3.law.pace.edu/cases/960510c1.html.

56 *Id.*

57 Steel Coil (P.R.C. v. Switz.), CIETAC (1999), *available at,* http://cisgw3.law.pace.edu/cases/991231c1.html.

58 *Id.*

59 Chrome-Plating Machines Production-Line Equipment (Switz. v. P.R.C.), CIETAC (1996), *available at* http://www.cisg.law.pace.edu/cases/960712c1.html.

price CIF Shanghai at 257,070 Swiss francs. The buyer failed to pay the contract price, causing the seller to resell at a lower price. The tribunal awarded the seller lost profits for the price difference between the resale amount and the contract price of the machines had the contract been fully performed.

The tribunal applied similar calculations based upon Article 75 of the CISG in the *Nickel-Plating Machines Production-Line Equipment Case* (12 July 1996),[60] the *Dioctyl Phthalate Case* (16 August 1996),[61] the *Yam-Dyed Fabric Case* (21 July 1997),[62] the *Chrome-Plating Production Line Equipment Case* (12 February 1999),[63] the *New Zealand Raw Wool Case* (8 April 1999),[64] and the *Industrial Raw Materials Case* (4 June 1999).[65]

D. Buyer's Lost Profits Calculated as the Buyer's Anticipated Net Profits (Anticipated Gross Profits Minus Fees Payable)

In the *Tin Plate Case* (17 October 1996),[66] a Korean seller and Chinese buyer entered into a contract for the supply of Korean tin plates. The seller defaulted on the contract by failing to deliver the goods as stipulated, resulting in the buyer bringing an arbitration proceeding. The buyer sought compensation of 432,200 yuan for the loss of expected profit under the contract. This was calculated by determining the domestic sales contract price less the cost under the present contract and less other expenses. Import duties and gains taxes, however, were not deducted, and the seller subsequently argued that they should have been. The tribunal accepted the majority of the seller's calculations and awarded the loss of expected profit as the difference between the contract price and the price under the sales contract. The tribunal, however, stated that the amount of the loss of expected profit should be the contract price for domestic sales contract: the sum of the contract price, customs duties, and gains taxes.[67]

60 Nickel-Plating Machines Production-Line Equipment (F.R.G. v. P.R.C.), CIETAC (1996), *available at* http://cisgw3.law.pace.edu/cases/960712c2.html.

61 Dioctyl Phthalate (P.R.C. v. N. Korea), CIETAC (1996), *available at* http://cisgw3.law.pace.edu/cases/960816c1.html.

62 Yam-Dyed Fabric (P.R.C. v. U.S.), CIETAC (1997), *available at* http://cisgw3.law.pace.edu/cases/970721c1.html.

63 Chrome-Plating Production-Line Equipment (Switz. v. P.R.C.), CIETAC (1999), *available at* http://cisgw3.law.pace.edu/cases/990212c1.html. In this case, the CIETAC tribunal first rendered its arbitral award on 12 July 1996. The Buyer applied for setting-aside of the award before Beijing Municipal No. 2 Intermediate People's Court. On October 24, 1997, the Court notified the CIETAC for the latter to re-arbitrate the case. Based on the notification from the Court, on October 29, 1997 the CIETAC decided to re-arbitrate. On February 12, 1999, a new CIETAC tribunal rendered this arbitral award.

64 New Zealand Raw Wool (N.Z. v. P.R.C.), CIETAC (1999), *available at* http://www.cisg.law.pace.edu/cases/990408c1.html.

65 Industrial Raw Material (P.R.C. v. U.S.), CIETAC (1999), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/990604c1.html.

66 Tinplate (N. Korea v. P.R.C.), CIETAC (1996), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/961017c1.html. This case can also fall within the category of the price difference between the contract price and the price of the intended resale to sub-buyer (minus costs of resale) as the buyer changed its pleadings to deduct some costs however not all costs were accounted for.

67 *Id.*; *see* Compound Fertilizer (Austl. v. P.R.C.), CIETAC (1996), *available at* http://cisgw3.law.pace.edu/cases/960130c1.html (this case had a similar ruling).

E. Buyer's Lost Profits Calculated as the Price Difference Between the Contract Price and the Price of the Intended Resale to Sub-buyer (Minus Costs of Resale)

In the *Palm Oil Case (*22 January 1996),[68] a Singaporean seller and a Chinese buyer entered into a contract for the sale of 3000 tons of refined edible palm oil. Upon the seller's failure to deliver the goods, the buyer sought damages, including loss of profits. The buyer's final calculation of lost profits provided to the tribunal was based upon the difference between the resale price and the "prime price," including tax, which the buyer would have received had the seller performed according to the contract. The tribunal accepted this calculation and held that the CISG and international trade usages also found such a method appropriate.

A similar approach was followed in the *Art Paper Case* (12 February 1996),[69] the *Dried Sweet Potatoes Case (*14 March 1996),[70] the *Tinplate Case (*17 October 1996), and the *Carbamide Case* (10 July 1997).[71] In all of these cases, tribunals held that the loss of profit should be calculated as the difference between the contract price and the intended price for reselling to the buyer's customer.

F. Buyer's Lost Profits Calculated as the Difference between the Prices of the Intended Resale to Sub-buyer and the Actual Resale Made

In the *Old Corrugated Carton Case (*8 March 1996),[72] a Dutch seller and a Chinese buyer entered into a contract for the supply of old corrugated cartons with certain specifications. The seller's delivery did not correspond to those specifications, thereby causing the buyer to resell the goods to another one of its clients for only 600 yuan, as opposed to the 1500 yuan originally contracted for. The buyer sought the difference in the respective prices as lost profits. The seller argued that such a calculation should not be accepted, but rather the loss of price difference claimed by the buyer should be limited to the difference between the contract price and the market price at that time (implicitly relying upon Article 76). The tribunal rejected the seller's methodology on the basis that the loss as calculated by the buyer was clearly foreseeable and therefore the seller should be liable. Similar conclusions were reached in the *Heliotropin Case* (10 July 1993),[73] *the Hot-Rolled Steel Plates Case* (16 July 1996),[74] the *Graphite Elec-*

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68 Palm Oil (Sing. v. P.R.C.), CIETAC (1996), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/960122c1.html.

69 Art Paper (U.S. v. P.R.C.), CIETAC (1996), *available at* http://cisgw3.law.pace.edu/cases/960212c1.html.

70 Dried Sweet Potatoes (P.R.C. v. Switz.), CIETAC (1996), *available at* http://cisgw3.law.pace.edu/cases/960314c1.html.

71 Carbomide (U.S. v. P.R.C.), CIETAC (1997), *available at* http;//cisgw3.law.pace.edu/cases/970710c1.html.

72 Old Boxboard Corrugated Cartons (Neth. v. P.R.C.), CIETAC (1996), *available at* http://cisgw3.law.pace.edu/cases/960308c1.html.

73 Heliotropin (P.R.C. v. U.S.), CIETAC (1993), *available at* http://cisgw3.law.pace.edu/cases/930710c1.html.

*trodes Scraps Case (*2 June 1997),[75] and the *PVC Suspension Resin Case* (7 April 1999).[76]

G. Buyer's Lost Profits According to the Calculations Set Out in Article 76

Article 76 in essence allows a party—instead of making a cover purchase—to simply claim the difference between the contract price and the current price at the time of avoidance. Article 76, despite only being applicable in case of avoidance, does not deprive the aggrieved party from claiming damages which can only be obtained by taking recourse to Article 74. Hence loss of profit which re not included in Article 76, and any other incidental losses associated with the breach of the contract are recoverable under Srticle 74.

Article 76 of the CISG 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.[77]

The *Steel Case* (19 September 1994)[78] involved an Italian seller and a Chinese buyer who entered into a contract for various forms of steel. The seller could not deliver on time even after the buyer had granted various extensions. The buyer initiated arbitration proceedings to avoid the contract and seeking indemnification from the seller for the difference between the contract price and market price of the goods. The tribunal correctly laid out a three-step process provided for in Article 76 by stipulating that the burden of proof rests on the buyer. The tribunal stated the buyer must show:

> (1) The domestic market price was reasonable for the purposes of Article 76(2) of the CISG;

[74] Hot-Rolled Steel Plates (Austria v. P.R.C.), CIETAC (1996), *available at* http://cisgw3.law.pace.edu/cases/960716c1.html.

[75] Graphite Electrodes Scraps (P.R.C. v. F.R.G.), CIETAC (1997), *available at* http://cisgw3.law.pace.edu/cases/970602c1.html.

[76] PVC Suspension Resin (U.S. v. P.R.C.), CIETAC (1997), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/990407c1.html.

[77] CISG, *supra* note 5, art. 76.

[78] Steel (Italy v. P.R.C), CIETAC (1994), *available at* http://cisgw3.law.pace.edu/cases/940919c1.html.

(2) The loss of profits was suffered by the buyer itself and was foreseen, or ought to have been foreseen, by the seller when the parties executed the contract; and

(3) The buyer had taken reasonable measures to mitigate the damages according to Article 77 of the CISG.[79]

The tribunal held that if the buyer claims the difference between the contract price and the market price, the market price should be the price at the time and place of delivery—in this case, the price of the goods at the Russian port between June and July 1993. The tribunal held that the domestic Chinese price at the same time was not comparable.

In the *High Tensile Steel Bar Case* (25 October 1994),[80] a United States seller and a Chinese buyer contracted for high tensile steel bars. One of the terms of the contract stipulated that the seller open a performance bond within five business days after receiving the pre-advice letter of credit issued by the buyer. The seller failed to issue the performance bond and allowed the buyer to cancel the contract if it so pleased. The buyer took up this option and subsequently claimed that the seller's breach prevented it from performing a contract with a third party.

The buyer sought reimbursement from the seller for the amount it had to pay the third party due to the seller's breach. The buyer further sought damages for anticipated profits, basing its calculation on the difference between the contract price and the market price according to Article 76. The arbitral tribunal held that the buyer's calculation of damages was correct and the buyer was entitled to all damages sought.

Similar approaches were followed in the *Australian Raw Wool Case (*23 April 1995),[81] the *Scrap Copper Case (*12 January 1996),[82] and the *Caffeine Case* (29 March 1996).[83] In *"FeMo" Alloy Case* (2 May 1996),[84] the tribunal also awarded the price difference between the contract price and the international market price calculated under Article 76 of the CISG as the relevant lost profits.

As has been seen, the CISG allows an aggrieved party to claim the difference between the contract price and the current price at the time of avoidance. Furthermore lost profits, which are not included in the price differential, can also be claimed via Article 74. However there is an obligation on the aggrieved party to mitigate the losses as much as possible. If a party fails to do so the actual losses

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79 *Id.*

80 High Tensile Steel Bar (U.S. v. P.R.C.), CIETAC (1994), *available at* http://cisgw3.law.pace.edu/cases/941025c1.html.

81 Australian Raw Wool (Austl. v. P.R.C.), CIETAC (1995), *available at* http://cisgw3.law.pace.edu/cases/950423c1.html.

82 Scrap Copper (U.S. v. P.R.C.), CIETAC (1996), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/960112c1.html.

83 Caffeine (P.R.C. v. H.K.), CIETAC (1996), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/960329c1.html.

84 "FeMo" Alloy (P.R.C. v. U.S.), CIETAC (1996), *available at* http://cisgw3.law.pace.edu/cases/960502c1.html.

including loss of profits will be reduced. The reduction of the damages normally corresponds to the amount that would have been saved if the party had mitigated.

H. Awarding Lost Profits as Well as Price Difference under Article 75 or 76 and Associated Calculations to Either Party

Calculations that invoke the application of Articles 75 or 76 of the CISG are relatively uncontroversial because they are founded on factual appraisal of the circumstances. Article 75 states:

> 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.[85]

The CISG recognizes that not in all cases an aggrieved party can be satisfied with monetary compensation. Under certain circumstances the party suffering the loss has to satisfy third parties, that is, the goods were to be unsold. Therefore Articles 75 and 76 do exactly that. Article 75 covers situations where a cover purchase needs to be made and Article 76 covers situations where the aggrieved party claims monetrary damages calculated on the difference between the contract price and the current price for the goods at the time the contract was avoided. The aggrieved party in essence is put to an election. They either claim damages and lost profits under Article 75 or Article 76 but never both.

In relation to lost profits, the tribunal has awarded these losses with the rationale that an aggrieved party should not benefit from the breach.[86] For example, due to fundamental breach, the buyer in the *Cotton Bath Towel Case* (26 October 1996)[87] was forced to dispose of the goods below contract price. If the contract had been performed per the agreement, the buyer could have sold the goods to a sub-buyer and obtained a profit.[88] In such cases, the tribunal has awarded the buyer the difference between the contract price and the lower resale price, and lost profits were calculated as the difference between the contract sale and the intended sale to the sub-buyer.[89]

However, where the aggrieved party is the seller, the tribunal has generally denied the seller's claim for lost profits in order to preserve the principle of disallowing over-compensation. The award for the price difference under Arti-

[85] CISG, *supra* note 5, arts. 75, 76. Articles 75 and 76 provide for a calculation of lost profits in certain circumstances stipulated in the text of the articles.

[86] Canned Mandarin Oranges (P.R.C. v. F.R.G.), CIETAC (1999), *available at* http://cisgw3.law.pace.edu/cases/990301c1.html; Cysteine (P.R.C. v. F.R.G.), CIETAC (2000), *available at* http://cisgw3.law.pace.edu/cases/000107c1.html.

[87] Cotton Bath Towel (P.R.C. v. Austl.), CIETAC (1996), *available at* http://cisgw3.law.pace.edu/cases/961026c1.html.

[88] *Id.*

[89] *Id.*

cles 75 and 76 had already covered such lost profits. This approach was also followed in the *Canned Oranges Case* (1 March 1999)[90] and the *Cysteine Case* (7 January 2000).[91]

These cases are good examples within the regime of the CISG demonstrating that the principle of full compensation requires a reading of all relevant requirements in order to arrive at the correct solution. In the above cases Articles 75, 76 and 77 are the prime articles on which the aggrieved party relied on. However the principle of full compensation allowed the aggrieved party to fall back onto Article 74 to achieve the started goal of the CISG namely to bring the parties back to the position they would have been had the contract been properly performed.

V. Inconsistencies

Before CIETAC's basis of mathematical calculations can be analyzed, its interpretation of Article 74 of the CISG must first be addressed. The points of contention do not arise with CIETAC's mathematical calculations themselves, but with CIETAC's interpretations of the principles contained within the four corners of the CISG. This section identifies three areas under which CIETAC's interpretations conflict with the aim of Article 74 of the CISG: (1) the incorrect application of the principle of reasonableness; (2) the incorrect treatment of third-party transactions; and (3) the inevitably ethnocentric approach taken by CIETAC.

A. Criterion of Reasonableness

Reasonableness is an important concept in the CISG, but it has not been applied accurately by CIETAC. The *Equipment Case* (20 December 1993)[92] is illustrative. In the *Equipment Case*, a United States seller and a Chinese buyer entered into a contract for the sale of sets of equipment, the payment of which was to be effected by letter of credit. The buyer failed to issue the letter of credit and the seller applied for arbitration. In determining its loss of profits, the seller sought the difference between the contract price and the cost that the seller paid to the manufacturer. However, the arbitral tribunal rejected this calculation on the basis that the profit to be made by the seller was unreasonable and therefore unforeseen by the buyer.

Many argue that reasonableness of the amount of lost profits cannot be the basis for awarding loss of profits. Article 74 specifically provides that the principle of foreseeability will cap the amount of profit an aggrieved party can claim.[93]

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[90] *See* Canned Mandarin Oranges, *supra* note 86.

[91] *See* Cysteine, *supra* note 86.

[92] Equipment (U.S. v. P.R.C.), CIETAC (1993), *available at* http://cisgw3.law.pace.edu/cases/931220c1.html.

[93] CISG, *supra* note 5, art. 74 ("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.").

Foreseeability in the CISG does not stipulate that the party in breach must foresee the exact amount of damage suffered, but rather that some damage could be suffered. The basis of the arbitral tribunal's reliance upon the criterion of reasonableness in this case can be compared to the criterion of reasonableness in Article 46(2) of the 2005 version of CIETAC Arbitration Rules. Article 46(2) states as follows:

> The arbitral tribunal has the power to decide in the award, according to the specific circumstances of the case, that the losing party shall compensate the winning party for the expenses reasonably incurred by it in pursuing its case. In deciding whether the winning party's expenses incurred in pursuing its case are reasonable, the arbitral tribunal shall consider such factors as the outcome and complexity of the case, the workload of the winning party and/or its representative(s), and the amount in dispute, etc.[94]

Although this article was not in force at the time of the decision, it no doubt provides a comparison as to how the tribunal decided the lost profits issue based on reasonableness. The tribunal's decision would have been correct in law had Article 74 of the CISG alternately been framed to state that 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 *must be reasonable* and 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. However, Article 74 of the CISG does not apply a reasonable test, and therefore, the tribunal arguably erred in its reasoning by placing a criterion of reasonableness, weighed by factors subject to the discretion of the tribunal, into its interpretation of Article 74 of the CISG.

We are not arguing that the decision was incorrect, but instead that reliance upon reasonableness *in this context* is fraught with danger. It negates party autonomy and the right of a party to be entitled to the bargain for which it contracted. The correct question for the tribunal would have been: are the damages foreseeable in "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?"[95]

An accurate application of this approach was applied by the tribunal in the *Weaving Machines, Tools and Accessories Case* (5 September 1994).[96] The tribunal in that case articulated a three-step approach in reaching its decision. First, subject to the CISG, the breaching party should compensate the aggrieved party for all losses (including loss of profits) caused by its breach. Second, in light of the facts and matters of the case, the loss must be foreseeable. Finally, whether

[94] CIETAC 2005, *supra* note 8, art. 46(2).

[95] CISG, *supra* note 5, art. 7.

[96] Weaving Machines, Tools and Accessories (Switz. v. P.R.C.), CIETAC (1994), *available at* http://cisgw3.law.pace.edu/cases/940905c2.html.

the damages claimed by the aggrieved party are reasonable must be ascertained, and not only in the context of whether the damages could have been mitigated.[97]

B. Third Party Transactions

In many cases goods are bought for the purpose of reselling to a third party. If the original contract is either avoided or breached the resulting loss will flow on to the third party. The CISG will allow the buyer to claim these damages from the original seller.

In the *Bicycles Case* (11 August 1994),[98] a French buyer and Chinese seller entered into a contract for bicycles. Upon receiving the bicycles, some were found to be defective. The seller lowered the price of the goods and the buyer disposed of the defective products. The buyer claimed damages, including the lost profits suffered from the avoidance of a sole distributorship contract with a third party as a result of the non-conforming bicycles. The tribunal rejected the buyer's claims, stating that the claims "exceed the total contract price, which [the seller] could not foresee when signing the contract." The tribunal failed to provide sufficient grounds as to the reason claims exceeding the contract price would be considered unforeseeable.

Contrast the *Bicycles Case* with the *Nickel-Plating Machines Production-Line Equipment Case* (12 February 1999),[99] where the tribunal awarded the seller damages exceeding the contract value. Specifically, it awarded damages of DM 2,026,439 (not including legal expenses) on a contract valued at only DM 1,550,000. The reasoning provided in the *Bicycles Case* is insufficient to determine a clear outcome. There are three possible reasons that could arguably be advanced. First, the buyer could not discharge his burden of proof sufficiently. Second, the claims exceeded the contract price, and the loss, therefore, is disproportionate and needs to be cut back. Third, the damage suffered was unforeseeable. If the second argument is advanced, then such reasoning is erroneous and not in line with Article 74 of the CISG, because it would indicate that the arbitral tribunal placed the emphasis on the fact that the claims exceeded the contract price and the damage suffered was unforeseeable. This would indicate that the tribunal, by its own standards, dictated that if at any time damages exceed the contract price, such damages would automatically be unforeseeable, regardless of whether the breaching party actually foresaw such a result.

The tribunal in this case further disregarded the damages sought by the buyer for loss of its distributorship contract with a third party, holding that "this contract signed by [buyer] and France GIB has nothing to do with this case, so it cannot be used as the basis to calculate damages."[100] Because the buyer's contract with the third party was avoided due to the seller's breach, the requirement of causation under Article 74 is satisfied. The reasoning by the arbitral tribunal

97 *Id.*

98 Bicycles (Fr. v. P.R.C.), CIETAC (1994), *available at* http://cisgw3.law.pace.edu/cases/940811c1.html.

99 Nickel-Plating Machines Production-Line Equipment, *supra* note 60.

100 Bicycles, *supra* note 98.

that such damages suffered have nothing to do with the case against the seller is inconsistent with Article 74 of the CISG.

Furthermore, a seller should realize that a buyer who imports bicycles *en masse* is likely to resell the goods to consumers. Consequently, if the bicycles are non-conforming, a reasonable seller should foresee the buyer's lost profits. In other words, the buyer would suffer losses as a consequence of not being able to perform its duties to the third party, and the seller ought to have known that fact. As already stated, a seller does not need to foresee the exact amount of damages, but rather the seller need only foresee the assumed risk and potential liability that would result in damages at the conclusion of the contract.[101]

An illustration of the tribunal's inconsistent decisions is highlighted in the *Lindane Case* (31 December 1997).[102] Here the buyer requested the tribunal hold the seller liable for damages claimed by the buyer's client, because the goods were not delivered. The tribunal noted that the damage claim made by the buyer's client was a direct result of the seller's failure to deliver the goods to the buyer, thereby establishing the link of causation. The arbitral tribunal further noted that because the buyer was a trading company, it should have been self-explanatory to the seller that the buyer did not aim to purchase the contractual goods for domestic uses, but for trade purposes (an obvious point if the CISG is to apply in the first place).[103] Therefore, the arbitral tribunal concluded it was reasonable for the seller to foresee that the failure of its performance to the contract may lead to certain damages to the buyer.

Furthermore, in the *High Tensile Steel Bar Case* (25 October 1994),[104] *Dried Sweet Potatoes Case* (14 March 1996),[105] and the *Hot-Rolled Steel Billets Case* (5 August 1995),[106] the arbitral tribunals accepted that buyers had the right to be compensated for a settlement made with a third party.[107] The contract between the original buyers and the third party was avoided due to the original seller's breach.

The arbitral tribunal rejected the causal connection between the seller's breach and the buyer losing a contract with a third party in the *Bicycles Case*, finding instead that the contract with the third party had no bearing on the case. This is inconsistent with international practices and CIETAC's own subsequent decisions.[108] It should be noted that a clear distinction between losses and loss of profits is not always explained, but it can be reasonably assumed that if goods are

[101] *See supra* Part III.

[102] Lindane (Fr. v. P.R.C.) CIETAC (1997), *available at* http://cisgw3.law.pace.edu/cases/971231c1.html.

[103] *Id.*

[104] High Tensile Steel Bar, *supra* note 80.

[105] Dried Sweet Potatoes, *supra* note 70.

[106] Hot Rolled Steel Billets, (U.S. v. P.R.C. and U.S.), CIETAC (1995), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/950805c1.html.

[107] *See id.*; High Tensile Steel Bar, *supra* note 80; Dried Sweet Potatoes, *supra* note 70.

[108] *See, e.g.*, Hot Rolled Steel Billets, *supra* note 106.

either faulty or are not delivered, and hence cannot be sold to a third party, profits will be lost.

C. Reliance upon Domestic Law

Once the CISG is invoked as the applicable law, recourse to domestic law is only applied in circumstances where the CISG is either silent on or has specifically excluded the particular issue.[109] The principle of uniformity demands that the use of domestic law be restricted to situations specifically stipulated by the CISG; that is, the filling of external gaps.[110]

One of the unfortunate practices employed by CIETAC arbitrators has been the application of domestic law in conjunction with the CISG, specifically in situations where the CISG clearly addresses the issue. This practice is not only restricted to the calculation of loss of profit but pervades many aspects of case management. CIETAC decisions refer first to the domestic law, and then its equivalence in the CISG. The problem with such a practice is that the interpretation of the CISG articles is jeopardized when substituting domestic law to the CISG or trying to bring about a decision satisfying both domestic and CISG articles. Rather than applying the international interpretation of the relevant CISG article, the panel may be tempted to interpret the article in line with domestic law, on the basis that the wording is similar or in some provisions the same.

As a contracting state, China's domestic law should be overridden by the CISG;[111] however, the words "to override and replace" are far too positive and final and not sufficiently fluid.[112] Furthermore, the words "to modify or replace" would nearly, but not quite, achieve the effect of "to override" and such "near precise" language fits much better into Chinese decision making as it allows interpretation of the CISG within the confines of Chinese policy.[113]

Such observations can be found in various CIETAC decisions. In the *Sesame/ Urea Case* (13 June 1989),[114] the *Monohydrate Zinc Sulfate Case* (26 June 1997),[115] the *BOPP Film Case* (8 September 1997),[116] and the *Isobutanol Case* (7 July 1997),[117] the tribunal insisted upon applying domestic law which sup-

109 CISG, *supra* note 5, art. 7(2).

110 BRUNO ZELLER, FOUR-CORNERS—THE METHODOLOGY FOR INTERPRETATION AND APPLICATION OF THE UN CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS, Ch. 5, ¶ 1 (May 2003), *available at* http://www.cisg.law.pace.edu/cisg/biblio/4corners.html.

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

112 BRUNO ZELLER, *CISG and China*, *in* CISG AND CHINA—THEORY AND PRACTICE: AN INTERCONTINENTAL EXCHANGE, 13 (Michael Will ed., 1999).

113 *Id.*

114 Sesame/Urea (P.R.C. v. Jordan), CIETAC (1989), *available at* http://cisgw3.law.pace.edu/cases/890613c1.html.

115 Monohydrate Zinc Sulphate (P.R.C. v. N. Korea), CIETAC (1997), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/970626c1.html.

116 BOPP Film, (N. Korea v. P.R.C.), CIETAC (1997), *available at* http://cisgw3.law.pace.edu/cases/970908c1.html.

117 Isobutanol (P.R.C. v. U.S.), CIETAC (1997), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/970707c1.html.

ported the respective articles in the CISG. In the *Black Melon Seeds Case* (4 April 1997), involving a dispute between a buyer from Hong Kong and a Chinese seller,[118] the tribunal referred to Article 19 of the Economic Contract Law ("ECL"), which applies to domestic contracts. This reference was unnecessary, as there was no apparent gap within the CISG, upon which domestic law would be called to fill. The use of domestic law side by side with the CISG may suggest "that the CISG is not used with confidence in some [Chinese] courts,"[119] or Chinese tribunals for that matter. In sum, the CISG has to be interpreted first within its four corners, and only if a gap needs filling should there be any resort to domestic law. Otherwise, the internationality of the convention is jeopardized.[120]

VI. The Trend

Obvious criticism can be leveled at CIETAC's early decisions. However, such criticism must be made while taking into consideration that CIETAC is not the only arbitration organization that has expressed an ethnocentric bias toward its domestic law. Examples can be found, for instance, in Australia in *Downs Investment Pty Ltd v. Perwaja Steel SDN BHD*[121] and in the United States in the classic case of *Raw Materials Inc. v. Manfred Forberich GmbH & Co.*[122] It should not be surprising that CIETAC has ethnocentric tendencies considering the cultural and political habitat from which it has emerged.

Over the past decade, CIETAC's decisions on the CISG have become more consistent with international interpretation. Since 1999, the shift has been dramatic. One example is the *Flanges Case* (29 March 1999).[123] In brief the primary issues in dispute were connected with the existence of deficiencies or concealed deficiencies of the goods and the authenticity of the testing data. Unfortunately, the decision did not specifically state the law, but the conclusion was in line with Article 74 of the CISG. Arguably, the arbitrators must have had CISG Article 74 in mind in reaching the ruling.

This shift may correspond to China's reform of its contract law. In 1999, China introduced the Chinese Contract Law ("CCL"), which was hailed to be China's big leap forward in legal reforms, as the CCL sought to bring Chinese

118 Black Mellon Seeds (H.K. v. P.R.C.), CIETAC (1997), *available at* http://cisgw3.law.pace.edu/cases/970404c1.html.

119 *Zeller, supra* note 112, at 13.

120 *See generally* Frank Fisanich, *Application of the U.N. Sales Convention in Chinese International Commercial Arbitration: Implications for International Uniformity*, AM. REV. INT'L. ARB. 101–22 (1999), *available at* http://www.cisg.law.pace.edu/cisg/biblio/fisanich.html (regarding how Chinese arbitrators and lawyers are not applying the CISG uniformly, which poses an international threat).

121 Downs Inv. Pty. Ltd. v. Perwaja Steel SDN BHD, [2000] Q.S. CT. R. 421 (2000), *available at* http://cisgw3.law.pace.edu/cases/001117a2.html.

122 Raw Materials Inc. v. Manfred Forberich GmbH & Co., 2004 WL 1535839 (N.D. Ill. 2004).

123 Flanges (U.S. v. P.R.C.), CIETAC (1999), *available at* http://cisgw3.law.pace.edu/cases/990329c1.html.

law in line with the law of many developed nations.[124] Most significantly, the CCL shifted the focus of Chinese contract laws from preserving the characteristics of a centrally planned economy to preparing for an increasingly globalized economy. The shift was transparent when the CCL abolished the term "economic contract," opting instead to place the principle of freedom of contract as its main priority.[125]

Creating uniformity in Chinese contract law was overseen by Chinese administrators who searched the world over for the best practices and invited eminent academics and scholars to participate in helping China move forward.[126] Among the main references was the CISG, whose theoretical and practical preparation facilitated the public appearance of a uniform contract law in China.[127] The CCL invalidated the ECL applying to domestic contracts and to the special Law on Technology Contracts and the Law on Contracts Involving Foreign Interests ("FECL").[128]

Since the FECL and the CISG differed on several important issues,[129] some CIETAC decisions may well have been reached by applying a mixture of the two, "thereby restricting the effect of the CISG within the ideas of the FECL, which in turn is tailored towards serving the policies of the Chinese government."[130] Some academics have noted that the CCL demonstrates China's willingness to open its legal system to foreign influences and to receive inspiration from foreign laws.[131] The new domestic law also allows the Chinese legal system to gain the maturity signified in the concept of freedom of contract, which some claimed had been lacking.[132]

The trend of CIETAC decisions being more consistent with international interpretations of the CISG and relying less upon domestic law can arguably be linked to the introduction of the CCL, in so far as the Chinese legal mentality is shifting. Another benefit of the reformed contract law is the predictability of results. Prior

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124 Ding Ding, *CISG and China*, *in* CISG AND CHINA—THEORY AND PRACTICE: AN INTERCONTINENTAL EXCHANGE, 33–37 (Michael Will ed., 1999).

125 Feng Chen, *The New Era of Chinese Contract Law: History, Development and Comparative Analysis*, 27 BROOK. J. INT'L L. 153, 169 (2001).

126 *Id.*

127 Chen, *supra* note 125, at 169.

128 Frederich Blase, *CISG and China—An Intercontinental Exchange*, 4 VINDOBONA J. 95, 95 (2000).

129 Foreign Economic Contract Law of the People's Republic of China ("FECL") (1985) *in* 1 CHINA LAWS FOR FOREIGN BUSINESS: BUSINESS REGULATION (1998). Differences between the CISG and the FECL are apparent in the area of contract formation, in so far as the FECL has no provisions for offer and acceptance. Article 7 of the FECL states "A contract is formed when the clauses of contract [sic] are agreed in written form and signed by the parties. In case one party requests to sign a confirmation letter when the agreement is reached by the means of letter, telegram, or telex, the contract is only formed upon the confirmation letter being signed." Even taking into consideration China's reservation under Article 96 of Article 11, Article 7 of the FECL can be interpreted so that it is consistent with Article 8 of the CISG as there is only one valid way to form a contract and the agreed terms—to reduce all agreements to writing; *see also* Fisanich, *supra* note 120, at 103, 110.

130 Blase, *supra* note 128, at 95 (but note Friedrich Blase refers to Chinese courts rather than tribunals; nonetheless a comparison can be made).

131 *Id.*

132 *Id.*; Zhang, *supra* note 20.

to 1999, depending upon the type of transaction or business relationship, CIETAC decisions had the appearance of favoring the Chinese party.[133] This may be attributed to the Chinese party's understanding of the domestic legal system better then the foreign party. With the introduction of a uniform domestic law, hopefully it will become easier for foreign parties to understand the Chinese legal system. To what extent the domestic changes will impact CIETAC's interpretation and application of the CISG is unknown. However, one may be optimistic that the current trend of internationally-aligned CIETAC decisions may continue.

VII. Conclusion

CIETAC decisions on calculation of lost profits under Article 74 are difficult to comprehensively evaluate. Because of the lack of fully published decisions with satisfactory tribunal findings and reasoning, and the slow rate of translation of published decisions,[134] it is especially difficult for outsiders to ascertain clear rules under CIETAC's calculations of lost profits.

To add to the changing face of China's legal system, CIETAC needs to make a concerted effort to have its decisions published and translated as soon as practicable. CIETAC also needs to refer to academic reasoning behind the CISG in support of its decisions, rather than simply making statements like "the seller shall pay the buyer's loss of profit resulting from the defective goods, at a rate of 20% which it deemed to be reasonable."[135] In this case, the tribunal did not attempt to explain why twenty percent was deemed to be a reasonable rate; it merely stated that it was.[136] This arbitrary figure provides no guidance for future parties wishing to litigate or arbitrate, and poses questions as to the uniformity of application of the CISG as required by Article 7(1).

Providing the *obiter dicta* for its reasoning rather then the *ratio decidendi* will make CIETAC appear more transparent, thereby lending the body more credibility in the international community. It also will provide future parties guidance as to possible outcomes and predictability of arbitral decisions. In sum, CIETAC's rulings serve as "a significant gauge of what a practitioner should review prior to representing clients in transactional matters as well as in an arbitral hearing."[137]

Despite the need for improvements, CIETAC has come a long way. It has followed the trend of its country's legal system and has adopted practices and

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[133] This is the authors' personal perception from the reading of the cases.

[134] *See* Fisanich, *supra* note 120, at 120.

[135] Clothes (P.R.C. v. Ger.), CIETAC (2000), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/000131c1.html.

[136] Another illustration is provided by China 21 September 1992 CIETAC Arbitration proceeding, *in* SELECTED WORKS OF CHINA INTERNATIONAL ECONOMIC AND TRADE ARBITRATION COMMISSION AWARDS (1989-1995) 309–16 (Priscilla Leung Mei-Fun & Wang Sheng-Chang eds., UPDATED TO 1997, AUTHORIZED ENGLISH VERSION, 1998) (where the arbitral tribunal did not attempt to define "reasonable time." The arbitral tribunal merely indicated that the period in question was beyond what is expected in international trade practice).

[137] Allison Butler, *Contracts for the International Sale of Goods in China*, 21 INT'L LIT. Q. 1, 4 (2006), *available at* http://cisgw3.law.pace.edu/cisg/biblio/butler5.html.

procedures making it sufficiently advanced. The trend in the calculation of lost profits under Article 74 of the CISG by CIETAC, appears to be consistent with the interpretation and application of the CISG. The tentative conclusion, focusing only on pre-January 2000 cases, is that a shift toward accepted international interpretations of Article 74 can be observed and that a shift away from an ethnocentric approach is taking place. Allison Butler, in examining eleven post-January 2000 cases, reached the same tentative conclusion.[138] However, eleven cases are not an adequate statistical demographic from which to draw definitive conclusions and further research is needed once post-January 2000 cases become available.[139]

It is sometimes forgotten, but one must remember what a great feat CIETAC is, considering the circumstances under which the body operates. CIETAC exists in a country trying to find a balance between maintaining a socialist state while undertaking significant free-market reforms demanded by capitalist-backed globalization. Could it be more difficult?

[138] *See id.*, at 4–5.

[139] In the opinion of Al Kritzer, at least 200 post-2000 CIETAC decisions have not yet been made available for translation (e-mail on file with authors).