

# ATTORNEYS' FEES AS DAMAGES IN INTERNATIONAL COMMERCIAL LITIGATION

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I. General Considerations; The Zapata Case .....	203
II. Attorneys' Fees as Damages: Comparing Jurisdictions .....	205
A. Finland .....	205
B. Germany .....	209
III. Attorneys' Fees as Damages Under the CISG .....	212
A. Is There a CISG Duty to Award Attorneys' Fees? .....	212
B. Are Attorneys' Fees a Matter Governed By, But Not Expressly Settled in the CISG, as Referred to in Article 7(2)? .....	213
IV. Conclusions .....	215
A. Attorneys' Fees as Damages Under Article 74; The Anomalous Results .....	215
B. Are Collection Costs Foreseeable Consequences of a Breach? .....	215
C. The Zapata District Court Holding .....	217
D. The Zapata Appellate Court Holding .....	219
E. Anomalous Results: Breach v. Non-Breach .....	221

## I. GENERAL CONSIDERATIONS; THE ZAPATA CASE

Scholarly writings about the United Nations Convention on Contracts for the International Sale of Goods ("CISG" or "Con-

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vention")<sup>1</sup> have featured an increasing amount of debate about whether attorneys' fees may fall under Article 74 as damages.<sup>2</sup>

A United States district court evaluated attorneys' fees as damages under the CISG in *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co., Inc.*,<sup>3</sup> now commonly referred to as the *Zapata* case. The case involved a Mexican seller and an American buyer. The prevailing party, seller, had claimed damages, a part of which were attorneys' fees. The court acknowledged that the so-called "American rule"<sup>4</sup> calls for litigants to bear their own legal expenses: in the absence of an explicit statutory or contractual provision to the contrary, each party to a dispute must bear his own attorneys' fees. The court also posited that the United States "is in the minority of jurisdictions that do not make prevailing parties truly whole by saddling the adversaries with the winners' legal expenses."<sup>5</sup> The case has garnered major attention based on the amount of comments it has already received. The reason is possibly because the case emanates from the United States, a jurisdiction which so far does not have a large CISG jurisprudence, but whose rulings resonate throughout the commercial community.

Article 74 of the CISG provides:

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 light of

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<sup>1</sup> United Nations Convention on Contracts for the International Sale of Goods, U.N. Doc. A/CONF.97/18 reprinted in [1980] IX UNCITRAL YEARBOOK 149, available at <http://untreaty.un.org/ENGLISH/bible/englishinternetbible/partI/chapterX/treaty17.asp> [hereinafter CISG].

<sup>2</sup> See Harry M. Flechtner, *Recovering Attorneys' Fees as Damages Under the UN Sales Convention: A Case Study on the New International Commercial Practice and the Role of Foreign Case Law in CISG Jurisprudence, With a Post-Script on Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co.*, 22 NW. J. INT'L L. & BUS. (forthcoming 2002), <http://cisgw3.law.pace.edu/cisgw3biblio/flechtner4.html>.

<sup>3</sup> No. 99 C 4040, 2001 WL1000927 (N.D. Ill. Aug. 29, 2001), available at <http://cisgw3.law.pace.edu/cases/01828u1.html>.

<sup>4</sup> See Flechtner, *supra* note 2. See also John Yukio Gotanda, *Awarding Costs and Attorneys' Fees in International Commercial Arbitrations*, 21 MICH. J. INT'L L. 1, 10 (1999).

<sup>5</sup> *Zapata*, 2001 WL 1000927, at \*1.

the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.<sup>6</sup>

In the *Zapata* case, the district court reasoned that Article 74 of the CISG gives the basis to award the seller attorneys' fees as damages. This is in part because the "loser pays" rule is nearly universal and should therefore receive priority over the "American rule." The court then made a reference to Article 7 of the CISG, which provides that:

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.<sup>7</sup>

Bad faith on the buyer's part was set forth as additional grounds for awarding the attorneys' fees. The court concluded: "[seller] is entitled to recover its attorneys' fees not only as an element of *consequential loss* under the Convention, but under the court's inherent power to award attorney's fees in cases of bad faith."<sup>8</sup>

Setting aside issues associated with such additional grounds, the present author's view here is that this ruling, despite the good intentions to the contrary, did not entirely fulfill requirements laid down in either Article 7 or Article 74 of the CISG.

## II. ATTORNEYS' FEES AS DAMAGES; COMPARING JURISDICTIONS

### A. *Finland*

To clarify the issue of how attorneys' fees are approached in different jurisdictions, we shall by way of example, take a look at the Finnish Code of Judicial Procedure, *Oikeudenkäymiskaari*, ("Finnish Code").

It is a general principle under the Finnish Code that the party losing the dispute will be held liable for the legal fees of both parties to the proceedings.<sup>9</sup> This is the general, prevailing

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<sup>6</sup> CISG, *supra* note 1, art. 74.

<sup>7</sup> *Id.* art. 7.

<sup>8</sup> *Zapata*, 2001 WL 1000927, at \*6 (emphasis added).

<sup>9</sup> See CODE OF JUDICIAL PROCEDURE (FIN.), ch. 21, § 1 (1993) (translation by the author).

principle, also known as the loser-pays rule. In Finland, this rule has the following three exceptions:

- 1) In a case where a multitude of claims have been presented and some are resolved to benefit one party and some the other, the parties will each be liable only for his own legal fees, unless there is a reason to make a party in part liable for the other party's legal fees. Also, when only a part of the claim finds acceptance in the court, the above rule applies, unless the part that was not accepted constitutes only a discretionary matter.<sup>10</sup>
- 2) In a situation, where the proceedings were initiated by one of the parties without any apparent reason, or a party otherwise wilfully or negligently caused an unnecessary trial, that party will be liable for both his own and the other party's legal fees, regardless of the outcome of the trial, unless the circumstances provide for both parties bearing their own expenses.<sup>11</sup>
- 3) When a party to the proceedings has wilfully, negligently, or unnecessarily lengthened the process by acting against his duties and thus caused expenses to the other party, that party must compensate the other party for such expenses, without regard to how the legal expenses would otherwise be distributed between the parties.<sup>12</sup>

There are countries applying the loser-pays rule where the attorneys' fees awarded only consist of expenses incurred after the initiation of the proceedings in a court of law (see below).<sup>13</sup> Finland, rather, takes an extensive interpretation and includes in the attorneys' fees items such as pre-trial collection expenses and negotiations and consultations with an attorney before a summons has been served on the other party. There is a clear distinction to be made here. The Finnish "all encompassing" approach seems quite logical, considering that such expenses indeed are connected to the dispute at hand, since the case did end up in the court and expenses were accumulated during events preceding the trial.

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<sup>10</sup> See *id.* ch. 21, § 3.

<sup>11</sup> See *id.* ch. 21, § 1.

<sup>12</sup> See *id.*

<sup>13</sup> See Flechtner, *supra* note 2.

This brief introduction into the intricacies of Finnish procedural law leads us to the issue at hand: can attorneys' fees be considered damages under Article 74 of the CISG?

In the following, it will be established that there are three different environments where attorneys' fees are dealt with in disputes governed by the CISG.

The first environment is where the dispute falls in a jurisdiction, which follows the "loser-pays" rule and allows a wide interpretation of attorneys' fees, including pre-trial expenses. The party losing the dispute will be liable for the attorneys' fees of the other, limited perhaps by reasonableness considerations. The party is under no obligation to establish foreseeability at the time of the conclusion of the contract as to the attorneys' fees as is the case with Article 74 of the CISG. The party is also entitled to compensation for the attorneys' fees even in a case where there is no breach of the contract.

The second environment is where the court follows the "loser-pays" rule, but provides limitations as to which attorneys' fees the losing party must pay. The prevailing party will have to establish foreseeability of such attorneys' fees at the time of the conclusion of the contract with regard to expenses exceeding the limitations laid down by the procedural rules of the forum if the party wishes to claim them as damages under Article 74.

The third environment is where the forum does not abide by the "loser-pays" rule, but rather, where the parties are each responsible for his own attorneys' fees. In this instance, the party would only be able to recover attorneys' fees if the party claims them as damages under Article 74 or by citing other criteria, such as bad faith by the other party.

The question then is, can these different environments be neatly packed under the umbrella of Article 74 and is it even worth the effort? John Felemegas is of the opinion, that the district court in *Zapata* was correct when it stated that the "American rule," namely that the parties bear their own legal expenses, can be disregarded because of the circumstances in the case and because Article 7(1) of the CISG requires that regard should be had to the international character of the Convention and as a result, attorneys' fees would fall under Article

74.<sup>14</sup> At first, this logic seems correct, but it fails to consider the consequences.

If we think of the matter in the Finnish framework, the answer, at first, seems quite simple. Attorneys' fees will not be considered as damages, because of their nature under Finnish law as a procedural rather than a material issue.<sup>15</sup> The inherent logic of the Finnish system does not lead a member of the judiciary to consider attorneys' fees as damages requiring the establishment of foreseeability or of being subject to mitigation,<sup>16</sup> but rather as a matter subjugated to the outcome of the material issues at hand. This brings about the not-so-often meaningless tension between the local rules of procedure and the CISG rules, when their application assumes varying forms depending on the jurisdiction.

When looking at the *Zapata* interpretation through the lens of Finnish procedural rules, the other party would have possibly borne some or all of the costs because of bad faith considerations, but this would not have been seen as damages, but again, only as a procedural issue.

If we then approach the matter in the context of the CISG, does it really matter if a national law calls an issue "procedural" or "material" and, as a consequence, a national court concludes that a matter is or is not governed by the CISG or, as often happens, automatically assumes that without any analysis? It is of utmost importance for the viability of the Convention that national concepts and labels do not hamper uniformity, critical for the functioning of the Convention. Certainty is crucial to the functioning of international trade. Orlandi states that:

[A]ll abstract distinctions between substantive and procedural laws become redundant, if not harmful, especially when the par-

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<sup>14</sup> See John Felemegas, *The Award of Counsel's Fees Under Article 74 CISG, in Zapata Hermanos Sucesores v. Hearthside Baking Co.* (2001), at <http://cisgw3.law.pace.edu/cisg/biblio/felemegas1.html>.

<sup>15</sup> See Ervasti Kaijus, *A Study of Lower Court Practice* (Summary Publication No. 126, Helsinki, 1994), available at <http://www.om.fi/optula/4615.htm>.

<sup>16</sup> See CISG, *supra* note 1, art. 77. Article 77 of the CISG states:

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.

*Id.*

ties turn to the courts for equal enforcement of their contractual rights pursuant to these uniform bodies of rules.<sup>17</sup>

The present author agrees with this statement. What Orlandi also asserts as a possible solution to the dilemma and the tensions between international law conventions and national laws is what he refers to as the “Erie test” or “outcome-determinative test.” The concept is based on the United States case *Erie Railroad Co. v. Tompkins*,<sup>18</sup> where the court reasoned that in order for the judges to overcome the problem of whether an issue is substantive or procedural, the court must look at the impact of the choice of law on the outcome of the case. Within this context, Orlandi states:

[The judges] would instead look at the actual impact of the CISG provision on the outcome of the decision and apply the Convention whenever this best guaranteed the policy goals of international uniformity.<sup>19</sup>

The present author submits that this would indeed be a valid tool in forwarding the requirement of Article 7, namely, that due regard is to be had to the international character of the Convention. In the following, the author here has made an effort to establish that the policy goals of international uniformity are not furthered by awarding attorneys’ fees as damages under Article 74, despite their nature as substantive or material issues, and that if one wants to avoid the imbalance created by the two schools of thought, i.e., “American rule” and “loser pays” rule, there are other ways to do it rather than through the application of the CISG.

## B. *Germany*

Professor Flechtner refers to what the attorneys’ fees consist of in his commentary on attorneys’ fees as damages, stating that a German court<sup>20</sup> awarded some of the attorneys’ fees as damages because such costs were beyond the scope of the recov-

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<sup>17</sup> Chiara Giovannucci Orlandi, *Procedural Law Issues and Law Conventions*, 5 UNIFORM L. REV. 1, 23-25 (2000), available at <http://cisgw3.law.pace.edu/cisg/biblio/orlandi.html>.

<sup>18</sup> 304 U.S. 64 (1938).

<sup>19</sup> Orlandi, *supra* note 17, at 30.

<sup>20</sup> Oberlandesgericht [Appellate Court] Düsseldorf, 6 U 152/95, 11 July 1996 (F.R.G.), <http://cisgw3.law.pace.edu/cases/960711g1.html>.

ery afforded by the domestic "loser pays" rule in Germany, and pre-litigation attorney expenses would be characterized as substantive damages under German national sales law.

A German ULIS case<sup>21</sup> discussed the fees of a collection agency as damages claimed under Article 82 of ULIS.<sup>22</sup> The case is cited here because pre-litigation (*Vorgerichtliche*) expenses often result from efforts to collect an outstanding debt. The court established in this case that a German restrictive rule was not applicable.<sup>23</sup> The said rule would have limited the amount of damages the claimant could have claimed. Further proof was required as to the amount of collection expenses and according to the court, such expenses were limited to damages that the party in breach foresaw at the time of the conclusion of the contract.<sup>24</sup> The defendant was aware at the time of the conclusion of the contract that non-payment would prompt the claimant to seek collection of outstanding debts. The court stated that commissioning a collection agency in one's place of business is not a breach of duty to mitigate damages.<sup>25</sup> Compensation for these expenses was solely based on verifying the amount of the collection costs. The view of the defendant in the case, i.e., *that a national (German) rule concerning restrictions on compensation for collection fees by using an attorney instead of a collection agency, was not applicable. This rule was within the domain of German law of procedure and, due to rules of private international law and the circumstances of the case, was not applicable. This rule is based on a principle that it is a breach of duty to mitigate damages, if a domestic creditor uses a collection agency instead of an attorney. According to the court, the situation of a foreign creditor is not similar to the domestic*

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<sup>21</sup> Landgericht [District Court] Essen, 45 0 237/79, MDR 81/148, 10 June 1980 (F.R.G.), <http://cisgw3.law.pace.edu/cases/800610g1.html>.

<sup>22</sup> Convention Relating to a Uniform Law on the International Sale of Goods (ULIS), July 1, 1964, 384 U.N.T.S. 169. This convention was the predecessor to the CISG. For more information on the ULIS, its legislative history and the legislative history of the CISG articles on damages, see JARNO VANTO, DAMAGES UNDER CISG (2002), <http://www.utu.fi/oik/tdk/julkaisu/esitteet2002/yksb68.htm>. Article 82 is almost an exact match with Article 74 of the CISG. See CISG, *supra* note 1, arts. 74, 82.

<sup>23</sup> See Landgericht [District Court] Essen, 45 0 237/79, MDR 81/148, 10 June 1980 (F.R.G.), <http://cisgw3.law.pace.edu/cases/800610g1.html>.

<sup>24</sup> See *id.*

<sup>25</sup> See *id.*



creditor situation. A foreign creditor cannot be required to know that a less expensive way of collecting outstanding debts is to employ a German attorney.

This accords somewhat with what the district court stated in the *Zapata* case:

Courts applying the CISG cannot . . . upset the parties' reliance on the Convention by substituting familiar principles of domestic law when the Convention requires a different result . . . . It is therefore wholly misleading for the buyer to contend for the parochial application of the American rule.<sup>26</sup>

A 1995 German case did not award the claimant attorneys' fees, stating that it was against the duty of the party suffering from a breach of contract to mitigate his damages under Article 77 of the CISG.<sup>27</sup> The court concluded that the claimant was in breach of that duty in employing an Italian attorney for collection purposes instead of one in Germany where it would have been less costly.<sup>28</sup>

A recent German case held that the seller *was* entitled to attorneys' fees and that the word "loss" in Article 74 *encompasses the cost of pursuing one's rights*.<sup>29</sup> It is not entirely clear, based on the translation of the case, but it seems that, again, this was a matter of collection costs. A domestic set of rules "BRAGO"<sup>30</sup> for determination of attorneys' fees was used as a basis for the ruling on damages. Furthermore, an earlier German Appeals Court ruling<sup>31</sup> had reached a similar conclusion, stating and further characterizing Article 74 as encompassing compensation for the cost of a *reasonable* pursuit of one's legal rights.<sup>32</sup> This was an issue of costs in retaining an attorney. Even though the court stated the encompassing content of Article 74, it did not grant the fee as damages because it had al-

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<sup>26</sup> *Zapata*, 2001 WL 1000927, at \*3.

<sup>27</sup> See Amtsgericht [Lower Court] Alsfeld, 31 C 534/94, 12 May 1995 (F.R.G.), <http://cisgw3.law.pace.edu/cases/950512g1.html>.

<sup>28</sup> See *id.*

<sup>29</sup> See Amtsgericht [Lower Court] Viechtach, No. 1 C 419/01, 1 Apr. 2002 (F.R.G.), <http://cisgw3.law.pace.edu/cases/020411g1.html>.

<sup>30</sup> Bundesrechtsanwaltsgebührenordnung [hereinafter BRAGO].

<sup>31</sup> See Oberlandsgericht [Appellate Court] Düsseldorf, No. 17 U 146/93, 14 Jan. 1994, (F.R.G.), <http://cisgw3.law.pace.edu/cases/940114g1.html>.

<sup>32</sup> See *id.*

ready been claimed as a procedural cost and consequently could not be claimed twice.<sup>33</sup>

The court in the ULIS case was willing to sideline a domestic procedural rule, stating that it was in the domain of German law and consequently did not fare well with international sales law applied in the case. However, this was only to the extent that the German Law on Civil Procedure ("ZPO") did not rule on the distribution of legal expenses (attorneys' fees). This would not be a workable solution in Finland, where the view as to what attorneys' fees consist of is different.

### III. ATTORNEYS' FEES AS DAMAGES UNDER THE CISG

#### A. *Is There a CISG Duty to Award Attorneys' Fees?*

An argument can be raised that if an international convention places a duty on the State Party, the State Party or its manifestations, i.e., the courts should perform the duty. The Vienna Convention on the Law of Treaties provides the following: "A Party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."<sup>34</sup> Does then the CISG place a duty on the courts, whether Finnish, German, American, or some other nationality to award attorneys' fees as damages?

Clearly, Article 74 does not specifically name attorneys' fees as damages anymore than it names other expenses incurred or losses experienced. Actually the only "definition" of damage is found in the words: "[d]amages for breach of contract by one party consist of a sum equal to the loss . . ."<sup>35</sup> Looking at this Article now, we also see that it does not rule out attorneys' fees as damages either. This means that if attorneys' fees are to be allowed under Article 74, it would happen through submission of the facts of the case under the norm in which the facts assume their meaning, that is, interpretation. Can such an interpretation, in this case, that attorneys' fees fall under Article 74, be binding on a court of another country? Clearly the answer is, "No." The quality of the rulings and the reason-

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<sup>33</sup> See *id.*

<sup>34</sup> Vienna Convention on the Law of Treaties, Jan. 27, 1980, art. 26, 1155 U. N. T. S., 331.

<sup>35</sup> CISG *supra* note 1, art 74.

ing behind those rulings varies greatly depending on the level of the court (appellate, supreme, etc.) and the locality of the court. The Convention places the duty on the courts to give due regard to the international character of the Convention. One of the aspects of this is that in their rulings, courts should strive to find solutions that will be accepted on an international level and on a national level. We are, after all, not talking about a "supranational" Convention.

B. *Are Attorneys' Fees a Matter Governed By, But Not Expressly Settled in the CISG, as Referred to in Article 7(2)*

Let us assume, for the sake of argument, that attorneys' fees are so governed, but not expressly settled in the CISG. Then Article 7(2) points to general principles on which the Convention is based. The UNIDROIT Principles of International Commercial Contracts ("UNIDRIOT Principles") provide as one such principle, the principle of full-compensation.<sup>36</sup> In loser-pays jurisdictions, full-compensation is reached through procedural cost division rules, without the constraints of the requirement of a breach of contract; foreseeability of loss; and the mitigation of loss placed on attorneys' fees, if they were regarded as "loss" within the meaning of Article 74, at least in countries that take an expansive interpretation on attorneys' fees as encompassing fees accrued before the initiation of proceedings.

The Convention itself provides that if a matter is governed by, but not expressly settled in it, the matter is "to be settled in conformity with the general principles on which [the Convention] is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law."<sup>37</sup> Like the CISG, neither of the widely accepted principles, the UNIDROIT Principles nor the Principles of European Contract Law ("PECL") (both to a major extent regarded as "restatements" of existing *lex mercatoria* principles) explic-

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<sup>36</sup> See International Institute for the Unification of Private Law, Principles of International Commercial Contracts, art. 7.4.2 (Rome 1994), available at <http://www.undroit.org/english/principles/chapter-1.htm> [hereinafter UNIDROIT Principles].

<sup>37</sup> CISG, *supra* note 1, art. 7(2).

itly states that attorneys' fees should be regarded as damages. Let us still keep the principle of full compensation as our guiding star. It does not give a definitive answer but points us in the right direction. The Convention then maps our road by the direction of the rules of private international law. This is the last resort, but still supported by the Convention, that is, if it is accepted that attorneys' fees as damages is an issue governed by, but not settled in the CISG.

Article 74 requires that the damages be based on a breach of contract.<sup>38</sup> A consequence of this is that a defendant, in a country where a loser-pays rule is inapplicable, would be unable to recover attorneys' fees as damages after successfully having defended himself because no breach of contract was established. In such a case, the parties would bear their own costs. On the other hand, in a case of a breach of contract, if attorneys' fees were allowed as damages, the aggrieved party would be compensated. In both scenarios, parties have suffered financially as a result of litigation, but only in a case of breach would the other party be allowed compensation for attorneys' fees.

In loser-pays jurisdictions, the losing party would pay regardless of a breach and the prevailing party would be under no obligation to establish foreseeability as required by Article 74 or to mitigate the loss (attorneys' fees) as required by Article 77.

Another demand placed on damages under Article 74 is that they may "not exceed the loss 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>39</sup>

If we now look at the *Zapata* case, we may arguably admit that attorneys' fees could indeed be seen as possible consequences of the breach of contract at the time of the conclusion of the contract, which the party in breach foresaw or ought to have foreseen. Another issue is whether the party in breach foresaw or could have foreseen that he would be liable for such a loss, as he was relying on the "American rule."

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<sup>38</sup> See *id.* art 74.

<sup>39</sup> *Id.*

To the present author, it seems that the district court in *Zapata* acted more on the basis of a procedural rule, namely that an exception can be made to the "American rule" if either of the parties acted in bad faith and less on the basis of the CISG actually mandating an award of attorneys' fees. The role of Article 74 provided support for additional grounds for the award of attorneys' fees to the prevailing party rather than the principle ground.

#### IV. CONCLUSIONS

##### A. *Attorneys' Fees Allowed as Damages Under Article 74; The Anomalous Result*

What If attorneys' fees were allowed as damages under Article 74? As mentioned before, it would require a breach of contract. In jurisdictions operating under the "American rule," this would mean that where no breach was established, the prevailing party would suffer the cost of litigation, as is the case under normal circumstances in those jurisdictions. Then again, in loser-pays jurisdictions, where procedural rules determine that all attorneys' fees are compensated and those where they limit the attorneys' fees to those accumulated during the proceedings, the prevailing party would be compensated for such fees even if no breach had been established.

In "American rule" jurisdictions and in jurisdictions where procedural rules limit the attorneys' fees to those accumulated during the proceedings, those fees would also be subject to the requirement of mitigation as defined under Article 77.

##### B. *Are Collection Costs Foreseeable Consequences of a Breach?*

Can collection costs, as mentioned above in the presented German cases, accrued through use of an attorney or otherwise, be regarded as foreseeable consequence of the breach? The present author submits that they indeed can be regarded as foreseeable consequences of a breach of contract. A buyer not paying for the delivered goods could or ought to have foreseen at the time of the conclusion of the contract that the seller would make an effort to collect the outstanding payment. What difference does it then make in terms of Article 74 whether such costs

are classified as pre-trial collection expenses or attorneys' fees? The difference is that any legal system would experience difficulties in subjecting attorneys' fees accumulated during a trial to mitigation as required by Article 77 — which is in no minor part due to the fact that it would open the back door, questioning the necessity of the whole proceedings and not only individual actions taken during them. The second sentence of Article 77 makes this all the more difficult:

If he [the party relying on the breach] 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>40</sup>

This would put the court in a situation, where it would first have to determine whether during the proceedings the party failed to take measures to mitigate the loss resulting from attorneys' fees, then the party in breach would be able to claim reduction in the damages in the amount by which the loss should have been mitigated. This would be contrary to the rule that the majority of the jurisdictions follow, namely, that the loser pays, which — in cases where a breach is established — is the party in breach and, in instances in which no breach was established, the party who litigated to no avail, in which case no damages would be due under Article 74.

Collection costs, on the other hand, serve the purpose of trying to make the other party fulfill its contractual obligations, namely paying the purchase price, and thus amount to an effort on the other party's side to avoid litigation in a court of law. As stated in the cited German rulings, efforts to collect outstanding payments are efforts to pursue one's rights, but what was not said is that they are efforts to pursue one's rights *outside a court of law*. Thus, it is within a party's own discretion, as to what the most cost-efficient way to collect the debt. Indiscreet measures taken by a party can be questioned by both the court and the party in breach, possibly without questioning the validity of the entire proceedings.

Specifically, in "American rule" jurisdictions this would lead to considerations about which legal maneuvers are appropriate during the proceedings, both in terms of their necessity and in terms of the cost accumulated when the entire cost of the

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<sup>40</sup> CISG, *supra* note 1, art. 77.

proceedings would fall under Article 74. The CISG does not give a court any kind of support as to how attorneys' fees ought to be evaluated. Evaluating them would often lead to resorting to national rules and standards. Actually, resorting to national rules and standards *would* be in line with the Article 7(2) proviso of the Convention that states that "[q]uestions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law."<sup>41</sup>

In loser-pays jurisdictions, an additional consideration, in case attorneys' fees were allowed under Article 74, is: What would happen then if the court had first determined that attorneys' fees in their entirety were governed by CISG Article 74? Would the court then *not* award attorneys' fees as determined by the jurisdiction's cost shifting rules if *no* breach of contract were established. Or would the interpretation be taken so far that because Article 7(2) provides the rules of private international as the last resort, this would mean that either party's national procedural rules would be applied and we would all be back where we started?

The easy part in terms of Article 74 is foreseeability. Attorneys' fees can very easily be foreseen as a possible consequence of a breach of contract and consequently are not easily limited by that factor.

### C. *The District Court Holding in Zapata*

The district court in the *Zapata* case clearly awarded attorneys' fees as damages because its interpretation of the domestic procedural rule allowed it to do so. This happened much in the same vein as in the *ULIS* case of the German court, except that the *ULIS* case only ruled on fees not automatically covered by ZPO. Then the *Zapata* court stated that Article 74 of the CISG was also utilized as a basis for the ruling. It did not, however, spare a thought to the difficulties involved in admitting attorneys' fees under the wing of Article 74. By awarding attorneys' fees as damages in part because of bad faith conduct, the Court

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<sup>41</sup> CISG, *supra* note 1, art. 7(2).

lost its CISG trail. Article 74 is applicable if a party to a contract fails to perform his obligations under the contract, whether this failure was a result of bad faith conduct or not.

If it was stated in the CISG that attorneys' fees were to be awarded as damages under Article 74, a Finnish, German, or American court, would have to award attorneys' fees as damages under the CISG. The Convention does not mandate the award of attorneys' fees as damages, and consequently national courts of Contracting States are not under a duty to award them as such. Furthermore, the preamble to the Convention provides: "Being of the opinion that the adoption of uniform rules which govern contracts for the international sale of goods and tak[ing] into account the different social, economic and legal systems . . . ."<sup>42</sup> This means that, at least on a symbolic level, the Convention takes into account different legal systems and consequently also the different outcomes they may produce.

If attorneys' fees were not allowed as damages under Article 74, what other ways would there be to overcome the discrepancies in this context? One such resolution would be uniform rules for international or transnational civil procedure. Attempts toward this direction have been made. One such attempt is the American Law Institute's Principles and Rules of Transnational Civil Procedure Discussion Draft.<sup>43</sup> Such rules would be used when there is an international aspect to the proceedings and the domestic rules would be applied in the absence of such an aspect. The fundamental principle behind the rules (section 22.1) provides:

The prevailing party should be awarded its actual and reasonable expenditures in the proceeding, including attorneys' fees, or such a substantial portion thereof as the court may determine to be fair and appropriate.<sup>44</sup>

This draft adopts the "loser pays" rule, which is in line with the majority of the world's jurisdictions. This approach would

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<sup>42</sup> CISG, *supra* note 1, pmb1.

<sup>43</sup> See ALI/UNIDROIT Principles and Rules of Transnational Civil Procedure, Discussion Draft No. 2 (Apr. 21, 2001), available at <http://www.ali.org/ali/transrules.htm>.

<sup>44</sup> *Id.* § 22.1.



avoid the majority of the pitfalls associated with the application of international conventions in domestic courts.<sup>45</sup>

A positive aspect of the district court's holding in the *Zapata* case is that the court was willing to turn a few extra stones in favor of finding a solution that would accord with the requirements of Article 7 of the CISG, namely that in interpreting the Convention, regard is to be had to its international character.

Awarding attorneys' fees as damages is in conflict with the majority of world's legal systems. The district court in *Zapata* had good intentions when it first acknowledged that the majority of those systems abide by the loser-pays rule and then acknowledged that Article 7 of the CISG requires that the Convention ought to be interpreted with due regard to its international character. Ironically, this is just where the court went wrong because it used the wrong means, namely Article 74, to achieve a perfectly justified end.

#### D. *The Appellate Court Holding*

While the present author was editing this article, the appellate level ruling on the *Zapata* case was published.<sup>46</sup> The Court of Appeals for the Seventh Circuit reversed and remanded the district court ruling. The Seventh Circuit did not award the plaintiff attorney's fees as damages under Article 74 of the CISG. The Court stated:

[I]t seems apparent that "loss" does not include attorneys' fees incurred in the litigation of a suit for breach of contract, though certain pre-litigation legal expenditures . . . would probably be covered as "incidental" damages.<sup>47</sup>

The latter part was supported by United States case law without reference to foreign jurisprudence. The court concluded, as did the present author, that the Convention, by its wording or its "background," as the court called it, does not suggest that

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<sup>45</sup> For more on how these issues have been dealt with in international commercial arbitration, see generally Gotanda, *supra* note 4.

<sup>46</sup> *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co. Inc.*, 313 F.3d 385 (7th Cir. 2002), available at <http://cisgw3.law.pace.edu/cases/021119u1.html>.

<sup>47</sup> *Zapata*, 313 F.3d at 388.

loss was intended to include attorneys' fees, but that the Convention did not, by its wording, exclude attorneys' fees either.

Then the Court got lost in a distinction that ought to carry no weight in terms of the Convention, namely the distinction between material and procedural law. The court stated: "The Convention is about contracts, not about procedure."<sup>48</sup>

This is a misinformed statement that does not take into consideration the numerous implications that the CISG articles have on what can, under national laws, be determined as procedural rules. The court correctly acknowledged that an international convention could modify the American rule. The court then stated, as is mentioned in this text, that the question of attorneys' fees is not "expressly settled" in the Convention. The court did not mention that the question of attorneys' fees would be an issue "governed by the CISG" within the meaning of Article 7(2). Rather, the court stated:

[T]here are no principles that can be drawn out of the provisions of the Convention for determining whether "loss" includes attorneys' fees; so by the terms of the Convention itself the matter must be left to domestic law . . . .<sup>49</sup>

This reasoning does not conform to the wording of the Convention. Article 7 clearly states "the general principles on which it is based." There is a multitude of principles on which the CISG is based. Principles of *lex mercatoria*, which appear in codified form, for example, in the UNIDROIT Principles and the PECL, could have been of assistance in determining whether there are other than domestic reasons to include or exclude attorneys' fees within the concept of "loss" in Article 74.

The present author, as stated, is of the opinion that the principles mentioned above do not support the inclusion of attorneys' fees in the concept of loss under Article 74. Reaching that conclusion requires a more complex analysis than just denying the existence of *any* principles on which such a conclusion would be based insofar as the CISG is concerned.

The Court correctly stated that the district court's interpretation of loss in the context of Article 74 would produce anomalies. This article has mentioned just a few of them.

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<sup>48</sup> *Id.*

<sup>49</sup> *Id.* at 388.

Indeed the most bothersome part of the Court's ruling is the following statement:

And how likely is it that the United States would have signed the Convention had it thought that in doing so it was abandoning the hallowed American rule? To the vast majority of the signatories of the Convention, being nations in which loser pays is the rule anyway, the question whether "loss" includes attorneys' fees would have held little interest; there is no reason to suppose they thought about the question at all.<sup>50</sup>

As we have seen, the question whether the concept of loss in Article 74 includes attorneys' fees does hold a significant amount of interest in the loser-pays countries, of which the numerous cases are just an example.

The conclusion that the court made, namely that attorneys' fees would not fall under Article 74, was correct. The analysis leading to it is not, however, worthy of praise. The court failed to create internationally acceptable grounds for excluding attorneys' fees from the sphere of Article 74, defending its position solely with domestic arguments and lacking anything other than a purely superficial analysis of the issues involved.

#### E. *Anomalous Results: Breach v. Non-Breach*

The most problematic aspect of the issue at hand, returning to general considerations, is the imbalance already mentioned that allowing attorneys' fees under Article 74 would create. If a party proves that there is no breach of contract, nothing in the CISG would support recovery of attorneys' fees in that instance. This would result in an imbalance surely not intended by the CISG drafters. In "American rule" jurisdictions it would specifically mean that a party in a case where a breach of contract was established would be able to collect its attorneys' fees; whereas, in cases where no breach was established, no such opportunity would present itself, either by means of the CISG itself or the gap-filling national law.

It is reasonable to presume that such an imbalance between the parties to a sale transaction was not something that the CISG drafters intended to create. The balance between the rights of the buyer and the seller is evident throughout the

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<sup>50</sup> *Id.* at 389.

CISG.<sup>51</sup> The preamble to the Convention further strengthens this objective, stating as it does that the uniform rules take into account the different legal systems. The uniformity not created and the imbalance created in one legal system as opposed to others would not serve the purposes of the Convention, making it safe to presume that attorneys' fees do not belong under Article 74.

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<sup>51</sup> One might mention Articles 45 and 61 of the CISG, where the buyer and the seller, respectively, have such similar rights with regard to the failure to perform by the seller or the buyer.