

Section 4 : Price Reduction

[NB: 9:503-507 in version as sent to press, proof missing]

Article 9:401: Right to Reduce Price

- (1) *A party which accepts a tender of performance not conforming to the contract may reduce the price. This reduction shall be proportionate to the decrease in the value of the performance at the time this was tendered compared to the value which a conforming tender would have had at that time.*
- (2) *A party which is entitled to reduce the price under the preceding paragraph and which has already paid a sum exceeding the reduced price may recover the excess from the other party.*
- (3) *A party which reduces the price cannot also recover damages for reduction in the value of the performance but remains entitled to damages for any further loss it has suffered so far as these are recoverable under Section 5 of this Chapter.*

COMMENT

A. The principle of price reduction

This Article generalises the remedy provided by the *actio quanti minoris*. In the conditions laid down in paragraph (1) the aggrieved party is entitled to a reduction in the contract price where the other party's performance is incomplete or otherwise fails to conform to the contract. The remedy is given whether the non-conformity relates to quantity, quality, time of delivery or otherwise. The remedy is designed both as an alternative to damages (see Illustration 2 below) and for cases where the non-performing party is excused from liability for damages (see comment B below). The Article applies only where the aggrieved party accepts the non-conforming tender. If it does not, its remedy is either to pursue a restitutionary claim under Article 9:307 or to claim damages under Section 5.

The amount of the price reduction is proportional to the reduction in the value of the promised performance. In some cases the value of the performance will be directly related to the proportion of the contract performed and the contract price may simply be reduced accordingly.

Illustration 1: S contracts to sell 50 tonnes of coffee to B at a price of £2,400 a tonne. S tenders only 30 tonnes. B may accept the short tender and reduce the price under this Article from £120,000 to £72,000 (see Illustration 3). Alternatively B can reject the short tender, in which case it can either claim recovery of the price under Article 9:307 or claim damages under Section 5, but it cannot invoke the present Article.

In other cases the value of the performance may be reduced by a greater (or less) proportion.

Illustration 2: B agrees to build a house for O for £150,000. If the work had been properly executed the house would have been worth £100,000 when completed, but because of B's defective workmanship it is worth only £80,000. As an alternative to claiming damages of £20,000, O may withhold or recover one-fifth of the price, i.e. £30,000.

B. Price reduction available even where non-performance excused

The fact that a shortfall in performance is excused under Article 8:108 does not affect the aggrieved party's right to a price reduction under this Article, for under Article 8:101(2) the only remedies which are excluded in the case of an excused non-performance are specific performance and damages.

Illustration 3: S in Marseilles contracts to sell 20 hospital scanning machines to B in London. As the result of the introduction of a quota system governing the export of scanning machines S is only able to supply B with 15 machines. S's non-performance is excused under Article 8:108 but if B decides to accept the 15 machines it is entitled to a price reduction of 25 per cent.

C. Price reduction may be obtained before or after payment

The aggrieved party may obtain a price reduction under this Article either by withholding payment, if it has not already paid the price, or by recovering the amount of the price reduction if the price has already been paid.

D. Price reduction is alternative to damages for reduction in value

Where the aggrieved party reduces the price under this Article it cannot also claim damages for reduction in the value of the performance as tendered compared with the value of a conforming tender (see Illustration 1). The two remedies are incompatible so that there is no right to cumulate them under Article 8:102. However, other loss remains recoverable within the limits laid down by Section 5.

Illustration 4: The facts are as in Illustration 2. O cannot live in the house until the defects in it have been put right and he incurs a loss of £500 in renting an apartment to live in meanwhile. The £500 remains recoverable whichever of the above remedies he pursues.

NOTES

1. Civil law

(a) The actio quanti minoris

The right to reduce the price, as provided in Article 9:401, is found in the civil law countries and in CISG art. 50. It is primarily applied when goods sold are defective, see AUSTRIAN ABGB § 932(1); DANISH Sale of Goods Act § 42 and 43; FINNISH

and SWEDISH Sale of Goods Acts, §§ 37, 38; FRENCH, BELGIAN and LUXEMBOURG CC art. 1644; GERMAN BGB §462; GREEK CC arts. 534, 535, 540; ITALIAN CC art. 1492(1); and PORTUGUESE CC arts. 911 and 913. However, in many countries the rule also applies to other contracts, see DANISH Lease Act §§ 11 (2)15 and 16 (2) and on construction contracts, *Gomard*, Obligationsret II 129 ff.; FINLAND, Sale of real property and service contracts, see *Sisula-Tulokas* 18 - 36. GERMAN BGB §§ 515 (barter), 537 (lease), 634(1) and (4) (work, but not services) and 651(d) (travel); GREEK CC arts. 573 (barter), 576 (lease) and 688 and 689 (work); ITALIAN CC art. 1668 (construction contracts); PORTUGUESE CC art. 1222 (work); and SPAIN CC art. 1486 (sales). In FRANCE, outside cases of defects, price reduction (*réfaction*) is limited to commercial cases, as a consequence of usages: *Terré*, No 630, in fine; but there is a tendency to generalise it to other contracts: Civ.3, 15 December 1993, D.1994.462, note Storck (lease).

The DUTCH BW treats price reduction as partial termination which in principle is available in all contracts, see BW arts. 6:265 and 6:270.

In the civil law the *actio quanti minoris* applies also where the non-performance is excused.

(b) Calculation of the reduction

As in Article 9:401, CISG art. 50 provides that the buyer may reduce the price in the same proportion as the value that the goods actually delivered had at the time of delivery bears to the value that conforming goods would have had at that time, and the same rule applies in most civil law countries, see e.g. GERMAN BGB § 472 (value at the time of contracting).

(c) Recovery of the excess paid

The rule stated in Article 9:401(2) under which a party which has paid the full price may recover the excess is probably accepted in all countries.

(d) Damages not excluded

It is in the nature of things that a party which reduces the price cannot also claim a sum equal to the reduction in value as damages. However, most laws allow the aggrieved party to recover damages for further loss. See e.g. AUSTRIAN ABGB § 932(1) last sentence stating, that “in all cases, the transferor is liable for damages caused by his fault”. See also CISG art. 45(2) and notes to Article 8.102, above. In GERMANY, however, damages and reduction of price exclude each other, see BGB §§ 463, 480(2); *Münchener Kommentar (-Westermann)* § 472 no. 3. This is also true in GREECE, but further loss may be recovered: *Deliyannis & Kornlakis* I 243-244. Under SPANISH law the aggrieved party can recover damages if the other party acted in bad faith (CC art. 1486(2)).

2. Common Law

The *actio quanti minoris* of the civil law is unknown in the COMMON LAW, but when the non-performance is not excused Common law reaches very similar results.

(a) *Cases of breach*

Where goods are defective the *prima facie* rule is that the buyer can recover as damages the difference between the value of the goods actually delivered and the value which the goods would have had if they had been in accordance with the contract, see *Treitel*, Remedies §100. Further,

(i) where the performance is incomplete and the price can easily be apportioned, the buyer may treat the contract as apportionable and pay only for the units delivered (e.g. *Dawood Ltd. v. Heath Ltd.* [1961] 2 Lloyd's Rep 512, Q.B.);

(ii) The UK Sale of Goods Act 1979, s.53(1) allows the buyer in case of defects to set up certain claims "in diminution or extinction of the price"; and

(iii) The aggrieved party may also - and this applies to all contracts - set off claims arising out of the same transaction against sums he would otherwise have to pay.

On (ii) and (iii) see *Beale*, Remedies 50-52 and *Goode*, Commercial Law 671.

As in most civil law countries, further loss may be claimed as damages.

(b) *Non-performance excused*

In cases of frustration the position of English law differs from that of the civil law. The Law Reform (Frustrated Contracts) Act 1943 s. 1 (3) will normally apply. As a measure, sometimes described as essentially restitutionary (see Robert Goff J. in *B.P. Exploration Co.(Libya) Ltd. v. Hunt (No.2)* [1979] 1 W.L.R. 783, though see also Lawton LJ in the C.A. [1981] 1 W.L.R. 232), the court may order the return of money paid and payment for benefits (other than money) received before the time of discharge of the obligation, subject to deductions for expenses incurred, see *Treitel*, Contracts 825-829.

In the unusual case where the contract is not frustrated but non-performance of part of the obligation is excused, whether the price may be reduced will probably depend on whether the performance can easily be apportioned, see (a)(i) above.

In SCOTLAND if a contract is frustrated the obligations of the parties under the contract cease but there may be an equitable adjustment of the rights of the parties under the principles of unjust enrichment (*Cantiere San Rocco v. Clyde Shipbuilding and Engineering Co* 1923 S.C. (H.L.) 105).

See generally on the common law *Treitel*, Remedies § 100; *Beale*, Remedies 50-52.

Section 5 : Damages and Interest

Article 9:501: Right to Damages

- (1) *The aggrieved party is entitled to damages for loss caused by the other party's non-performance which is not excused under Article 8:108.*
- (2) *The loss for which damages are recoverable includes:*
 - (a) *non-pecuniary loss ; and*
 - (b) *future loss which is reasonably likely to occur.*

COMMENT

A. No damages without loss

This Article enables the aggrieved party to recover damages whenever it suffers loss from the other party's unjustified failure to perform. The section does not provide for nominal damages for a breach which has caused the aggrieved party no loss.

B. No fault necessary

Where a party's obligation is to produce a given result, its failure to do so entitles the aggrieved party to damages whether or not there has been fault by the non-performing party, except where performance is excused (see Article 8:108 and Comment). Where a party's obligation is not to produce a result but merely to use reasonable care and skill it is liable only if it has failed to fulfill its obligation, that is to say if it has not exercised the care and skill it has promised. In the absence of a clause specifying the required degree of care and skill, this is equivalent to the commission of a fault.

Illustration 1: A contracts to supply and install in B's house a central heating system that will provide a temperature of up to 22 degrees C when the outside temperature is no greater than 0 degrees C. A installs the system but despite the exercise of all reasonable care and skill on its part the maximum temperature it can achieve is 18 degrees C. A is liable for damages.

Illustration 2: A, a surgeon undertakes to carry out a major operation on B. Despite all reasonable care and skill on A's part, the operation is unsuccessful. A is not liable, for her undertaking was merely to act carefully, not to guarantee a successful outcome.

C. All forms of failure in performance covered

This Article applies to all forms of failure in performance: see Article 1:301(a). There is no requirement that the aggrieved party serve a notice to perform before it can recover damages for delay.

Illustration 3: S agrees to build a boat for B for £100,000. No time for completion is fixed by the contract but a reasonable time would be six months. S takes nine months to complete the boat and make it available to B. S is liable for damages for the delay, whether or not B has given notice requiring the boat to be finished within a given period.

D. Loss that would not have occurred without the failure in performance

The aggrieved party may not recover damages for loss not caused by the failure to perform. However, not every intervening event, even if unforeseeable, which exacerbates the loss falls within this principle. The question in each case is whether that event would have had an impact on the contract if the failure in performance had not occurred. Only if this question is answered in the affirmative will the event in question be treated as breaking the chain of causation.

Illustration 4: S agrees to sell to B machinery which S knows is required by B to manufacture goods in its factory. The machinery is due to be delivered on 1st June but S fails to make delivery. B is losing profit at the rate of £1,000 for each week's delay. This is a normal level of profit for a business of this kind. On 29th June a fire breaks out in B's factory, which is burnt to the ground. On 16th July S delivers the machinery. B, which would not have been able to put the machinery to use elsewhere during this period, can recover £4,000 damages for the loss of profit up to 29th June but nothing for loss suffered beyond that date.

Illustration 5: In June S in London agrees to sell a quantity of machine guns to a weapons dealer, B, in Serbia for £50,000, the guns to be shipped by 30th September against payment. In July S decides that he does not wish to support B's arms business and informs B that he does not intend to ship the guns. In August the British government places an embargo on the exportation of arms to the former Yugoslavian Republics and this is still in force when B's claim for damages is heard 18 months later. B is not entitled to damages.

Illustration 6: In June S in Paris contracts to sell a Seurat painting to B in Hamburg for FF. 1 million, the painting to be shipped to B in Hamburg by the end of August. Because of the delays on the part of its staff S is unable to arrange shipment earlier than 1st October. On 5th September the French government impose a ban on the exportation of works of art without a licence, and despite using its best endeavors S is unable to obtain a licence to export the Seurat painting. The value of the painting at the end of August is considered by experts to be FF. 2 millions. B is entitled to damages of FF. 1 million, the difference between the value of the painting and its price, since but for S's delay in shipping the painting its export would not have been affected by the ban.

E. Non-pecuniary loss

Recoverable loss is not confined to pecuniary loss but may cover, for example, pain and suffering, inconvenience and mental distress resulting from the failure to perform.

Illustration 7: A books a package holiday from B, a travel organisation. The package includes a week in what is described as spacious accommodation in a luxury hotel with excellent cuisine. In fact, the bedroom is cramped and dirty and the food is appalling. A is entitled to recover damages for the inconvenience and loss of enjoyment he has suffered.

F. Future loss

The loss recoverable by the aggrieved party includes future loss, that is, loss expected to be incurred after the time damages are assessed. This requires the court to evaluate two uncertainties, namely the likelihood that future loss will occur and its amount. As in the case of accrued loss before judgment (see Article 9:502) this covers both prospective expenditure which would have been avoided but for the breach and gains which the aggrieved party could reasonably have been expected to make if the breach had not occurred. Future loss often takes the form of the loss of a chance.

Illustration 8: E is appointed sales manager of F's business under a three-year service contract. She is to be paid a salary and a commission on sales. After 12 months E is wrongfully dismissed, and despite reasonable efforts to find an alternative post she is still out of work when her action for wrongful dismissal is heard six months later. E is entitled to damages not only for her accrued loss of six months salary but also for the remaining 18 months of her contract, due allowance being made for her prospects of finding another job meanwhile. She is also entitled to damages for loss of the commission she would probably have earned.

NOTES

1. Loss

It is a common feature of the legal systems in the European Communities that damages are awarded only if and to the extent the aggrieved party has suffered a loss as a consequence of the non-performance of the contract. This applies both to pecuniary and to non-pecuniary loss, see on the latter note 4 below. The only exception may be the COMMON LAW where even if the aggrieved party has suffered no loss, nominal damages are allowed in case of breach of contract. In SCOTLAND, while what are described as nominal damages have been awarded, it would appear that in the cases concerned there has been loss in the form of inconvenience, see *McBryde* § 20-87.

The legal systems seem to agree that damages are not awarded if there has been a gain for the defaulting party but no loss to the aggrieved party. Nor are punitive damages awarded.

2. Strict liability or fault liability

Some laws impose strict liability on the defaulting party, others require fault, and others again have a mixed system, where the defaulting party is strictly liable in some

cases and where it is liable only for fault in other cases. See on this issue the notes to Article 8:101, above.

3. Notice

(a) Notice of non-performance not required

As in the Principles, notice of the non-performance is not a condition for claiming damages in the COMMON LAW. Performance is due without demand even when no time for performance has been set. The same rule is followed in CISG as far as delay of performance is concerned, see *Treitel*, Remedies § 115; on defects see (b) below.

(b) Notice of non-performance necessary

Unlike the Principles, several laws require that the aggrieved party gives notice of the non-performance. However, the effects of the notice varies.

In sale of goods between merchants, GERMAN and AUSTRIAN HGB §§ 377 and 378 require notice of defects to be given without delay, or the buyer will lose all remedies, including his claim for damages. The same rule applies for all sales in DENMARK, see Sale of Goods Act § 52, and in CISG, see art. 39. See also DUTCH BW 7:23. (Indeed, FRENCH, BELGIAN and LUXEMBOURG CC art. 1648. AUSTRIAN ABGB § 933 and GERMAN BGB § 477 deprive the buyer of his right to damages for defects if he does not sue the seller within certain time limits, i.e. "*dans un bref délai*" and within 6 months respectively. In Belgian law this is considered to be an application of a more general rule based on good faith: Cass. 8 April 1988, Arr.Cass. no.482; *Foriers* 261 no.4; *M.E.Storme* Invloed no.461ff. See also GREEK CC arts. 554-558; ITALIAN CC art.1495.) See also FINNISH and SWEDISH Sale of Goods Act, ss. 29 and 59, see *Ramberg*, Köplagen 573 f.

Most other rules requiring notice do not deprive the aggrieved party who has not given notice, or sued the other party within certain time limits, of all his rights. However, whether notice has been given has other effects. Damages may not be recovered unless notice has been given. Notice may also increase the defaulting party's liability: damages for delay will start to run, and some losses will be recoverable, only if they occur after notice has been given. On notice, see FRENCH, BELGIAN and LUXEMBOURG CC arts. 1139 and 1146; SPANISH CC art. 1100; ITALIAN CC art. 1219; AUSTRIAN ABGB § 904; DUTCH BW art. 6:82; GERMAN BGB § 284; and GREEK CC art. 340. See also *Treitel*, Remedies §§ 111-114.

4. Non-pecuniary loss

Non-pecuniary loss may be pain and inconvenience following from physical harm or from disappointment or vexation, and may be due to attacks on a person's personality, reputation or honour or to the death of a spouse or other closely related person. The legal systems differ not only in the extent to which they award damages but also as to which harm they will compensate.

(a) *Préjudice moral*

Important developments have occurred in FRANCE and BELGIUM. Non-pecuniary damages were formerly seldom awarded, but today damages are allowed for "*préjudice moral*" which includes damages for attacks on a person's honour or reputation, loss of a closely related person, certain kinds of physical harm which do not entail economic loss (loss of sense of smell, disfiguring scar) and disappointment. See *Viney*, Conditions nos.253ff. and *Treitel*, Remedies § 156.

PORTUGUESE law also provides rules on damages for non-pecuniary loss, see *Telles* 383, *Jorge* 597 and *Costa*, Obrigações 505 ff.. So does SPANISH law, Supreme Court 9 May 1984, 13 December 1984, 16 December 1986, 3 June 1991 (*Lacruz-Delgado*, II, 1, § 27, 211-212; *Diez-Picazo* II, 688).

(b) Pain and suffering and disappointment distinguished

In ENGLISH law damages for non-pecuniary loss such as pain and suffering or physical inconvenience may be recovered for breach of contract: e.g. *Godley v. Perry* [1960] 1 W.L.R. 9, Q.B.; *Hobbs v L.S.W.R.* (1875) LR 10 Q.B. 111, C.A. However, damages are not awarded for vexation or disappointment unless the contract was specifically meant to provide enjoyment (e.g. a package holiday contract: *Jarvis v. Swan Tours Ltd.* [1973] Q.B. 233, C.A.) or to give peace of mind (*Heywood v. Wellers* [1976] Q.B. 446, C.A.): see *Bliss v. SETRHA* [1985] I.C.R. 700, C.A. These authorities have been followed in IRELAND, see *Clark* 461. SCOTTISH law seems to be similar to English law, see e.g. *Diesen v. Samson* 1971 S.L.T. (Sh.Ct.) 49. In AUSTRIAN law, damages for pain and suffering may be recovered in contract as well as in tort (ABGB § 1325; see also § 1331). General recovery of non-pecuniary losses is unrestricted, see (c) below.

(c) Limited recovery for non-pecuniary loss

ITALIAN, GERMAN, DANISH, FINNISH, GREEK and DUTCH law will only allow damages for non-pecuniary loss if this is provided for by statute; see, e.g. GERMAN BGB § 253; *Treitel*, Remedies § 157. ITALIAN CC art. 2059 limits recovery in tort to cases where the defendant's conduct amount to a criminal offence, which excludes non-pecuniary damages for non-performance of contracts, see *Cian & Trabucchi* arts. 1223 and 2059. In GERMANY the tort rule in BGB § 847 on non-pecuniary damages for bodily harm and false imprisonment has been applied in cases giving rise to liability both in tort and contract, but not where the claim was based on contract only. However, BGB § 651 f entitles a customer to a reasonable compensation for wasted holiday where a supplier of travel facilities through breaking the contract has prevented or seriously prejudiced the customer's journey, see on BGB § 253 etc. *Treitel*, Remedies § 157. In AUSTRIA, an influential writer has argued that all types of non-pecuniary loss may be recovered if there has been gross negligence: *Bydlinski* Jbl 1965, 173, 237. In DENMARK and the NETHERLANDS non-pecuniary damages are mostly available in tort but the rules such as BW art. 6:106 and §§ 3 and 26 of the Danish Damages Act 1984 may in certain cases also apply to contracts, see on DUTCH law BW art. 6:95 and 6:106, and on DANISH law, *Vinding Kruse* 345 ff.; similarly SWEDISH law, see *Hellner*, Skadeståndsrätt 357 ff and FINNISH law, see *Taxell*, Skadestånd 183. On GREEK law, see CC art. 299

(only for tort cases where personality rights have been infringed) and *Ligeropoulos*, Erm.AK art. vol II/1 299 nos. 2-4, 8 (1994), who criticizes the existing rule.

5. *Future loss*

All the legal systems will allow damages for loss which will occur after the day damages are assessed provided the loss is not too remote, see notes to Article 9:503 below. Such loss may follow from the death of a breadwinner (spouse or parent) or personal disablement, where recoverable as contract damages, and from loss of future profit. See for instance CISG art. 74 and, on the indemnity which the commercial agent whose contract with the principal has been ended may claim for future commissions, art. 17 of the Council Directive of 18 Dec. 1986 (86/653 EC). In some legal systems damages are awarded even if the loss is to some extent speculative, see on FRENCH and ENGLISH law the notes to Article 9:503. Under AUSTRIAN law, recoverability of loss of future profits is, according to ABGB §§ 1324, 1325 and 1331, dependent on the degree of fault: lost profits may only be recovered if the injury is attributable to the defaulting party's intentional or grossly negligent act. However, the dependants of a person who has been killed may claim compensation for loss of support from the person who caused the death irrespective of the degree of fault.

See generally *Treitel*, Remedies Chapter IV.

Article 9:502: General Measure of Damages

The general measure of damages is such sum as will put the aggrieved party as nearly as possible into the position in which it would have been if the contract had been duly performed. Such damages cover the loss which the aggrieved party has suffered and the gain of which it has been deprived.

COMMENT

A. Nature of interest protected

This Article combines the widely accepted "expectation interest" basis of damages and the traditional rule of "*damnum emergens*" and "*lucrum cessans*" of Roman law, namely that the aggrieved party is entitled to compensation of such amount as will give it the value of the defeated contractual expectation. In a contract for the sale of goods or supply of services this is usually measured by the difference between the contract price and the market or current price ; but where the aggrieved party has made a cover transaction then in the conditions set out in Article 9:506 it can elect to claim the difference between the contract price and the cover price. The sums recoverable as general damages embrace both expenditure incurred and gains not made. Damages under this Article are not intended to provide restitution (i.e. restoration of the parties of the status quo ante by mutual surrender of benefits received); this remedy is available in the circumstances described in Article 9:307.

Illustration 1: S sells a Renault car to B for £5,000, warranting it to be a 1990 model. In fact it is a 1988 model, the market value of which is £1,500 less than that of a 1990 model. The contract price is not as such relevant to the computation of damages. S is entitled to damages of £1,500, the difference between the value of the car as warranted and its value as delivered.

B. Other loss

In addition to its primary claim for loss of bargain (that is, the loss which any aggrieved party would be likely to suffer from the non-performance) the aggrieved party can recover for loss resulting from its particular circumstances, so far as foreseeable within Article 9:503. In Anglo-American usage such loss is sometimes termed "consequential loss".

Illustration 2: B buys a washing machine in a sale at a special price of £200. The normal cost is £300. Because of a serious defect in the machine garments put into it for washing, worth £50, are ruined. On rejecting the machine B is entitled to recover not only the price paid and £100 for loss of bargain but also the sum of £50 for consequential loss.

The damages recoverable may include interest upon the amount of the loss from the date at which the loss was incurred to the date of payment.

C. Computation of losses and gains

The aggrieved party must bring into account in reduction of damages any compensating gains which offset its loss ; only the balance, the net loss, is recoverable. Similarly, in computing gains of which the aggrieved party has been deprived, the cost it would have incurred in making those gains is a compensating saving which must be deducted to produce a net gain. Compensating gains typically arise as the result of a cover transaction concluded by the aggrieved party. But it is for the non-performing party to show that the transaction generating the gains was indeed a substitute transaction, as opposed to a transaction concluded independently of the default. A compensating saving occurs where the future performance from which the aggrieved party has been discharged as the result of the non-performance would have involved the aggrieved party in expenditure.

Illustration 3: O, a construction company which owns a piece of equipment for which it has no immediate need, enters into an agreement to lease the equipment to H for a year at a rental of DM 1000 a month. After three months, O terminates the agreement and repossesses the equipment because of H's default in payment of the rent. Two months later, O succeeds in re-letting the equipment for seven months at a rent of DM 1200 a month. O is entitled to the rent due and unpaid at the time it terminated the original agreement and to damages for loss of future rental income, but its claim for the two months' loss of rent after termination of the agreement, i.e. DM 2000, is reduced by DM 1400, the additional rental it will receive over the remaining 7 months of the original agreement.

Illustration 4: S, a commodity dealer, contracts to sell to B 50 tonnes of soyabean meal at a price of 300,000 lire a tonne for delivery on 1st August. On that date, when the price of soyabean meal has fallen to 250,000 lire a tonne, B fails to take up and pay for the meal. A week later S sells 50 tonnes of soyabean meal to C at 375,000 lire a tonne. Even if the market price rule (that is to say the rule that, in the case of goods of a kind available on a market, the normal measure of damages is taken to be the difference between contract price and market price) did not apply, S would not have to bring into account in its claim against B the extra profit on its sale to C, in the absence of evidence that its transaction was a substitute for the contract with B.

NOTES

1. *Expectation interest*

The legal systems seem to agree that the general measure of damages should be such as to put the aggrieved party into the position in which he would have been if the contract had been duly performed. In the COMMON LAW this measure of damages has come to be called the expectation interest (see *Fuller & Perdue* (1936) 46 Yale L.J. 52), in GERMANY and AUSTRIA "*positives Interesse*" or "*Erfüllungsinteresse*". It is contrasted with the reliance interest which aims at putting the aggrieved party into

the position in which he would have been if the contract had not been concluded (German "*Vertrauensinteresse*"). On this distinction see in DENMARK, *Gomard*, *Obligationsret* II 153 ff.; ENGLAND, *Treitel*, *Remedies* § 82, and on the expectation interest *Robinson v. Harman* (1848) 1 Ex. 850, 855; FINLAND, *Aurejärvi* 132-136; GERMANY, *Palandt(-Heinrichs)* nos.16-18; AUSTRIA, *Kozoil*, I 34; ITALY, *Visintini* 196; SWEDEN, *Ramberg*. *Köplagen* 112, 649 f. In FRENCH law writers are generally unfamiliar with the distinction, see *Treitel*, *Remedies* § 89; But in SPAIN, it is increasingly accepted (*Diez Picazo* II, 683; *Pantaléon*, 1019 ff.).

2. Loss and gain

That damages generally may cover both loss which the aggrieved party has suffered and gain of which he had been deprived is expressly provided in FRENCH, BELGIAN and LUXEMBOURG CC art. 1149, GREEK CC art. 298, GERMAN BGB § 252 cfr. § 249, ITALIAN CC 1223, the DUTCH BW 6:96, PORTUGUESE CC art. 564(1) and SPANISH CC art. 1106; see also CISG art. 74.

3. Consequential loss

Damages for loss due to personal injury and damage to property (other than the thing contracted for) are allowed in most of the legal systems, see for ENGLAND, *McGregor*, *Damages* §57 ff.. In GERMANY these damages are awarded for positive breach of contract ("*positive Vertragsverletzung*"), see notes to Article 8:101, above. Under AUSTRIAN law recovery of "loss of profits" in addition to "positive damage" (loss suffered) is, according to ABGB §§ 1323, 1324, provided only if the party responsible therefor is to blame for gross negligence.

4. "Compensatio lucri cum damno"

It seems to be universally accepted that loss should be offset by the gains which the aggrieved party has made due to the non-performance, see on ENGLISH and GERMAN law *Treitel*, *Remedies* §§ 149-50; FINNISH law, *Sevon-Wilhelmsson & Koskelo*, 87; FRENCH law, Cass.req. 1 Jan. 1927, D.H.27.65; ITALIAN law, Cass. 5 April 1990 no. 2802 in Mass. Foro It. 1990; GREEK law, *Georgiadis & Stathopoulos* II arts. 297-298 nos. 87-111; PORTUGUESE law, *Telles* 390 and *Costa*, *Obrigações* 688 f; BELGIAN law, *Ronse* nos. 519ff; DUTCH BW art. 6:100; and SPANISH law, Supreme Court 17 February 1925, 19 November 1928, 20 June 1953, 13 May 1965 (*Alabaladejo*, II, 1, § 33.3).

5. Reliance interest

Some laws allow the aggrieved party to claim reliance interest instead of expectation interest. This is possible under DANISH law where the aggrieved party can claim it, even though he would thereby be put into a better position than he would have been had the contract been performed, see *Gomard*, *Obligationsret* II 202. In GERMANY reliance interest may be claimed if the aggrieved party terminates the contract and thereby is excluded from getting expectation interest, see *Palandt(-Heinrichs)* § 325 no.25. GREECE has a specific provision permitting equitable damages (see notes to Article 8:102 above). The position in SWEDISH law is unresolved, see *Ramberg*, *Avtalsrätt* 56 f.

ENGLISH law allows recovery of the reliance interest but this cannot put the aggrieved party in a better position than he would have been if the contract had been performed, see *Treitel*, Remedies § 94. Thus expenditures which are wasted can be recovered as reliance interest, but if these expenditures would not have been recouped if the contract had been performed they cannot be recovered, for this would put the aggrieved party into a better position than he would have been in: *C&P Haulage Ltd. v. Middleton* [1983] 1 W.L.R. 1461 (C.A.). For SCOTTISH law see *Macgregor*.

See generally *Treitel*, Remedies §§ 75-107.

Article 9:503: Foreseeability

The non-performing party is liable only for loss which it foresaw or could reasonably have foreseen at the time of conclusion of the contract as a likely result of its non-performance, unless the non-performance was intentional or grossly negligent.

COMMENT

A. Foreseeable consequences of failure to perform

This Article sets out the principle adopted in many jurisdictions by which the non-performing party's liability is limited to what it foresaw or ought to have foreseen at the time of the contract as the likely consequence of its failure to perform. However, the last part of this Article provides a special rule in the case of intentional breach or gross negligence.

Illustration 1: B, a stamp dealer, contracts to buy from S for £10,000 his set of stamps, to be delivered to B on 1st June. S fails to deliver the stamps, which on 1st June have a market value of £12,000. Because of S's breach, B is unable to fulfil a contract to resell the collection to T for £25,000. S, though aware that B required the stamps for resale, was not aware that B would resell the stamps as a collection. B is entitled to recover as damages the sum the £2,000, being the difference between the market value of the stamps on 1st June and the sale price. S is not liable for the remaining £13,000 of B's loss, which S could not reasonably have foreseen at the time he contracted to sell the stamps to B.

Illustration 2: S sells an animal food compound to B for feeding to pigs. B does not tell A for what breed of pigs the food is required. The compound contains a mild toxin which is known to cause discomfort to pigs but no serious harm. B's pigs are, however, of a unusual breed which is peculiarly sensitive to the toxin and after being fed with the compound many of the pigs die. S is not liable for the loss since it could not reasonably have foreseen it.

B. Exception in case of intentional breach or gross negligence

Although in general the non-performing party is liable only for loss which it foresaw or ought to have foreseen at the time of the contract, the last part of this Article lays down a special rule in cases of intentional failure in performance or gross negligence. In this case the damages for which the non-performing party is liable are not limited by the foreseeability rule and the full damage has to be compensated, even if unforeseeable.

Illustration 3: A contracts with B to construct and erect stands for a major exhibition at which leading electronic firms will display their equipment, hiring the stands from B. A week before the exhibition is due to open A demands a

substantial increase in the contract sum. B refuses to pay, pointing out that A's failure to complete the remaining stands will not only cost B revenue but expose it to heavy liability to an exhibitor, C, which intended to use the exhibition to launch a major new product. A nevertheless withdraws its workforce, with the result that C's stand is not ready in time and it claims substantial compensation from B.

A's breach being intentional and with knowledge of the likely consequences, the court has to award B and indemnity in respect of its liability of C, even though A could not reasonably have foreseen the magnitude of such liability at the time it made its contract with B. The same may be done even if A was not aware of the serious consequences for B of the intentional breach.

NOTES

The presentation in the following covers mainly ENGLISH, FRENCH, GERMAN and DUTCH law.

IRISH, SCOTTISH and DANISH laws seem to follow English law, see on Danish law, *Gomard*, Obligationsret II 188 ff.; on Irish law *Clark* 543ff.; and on SCOTTISH law, *MacQueen* 295-303.

BELGIAN, LUXEMBOURG, SPANISH and ITALIAN laws are similar to French law, see Spanish CC art. 1107 and on Italian CC art. 1223 and 1225, *Visintini* 209.

GREEK and (*semble*) PORTUGUESE laws seem to follow German law. See on Greek law *Ligeropoulos*, Introd. remarks to arts. 297-300 nos. 44-46 a, 49-50, 53 and *Stathopoulos* in *Georgiadis & Stathopoulos* II arts. 297-298 nos. 51-56; on Portuguese law, *Varela* I 866.

1. Foreseeability

As in Article 9:503, ENGLISH law limits liability to foreseeable losses. The rule was stated in *Hadley v. Baxendale* (1854) 9 Ex. 431 (Court of Exchequer). The defaulting party is liable for loss which he foresaw or which a reasonable person in his position ought to have foreseen when the contract was made having regard to the facts he knew or ought to have known. If a seller of machinery wrongfully delays delivery with the result that the buyer is unable to reap the profits from using the machinery, the buyer may recover the profits which in the normal course of things he would have made on the machinery. However, he cannot recover the profit which he could have earned on some exceptionally lucrative contracts he had made of which the seller knew nothing, see *Victoria Laundry (Windsor) Ltd. v. Newman Industries Ltd.* [1949] 2 K.B. 528, C.A. See on English law, *Treitel*, Contracts 870-879. This limitation to the foreseeable loss, which has been adopted in CISG art. 74, must be seen in light of the strict

contract liability in English law and in CISG. On CISG see *v. Caemmerer & Schlechtriem (-Stoll)* § 623 ff..

This foreseeability test is also provided in FRENCH, BELGIAN and LUXEMBOURG law, see CC art. 1150. In Belgium and France the test is applied broadly: only the possibility of the particular kind of damage needs to have been foreseeable, see respectively Cass., 23 Feb. 1928, Pas. 85 and Cass.com. 1965, D. 1965.449.

2. "Immediate and direct" consequences

In addition to the foreseeability test of art.1150, FRENCH, BELGIAN and LUXEMBOURG CC art. 1151 provides that liability for damages is limited to losses which are the "immediate and direct" consequences of the non-performance. It has been questioned whether this additional test adds anything to the foreseeability test, see *Treitel*, Remedies §§ 140 and 141. In FRENCH law, however, it is considered that a loss may be direct yet unforeseeable, see *Malaurie and Aynès*, Obligations no. 839-842. In Belgium it is held to add nothing, Cass. 24 June 1977, Pas. 1087. On ITALIAN law see *Realmonte*.

3. The principle of "adequate causation"

GERMAN law has rejected the foreseeability test and applies instead the theory of "adequate causation". The loss must have been caused by the non-performance and only such kind of loss which occurs in the ordinary course of things are recoverable. However, if there is causation the principle will make the defaulting party liable if the default appreciably increased the possibility of the loss that in fact occurred. In determining whether this was the case the court will apply the standard of an experienced observer at the time of the non-performance.

The rule puts the plaintiff in a better position than under the foreseeability test, as the experienced observer may foresee more than a reasonable person would have at the time the contract was made. The German rule must be seen in the light of the fault principle governing German contract law, see notes to Article 8:101. On German law, see *Treitel*, Remedies §§ 137-138, *Dölle (-Weitnauer)*, Introd. to arts. 82-89, 525 ff., particularly 534-535.

AUSTRIAN law (see *Kozoil*, 140) and SWEDISH law (see *Rodhe*, Obligationsrätt 121) resemble GERMAN law. FINNISH law also uses "adequate causation" but in practice elements of foreseeability appear, see *Taxell*, Skadestånd 178 and *Hemmo*.

4. "Imputability"

DUTCH law applies an imputability test, see BW art. 6:98. Damages can only be recovered for loss which is related to the event which made the obligor liable in such a way that the loss, having regard to its kind and that of the liability, can be imputed to the obligor as a consequence of the event.

5. *Intentional non-performance*

In FRENCH and ITALIAN law the foreseeability requirement - but not the "directness" requirement - is excluded in case of intentional non-performance (*dol*), see French CC art. 1150 and 1151 and Italian CC art. 1225. However, in French law gross negligence is regarded as *dol*. SPANISH CC art. 1107(2) is similar to French CC art. 1150 (see *Pantaléon*, (1991) 1019-1091 and (1993) 1719-1745).

Under AUSTRIAN law the degree of fault affects the extent of damage to be recovered, since loss of profit is only compensated in the case of gross negligence and intentional wrongdoing, as well as the method of computation (whether based on objective or on subjective criteria).

The degree of the defaulting party's fault is not taken into account as a general rule for the purpose of awarding damages in the COMMON LAW systems, in SCOTLAND or in GERMAN law, see *Treitel*, Remedies §§ 123-126.

6. *Certainty*

The systems generally require a sufficient degree of "certainty" of loss in order to award damages, but this is not to be taken literally. In FRANCE, BELGIUM, GERMANY, ENGLAND and SCOTLAND the courts have awarded damages for loss of future profit, which is not always "certain", see notes to Article 9:501, and damages for the loss of a chance, e.g. to win a beauty contest, have also been awarded, see the English case of *Chaplin v. Hicks* [1911] 2 K.B. 786, C.A. and, on SCOTTISH law, *Hogg*. GREEK CC art. 298 sent.2 provides for the recovery of lost profit which probably could have been made in the ordinary course of events or according to the special circumstances.

See generally *Treitel*, Remedies, Chapter IV; *Dölle (-Weitnauer)* Introd. to arts. 82-89, 525 ff., esp. 531-549.

Article 9:504: Loss Attributable to Aggrieved Party

The non-performing party is not liable for loss suffered by the aggrieved party to the extent that the aggrieved party contributed to the non-performance or its effects.

COMMENT

A. Loss caused by unreasonable action or inaction

This Article embodies the principle that an aggrieved party should not recover damages to the extent that its loss is caused by its own unreasonable behaviour. It embraces two distinct situations. The first is where the aggrieved party's conduct was a partial cause of the non-performance ; the second, where the aggrieved party, though not in any way responsible for the non-performance itself, exacerbated its loss-producing effects by its behaviour. A third situation, where the loss resulting from the non-performance could have been reduced or extinguished by appropriate steps in mitigation, is covered by Article 9:505.

The reason for the division between this and the next Article is that some legal systems distinguish these situations, at least in some degree. Thus in English law the first two situations fall within the concept "contributory negligence" and the third involves a "failure to mitigate". Most continental European legal systems do not distinguish the two concepts, though they reach similar results by using concepts such as causation.

B. Conduct contributing to the non-performance

To the extent that the aggrieved party contributed to the non-performance by its own act or omission he cannot recover the resulting loss. This may be regarded as a particular application of the general rule set out in Article 8:101 (3).

Illustration 1: B orders a computer system from S which is to be specially designed to allow B to send to prospective property buyers details of houses coming on to the market which appear to meet their requirements. The computer system fails to operate properly, due partly to a design defect and partly to the fact that B's instructions to S were incomplete. B's loss is irrecoverable to the extent that it results from its own inadequate instructions.

C. Conduct contributing to the loss-producing effects of non-performance

Where the aggrieved party, though not in any way responsible for the non-performance, exacerbates its adverse effects he cannot recover damages for the additional loss which results.

Illustration 2: A leases a computer which under the terms of the contract is to be ready for use in England where the voltage is 240v. The computer supplied is capable of operating on various voltages and, in breach of contract, is

actually set for 110v. A prominent sign pasted on the screen warns the user to check the voltage setting before use. A ignores this and switches on without checking. The computer is extensively damaged and repairs will cost A £1,500. The court may take the view that the loss was at least half A's fault and award only £750 damages.

NOTES

See Notes to Article 9:505.

Article 9:505: Reduction of Loss

- (1) *The non-performing party is not liable for loss suffered by the aggrieved party to the extent that the aggrieved party could have reduced the loss by taking reasonable steps.*
- (2) *The aggrieved party is entitled to recover any expenses reasonably incurred in attempting to reduce the loss.*

A. Failure to mitigate loss

Even where the aggrieved party has not contributed either to the non-performance or to its effects, it cannot recover for loss it would have avoided if it had taken reasonable steps to do so. The failure to mitigate loss may arise either because the aggrieved party incurs unnecessary or unreasonable expenditure or because it fails to take reasonable steps which would result in reduction of loss or in offsetting gains.

Illustration 1: B buys an old car from S for £750. S warrants that the car is in good running order. B discovers that it will cost £1,500 to put the car into good running order, and he has this work done although similar cars in good condition are available for £800. B's damages will be limited to £800 ; the extra amount represents an expenditure which was quite disproportionate to the value of the car as repaired (The result might be different if there were some good reason for B to have repairs done, e.g., the car was unique in that it had once belonged to General de Gaulle).

Illustration 2: C hires a camper van to take his holiday in Portugal. When he comes to collect the camper van, the car hire company tells C that it has made a mistake in bookings and no van is available from it, but it has managed to find for him another company which has a van available at a higher price. Even if C unreasonably ignores this and abandons his holiday, his damages should be limited to the loss he would have suffered if he had acted reasonably in taking the substitute van, namely the difference in cost between the vans and compensation for inconvenience in having to collect his replacement.

The aggrieved party will not necessarily be expected to take steps to mitigate its loss immediately it learns of the breach; it will depend on whether its actions are reasonable in the circumstances.

Illustration 3: O engages B, a builder, to come within 24 hours to repair the roof of O's house, which is leaking and causing damage to the decorations. B does not come within the 24 hours but assures O that it will come the next day. It is reasonable for O to wait until the day after before calling in another builder, and O may claim damages resulting from this period of delay ; but it may not be reasonable to wait any longer and if O does so it may not recover damages for the resulting additional loss.

The aggrieved party is only expected to take action which is reasonable, or to refrain from action which is unreasonable, in the circumstances. Thus it need not act in any way that will damage its commercial reputation just to reduce the non-performing party's liability.

Illustration 4: D buys goods from E in order to resell them to F. The goods supplied by E are not of proper quality. Although under the terms of its contract with F, D could require F to take the goods without a price reduction, this would be unreasonable in the light of their long-standing business relationship and D gives F a reduction of price. D may recover the amount by which it reduced the price as damages from E.

The principle applies also when one party is guilty of anticipatory non-performance within Article 9:304, e.g., by announcing that it will not perform the contract when the time comes. The aggrieved party should not incur further expenditure needlessly and should take steps to reduce its loss.

Illustration 5: K contracts to build a yacht to L's special design. L repudiates the contract. If K has done little work on the yacht and it would not be able to find a ready buyer for such a unique design of boat, it is reasonable to expect it to stop work ; it may recover the cost of the work done to date and the loss of anticipated profit. If, on the other hand, it has done most of the work and can find another buyer at a reasonable price, then even where it has terminated the contract under Article 9:304 it may be expected to complete the boat and resell it. It will be entitled to damages of the difference between the original contract price and the resale price (Article 9:506), plus the incidental costs of arranging the resale.

C. Expenses incurred in mitigating loss

Frequently the aggrieved party will have to incur some further expenditure in order to mitigate its loss. This incidental expenditure is also recoverable provided it is reasonable.

Illustration 6: X agrees to buy Y's chalet, which Y had advertised widely. Later X repudiates the contract. Y decides to make a cover transaction. In order to resell the house he has to advertise it again. He is entitled to the reasonable cost of the further advertising as well as to the difference between the price X had agreed to pay and the price for which the chalet was ultimately sold.

D. Reasonable attempts to mitigate which in fact increase the loss

Sometimes a party may take what at the time appears to be a reasonable step to reduce its loss but in fact increases it. The full loss suffered is recoverable.

Illustration 10: G enters a long term supply contract to buy oil from H ; deliveries are to commence in six months' time. Three months later oil prices

rise rapidly because of a threatened war in the Gulf and H repudiates the contract. G quickly terminates the contract and enters a substitute contract with J at the price then being quoted for delivery three months later. By the time the date for delivery comes the threat of war has receded and G could have bought the oil for the original contract price. It acted reasonably in entering the substitute contract and is entitled to damages based on the difference between the original contract price and the price it had to pay to J.

E. Loss reduced by steps going beyond what could reasonably be expected

Sometimes a party will take a step which reduces its loss but which goes beyond what it might reasonably have been expected to do. The reduction in loss will still be taken into account, as it is entitled only to damages for actual loss: see Article 9:501.

NOTES

Notes to Articles 9:504 and 9:505

1. Loss caused by aggrieved party (Article 9:504)

(a) Different treatment of loss caused by aggrieved party and "mitigation"

Some legal systems treat the aggrieved party's contributory negligence and his "duty" to mitigate his loss differently. FRENCH cases, which mostly have dealt with tort liability, have admitted that in contracts also contributory negligence by the aggrieved party may reduce his claim for damages. The creditor's act will constitute a cause of exoneration even if it does not constitute *force majeure*: Civ.1, 31 January 1973, D.1973.149, note Schmelk; see *Malaurie & Aynès*, Obligations no. 833. French law does not know mitigation as such, but some similar results may be obtained by the application of the general rule about fault. See Cass. civ. 1, 29 April 1981, JCP 1982, 19730 where damages were reduced, as it was a "fault" of the obligee not to avoid loss due to the negligent non-performance of the obligor, and Paris, 7 Jan. 1924 DP 24.1.143 where the court would not permit the obligee to let the loss grow without notifying the obligor so that he could stop the supply of defective goods. See also on leases CC art. 1760. However, French law is reluctant to impose duties on the aggrieved party: Com. 28 June 1994, B.IV. no 248 (warranty against *vices cachées*). On SPANISH law, Supreme Court 1960, 15 November 1994 (see *Bercovitz*, CCJC 550; Angel 13 ff.; and *Diez Picazo*, II, § 89). On DANISH law see *Gomard*, Obligationsret II, 186 (duty to mitigate) and 187 (contributory negligence).

In ENGLISH law "contributory negligence" will generally either be no defence to a claim in contract or, on the theory that the loss was not caused by the breach, will lead to no compensation at all. However, a reduction of damages may be allowed in certain cases where the obligor was under a concurrent duty of care in tort and the plaintiff also failed to act carefully, see *Treitel*, Contract 886-891. The aggrieved party's failure to mitigate may lead to a reduction of the damages: *ibid.*, 881-886. SCOTTISH law is to the same effect, *McBryde*, Contract, 454-462. The same rule is laid down in art. 77 of CISG. Furthermore, CISG art. 80 provides that a party may

not rely on the failure of the other party to perform, to the extent that such failure was caused by the first party's act or omission. It has been convincingly argued that this rule may be extended by way of the interpretation by analogy rule provided in art. 7(2) so as to allow reduction of damages in case of the aggrieved party's "contribution" to the non-performance, see *Bianca & Bonell (-Tallon)* Art. 80 note 2.5 p. 598, but see *v. Caemmerer & Schlechtriem (-Stoll)* 677.

In IRELAND there is a duty to mitigate the loss, as in England, thereby matching Article 9:505(1). Furthermore, ss.2 and 34(1) of the Civil Liability Act 1961 allow the court to reduce the damages by reason of the defendant's contributory negligence, thereby matching Article 9:504.

(b) Contributory negligence and "duty" to mitigate loss treated alike.

Several of the Civil Law systems treat the aggrieved party's contributory negligence and his "duty" to mitigate his loss on an equal footing. Contributory negligence and failure to mitigate may lead the court to reduce or to disallow the claim for damages. This is the position in GERMANY, see BGB § 254(1) dealing with contributory negligence and § 254(2) with the failure to mitigate the loss. The ITALIAN CC has similar provisions in art. 1227(1) treating contributory negligence and in art. 1227(2) dealing with avoidance of loss, see *Gorla*, which in recent decisions has been extended to cover mitigation of loss: see e.g. Cass. 3 March 1983, no. 1594 in *Giust. civ.*, 1984 I c. 3156. See also AUSTRIAN ABGB § 1304 and GREEK CC art. 300, covering both contribution to the damage and mitigation of damage, and DUTCH BW art. 6:101; *Asser-Hartkamp*, *Verbintenissenrecht* nos. 448 ff., 453. Contributory negligence is treated in the PORTUGUESE CC art. 570 and the "duty" to mitigate may be imposed upon the aggrieved party by way of an analogy of art. 570, or under the rule of abuse of right. In BELGIAN law mitigation is treated as a sub-species of contributory negligence, Cass. 14 May 1992; *Ronse* no.460ff.; *Kruithof*, *R.C.J.B* 1989, 12ff. It is mentioned as a separate duty only in Insurance Contracts Act of 25 June 1992, art.20. SPANISH law seems similar: there is no express provision in the CC on the topic and doctrine seems to consider mitigation as a sub-species of contributory negligence or *mora creditoris*, *Diez-Picazo* 733 ff..In FINLAND Sale of Goods Act § 70 provides an express duty to mitigate the loss. This is seen as connected to the general principle of contributory negligence, *Sevón, Wilhelmsson & Koskelo* 87.

2. Expenses incurred (Article 9:505)

Like Article 9:505(2), the legal systems will allow the aggrieved party to recover expenses reasonably incurred in attempts to avoid or mitigate the loss. Expenses are to be reimbursed even if they increased the total loss, provided they were reasonable. This is the law in AUSTRIA, see e.g. *Ehrenzweig (-Mayrhofer)*, 309; BELGIUM, see esp. Insurance Contracts Act of 25 June 1992, art. 52; DENMARK, see *Nørager-Nielsen* 410; ITALY, Cass. 28 April 1988 no. 3209, *Archivio civile* 1988, 1054, *Cian & Trabucchi* art. 1227, 964; GERMANY, BGH 22 Jan. 1959, *NJW* 1959, 933, 934; ENGLAND, *McGregor*, *Damages* §§ 000-000; the NETHERLANDS, BW 6:96(2)(a); SWEDEN, see *Ramberg*, *Köplagen* 649 ff. In GREECE the rule is based upon the rule on adequate causation in CC art. 300, or on the "*negotiorum gestio*" rule in CC

art. 736, and in PORTUGAL on the rule in CC 566(2) on full compensation , see notes to Article 9:502, above. The right to recover expenses incurred is implicit in CISG art. 77, see also art. 74.

See generally *Treitel*, Remedies, § 145 ff..

Article 9:506: Substitute Transaction

Where the aggrieved party has terminated the contract and has made a substitute transaction within a reasonable time and in a reasonable manner, it may recover the difference between the contract price and the price of the substitute transaction as well as damages for any further loss so far as these are recoverable under this Section.

COMMENT

A. Cover transactions

It is often appropriate to measure the aggrieved party's loss by the cost of procuring a substitute performance. Where the aggrieved party has in fact made a reasonable cover transaction, Article 9:506 provides that the difference between the contract price and the cover price is recoverable. The non-performing party may also be liable for any further loss which the aggrieved party proves it has suffered, e.g. the cost of arranging a cover transaction.

Illustration 1: O agrees to allow H the use of its art gallery for an exhibition at a fee of £1,000. Shortly before the exhibition is to take place O informs H that the gallery will not after all be available. H succeeds in obtaining the use of a nearby gallery of similar size and quality for a fee of £1,500. She is entitled to damages of £500 representing the amount by which the cost of the cover transaction exceeds the contract price, as well as damages for any reasonable expenses (e.g. changing the address on leaflets and posters).

B. Alternative transaction must be a reasonable substitute

The aggrieved party cannot recover the difference between the contract price and the price of an alternative transaction which is so different from the original contract in value or kind as not to be a reasonable substitute.

Illustration 2: O supplies a Renault 9 on hire to H for three weeks at a rent of FF1000 a week. The car breaks down at the end of the first week while H is on holiday, and as no other Renault 9 is available he hires a Rolls Royce Silver Cloud for the remaining two weeks at a rent of FF5000 a week. H's damages for extra rental charges will be restricted to the additional cost, if any, of hiring the nearest available equivalent of the Renault 9 in size and value.

NOTES

The assessment of damages on the basis of a cover transaction, as provided in Article 9:506, is possible in all the legal systems; however, in some of them it is subject to restrictions.

A general rule on cover transactions is found in the FRENCH, BELGIAN and LUXEMBOURG Civil Codes art. 1144 on the obligee's *faculté de remplacement*. This in principle must be ordered by the court but French usages have allowed the aggrieved party to do it by himself in commercial transactions. Belgian case law has accepted the same even in non-commercial cases provided the non-performance was sufficiently fundamental (*van Ommeslaghe* R.C.J.B. 1986, nos.98-100). In the other legal systems, where the cover transaction is a "self help" remedy, the rules are found in provisions on sales, see DANISH Sale of Goods Act §§ 25, 30(2) and 45; FINNISH and SWEDISH Sale of Goods Acts, § 68; GERMAN and AUSTRIAN HGB §376(3) (applicable to commercial sales but extended in practice); the DUTCH BW art. 7:37; and ITALIAN CC arts. 1515 and 1516. CISG art. 75 is similar to Article 4.505 and so are GREEK and SPANISH case law: see respectively AP 1137/1990, EEN 58 (1991) 444-445 and *Vicent Chuliá*, II, 107.

The DUTCH BW, BELGIAN caselaw the FINNISH and SWEDISH Sale of Goods Acts and CISG require that the transaction is a reasonable one. The DANISH, GERMAN and ITALIAN provisions contain procedural rules; in Italy these have restricted the use of the cover transactions, see Cass., 14 July 1956, no. 2670 and 18 June 1957, no. 2313 in *Mass.Foro.It.* 1956 and 1957.

ENGLISH law does not specifically adopt the "cover price" as means of measuring the damages. However, where there is no market for the performance, and a current price cannot be established, see notes to Article 4.506, English courts will treat the cover price as a strong evidence of the amount of loss, see *Beale*, Remedies 196-197. SCOTTISH law is similar.

See generally, *Treitel*, Remedies §§ 102 ff.; *Honnold* §§ 409-415.

Article 9:507: Current Price

Where the aggrieved party has terminated the contract and has not made a substitute transaction but there is a current price for the performance contracted for, it may recover the difference between the contract price and the price current at the time the contract is terminated as well as damages for any further loss so far as these are recoverable under this Section.

COMMENT

Damages measured by current price

Insofar as the cost of substitute performance fairly measures the shortfall in the value of the non-performing party's performance it is recoverable as such whether or not the aggrieved party actually incurs the expenditure.

Illustration 1: S agrees to sell 50 tons of coffee to B at £1,800 a ton for delivery on 1st July. S fails to deliver the coffee. The market price on 1st July is £2,000 a ton. B is entitled to damages of £10,000 (i.e. $50 \times £200 = £10,000$) even if he does not make a substitute purchase on the market.

Illustration 2: S sells a car to B promising that it is in good condition. In fact it has engine defects which would cost £500 to rectify. Assuming that it would not be uneconomic to repair the car at this cost, B is entitled to £500 damages even though he decides not to have the repairs carried out.

NOTES

1. Current price as a measure of loss

As in Article 9:507 this "abstract" way of assessing the amount of loss is used in all the legal systems. The relevant provisions are mostly found in the provisions on sales, see DANISH SGA §§ 25, 30(1) and 45; DUTCH BW art. 7:36; FINNISH and SWEDISH Sale of Goods Acts, § 69; GERMAN and AUSTRIAN HGB § 376(2); ITALIAN CC art. 1518; U.K. Sale of Goods Act 1979, §§ 50(3) and 51(3); and in IRELAND see *Forde* § 1.207. A provision similar to Article 9:507 is found in CISG art. 76.

Though not provided in the legislation, the assessment of damages on the basis of the current price is admitted in FRANCE, BELGIUM and in the NETHERLANDS, where it is covered by the general clause in BW art 6:97 under which the court evaluates the damages in the manner best corresponding to its nature. The assessment is also admitted in SPAIN (TS 27 March 1974, 30 January 1976, 31 March 1977, 14 November 1977, 28 February 1978; see (*Vicent Chuliá*, II, 106; see

also *Diez Picazo*, II, 683-684 and *Carrasco* 670) and in GREECE with respect to commercial transactions, *Ligeropoulos* in *Erm.AK II/1*, art. 298 nos. 23-29, 83-86 (1949).

2. *Time of assessment*

As in Article 9:507, in CISG art. 76 and the FINNISH and SWEDISH SGA, the current price is generally that at the time of termination. In several other laws it is, however, the price at the time when performance was due, see UNITED KINGDOM SGA s.51(3); IRELAND, see *Forde* § 1.206; ITALIAN CC art. 1518; GERMAN and AUSTRIA HGB § 376(2); DANISH SGA § 25; and SPANISH Commercial Code arts. 329, 363 and 371 (see *Vicent Chuliá*, II, 106).

Literature: see notes to Article 9:506 above.

Article 9:508: Delay in Payment of Money

- (1) *If payment of a sum of money is delayed, the aggrieved party is entitled to interest on that sum from the time when payment is due to the time of payment at the average commercial bank short-term lending rate to prime borrowers prevailing for the contractual currency of payment at the place where payment is due.*
- (2) *The aggrieved party may in addition recover damages for any further loss so far as these are recoverable under this Section.*

COMMENTS

A. Purposes

This article provides for interest and damages on failure to pay money by the date at which payment is due, see Article 7:102.

B. Interest

Paragraph (1) confers a general right to interest on primary contractual obligations to pay; the provision does not cover interest on secondary monetary obligations, such as damages or interest.

Interest is not a species of ordinary damages. Therefore the general rules on damages do not apply. Interest is owed whether or not non-payment is excused under Article 8:108. Also, the aggrieved party is entitled to it without regard to any question whether it has taken reasonable steps to mitigate its loss.

The rate of interest is fixed by reference to the average commercial bank short-term lending rate. This rate applies also in the case of a long delay of payment since the creditor at the due date cannot know how long the debtor will delay payment. Since interest rates differ, the lending rate for the currency of payment (Article 7:108) at the due place of payment (Article 7:101) has been selected because this is the best yardstick for assessing the creditor's loss. Unless otherwise agreed, interest is to be paid in the same currency (cf. Article 9:510 Comment D) and at the same place as the principal sum. The parties are free to exclude or modify paragraph (1) e.g. by fixing the rate of default interest and/or its currency in their contract.

C. Additional damages

Paragraph (2) makes it clear that the aggrieved party's remedy for non-payment or delay in payment is not limited to interest. It extends to additional and other loss recoverable within the limits laid down by the general provisions on damages, in particular Article 9:503 and Article 9:505. This might include, for example, loss of profit on a transaction which the aggrieved party would have concluded with a third party had the money been paid when due; a fall in the internal value of the money, through inflation, between the due date and the actual date of payment, so far as this

fall is not compensated by interest under paragraph (1); and, where the money of payment is not the money of account, loss on exchange. However, in this last case the aggrieved party has the option of proceeding instead under Article 7:108(3).

Illustration 1: A agrees to pay B £50,000 if B will vacate A's property and find alternative accommodation. B moves out of the property but A fails to pay the agreed sum. In consequence B, who as A knew intended to use the payment to buy a house from C, has to negotiate with C to leave part of the purchase price outstanding on mortgage at interest. B is entitled to sue A for the interest and legal costs reasonably incurred.

Illustration 2: C agrees to lend £200,000 to D to enable D to purchase a business at a price equal to that sum from E. Under the contract of sale, the terms of which are known to C, time of payment is of the essence. At the last moment C refuses to advance the money and D is unable to obtain alternative funds in time. E terminates the contract and sells his business to F for £300,000, its true value. D is entitled to damages from C for the loss of the contract.

Illustration 3: S in London agrees to sell goods to B in Hamburg at a price of US\$ 100,000 payable in London 28 days after shipment. The goods are duly shipped to B, who is three months late in paying the price. During this period the value of the US dollar in relation to the pound sterling (the currency in which S normally conducts his business) depreciates by 20 per cent. Assuming that these consequences of delay in payment could reasonably have been foreseen by B at the time of the contract, S is entitled to recover US\$ 20,000 damages from B, in addition to interest, for the loss on exchange.

NOTES

1. Duty to pay interest

A statutory duty to pay interest exists under several international conventions and in all continental European countries; for references see note 2 below. CISG also recognizes this obligation (arts. 78, 84(1)). Contrary to all other conventions and statutes, CISG does not, however, fix a rate of interest because it proved impossible to agree upon a standard: the discount rate was thought to be inappropriate for measuring credit costs; nor could agreement be reached on whether the credit costs in the seller's or the buyer's country were to be selected. See however *Unidroit* art. 7.4.9.

ENGLISH law did not impose, in general, a statutory or common law obligation to pay interest upon default (*President of India v. La Pintada Cia. Navegacion SA* [1985] A.C. 104 (H.L.)). This rule was, however, much criticised; before the *President of India* case the English *Law Commission* had proposed the introduction of statutory interest on contractual obligations to pay money (Report on

Interest, No.88, Cmnd 7229, 1978). The rule has recently been changed for commercial debts by Late Payment of Commercial Debts (Interest) Act 1998. In any case, if proceedings have been commenced the court has discretion to award interest: Administration of Justice Act 1982, amending the Supreme Court Act 1981, s.35A. SCOTTISH law is the same.

In IRELAND, although a court can order a contractual debtor to pay interest from the date of judgment, and a creditor who has served notice claiming interest on a defaulting debtor can have interest from the date of demand (Debtors (Ireland) Act 1840, s.53), there is equally no general duty on a defaulting debtor to pay interest on the unpaid sum for the period of delay: see *Clark* 467.

2. Normal rates

The rates of statutory interest and the methods of computing them vary considerably.

(a) Fixed rate

The traditional method is to fix a statutory rate; it varies between 10 and 4 percent.

4%: GERMAN BGB § 288 (1).

5%: GERMAN HGB § 352 (1);

5%: ITALIAN CC art. 1224 (1), 1284 (as amended in 1996);

6% : the Geneva Conventions on Bills of Exchange of 1930, art. 48(2) and on Cheques of 1931, art. 45(1);

(b) Flexible rates

In recent years many countries have introduced flexible interest rates. The methods of determining the rate vary considerably.

DENMARK adds a percentage, to be fixed biannually by the Minister of Justice, to the respective official discount rate (Law on Interests of 1 September 1986, § 5); interest is due from the time a payment which is fixed in advance becomes due (§ 3). In FINLAND the Act on interest, as amended 3 March 1995, prescribes different rates: if there is an agreed rate of interest on the debit, the interest for delay is 4% above the agreed interest rate, in other cases the interest for delay is 7% (in certain cases 4%) above an official reference rate determined by the Bank of Finland. SWEDEN adds 8% to the official discount rate and, when time for payment has not been fixed in advance, allows a grace period of 30 days after notice that interest will be charged. In FRANCE the rate is the arithmetic average of the last twelve monthly figures of the official discount rate (Law of 11 July 1975, art. 1, as am. by Law of 23 June 1989); two months after a judicial condemnation to pay, that rate is increased by 5% (Law of 11 July 1985 arts. 1-2). The GERMAN Consumer Credit Law of 17 December 1990 (BGBL I 2840) § 11(1) fixes a rate of 5% above the respective official discount rate. GREECE adds 4% to the rate of interest charged by the central bank for financing of credit institutions against state funds given as a pledge (Act of the Council of Ministers 261/1996), which at the time of writing (July 1997) gives an interest rate for arrears of 23%. In BELGIUM an Act of 30 June 1970, as amended in 1986, now allows rate to be fixed by Royal Decree;

In other countries, the interest rate is fixed (and amended) annually by the government (GREEK CC art. 345; LUXEMBOURG: Law 22 Feb. 1984; the NETHERLANDS: BW art. 6:120; PORTUGAL: CC art. 559(1), Comm. C art. 102(2); SPAIN: CC art. 1108 and Law of 29 June 1984, arts. 1 and 2.)

3. Higher contractual rates

In some countries if there is a contractual interest rate that is higher than the statutory rate, the higher rate is applied to the time after default (DANISH law, see note 2(b) above, §6; ITALIAN CC art. 1224(1) sent. 2; the NETHERLANDS: BW art. 6:119(3); PORTUGUESE CC art. 806(2)); GREEK Introductory law to the Civil Code art. 109(1) 3. SPANISH CC art. 1108; also see Civil Procedure Code art. 921 establishing higher, punitive rate; SWEDISH Interest Act, § 1. In GERMANY, in contrast, the Federal Supreme Court has expressly refused to apply ; such a rule because it might give a windfall profit to the creditor if the market rate is much lower at the time of default. A bank is merely entitled to the average market rate for its various types of credits and, if the bank cannot establish this, to the market rate for its cheapest type of credit (BGH 8 Oct. 1991, BGHZ 115, 268, 269f., 271f.).

4. Loss in addition to interest

Loss in addition to interest may be claimed in most countries by virtue of the general rules on damages but lost profits and loss through inflation cannot always be recovered. See DENMARK (*Gomard*, Obligationsret II 197); FINLAND (*Wilhelmsson & Sevón* 156); FRENCH CC art. 1153(4); GERMAN BGB §§ 88(2); GREEK CC art. 345 sent.2; ITALIAN CC art. 1224 (2), except if the parties had fixed the rate of interest for default in the contract SWEDEN (*Ramberg*, Köplagen 568; SPANISH law, TS 28 November 1983, 6 May 1988, (*Albaladejo* II, 1, § 33.3). The possibility is not recognised in BELGIUM, see CC art. 1153, except for losses caused by devaluation of foreign currency.

Further loss may be recovered in ENGLAND (*Wadsworth v. Lydall* [1981] 1 W.L.R. 598, C.A., confirmed by the *President of India* case, supra note 1) and in FRANCE (Civ. 1, 21 June 1989, Bull. I. No 251); and the position is thought to be the same in IRELAND.

In contrast, additional damages may not be claimed in the NETHERLANDS (except in the special case mentioned in note 4 on Article 7:108, above); in PORTUGAL; and in SCOTLAND, *McBryde* ch. 20-78.

See generally *Treitel*, Remedies §§ 159-162.

Article 9:509: Agreed Payment for Non-performance

- (1) *Where the contract provides that a party which fails to perform is to pay a specified sum to the aggrieved party for such non-performance, the aggrieved party shall be awarded that sum irrespective of its actual loss.*
- (2) *However, despite any agreement to the contrary the specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the loss resulting from the non-performance and the other circumstances.*

COMMENT

A. Stipulation as to agreed payment binding

It is common for the parties to a contract to specify a sum to be paid for non-performance, with a view to avoiding the difficulty, delay and expense involved in proving the amount of loss in a claim for unliquidated damages. Such a clause may also prompt the debtor to perform voluntarily, when the penalty is heavy. To perform is then cheaper than paying the penalty. Paragraph (1) gives effect to such a provision, so that except as provided by paragraph (2) the court must disregard the loss actually suffered by the aggrieved party and must award it neither more nor less than the sum fixed by the contract. It follows that the aggrieved party is under no obligation to prove that it has suffered any loss.

Illustration 1: B agrees to build a house for A and to complete it by April 1st. The contract provides that for every week's delay in completion B is to pay A the sum of £200. B completes the house on April 29th. A is entitled to £800 as agreed damages, whether his actual loss (e.g., the cost of renting alternative accommodation during the four week period of delay) is greater or less than that sum.

Illustration 2: A agrees to sell his house to B, from whom he obtains a deposit of 20 per cent of the price to secure B's performance of the contract. B refuses to complete the transaction. A may forfeit the deposit.

Where, however, the contract specifies merely the minimum sum payable by the non-performing party, the aggrieved party may recover a higher figure if it can prove that its loss exceeds the minimum sum. In this case the aggrieved party may elect to sue for damages at large instead of invoking the provision for agreed damages.

B. Court's power to reduce grossly excessive stipulations

To allow the parties complete freedom to fix the sum payable for non-performance may lead to abuse. If there is a gross disparity between the specified sum and the actual loss suffered by the aggrieved party the court may reduce the sum even if at the time of the contract it seemed reasonable. Since the purpose is to control only those

stipulations which are abusive in their effect, the court's reducing power is exercisable only where it is clear that the stipulated sum substantially exceeds the actual loss. This power of the court has a limit : it should respect the intention of the parties to deter default and therefore should not reduce the award to the actual loss. The court has to fix an intermediate figure.

Illustration 3: A supplies equipment to B on lease for five years at a rent of £50,000 a year. The agreement provides that if the lease is terminated because of default by B in performing its obligations B shall pay A by way of agreed damages a sum equal to 80% of the future rentals. In the light of circumstances existing at the time of the contract this stipulation is not unreasonable. After a year the agreement is terminated because of B's default in payment. As the result of an unexpected increase in the demand for the type of equipment in question A, having secured the return of the equipment, is able to re-let it at twice the rent payable under the original lease. The court may reduce the agreed damages payable so as to take account of this fact.

C. "Excessive" sum

In deciding whether the stipulated sum is excessive the court should have regard to the relationship between that sum and the loss actually suffered by the aggrieved party, as opposed to the loss legally recoverable within the foreseeability principle embodied in Article 9:503. On the other hand, the computation of actual loss should take into account that element of the loss which has been caused by the unreasonable behaviour of the aggrieved party itself, e.g. in failing to take reasonable steps in mitigation of loss.

D. Genuine options not covered

Article 9:509 does not apply to a genuine option to pay a sum of money instead of performing, since Article 4:509(1) deals with non-performance, not with alternative performance (forfait clause, "*clause de dédit*"). On Alternative Performance see Article 7:105.

NOTES

1. Stipulated payment clause valid

As is provided in Article 9:509, the laws of the CIVIL LAW countries will enforce a stipulation in a contract under which the debtor undertakes to pay a fixed sum of money in the event of his non-performance. The stipulated payment clause will be enforced whether its purpose was to coerce the debtor to perform his principal obligation (penalty clause) or to serve as a pre-estimate of the loss suffered by the creditor in case of non-performance (liquidated damages clause). See also *Unidroit*_art. 7.4 As we shall see in note 4 below the COMMON LAW countries will not enforce a penalty clause.

The civil law codes confirm the validity of stipulated payment clauses either expressly or impliedly, see AUSTRIAN ABGB § 1336(1); BELGIAN CC art. 1152 and 1229; FRENCH CC arts. 1152 (as amended in 1975 and 1985) and 1229; LUXEMBOURG CC arts. 1152 and 1226 ff. (as amended in 1987); GERMAN BGB §§ 339-345; GREEK CC art. 405(2); ITALIAN CC art. 1382-1384; NETHERLANDS BW art 6:91-6:94; PORTUGUESE CC art. 810(1); and SPANISH CC art. 1152. The same holds true of DANISH law, see *Gomard*, *Obligationsret II* 239 ff.; FINNISH law (see *Taxell*, *Avtal och rättsskydd* 441); and SWEDISH law (see *Ramberg*, *Avtalsrätt* 309).

Unless otherwise agreed the stipulated payment is not payable if the non-performance is excused, see expressly DUTCH BW art.6: 92(3); GREEK CC art. 405(1); and by implication LUXEMBOURG CC arts. 1152 and 1226 ff. (as amended in 1987); GERMAN BGB § 339. On the other hand, and subject to the rules on reduction, see note 3 below, the stipulated payment is due irrespective of whether the aggrieved party suffered any loss, and irrespective of how great the loss was.

2. *Stipulated payment replaces damages*

In most of the Civil law systems the stipulated payment replaces the damages for non-performance which the aggrieved party would have recovered. This means that the defaulting party cannot claim damages instead of the stipulated payment. Nor can the aggrieved party claim damages in addition to the stipulated payment, unless, as provided in the ITALIAN CC art. 1382(1), PORTUGUESE CC art. 811(2) and (3) and SPANISH CC art. 1153, the parties have agreed on such payment. In AUSTRIAN law, damages over and above the stipulated sum may be claimed in respect of commercial transactions (4. EVHGB Art. 8 No. 3). By contrast, under GERMAN law the aggrieved party may claim damages for non-performance or improper performance in addition to stipulated payment (BGB §§ 340(2), 341(2)). If payment is stipulated for a failure to perform properly (as opposed to a performance which is not tendered), the aggrieved party is entitled to claim both performance and the agreed payment (BGB § 341(1)). These latter rules also apply in GREECE, see CC arts. 406(2) and 407 sent.2. In ITALY a payment stipulated for delay in performance may be recovered together with a claim for performance, CC art.1383. On DENMARK, see *Gomard*, *Obligationsrett II*, 239 f. In FINNISH law the solution depends on the interpretation of the term *Aurejärvi* 151.

3. *Reduction*

Under several Civil law systems the court may reduce the stipulated payment if it is manifestly excessive, see AUSTRIAN ABGB § 1336(2); DANISH, FINNISH and SWEDISH Contract Acts § 36; DUTCH BW 6:94; ITALIAN CC art. 1384; FRENCH and LUXEMBOURG CC art. 1152(2); GREEK CC art. 409, even if the parties have agreed otherwise; and GERMAN BGB § 343. However in Germany and Austria a payment stipulated in contracts between merchants cannot be reduced, see HGB § 348. At first sight the same rule appears to apply in BELGIUM, see CC art. 1152, which is not restricted to merchants. In GERMANY, however, the payment may be set aside or modified if it would be unconscionable to enforce it, see BGB §

242 and *Baumbach & Duden & Hopt* HGB § 348 note B. And in BELGIUM the Supreme court has held that if a stipulated payment is so excessive in relation to the loss which was foreseeable at the time the contract was made that it loses its function as a pre-estimate of the loss suffered and becomes a mere private penalty, it should be set aside as violating public policy, see Cass 24 Nov. 1972, R.C.J.B. 1973 302. Even if this is not the case, the stipulated payment may still be reduced if it is manifestly unreasonable at the moment of non-performance, see law of 23 November 1998, in effect confirming Cass. 18 Feb. 1988, Arr. Cass. 1987-88, 790 no.375; T.B.H./R.D.C. 1988, 636 note *Dirix*. Under the SPANISH CC art. 1154 the court may reduce payment to an equitable amount if the principal obligation has been performed partly or irregularly. In PORTUGAL reduction is also possible; however, in a decision of the Supreme Court it has been held that the payment may only be reduced if it was stipulated as a pre-estimate of the loss suffered and not if it was made to coerce the defaulting party to perform his principal obligation, see on STJ 3 Nov. 1983, *Pinto Monteiro* 474 ff. See also *Unidroit* art. 7.4.13(2).

4. Penalty clauses in the Common law

In the COMMON LAW stipulated payment clauses are divided into penalty and liquidated damages clauses. The former are invalid, the latter are valid. Penalty clauses are clauses stipulated "*in terrorem*" in order to coerce the debtor to perform the principal obligation. Liquidated damages clauses are clauses by which an attempt is made to pre-estimate the loss suffered by a breach of contract. The latter clauses cannot be modified. A clause will be regarded as a penalty clause if it is extravagant and unconscionable in amount in comparison with the greatest loss that could be proved to follow from such a breach, see *Dunlop Pneumatic Tyre Co. Ltd v. New Garage and Motor Co. Ltd*. [1915] A.C. 79, 87 (H.L.). A stipulation is a liquidated damages clause if the circumstances were such that an accurate or precise pre-estimate of the loss was impossible and the stipulated payment was a genuine attempt to make a pre-estimate of the loss, *ibid*. SCOTTISH law is the same; a clause has been upheld when precise assessment of damages was not possible: *Clydebank Engineering & Shipbuilding Co. Ltd. v. Castaneda* (1904) 7 F 77 (H.L.).

5. Clauses setting a sum less than the likely loss

On clauses which though drafted as penalty or liquidated damages clauses in effect limit the liability of the non-performing party, see note 4 to Article 8:109, above.

See generally ICC Guide to Penalty and Liquidated Damages Clauses no. 478; *Fontaine*, *Contrats* 127-170; *Treitel*, *Remedies* §§ 164-181.

Article 9:510: Currency by which Damages to be Measured

Damages are to be measured by the currency which most appropriately reflects the aggrieved party's loss.

COMMENTS

A. General remarks

1. Economic context

Exchange rates between individual currencies are subject to more or less heavy fluctuations. Consequently, the question in which currency damages have to be measured is relevant. Over or under-compensation must be avoided by fixing damages measured by reference to the correct currency.

2. Legal context

This provision fixes the currency in which contractual damages are to be measured. Technically speaking, the currency of account for damages is laid down.

By contrast, Article 7:108 deals in a general way with the currency of payment. If damages (or interest) have arisen in a currency other than the local currency of the place of payment, any conversion into the latter currency is governed by Article 7:108.

B. Purpose

Since damages have the purpose of putting the aggrieved party into the same position in which it would have been upon performance (Article 9:502) they have to be expressed in the currency which is most appropriate to achieve that result. Damages therefore should not automatically be measured in the local currency of the court; in most countries judgments in foreign currency are allowed. Even if they are not allowed, but the damages had arisen in a foreign currency and are measured in that currency, the conversion into the local currency at current exchange rates will lead to an appropriate result.

C. Explanation

In view of the vast variety of the facts of international commercial intercourse, the currency of the damages which is most appropriate to compensate the aggrieved party cannot generally be determined with precision. In many cases it will be the contractual currency of account. But where this is not the currency which the aggrieved party had to utilize in order to make good its loss, e.g. by making a cover transaction, the latter currency may be more appropriate, especially if the creditor utilizes the currency of its home country for this purpose. Generally this will be the currency in which it makes its business deals.

Illustration 1: Austrian machine manufacturer C has made a contract for delivery of certain machinery with French importer F. F wrongfully cancels the contract. C's damages have arisen in Austrian Schilling.

However, the factors may be different.

Illustration 2: As in Illustration 1, but C is an internationally active company stipulating that payments for its export sales are to be made on a US-Dollar bank account in New York. C's lost profits are to be calculated in US dollars.

It is also possible for loss to arise in several currencies.

D. Derived claims

Where a party is entitled to interest, such interest is usually measured and payable in the same currency as the principal. This is so in particular where the interest is expressed as a percentage of the principal sum.

The same is true if the amount of damages is fixed in the contract as a percentage of the price.

Illustration 3: In a construction contract, the parties have agreed on a penalty of 1% of the price for every week of default in completion of the construction, the price being expressed in Deutsche Mark. The penalty will be due in DM as well.

E. Autonomy of the parties

Of course, the parties are free to fix the currency of damages or interest by reference to any currency they like.

NOTES

1. Case law

Article 9:510 follows the modern ENGLISH and SCOTTISH rule on the currency of damages, which has been developed in *The Despina R. & the Folias* [1979] A.C. 685 (H.L.) (see also *Goode*, Commercial Law 1133; *Goode*, Payment Obligations 136 ff.). Also in some GERMAN and ITALIAN cases it has been accepted by the courts that a foreign currency may reflect the aggrieved party's loss more appropriately (Germany: especially OLG Hamburg 7 Dec. 1978, Versicherungsrecht 1979, 833; Italy: Cass. 6 June 1981 n. 3656, Mass. Foro It. 1981; see also Trib. Udine 24 Dec. 1987, Foro It. 1989, I p. 1618). However, in Germany the Bundesgerichtshof still accepts that damages may be awarded in DM provided that the debtor does not object (BGH 9 Feb. 1977, WM 1977, 478 (479); BGH 10 July 1954, BGHZ 14, 212 (217)). In FRANCE, judgment is mostly given in French francs, but as the tendency is to use the rate of exchange of the date of payment for the conversion (see Réponse Ministerielle No. 949, JCP 1982, IV, 166; *Derrida* no. 919 ff.; *Chartier* no. 442) the

result is practically the same as in case of a proper foreign currency judgment. In SPAIN a decision of the Tribunal Supremo (TS 26 Nov. 1987) has calculated damages in foreign currency but converted in pesetas according to the official rate of exchange of the day of the definitive judgment. The same holds true in GREECE under CC art. 291 which, however, focusses on the official rate of exchange at the date of payment. Claims for damages in foreign currency are accepted by the courts in AUSTRIA; the relevant time for converting is the time when the obligation is due (see e.g. *Ehrenzweig* (*Mayrhofer*) Schuldrecht AT, 49-53).

Under DUTCH BW art. 6:121 when, pursuant to an obligation, payment must be made in a currency other than that of the country where the payment must be made, the debtor is entitled to pay in the currency of the place of payment.

2. Legal writers

The position of legal writers in Europe appears not to be uniform. Whereas in ITALY judgments awarding damages in foreign currency have been criticized (*Ascarelli* 416, *Campeis & De Pauli* 412 ff.), there is support for awarding damages in foreign currency not only in ENGLAND and in BELGIUM (*Fallon*, Annal. dr. Liège 33 (1988) 77-89; *Niyonzima* 206 ff.. no. 233, 214 no. 239), but the same is true also for GERMANY, where some authors advocate a more careful analysis of the currency of the loss and propose following either the very wide English formula (*Alberts*, NJW 1989, 609-615 (612); *idem*, *Währungsschwankungen* 48 f., 135, 137, 166) or, more precisely, recommend the creditor's currency (*von Hoffmann* 125-141) or the currency of the assets of the creditor (*Remien*, *RabelsZ* 53 (1989) 245-292). See also in GREECE *Kallimopoulos* 130-138, 350-375. In SPAIN, traditional doctrinal analysis and case law (TS 7 November 1957, 6 April 1963) favoured payment in the national currency but more recent scholarship would allow the debtor the choice: *Paz-Ares*.

3. Currency of the contract

It is sometimes thought that damages for breach of contract should be measured in the currency of [account of] the contract (*Staudinger* (-*K. Schmidt*) § 244 no. 17), but such a rule is not accepted in ENGLISH practice (see *The Despina R and the Folias*, *ibid.* 700-701) and also disputed in GERMANY (see *Remien*, *RabelsZ* 53 (1989) 245, 276-280: only where contractual claims for damages take the place of a contractual claim for the price). See also *Unidroit* art. 7.4.12.

