

# An Analysis of Market-Based Damages for Breach of Contract in the CISG and PECL

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Current Price Damages under the CISG and PECL

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## CURRENT PRICE DAMAGES UNDER THE CISG AND PECL

### 1. General

Both the CISG and the PECL distinguish between two mutually-exclusive types of situations following breach (“non-performance” in the context of the PECL) of contract and avoidance (“termination” in the context of the PECL) by either party.

**1.1** In one type of situations, the aggrieved party engages in an alternative transaction that substitutes for the performance expected from the original, now avoided (terminated) contract (so-called “cover” transactions). Such cases fall under CISG Art. 75 and PECL Art. 9:506, respectively. In the other type of situations, the aggrieved party does not resort to a substitute transaction. In such cases, market price-based damages may become available to the aggrieved party under so called “current price” clauses, CISG Art. 76 and PECL Art. 9:507, respectively (note, that under perfect market conditions, the two types of situations converge).<sup>1</sup> This commentary commences by exploring the general logic of current price damages shared by the CISG and PECL, and subsequently identifies and analyzes the differences in approach between the two instruments.

**1.2** Monetarily speaking, current price damages are a compensation for devaluation or increase of price in terms of a *theoretical* substitute transaction. They represent the difference between the contractual price of goods (or, in the case of the PECL, also services, *etc.*) and their price at a certain later time, whether higher or lower (how this later time is determined is discussed below). Thus, an aggrieved seller may demand such damages if, in consequence of buyer’s breach, the goods left at her disposal have a lower market value than the contractual price.<sup>2</sup>

**1.3** An aggrieved buyer is entitled to such compensation if the available current price is higher than the contractual price, even without proof of intentions to resell or otherwise transact in the goods under such conditions.<sup>3</sup> As – had the contract been performed – the aggrieved buyer would have been in a position to capitalize on the price increase, this premium – held by the breaching seller – should be transferred to the buyer. Seen from this perspective, current price damages are rather a measure of restitution following unjust enrichment than a kind of expectation damages; they share a distinct family relation with recovery of gains made in breach from a substitute transaction. Thus, current price damages require no proof of expectation, nor foreseeability or any actual loss, beyond the change in actual current price.<sup>4</sup> Consequently, current price damages do not exclude, either in the CISG or in the PECL, other kinds of damages for breach of contract, in particular expectation or consequential damages, such as under CISG Art. 74 or PECL Art. 9:501.<sup>5</sup>

1.4 Although not universal,<sup>6</sup> current price clauses exist in many national systems, and especially so in the case of sales.<sup>7</sup> Note, that a condition for a claim of current price damages is that the contract had been avoided (terminated), i.e., no forthcoming performance is expected.<sup>8</sup> In that it differs from both expectation and reliance damages, claims to which are indifferent to the theoretical possibility of further performance. Likewise, current price damages can obviously not be claimed together with enforcement of performance (“specific performance”), which would result in double compensation.

## 2. Current Price and Risk

The current price against which the contractual price is measured must be general and reliably verifiable, given to “fair determination.”<sup>9</sup> Because current price damages do not apply in cases of alternative transactions, they are not measured against an actual, idiosyncratic price paid. Although the terminology is that of “damages,” the issue can be seen as a matter of the *exposure to risk* born by the breaching party. The breaching party is not exposed to the risk that an idiosyncratic transaction might become available to the aggrieved party, but only to a risk determined by a generally verifiable standard. Therefore, although “current price” and “market price” are not identical, and although in principle current price damages are available not only under market conditions, market prices obviously provide a good indication for determining both the availability of current price damages and their amount.<sup>10</sup> Courts have occasionally recognized standards other than market price to determine current price damages.<sup>11</sup> Conceivably, however, aggrieved parties will fail to prove the existence of either market-based or other verifiable ways of determining prevailing current prices, resulting in disallowance of current price damages altogether.<sup>12</sup>

## 3. No Substitute Transaction

A problem arising from the functional “division of labor” between the substitute transaction and current price provisions is the determination, necessary for the application of the latter, whether a substitute transaction did not, in fact, take place. The problem is especially acute in cases of large turns of business: it would not be obvious whether unspecified goods later sold (or any equivalent non-sales transaction) should be dealt with as a substitute transaction or an independent one.<sup>13</sup> The structure of CISG Art. 75 may assist in determining this, requiring substitute transactions to stand in some relation of reasonableness to the original transaction, namely be performed “in a reasonable manner and within a reasonable time after avoidance” of the contract. As Art. 76 grants the price differential between the contractual price and that prevailing at the time of avoidance (or of tender, in cases of delivery – see below), Art. 76 leaves little room to manipulation of time: if an alternative transaction was not performed within a reasonable time, Art. 75 damages would no longer be available, but Art. 76 damages would be. Such would be the case of, e.g., a seller who attempts a substitute transaction but eventually fails; current price damages will still be available as a fall-back option.<sup>14</sup>

Due to obvious considerations, courts prefer to grant “actual” rather than “abstract” price differentials – namely those resulting from a substitute transaction rather than market price.<sup>15</sup> The choice, however, is in the hands of the aggrieved party, but so is the burden of proof to show that no substitute transaction has in fact taken place.<sup>16</sup> Professor Schlechtriem argues that this burden is easily met in cases of “constant dealing” where it is “difficult or impossible” to determine which particular transaction should be considered the cover for the breached contract.<sup>17</sup> However, this may cut the other way: that in such situations, there is high probability that a cover transaction in fact occurred, even if it were difficult to identify a single, specific substitute. The fact that any of a number of transactions may have been the substitute transaction does not amount to the conclusion that there was no substitute transaction. The breaching party opposing the allowance of current price damages need not point to a distinct cover transaction if he can point to a number of them, of which one (or

more) function as the cover transaction, even if it is impossible to differentiate it from the commercial aggregate. Thus, as current price provisions state lack of substitute transaction as a condition for recovering current price damages, the burden of proof – carried by the aggrieved party seeking current price damages<sup>18</sup> – may, in many instances, determine this point.

#### 4. Relevant Place

CISG Art. 76(2) determines that current price is the price prevailing at the place where delivery should have taken place (*see* CISG Art. 31 for determination of place of delivery), but allows for a “reasonable substitute” in case there is no current price at the designated place of delivery. Prices for goods may vary considerably among some markets, and evidence regarding a prevalent price in one market may be rejected as not amounting to a “reasonable substitute” for the originally intended market.<sup>19</sup> The reasonable substitute structure does not allow the plaintiff to engage in “current price shopping.” Such behavior will fail to constitute a “reasonable substitute” as well as run counter to standards of good faith.<sup>20</sup> The PECL is silent on the question of place according to which current price is to be determined. One may reasonably apply the CISG’s criterion there, unless there were good reasons to diverge from it. Performances that are easily transferable from one place to another may attempt to command the current price of an emerging or other market more lucrative than the original contract entailed, and thus jumble the *ex-ante* assessment of risk involved with current price damages. Such a manipulation may or may not be considered legitimate under the “reasonable substitute” principle as applied to various types of transactions, but the burden of proof that the substitute market is indeed a “reasonable” substitution lies with the aggrieved party requiring it. The measure in which the original performance was in any significant way geographically entrenched may serve as a criterion for the “reasonableness” of different current price determinations.

Art. 76(2) adds a clause that is seemingly out of synch with the general logic of current price damages and is furthermore not expressed in PECL 9:507: namely, that when calculating current price differentials according to a price prevalent in a place other than the designated place of delivery, the cost of transporting the goods is to be taken into account. One may reasonably object that when no actual transaction is involved current price is based on a “virtual” or “abstract” or “imagined” transaction, recall – it is irrelevant to internalize transportation costs into the price differential. However, the existence of this clause expresses the strong ties of current price damages to those resulting from an actual substitute transaction (such as under CISG Art. 75). The clause assumes that commerce, production and other activities go on, and that current price damages need be such as to in fact allow the aggrieved party to engage in some future transaction, even when that will no longer fall under the “reasonable time” requirement of Art. 75.<sup>21</sup> Hence the two mutually-exclusive mechanisms truly attempt to approach identical concerns, making current-price damages appear less “abstract” than the authors cited above take them to be.

#### 5. Relevant Time

As current price damages are determined *ex-post*, the question of the time of their determination is significant. The CISG and PECL differ somewhat on this point. PECL determines that the current price against which the contractual price is determined is the current price at time of the contract’s termination. This gives the aggrieved party – who terminates the contract – an *ex-ante* measure of control in determining the current price damages. One could theoretically consider – and indeed national courts have at times recognized – other standards: the time of breach, the time when the breach became known or should have become known to the aggrieved party, the time when avoidance (termination) first became available, or the time of any number of notices exchanged between the parties.

## 6. Current Price Damages after Goods were Delivered

Regarding the time according to which current price damages are calculated, there is an apparent difference between the PECL and CISG with respect to one special category of cases in which such damages may become available. Dealing as it does with the special risks associated with international sales of goods, the CISG is consistently sensitive to situations in which contracts are avoided pursuant to delivery.<sup>22</sup> As current price damages become available only following avoidance of the contract, Art. 76(1) makes a special provision for such damages in cases where the aggrieved party has avoided the contract after taking over the goods (e.g., for failure of conformity or any other fundamental breach, or following a *Nachfrist* period). In such cases, the current price is determined according to the time of the taking of the goods, instead of the time of avoidance of the contract. Thus aggrieved parties who have taken the goods may not benefit from deferring avoidance tactically or speculatively, until such time as a more favorable current price emerges.<sup>23</sup> The PECL, dealing as it does with all contractual situations, includes no such provision. This apparent shortcoming is mitigated by two factors. One is the PECL's more overt imposition of good faith obligations, that would presumably disallow such tactical behavior. The other, more specific factor considers that under both CISG and PECL, avoidance (termination) of the contract pursuant to delivery is restricted to a "reasonable time,"<sup>24</sup> a determination germane to both the availability as well as the amount of current price damages. As also under PECL current price damages become available only upon avoidance of the contract, the "reasonable time" restricting the latter – in cases in which tender was assumed – also limits the timeframe of the former. This does not make for an absolute congruence between the two systems, as aggrieved parties under PECL are allowed to defer termination of the contract – and thus to an extent determine the amount of current price damages – under the reasonable time restriction. Under CISG, the aggrieved party has no such power, and current price damages under conditions of tender will be determined according to the time of tender.

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<sup>1</sup> In one case at least, the court calculated damages according to Art. 76 although a substitute transaction did in fact take place. However, as the actual price collected by the aggrieved seller on the substitute transaction was only about 25% of the contract price, the court deemed the transaction not "in a reasonable manner" as required by Art. 75 CISG and instead invoked the formula of Art. 76. Note, that the goods in question (lots of bacon) were perishable, and that the seller acted according to his general duty to mitigate the loss (CISG Art. 77). Germany 22 September 1992 *Oberlandesgericht* [Appellate Court] Hamm, 19 U 97/91, CLOUT abstract no. 227, available online at <<http://cisgw3.law.pace.edu/cases/920922g1.html>>.

<sup>2</sup> For usage of the formula calculating the price differential between the contractual price and a generally-verifiable standard such as market price *see* Switzerland 21 October 1999 *Kantonsgericht* [District Court] Zug, A3 1997 61, available online at <<http://cisgw3.law.pace.edu/cases/991021s1.html>>.

<sup>3</sup> Current Price clauses are subject to parties' general power to derogate under CISG Art. 6. Post-breach agreements such as settlement agreements may be construed to include waiver of current price damages (as well as other remedies available according to the governing law). *See* China 1

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April 1993 CIETAC Arbitration proceeding, available online at <http://cisgw3.law.pace.edu/cases/930401c1.html>.

<sup>4</sup> Consequently, Lando and Beale refer to the assessment of current price damages as “abstract,” see Ole Lando and Hugh Beale (eds.), *Principles of European Contract Law: Parts I and II* (Kluwer Law International (2000) (hereinafter “Lando and Beale”) p. 211. See also Joseph Lookofsky and Herbert Bernstein, *Understanding the CISG in Europe*, Deventer, Kluwer 1997 (henceforth “Lookofsky and Bernstein”) p. 102. Yet other authors term current price damages as “virtual,” although to both those who pay them and those who collect them they must seem real indeed (the transaction they represent is virtual, or rather imaginary), see D. Busch, EH. Hondius, HJ Van Kooten, HN Schelhaas, WM Schrama, eds., *The Principles of European Contract Law and Dutch Law: A Commentary* (Kluwer 2002) (Henceforth “Busch et al”), p. 420. Some courts seem to have caught up with the terminology, see Germany 2 September 1998 *Oberlandesgericht* [Appellate Court] Celle, 3 U 246/97, available online at <http://cisgw3.law.pace.edu/cases/980902g1.html>.

<sup>5</sup> See Grant R. Ackerman (ed.) *U.N. Convention on Contracts for the International Sale of Goods, Annotated*, Boston, 1993, Commentary on Article 76, p. 76-2 - 76-3.

<sup>6</sup> Busch et al, p. 420-1.

<sup>7</sup> Lando and Beale, Notes to Article 4.506, p. 211.

Provisions may be found in Danish, Dutch, German, Italian codes as well as the UK Sale of Goods Act 1979 law and Israel’s Contract Law (Remedies for Breach of Contract) 1970, Art. 11. Judicial allowance for current price damages exists in France, Belgium, and the Netherlands (see Lando and Beale) as well as in Spain and Greece with respect to commercial transactions. For further comparative information see Hugo Treitel, “Remedies for Breach of Contract”, in: *International Encyclopedia of Comparative Law* (Tübingen, Mouton, The Hague, Paris: J.C.B. Mohr, 1976) §§ 102 ff, and John O. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention*, 3rd ed. (The Hague: Kluwer, 1999) (henceforth “Honnold”) §§ 409-15, available online at <http://cisgw3.law.pace.edu/cisg/biblio/honnold.html>.

<sup>8</sup> This condition has been stressed by courts; see Germany 6 April 2000 *Landgericht* [District Court] München 12 HKO 4174/99; case presentation including English translation available online at <http://cisgw3.law.pace.edu/cases/000406g1.html>.

<sup>9</sup> See Busch et al 420.

<sup>10</sup> For case law see *supra* note 2, *infra* note 19.

<sup>11</sup> See Germany 28 October 1999 *Oberlandesgericht* [Appellate Court] Braunschweig, 2 U 27/99, available online at <http://cisgw3.law.pace.edu/cases/991028g1.html>, where the court calculated Art. 76 damages based on the seller’s relevant margin of profit – at the time, the lowest available standard (set at 10%).

<sup>12</sup> See Germany 2 September 1998 *Oberlandesgericht* [Appellate Court] Celle, 3 U 246/97, available online at <http://cisgw3.law.pace.edu/cases/980902g1.html>, where plaintiff failed to prove current price for generic, “no-name vacuum cleaners.” An instance of an important, more general case was expressed in ICC award No. 8740, of 1996, Unilex, available online at <http://cisgw3.law.pace.edu/cases/968740i1.html>. The question was whether current price may be established for quantities of coal, seller arguing that the determinative factors were too volatile for any accurate estimate, and buyer claiming that “an experienced trader would be capable of establishing a price for a particular quality of coal to be delivered at a certain time to a certain place.” Analyzing the various factors, the tribunal ruled that “the value of coal is primarily subjective in nature and dependent on the specific needs of the consumer and,

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therefore, there is no market value on which to award damages.” The aggrieved buyer was unable to establish current price and thus not entitled to recover under Art. 76. This raises the general question whether volatile commodity markets are ever appropriate standards for Art. 76 damages, and furthermore the broader question of the applicability of the CISG – designed chiefly for international transactions in goods as its prototype – to transactions in commodities. For discussions see Michael Bridge, *The International Sale of Goods: Law and Practice* (Oxford University Press 1999) note 2.41; also Peter Schlechtriem, “Interpretation, gap-filling and further development of the UN Sales Convention” available online at <<http://cisgw3.law.pace.edu/cisg/biblio/schlechtriem6.html>>.

<sup>13</sup> The Secretariat Commentary acknowledges this difficulty, commenting that “If the seller has a finite supply of the goods in question or the buyer has a finite need for such goods, it may be clear that the seller has resold or that the buyer has made a cover purchase, as the case may be. However, if the injured party is constantly in the market for goods of the type in question, it may be difficult or impossible to determine which of the many contracts of purchase or sale was the one in replacement of the contract which was breached.” *Secretariat Commentary to CISG Art. 76*, available online at <<http://cisgw3.law.pace.edu/cisg/text/secomm/secomm-76.html#3>>.

<sup>14</sup> See Honnold, pp. 452-3.

<sup>15</sup> Every rational system would assume preference for a substitute transaction over one in which goods are “lost,” transaction-wise. See Germany 22 September 1992 *Oberlandesgericht* [Appellate Court] Hamm, 19 U 97/91, available online at <<http://cisgw3.law.pace.edu/cases/920922g1.html>>. See also Germany 26 November 1999 *Hanseatisches Oberlandesgericht* [Appellate Court] Hamburg, 1 U 31/99, CLOUT Abstract No. 348, available online at <<http://cisgw3.law.pace.edu/cases/991126g1.html>> where the court ruled for a preference of Art. 75 over Art. 76 damages in cases where either could conceivably be claimed.

<sup>16</sup> Parties will fail to meet this requirement if courts deem a pursuant transaction to be a substitute one; see Germany 26 November 1999 *Hanseatisches Oberlandesgericht* [Appellate Court] Hamburg, available online at <<http://cisgw3.law.pace.edu/cases/991126g1.html>>.

<sup>17</sup> See Peter Schlechtriem, *Uniform Sales Law: the UN Convention on Contracts for the International Sale of Goods* (Vienna: Manz 1986) pp. 97-8, available online at <<http://cisgw3.law.pace.edu/cisg/biblio/schlechtriem.html>>.

<sup>18</sup> Plaintiff carries onus of proof as to all the constituents of the claim for damages. In the context of Art. 76 see Germany 2 September 1998 *Oberlandesgericht* [Appellate Court] Celle, 3 U 246/97, available online at <<http://cisgw3.law.pace.edu/cases/980902g1.html>>.

<sup>19</sup> See China 18 April 1991 CIETAC-Shenzhen Arbitration, available online at <<http://cisgw3.law.pace.edu/cases/910418c1.html>>. The tribunal rejected steel prices published in a trade journal as a basis for Art. 76 damages, even though the aggrieved buyer had them adjusted from US prices to Chinese prices; the tribunal ruled that no dependable formula for adjusting the price from a foreign market was available, and that under an POB (Chinese port) contract, a local price could and should be used. The current price damages were thus determined according to a price negotiated in the context of a substitute transaction that was not ultimately concluded whose details were similar to the original contract and were presented to the court without a specific claim of representing a “market price.”

<sup>20</sup> See CISG Art. 7, PECL Art. 1:201.

<sup>21</sup> For the close relation between an actual substitute transaction and an “imagined” one in the context of internalizing shipment to/from other regions as well as other factors that require

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adjusting the imagined transaction to a real one *see* CIETAC-Shenzhen Arbitration case, *supra* note 19.

<sup>22</sup> *See* CISG Art. 49, 64.

<sup>23</sup> *See* Lookofsky and Bernstein, p. 102 f141; *also* B. Audit, *La vente internationale de marchandises*, Paris: LGDJ, 1990, p. 178; *also* Burghard Piltz, *Internationales Kaufrecht*, München 1993, § 5 Rd.Nr. 439.

<sup>24</sup> *See* CISG Art. 49(2), PECL Arts. 9:303(2) and (3)(a). *See* commentaries on CISG Arts. 46 and 64. Some legal systems insist on shorter times for declarations of avoidance or rescission, such as the German “*unverzüglich*,” “without undue delay”, BGB §121 (controlling all acts of rescission, including HGB §377) or the French “*interpellation suffisante*” prevalent in the Code Civil. German courts acknowledged a discrepancy between the two criteria, even when the facts satisfied both; *see*

17 September 1991 *Oberlandesgericht* Frankfurt ,5 U 164/90, available online at <http://cisgw3.law.pace.edu/cases/910917g1.html> (in which a one-day delay in sending an avoidance telex was judged both reasonable and *unverzüglich*);

22 August 2002 *Landgericht* Freiburg, 8 O 75/02, available online at <http://cisgw3.law.pace.edu/cases/020822g1.html> (in which an Italian buyer of a used car was allowed to avoid the contract as late as three months after she discovered the car was previously stolen and title cannot be transferred; the court accepted the time as pertinent to the various inspections required).