THE RECOVERY OF LOST PROFITS UNDER ARTICLE 74 OF THE U.N. CONVENTION ON THE INTERNATIONAL SALE OF GOODS

An analysis of court and arbitral decisions to determine possible causes of non-conformity and to identify solutions that would increase the consistency of awards

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1. INTRODUCTION

The ability to obtain damages for losses suffered in the course of trade is a critical and necessary requirement for parties to be willing to engage in commerce. Without legal recourse for losses as a consequence of other parties' non-performance, the incentive to participate in trade is greatly diminished. International commerce is hampered to the extent that parties from different countries risk trading under foreign laws that might not offer comparable protection. The availability of relief for a breach of contract accords with economic efficiency in a free enterprise economy.[1] The U.N. Convention on the International Sale of Goods (CISG) was created in 1980 to codify and harmonize a legal framework aimed at encouraging and facilitating international trade. An important feature of the CISG is Article 74, which provides a guide for the recovery of foreseeable losses, including lost profits, as a consequence of a party's breach of contract.[2] This right to obtain damages is a primary mechanism of the CISG remedial scheme.[3] This paper will examine the recovery of lost profits under Article 74 CISG and discuss the practical issues that tribunals and parties face when evaluating a lost profit claim. Decisions concerning the recovery of lost profits under the CISG have been criticized as lacking uniformity due to problems in interpreting Article 74 CISG, differences in domestic evidentiary standards, use or non-use of general principles of international law, arbitrator discretion, and difficulties in the actual calculation of lost profits.[4] A discussion of these issues will attempt to shed light on the problems and determine if there is a lack of uniformity, and if so, what steps can be taken to increase the consistency of awards.

2. THE PURPOSE AND LIMITATIONS OF ARTICLE 74 CISG

Article 74 CISG states that an aggrieved party may recover foreseeable damages equal to the loss, including loss of profit, suffered as a consequence of the breach.[5] The article is meant to put an

[1] *See* E. Allan Farnsworth, *Damages and Specific Relief*, 27 AMERICAN JOURNAL OF COMPARATIVE LAW 247, 247 (1979).
[2] United Nations Convention on Contracts for the International Sale of Goods (1980) [CISG] Article 74: Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.
[3] *See* DJAKHONGIR SAIDOV, METHODS OF LIMITING DAMAGES UNDER THE VIENNA CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (2001), at 1.
[4] This paper will not discuss mitigation issues stemming from Article 77 CISG. The failure of an aggrieved party to mitigate possible lost profits would result in a reduction of a lost profit award; however this is secondary to the primary task of establishing whether lost profits actually occurred, and in what amount. The focus of this paper is on the difficulty in determining proof of lost profits and the discrepancies in lost profit awards, therefore the topic of mitigation will not be addressed.
[5] *See* CISG Article 74.

injured party in as good a position as if the contract had actually been performed.[6] In other words, a party should be entitled to receive the benefit of the bargain which had been contracted for.[7]

The second sentence of Article 74 CISG contains an important limitation on the recovery of possible losses, in that the loss must be foreseeable or ought to have been foreseeable.[8] This is a needed protection for the breaching party because losses can be extreme and unpredictable.[9] The concept of foreseeability is well known in common law jurisdictions from the 1854 English decision of *Hadley v. Baxendale*.[10] Civil law countries such as France also recognize the theory of foreseeability and limit damages to those which were foreseen or which could have been foreseen at the time of the contract.[11]

The test of foreseeability is essentially an objective standard, where the question is whether a reasonable person in the position of the promisor and with knowledge of the circumstances surrounding the conclusion of the contract, ought to have foreseen the possible losses at the time of the conclusion of the contract.[12] This important limit on the recovery of damages is to prevent compensating an injured party for losses that could not reasonably have been foreseen by the party in breach.[13] Article 74 CISG therefore has a dual purpose: to provide a mechanism for injured parties to obtain relief, and to only allow the recovery of foreseeable losses which gives merchants the ability to calculate and limit their contractual liability.[14]

The concept of foreseeability has its greatest impact on consequential losses, such as lost profits.[15] A seller would be liable for a buyer's lost profits on a resale of the goods only if the seller was aware or should have been aware of the resale.[16] However, as one scholar points out, even in the absence of positive indications of a resale, the seller is always aware of this possibility when tradable goods are sold to a merchant.[17]

3. LOST PROFITS

A loss of profit in the context of Article 74 CISG would be any increase in assets that the breach of contract prevented.[18] A loss suffered by a party is any costs and expenses incurred as a result of

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[6] *See* JOHN HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION (3d ed. 1999), at 444.
[7] *See* E. Allan Farnsworth, *Damages and Specific Relief*, 27 AMERICAN JOURNAL OF COMPARATIVE LAW 247, 247 (1979).
[8] *See* CISG Article 74.
[9] *See* JOHN HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION (3d ed. 1999), at 446.
[10] *Id.* at 446.
[11] *Id.* at 447.
[12] *See* SCHLECHTRIEM/SCHWENZER/Stoll/Gruber, COMMENTARY ON THE UN CONVENTION ON THE INTERNATIONAL SALE OF GOODS, 2d ed., Oxford, art. 74, at 765.
[13] *See* E. Allan Farnsworth, *Damages and Specific Relief*, 27 AMERICAN JOURNAL OF COMPARATIVE LAW 247, 247 (1979).
[14] *See* PETER SCHLECHTRIEM & INGEBORG SCHWENZER, COMMENTARY ON THE UN CONVENTION ON THE INTERNATIONAL SALE OF GOODS, 2d ed., Oxford, at 747.
[15] *Id.* at 767-68.
[16] *Id.*
[17] *Id.*
[18] *Id.* at 758.

the breach.[19] It is usually more difficult to prove a loss of profit than a loss suffered because of the typical speculation involved with lost profits in the hypothetical future or past.[20] Conversely, losses suffered can be established readily through paid invoices, receipts, or other types of bills.

Lost profits from the breach of a long term contract to supply goods can be particularly difficult to assess. The buyer might claim a loss on the resale of goods which the seller failed to deliver, but in the absence of orders for those goods it is difficult to state with precision that the alleged profits would have been earned.[21] However, if the buyer could present orders for the goods that were not delivered, the loss of profit could be established readily.[22]

The situation of a manufacturer buyer that needs goods for production of finished products presents an additional problem.[23] When a seller fails to supply goods and the manufacturer buyer is unable to complete the manufacturing process, the buyer will likely claim lost profits due to the inability to sell any finished goods. In this situation, what an aggrieved party will have to demonstrate is his or her ability to sell the goods at a profit.[24]

4. BURDEN OF PROOF

It is generally accepted that the burden of proving the extent of damages lies on the aggrieved party.[25] Although the CISG does not expressly set forth the distribution of the burden of proof, the party who has suffered the loss must prove that the loss occurred, the amount of the loss, and that the breach of contract caused the loss.[26] This becomes difficult in the absence of specific orders for goods or a precise calculation of expected profits. In order to discharge the burden of proof, an aggrieved party has to substantiate the amount of loss suffered in some manner.[27]

The situation where a party has failed to present proof of the exact extent of the losses presents a very difficult problem for tribunals, and there is divergence in the case law about the consequences.[28] For example, German and American courts may dismiss the claim under these circumstances, while Belgian and Swiss courts may award an estimated amount according to their belief of what is right, or *ex aequo et bono*.[29] The lack of uniformity in arbitral and court opinions

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[19] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 19 (2006).
[20] *Id.* at 17.
[21] *Id.*
[22] *Id.* at 19.
[23] *Id.* at 39.
[24] *Id.*
[25] *See* Sieg Eiselen, *Remarks on the Manner in which the UNIDROIT Principles of International Contracts May be used to Interpret or Supplement Article 74 CISG*, (October 2004), at ¶ s, *available at* http://www.cisg.law.pace.edu/cisg/principles/uni74.html.
[26] *See* PETER SCHLECHTRIEM & INGEBORG SCHWENZER, COMMENTARY ON THE UN CONVENTION ON THE INTERNATIONAL SALE OF GOODS, 2d ed., Oxford, at 771.
[27] *Id.* at 772.
[28] *See* Sieg Eiselen, *Remarks on the Manner in which the UNIDROIT Principles of International Contracts May be used to Interpret or Supplement Article 74 CISG*, (October 2004), at ¶ s, *available at* http://www.cisg.law.pace.edu/cisg/principles/uni74.html.
[29] *Id. Citing* Hof van Beroep Antwerp, 18 May 1999 (Belgium), *available at* http://cisgw3.law.pace.edu/cases/990518b1.html; Rechtbank van Koophandel Hasselt, 8 Oct. 1996 (Belgium), *available at* http://cisgw3.law.pace.edu/cases/961008b1.html; Handelsgericht Aargau, 26 September 1997 (Switzerland), *available at* http://cisgw3.law.pace.edu/cases/970926s1.html;

concerning the recovery of lost profits where precise evidence of losses is lacking has several causes. The following examination of the central issues involved in the divergence of the decisions will attempt to outline the problems and ascertain whether there is a possible solution.

5. STANDARDS OF PROOF FOR THE RECOVERY OF LOST PROFITS

As a preliminary issue, the standard of proving loss refers to how much proof needs to be shown and what degree of specificity should come from the evidence presented in order to prove the alleged loss.[30] Unfortunately for tribunals, courts, and merchants, the issue of standards for proving loss and determining damages in the international sale of goods has not received sufficient attention in legal discourse.[31] The lack of consensus and direction on what standards to apply may be due to the variability inherent in the determination of financial loss. One scholar points out that loss of profit involves guesswork in relation to future or hypothetical future events and depends on contingencies such as economic conditions, prices, and preferences of consumers.[32] The uncertainty from utilizing multiple variables in a financial calculation makes it nearly impossible to substantiate an amount of loss with absolute precision.[33] A uniform standard of proof to be applied by tribunals and courts in determining lost profits and damages could result in more consistent decisions.

Most legal systems have a requirement that damages claimed must be established with a level of certainty.[34] However, the requirements for recovering lost profits and the limitations on their recovery vary from country to country.[35] Therefore, the relevant question to be resolved in light of the contrasting domestic standards is how the issue of proving lost profits and damages should be determined under the CISG, and if a uniform standard can be implemented.[36]

A. The CISG and Standards of Proof

The CISG does not contain any express reference to certainty in Article 74. In addition, there is no mention of what degree of probability to apply when appraising whether a profit would have been made.[37] Several tribunals have indeed emphasized the point that the CISG is silent as to the

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Landgericht Düsseldorf, 5 March 1996 (Germany), *available at* http://cisgw3.law.pace.edu/cases/960305g1.html; Landgericht Hamburg, 17 June 1996 (Germany), *available at* http://cisgw3.law.pace.edu/cases/960617g1.html.

[30] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 6 (2006).

[31] *Id.* at 2.

[32] *Id.* at 7.

[33] *Id.*

[34] *See* DJAKHONGIR SAIDOV, METHODS OF LIMITING DAMAGES UNDER THE VIENNA CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (2001), at 27.

[35] *See* John Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEORGETOWN JOURNAL OF INTERNATIONAL LAW 61, 66 (2004).

[36] *See* Djakhongir Saidov, *Damages: The Need for Uniformity*, JOURNAL OF LAW AND COMMERCE (forthcoming), at 8.

[37] *See* PETER SCHLECHTRIEM & INGEBORG SCHWENZER, COMMENTARY ON THE UN CONVENTION ON THE INTERNATIONAL SALE OF GOODS, 2d ed., Oxford, at 759.

standard of proving loss.[38] These decisions, holding that the CISG does not provide guidance on the degree of certainty necessary for a judge to formulate a profit hypothesis illustrate an important point. The scholar Djakhongir Saidov states that these cases "highlight the issue of standards of proving losses and determining the amount of damages which has been a source of non-uniformity in the application of the Convention."[39] Thus, with the absence of a specific provision on determining lost profits under the CISG, one scholar states that a competent judge should be convinced that the profit would actually have been made had the contract been properly performed, before relief for this type of loss is granted.[40]

B. Standards of Proof from Procedural Law

Several tribunals and scholars suggest that because the CISG does not contain an express reference to any standard of proof for assessing lost profits, it is an issue beyond the scope of the CISG and the procedural law of the forum should apply.[41] Many cases have determined that the Convention determines the grounds for recovery, but domestic procedural law applies to the assessment of evidence of loss and how a judge should reach his or her opinion.[42] These decisions submit that the standard of proof for establishing lost profits is an evidentiary issue and one tribunal stated that the "law of evidence is determined by the lex fori, as the law of evidence belongs to the procedural law ... Therefore each court applies its own laws of evidence."[43]

The effect of this approach to the determination of lost profits has been to lose uniformity in decision-making through the variability in proof requirements from country to country.[44] The compensation for lost profits fluctuates as courts are likely to apply the standards contained in

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[38] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 7 (2006); *citing* Commercial Court Zurich, 10 Feb. 1999 (Switzerland), *available at* http://cisgw3.law.pace.edu/cases/990210s1.html; District Court Saane, 20 Feb. 1997 (Switzerland), *available at* http://cisgw3.law.pace.edu/cases/970220s1.html.

[39] Djakhongir Saidov, *Damages: The Need for Uniformity*, JOURNAL OF LAW AND COMMERCE (forthcoming), at 7.

[40] *See* PETER SCHLECHTRIEM & INGEBORG SCHWENZER, COMMENTARY ON THE UN CONVENTION ON THE INTERNATIONAL SALE OF GOODS, 2d ed., Oxford, at 759.

[41] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 47-48 (2006); *citing* JOSEPH LOOKOFSKY, CONSEQUENTIAL DAMAGES IN COMPARATIVE CONTEXT: FROM BREACH OF PROMISE TO MONETARY REMEDY IN THE AMERICAN, SCANDINAVIAN AND INTERNATIONAL LAW OF CONTRACTS AND SALES, Jurist-og Okonomforbundets Forlag, Copenhagen, 1989, at 283; Eric Schneider, *Consequential Damages in the International Sale of Goods: Analysis of Two Decisions*, *available at* http://www.cisg.law.pace.edu/cisg/wais/db/articles/schnedr2.html; District Court Sissach, 5 November 1998 (Switzerland), *available at* http://cisgw3.law.pace.edu/cases/981105s1.html; Commercial Court Zurich, 10 Feb. 1999 (Switzerland), *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/990210s1.html; Commercial Court St. Gallen, 3 December 2002 (Switzerland), *available at* http://cisgw3.law.pace.edu/cases/021203s1.html.

[42] *See The UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods*, 8 June 2004, *available at* http://www.cisg.law.pace.edu/cisg/text/digest-art-74.html; *citing* Bundesgericht, 15 Sept. 2000 (Switzerland), *available at* http://cisgw3.law.pace.edu/cases/000915s1.html; Bezirksgericht Saane, 20 Feb. 1997 (Switzerland), *available at* http://cisgw3.law.pace.edu/cases/970220s1.html; Helsingfors hovrätt Helsinki, 26 Oct. 2000 (Finland), *available at* http://cisgw3.law.pace.edu/cases/001026f5.html; Delchi Carrier v. Rotorex, Federal District Court (N.D.N.Y. 1994), *available at* http://cisgw3.law.pace.edu/cases/940909u1.html.

[43] Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 47-48 (2006); *citing* District Court Sissach, 5 November 1998 (Switzerland), *available at* http://cisgw3.law.pace.edu/cases/981105s1.html; Commercial Court Zurich, 10 Feb. 1999 (Switzerland), *available at* http://cisgw3.law.pace.edu/cases/990210s1.html; Commercial Court St. Gallen, 3 December 2002 (Switzerland), *available at* http://cisgw3.law.pace.edu/cases/021203s1.html; PETER SCHLECHTRIEM & INGEBORG SCHWENZER, COMMENTARY ON THE UN CONVENTION ON THE INTERNATIONAL SALE OF GOODS, 2d ed., Oxford, at 772.

[44] *See* John Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEORGETOWN JOURNAL OF INTERNATIONAL LAW 61, 86 (2004).

their national law on evidence.[45] This approach is employed by some tribunals because there is no precise formula to provide how much and what type of evidence must be presented to prove a loss with reasonable certainty.[46]

One may hypothesize that common law jurisdictions or civil law jurisdictions may have similar evidentiary standards leading to consistent awards in their respective realms, but this is not necessarily the case. For example, the Swiss Code of Obligations, Article 42, allows for the recovery of lost profits, but contains a strict standard of proof making it fairly difficult for a claimant to obtain damages.[47] Conversely, Belgian evidentiary standards only require that damages be certain in existence, not in amount.[48] Thus, depending on the national court, there may be a less than uniform application of the general damages rule when courts attempt to coordinate Convention conceptions with those of local law.[49]

C. Creating a Standard of Proof in the CISG

Some tribunals have resorted to a different approach than procedural law to determine what standard of proof is required to establish lost profits under Article 74 CISG.[50] These cases have referred to a level of proof to be determined by an exact, or precise, or specific ascertainment of damages.[51] However, the cases do not explain how the judges or arbitrators arrived at these standards, nor do they explain the meaning of these standards.[52] The cases have been criticized for the failure to demonstrate how the judgments were determined, because the CISG does not mention any of the standards used in the decisions.[53] Other cases have tried to add a standard of reasonableness or sufficient evidence to the CISG.[54] Again, at least one scholar has pointed out that the statements do not reference any legal standard which makes the decisions extremely difficult to analyze.[55]

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[45] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 66 (2006); JOSEPH LOOKOFSKY, UNDERSTANDING THE CISG IN THE USA (1995), at 79.
[46] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 16-17 (2006).
[47] *See* John Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEORGETOWN JOURNAL OF INTERNATIONAL LAW 61, 76 (2004).
[48] *Id.*
[49] *See* JOSEPH LOOKOFSKY, UNDERSTANDING THE CISG IN THE USA (1995), at 80.
[50] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 54-55 (2006); *citing* Appellate Court Celle, 2 Sept. 1998 (Germany), *available at* http://cisgw3.law.pace.edu/cases/980902g1.html; Appellate Court Koln, 21 May 1996 (Germany), *available at* http://cisgw3.law.pace.edu/cases/960521g1.html; District Court Munchen, 20 Feb. 2002 (Germany), *available at* http://cisgw3.law.pace.edu/cases/020220g1.html; ICC case No. 9187, June 1999, *available at* http://www.cisg-online.ch/cisg/urteile/705.htm.
[51] *Id.*
[52] *See* Djakhongir Saidov, *Damages: The Need for Uniformity*, JOURNAL OF LAW AND COMMERCE (forthcoming), at 7-8.
[53] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 56 (2006).
[54] *Id.* at 65; *citing* District Court of Kuopio, 5 Nov. 1996 (Finland), *available at* http://cisgw3.law.pace.edu/cases/961105f5.html; CIETAC Arbitration proceedings, 1995, *available at* http://www.unilex.info/case.cfm?pid=1&do=case&id=210&step=abstract; Tribunal de Commerce Namur, 15 Jan. 2002 (Belgium), *available at* http://cisgw3.law.pace.edu/cases/020115b1.html; District Court Gottingen, 20 Sept. 2002 (Germany), *available at* http://cisgw3.law.pace.edu/cases/020920g1.html; Appellate Court Hamburg, 5 Oct. 1998 (Germany), *available at* http://cisgw3.law.pace.edu/cases/981005g1.html.
[55] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 65 (2006).

However, if there is a general principle of reasonableness in the CISG, in can be argued that through Article 7(2) CISG, the principle of reasonableness can be utilized in the interpretation of Article 74 CISG.[56] If reasonableness is to be used in the interpretation of Article 74 CISG, then a claimant should be required to prove loss with only a degree of precision or certainty which can be reasonably expected.[57] Basically, a claimant would have to prove losses with a reasonable degree of certainty.[58] In the context of lost profit awards, the relevant question at this point would be whether arbitrators and judges from different legal regimes would have more consistent decisions using reasonableness as a uniform standard of proof. This would appear to be the motivation behind the use of reasonableness as a general principle of the CISG, and the analogous push to use the reasonableness standard found within the UNIDROIT Principles of Private International Law by virtue of Article 7(2) CISG.[59]

D. The Use of UNIDROIT Principles to Interpret Article 74 CISG

The use of UNIDROIT Principles in the interpretation of Article 74 CISG is arguably possible through Article 7(2) CISG. Article 7(2) CISG allows questions not addressed, or gaps in the CISG to be settled with the use of general principles from the CISG, or in the absence of such principles, private international law.[60] Article 7 encourages courts and tribunals to adopt solutions which take note of the international character of the Convention and would lead to uniformity in practice when interpreting the Convention and filling any gaps that exist.[61] If Article 74 CISG is silent on the issue of standards of proof to recover lost profits, the first step would be to try and identify a general principle to address the issue.[62] If no general principle is found, then an applicable rule of private international law can be used to assist in interpretation of the question.

1. A General Principle of the CISG May be Applied

One scholar submits that a general principle which may be relevant is that of reasonableness because of the pervasive use of the term in the CISG.[63] The scholar Albert Kritzer has pointed out that the term reasonableness is mentioned in no less than thirty-seven provisions of the CISG, thus it would appear justified as a general principle of the Convention.[64] The application of the

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[56] *See* Article 7(2) CISG: Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.

[57] *See* Djakhongir Saidov, *Damages: The Need for Uniformity*, JOURNAL OF LAW AND COMMERCE (forthcoming), at 9.

[58] *Id.*

[59] *See* Article 7(2) CISG: Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law. UNIDROIT Principles, if established as private international law, could be used to aid in the interpretation of CISG provisions.

[60] *Id.*

[61] *See* Sieg Eiselen, *Unresolved damages issues of the CISG: a comparative analysis*, 38 COMPARATIVE AND INTERNATIONAL LAW JOURNAL OF SOUTH AFRICA 32, 45 (2005/1).

[62] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 62-63 (2006).

[63] *Id.* at 70-71.

[64] *See* Albert Kritzer, Reasonableness Editorial Remarks. *Available at* http://www.cisg.law.pace.edu/cisg/text/ reason.html.

standard of reasonableness as a general principle will lead to the conclusion that losses need only be proved with a degree of precision that can reasonably be expected from the circumstances.[65] Under this interpretation, the scholar Djakhongir Saidov states that the standard becomes very similar to that fixed in the UNIDROIT Principles, where losses need to be proved with a "reasonable degree of certainty."[66]

2. *A Principle of Private International Law can be Used to Supplement the CISG*

To use the UNIDROIT Principles to assist in the interpretation of Article 74 CISG, there must be a question that is not expressly settled within the CISG.[67] Arguably, the question of what standard of proof should be used for the recovery of lost profits is not expressly addressed in Article 74 CISG.[68] The scholar Sieg Eiselen submits that a number of issues such as calculation of future damages and proof of damages have been left open or unresolved in the CISG.[69] Articles 7.4.1, 7.4.2, and 7.4.3, of the UNIDROIT Principles address the issues of damages and certainty of proof and can therefore be helpful in interpreting and applying Article 74 CISG.[70]

3. *The UNIDROIT Principles' Reasonable Certainty as a Standard of Proof*

The use of the reasonableness standard for determining the certainty required to establish lost profits can be carried out on the basis of the UNIDROIT Principle 7.4.3(1).[71] There is some controversy over the use of the UNIDROIT Principles, but there seems to be strong support for their use in a persuasive sense as rules which fulfill a modern international sales law.[72] One of the stated purposes of the UNIDROIT Principles is to help interpret or supplement international law instruments such as the CISG.[73] The CISG also contains provisions which allow the use of general

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[65] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 70-71 (2006).

[66] *Id. Citing* UNIDROIT Principle 7.4.3(1): Compensation is due only for harm, including future harm, that is established with a reasonable degree of certainty.

[67] *See* CISG Article 7(2).

[68] *See* Sieg Eiselen, *Remarks on the Manner in which the UNIDROIT Principles of International Contracts May be used to Interpret or Supplement Article 74 CISG*, (October 2004), at ¶ k, *available at* http://www.cisg.law.pace.edu/cisg/principles/uni74.html.

[69] *Id.*

[70] *Id.* at ¶ b. *See* UNIDROIT Principles 7.4.1 - Right to Damages: Any nonperformance gives the aggrieved party a right to damages either exclusively or in conjunction with any other remedies except where the nonperformance is excused under these Principles; 7.4.2 - Full Compensation: (1) The aggrieved party is entitled to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance of cost or harm, (2) Such harm may be nonpecuniary and includes, for instance, physical suffering or emotional distress; 7.4.3 - Certainty of Harm: (1) Compensation is due only for harm, including future harm, that is established with a reasonable degree of certainty, (2) Compensation may be due for the loss of a chance in proportion to the probability of its occurrence, (3) Where the amount of damages cannot be established with a sufficient degree of certainty, the assessment is at the discretion of the court.

[71] *See* DJAKHONGIR SAIDOV, METHODS OF LIMITING DAMAGES UNDER THE VIENNA CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (2001), at 28.

[72] *See* Sieg Eiselen, *Unresolved damages issues of the CISG: a comparative analysis*, 38 COMPARATIVE AND INTERNATIONAL LAW JOURNAL OF SOUTH AFRICA 32, 34 (2005/1); *citing* BONELL, NEW APPROACH, at 12-13, *citing* Kritzer, *General Observations on Use of the UNIDROIT Principles to Help Interpret the CISG*, at 34.

[73] *See* DJAKHONGIR SAIDOV, METHODS OF LIMITING DAMAGES UNDER THE VIENNA CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (2001), at 28.

principles or private international law, such as the UNIDROIT Principles, where issues are within the Convention's scope, but not expressly settled in it.[74] One scholar also states that where the Principles address issues also covered by the CISG and follow solutions found in that Convention, the supranational committee of experts constituted to devise the UNIDROIT Principles can be regarded as a council of "wise men [and women]" whose views can help us interpret the CISG.[75] Thus, there is no prohibition on the use of UNIDROIT Principles to assist in interpreting an issue within the CISG if the CISG is silent on that issue.

Other practical support for the use of UNIDROIT Principles in the interpretation of the CISG can be found in actual trade data. The top ten international importers and exporters of goods, constituting over 50% of the world's trade, are all signatories to the CISG and all but 2 countries are members of UNIDROIT.[76] This would imply that use of the UNIDROIT Principles to aid in the explanation of CISG provisions would not be unreasonable, unpredictable, or even unexpected for the dominant international trading countries.

Use of the UNIDROIT Principles to help interpret Article 74 CISG could aid tribunals and courts to arrive at more consistent decisions concerning proof of lost profits. UNIDROIT Principle 7.4.3 directly addresses the issue of certainty of harm.[77] Use of UNIDROIT Principle 7.4.3(1) to assist in the selection of a standard of proof for Article 74 CISG would result in a requirement that lost profits be established or proven with a reasonable degree of certainty.[78] Use of this single standard for the level of certainty required to establish lost profits could lead to less arbitrary determinations than using variable standards based on domestic procedural law. Thus, accepting a uniform standard to prove loss and the amount of damages is more likely to lead to a greater degree of consistency than if the matter was dealt with on the basis of applicable legal systems, each potentially containing a different standard.[79] The critical issue with the use of UNIDROIT Principles is that the majority of tribunals and courts would have to utilize the Principles voluntarily and eliminate the use of domestic standards of proof to achieve any tangible consistency in lost profit decisions.

E. Ex Aequo et Bono Awards

Some tribunals and courts have based their awards on the concept of *ex aequo et bono*, or according to what is just and good.[80] These decisions have contributed to the lack of uniformity in lost profit decisions. In these cases, although a party failed to prove the amount of the loss or expenses that

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[74] *Id.*

[75] *See* comments of Michael Joachim Bonell, at 1. *Available at* http://cisgw3.law.pace.edu/cisg/text/matchup/ general-observations.html.

[76] *See* World Trade Organization 2004 Data, *available at* http://www.wto.org/English/res_e/statis_e/its2005_e/section1_e/i05.xls; *see also* UNIDROIT Members, *available at* http://www.unidroit.org/English/members/main.htm; CISG Members, *available at* http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html.

[77] *See* UNIDROIT Principle 7.4.3(1): Compensation is due only for harm, including future harm, that is established with a reasonable degree of certainty.

[78] *See* Sieg Eiselen, *Unresolved damages issues of the CISG: a comparative analysis*, 38 COMPARATIVE AND INTERNATIONAL LAW JOURNAL OF SOUTH AFRICA 32, 37-38 (2005/1).

[79] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 69 (2006).

[80] *See* Djakhongir Saidov, *Damages: The Need for Uniformity*, JOURNAL OF LAW AND COMMERCE (forthcoming), at 8.

had been incurred due to the breach of contract, the court believed a loss had occurred and awarded damages.[81] The scholar John Gotanda points out that some judges in civil law countries often base their award on "intuition and justice" and that "awards are not accompanied by discursive explanations, and theoretical basis thus is difficult to determine."[82]

The practice of allowing damages to be assessed at a court's or tribunal's discretion in the absence of the required degree of certainty reflects a concern for the Claimant.[83] One scholar refers to this process as a further continuation of the policy of disfavor of an all or nothing approach to the award of damages.[84] However, while benefiting an injured party that does not have adequate evidence of the loss suffered, it also creates an extremely difficult situation for potentially defaulting parties to calculate the amount of liability they may be exposed to.[85] The justification for this practice in aiding Claimants without sufficient evidence of lost profits must be weighed against the lack of good faith in assessing awards against Respondents that have essentially won their case on an evidentiary basis.

The result of *ex aequo et bono* decisions is to create more discrepancies and non-uniformity in cases concerning the recovery of lost profits. While arbitral discretion is an important tool in the hands of tribunals, it does contribute to the lack of consistency in damage awards in some cases.

F. Summary of the Issues with Standards of Proof and Recovery of Lost Profits

The issues involved with the standard of proof for establishing and recovering lost profits are complex. Interpreting Article 74 CISG consistently is unlikely to occur without substantive changes to the CISG provision or specific guidance on how Article 74 should be interpreted. The dispute over whether the CISG is silent on the evidentiary burden, allowing reliance on domestic evidentiary rules or supplementation with the UNIDROIT Principles contributes to the lack of uniformity. The creation of unexplained standards within the CISG and *ex aequo et bono* awards are additional sources of inconsistency. However, one scholar submits that the lack of harmonization concerning standards of proof for lost profits is not an area of concern, but rather the calculation of lost profits that is in need of consistency and uniformity.[86]

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[81] *Id. Citing* Oberlandesgeright Köln, 21 May 1996 (Germany), *available at* http://cisgw3.law.pace.edu/cases/960521g1.html; ICC case No. 9187, June 1999, *available at* http://www.cisg-online.ch/cisg/urteile/705.htm; Landgericht Göttingen, 20 Sept. 2002 (Germany), *available at* http://cisgw3.law.pace.edu/cases/020920g1.html; Landgericht München, 20 Feb. 2002 (Germany), *available at* http://cisgw3.law.pace.edu/cases/020220g1.html.

[82] John Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEORGETOWN JOURNAL OF INTERNATIONAL LAW 61, 77 (2004).

[83] *See* Djakhongir Saidov, *Standards of Proving Loss and Determining the Amount of Damages*, 22 JOURNAL OF CONTRACT LAW 1, 73-74 (2006).

[84] *Id.*

[85] *Id.* at 75-76.

[86] *See* John Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEORGETOWN JOURNAL OF INTERNATIONAL LAW 61, 87 (2004).

6. CALCULATION OF LOST PROFITS IS THE REAL ISSUE IN THE NON-UNIFORMITY OF DECISIONS

In the opinion of the scholar John Gotanda, tribunals have not had trouble determining whether a claimant is entitled to lost profits.[87] The cause of the seemingly arbitrary awards is due to the complex process of calculating the lost profits.[88] The discrepancies in national laws over the requirements and limitations of evidentiary standards are not problematic and the lack of national guidance on calculation of profits is the real issue.[89] Indeed, Professor Gotanda states that the fact that awards of lost profits by tribunals deciding transnational contract disputes seem to vary greatly is not in-and-of-itself a cause for concern.[90]

Claims for lost profits raise arguably the most complicated issues for tribunals deciding international contract issues.[91] This is due to the process of calculating lost profits; where tribunals must select a process from a number of calculation methods, examine financial data, and then apply projections where a small change in a variable can produce large swings in the amount of an award.[92] This task may produce awards of lost profits that often seem inconsistent or arbitrary, but "[S]uch a computation made in advance on the basis of purely theoretical data cannot hope to be absolutely accurate but only comparatively likely."[93] Therefore, the lack of uniformity in lost profit awards can be attributed to the fact that tribunals must proceed in the complex calculation of lost profits without any universal rules and with only the knowledge available at the time of the hearing.[94]

A. The Lack of Universal Rules for the Calculation of Lost Profits

The most difficult cases for tribunals to determine lost profits involve the breach of a long term contract.[95] This is because of the speculative projections of future earnings that may be greatly affected by changing and unpredictable economic conditions.[96] Interest rates, energy prices, and raw material costs all contribute to the complex process of forecasting the financial data necessary for the calculation of long term lost profits. For example, a buyer that enters into a long term contract with a seller for goods to be distributed on a national scale might incur lost profits if the seller fails to deliver the goods. The amount of lost profits will depend on current and future market share, current and future competition, future consumer purchasing habits, economic trends, future energy costs, and future transportation costs, among a multitude of other variables.

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[87] *Id.*
[88] *Id.*
[89] *Id.* at 99.
[90] *Id.*
[91] *Id.* at 61.
[92] *Id.*
[93] *Id. Quoting* Himpurna Cal. Energy Ltd. v. PT. (Persero) Perusahaan Listruik Negara, Final Award of 4 May 1999, 25 Y.B. COM. ARB. 13, 102-103 (2000).
[94] *See* John Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEORGETOWN JOURNAL OF INTERNATIONAL LAW 61, 62 (2004); Sieg Eiselen, *Unresolved damages issues of the CISG: a comparative analysis*, 38 COMPARATIVE AND INTERNATIONAL LAW JOURNAL OF SOUTH AFRICA 32, 40 (2005/1).
[95] *See* John Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEORGETOWN JOURNAL OF INTERNATIONAL LAW 61, 89 (2004).
[96] *Id.*

The obvious difficulty in calculating a precise amount of lost profits while taking these variables under consideration forms the essence of the problems facing tribunals and courts.

In addition, the inclusion of mitigation responsibility for an aggrieved party under Article 77 CISG may impact a tribunal's decision. In ICC Final Award in Case No. 5946, lost profits were awarded for the duration of a forty month contract.[97] Conversely, ICC Final Award in Case No. 7006 only included the lost profits from one year of a long term contract under the determination that the Claimant could have mitigated the losses after that year.[98]

An additional concern in the calculation of lost profits is how to calculate future cash flows to reflect the current loss. The generally accepted way for parties and tribunals to determine an award of future lost profits due to a breach of contract is the discounted cash flow (DCF) method.[99] This method utilizes a discount rate to apply to the award of future profits to determine the amount in present day dollars. The problem with the DCF method is that it is difficult to apply in practice.[100] Not only is the determination of future cash flows dependent on estimations and future predictions, but selection of a discount rate is also a complex calculation dependent on any number of historical, current, and future financial variables.

B. Estimation and Variability in Financial Claims is Normal

The use of DCF to calculate lost profits is a complicated process that contributes to the lack of uniformity in lost profit awards. However, businesses and financial institutions perform DCF calculations as part of normal business practice and operations. The variance in possible outcomes using the method is not a cause for concern and simply reflects the attempt to quantify an amount that is dependent on unpredictable variables.[101] One tribunal summed up the process with the following:

> There is no reason to apologise for the fact that [the approach used to calculate lost profits, in this case the DCF method,] involves approximations; they are inherent and inevitable. Nor can it be criticised as unrealistic or unbusinesslike; it is precisely how business executives must, and do, proceed when they evaluate a going concern. The fact that they use ranges and estimates does not imply abandonment of the discipline of economic analysis; nor, when adopted by the arbitrators, does this method imply abandonment of the discipline of assessing the evidence before them.[102]

Thus, the most common method of calculating lost profits, the DCF method, contributes to the apparent discrepancies and arbitrariness of lost profit awards. However, the ability to forecast long

[97] *Id.* at 92.
[98] *Id.*
[99] *Id.* at 89.
[100] *Id.* at 90-91.
[101] *Id.* at 99.
[102] *Id. Quoting* Himpurna Cal. Energy Ltd. v. PT. (Persero) Perusahaan Listruik Negara, reprinted in 25 Y.B. COM. ARB. 13, 102-03 (Berm.-Indon. 2000).

term lost profits in the absence of perfect foresight requires some calculation techniques that will not be completely accurate. The use of DCF with its inherent weaknesses should be continued with the following suggestions for improvement in the next section of this paper.

7. POSSIBLE SOLUTIONS

A. How to Achieve a More Consistent Standard of Proof for Lost Profits

What standard of proof is required to establish lost profits is an undecided question. Tribunals and courts have divergent opinions on what standards are within the CISG, whether recourse to procedural law of the *lex fori* is appropriate, or to utilize Article 7(2) CISG and apply general principles within the CISG or from private international law such as UNIDROIT. The inconsistency in awards of lost profits can be readily traced to these different approaches to the issue.

One solution proposed by a scholar would be to develop a body of judge-made international rules, a *lex mercatoria*.[103] He suggests that this method would support a uniform interpretation for lost profit standards of proof and recovery within the CISG regime.[104] The lex mercatoria rule could supplement Article 74 CISG in a manner similar to §351(3) of the Restatement 2d of Contracts.[105] This concept is familiar in the common law as a form of *stare decisis*, where previous decisions by courts or tribunals are followed as precedent rather than reinventing the wheel with every new case. However, the concept of a lex mercatoria as providing a precedent for numerous domestic forums would likely face resistance in civil law jurisdictions, where *stare decisis* is not the norm. But given the confusion and diversity of approaches in determining what standard should be applied to proof of lost profits, the concept of a *lex mercatoria* for damages might warrant its application in some fashion.

B. How to Improve the Calculation of Lost Profit Awards

The scholar John Gotanda has submitted that the discrepancies in lost profit awards are not a cause for concern, but rather the lack of uniform rules for the calculation of lost profits.[106] The general calculation method, DCF, has inherent flaws which contribute to divergent opinions on the amount of possible awards.[107] However, he suggests that the DCF method is structurally sound and grounded in economic theory and practice: any steps to improve consistency in arbitral awards should concentrate on its application.[108]

[103] *See* JOSEPH LOOKOFSKY, UNDERSTANDING THE CISG IN THE USA (1995), at 80, n. 113.
[104] *Id.* at 80.
[105] *Id. Referencing* Restatement 2d of Contracts §351(3): designed to prevent compensation for "disproportionate (albeit foreseeable) loss."
[106] *See* John Gotanda, *Recovering Lost Profits in International Disputes*, 36 GEORGETOWN JOURNAL OF INTERNATIONAL LAW 61, 87 (2004).
[107] *Id.* at 89, 90-91.
[108] *Id.* at 109, 109-110.

The first method to improve lost profit calculations would be to employ experts to assist in evaluating claims.[109] The use of experts may help tribunals and parties better understand the complexities involved in calculating lost profits and lead to more consistent and reasoned decisions.[110] The drawback from the use of experts would be the increased cost of arbitration and an increase in the time necessary to resolve disputes.[111] These possible drawbacks can likely be overcome by the benefit of an expert's skill when substantial sums are at risk.[112] The use of experts should not face resistance from parties and tribunals other than in the additional costs it would entail. Any party involved in a dispute with a sizeable claim of lost profits should seriously consider the use of experts to assist in the calculation process.

A second method that would lead to more uniformity in decisions concerning the calculation of lost profits would be to employ final offer arbitration, utilized in baseball contract negotiations.[113] Final offer arbitration calls for the parties to propose an amount that the respective sides should be entitled to and the tribunal then chooses between the two totals.[114] The advantage of this form of arbitration is that it forces the parties to be more reasonable in their positions and to be more realistic with their calculations.[115] Theoretically, this should lead to a narrowing of the gap between the amount of lost profits submitted by a Claimant and the amount of lost profits a Respondent believes it owes.[116] Final offer arbitration has great potential as a tool to increase the uniformity of lost profit awards. By increasing the risk to parties for submitting overly speculative claims, lost profit awards should become more consistent and reasonable.

The final technique suggested by John Gotanda to assist in calculating lost profits is to contractually stipulate how to calculate the losses.[117] The inclusion of contractual terms for resolving various issues that inevitably arise during disputes is logical and reasonable. Realistically, the insertion of terms becomes an issue of practicality, where parties engaged in commerce often do not stipulate many potential terms due to time constraints. However, merchants or companies that conclude large and substantial contracts should probably include some terms concerning lost profit calculations as a measure to limit financial exposure.

8. CONCLUSION

The lack of consistency in lost profit awards can be attributed to the divergent opinions on what standard of proof to use for establishing lost profits. While one scholar submits that tribunals do not have difficulty in determining a standard of proof to assess evidence, the various approaches to the issue demonstrate a lack of consensus. It is hard to imagine that utilizing evidentiary standards of the *lex fori*, UNIDROIT Principles, and arbitrator discretion all result in uniform

[109] *Id.* 109-110.
[110] *Id.*
[111] *Id.*
[112] *Id.*
[113] *Id.* at 109.
[114] *Id.*
[115] *Id.*
[116] *Id.*
[117] *Id.*

decisions. The use of a single standard, possibly the UNIDROIT Principle of reasonableness, would likely lead to more consistent results.

The difficulties in the calculation of lost profits, described by John Gotanda, also contribute to the arbitrariness of damage awards. The DCF method is a suitable process to determine calculations of long term profits. The suggestion of using final offer arbitration and experts to assist parties and tribunals in assessing and determining lost profit claims could lead to more uniform decisions and warrants further research.