THESIS

Development of the Contractual Remedies in the International Trade: Comparative Analysis and Example of Implementation in Standard Construction Contracts

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**Abstract**

This study investigates the nature and economic effects of the contractual remedies and their role and specifics of application in the contemporary international trade, demonstrated on the example of standard construction contracts. Various remedies are examined within several legal orders across Civil and Common law traditions from the position of their convergence and utilization in the international contracting. Main focus of the research is on the economic efficiency of the contractual remedies as elements of integrated system, flexible and adjustable due to changes (internal and external to the parties’) in the circumstances after conclusion of the contract. Purpose of the study is to analyze possibilities for further harmonization of the contractual remedies’ regulation and adoption of their more efficient forms, developed within different jurisdictions and soft law codifications. These improved forms, as discussed in the work, are capable of enhancing economic efficiency of individual remedies and their productive incorporation in a cohesive remedial system, enabling contractual parties to divide various interests inside one contract and vary levels of their respective protection, exploiting suitable function of each remedy.

First part is dedicated to studying definition of remedy, its functions and approach to it, developed within various contractual theories; it also briefly examines general differences between Common and Civil law systems, explaining dissimilarities in formation of remedies in various legal orders. In the second part I analyze specifics of each remedy in respective jurisdictions, including analysis of local statutory and case law, considering laws of France, Germany, UK, USA, and Finland and international codifications, underlying economic effects and drawbacks of every remedy. Remedies in question are: specific performance; damages’ compensation; termination of contract; liquidated damages and penalty; price reduction and performance withholding.

Third chapter is devoted to history of development of the construction contract, combining elements of sale and service; application of each remedy in the standard construction contracts in their dynamic system and methods of improving economic efficiency.

The research concludes that each remedy may simultaneously have various functions (preventive, restorative and corrective) regardless of compensatory or non-compensatory criterion, which currently becomes irrelevant. Remedial system adopted in the contract should be flexible and easy adjustable to the changes in the post-contractual circumstances. Following the ongoing process of normative convergence various legal orders should be harmonized; they should recognize autonomy of the parties to create own enforceable hierarchy of remedies within the contract and should ensure judicial intervention solely from the angle of safeguarding just and fair outcome. Study further determines that measures of enhancing economic efficiency of each remedy have been already developed in the practice and only need recognition and change of attitude in the respective national systems, widening perspectives of interpretation and qualification.

**Avainsanat – Nyckelord – Keywords**

International Contract; Remedy; Specific Performance; Damages; Termination; Liquidated Damages; Penalty; Withholding; Price Reduction; Economic Efficiency; Comparative Study; Standard Construction Contracts

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**Muita tietoja – Övriga uppgifter – Additional information**

135 (without bibliography)
List of Abbreviations

Art. – Article
BGB – German Civil Code
B2B – “business-to-business”, refers to relationship between two commercial entities
FCC – French Civil Code
FIDIC – Conditions of Contract for EPC/Turnkey Projects (“Silver Book”), issued by the International Federation of Consulting Engineers (1999).”
FSGC – Finnish Sale of Goods Act
LD – Liquidated damages
LL – Limitation of liability
NLM 02E – General Conditions for the Supply and Erection of Machinery and other Mechanical, Electrical and Electronic Equipment (2002)
Prof. – Professor
Sec. – Section
UCC – Uniform Commercial Code of the USA
UK – United Kingdom of Great Britain and Ireland (refers to law and legal system of England in particular)
US – United States of America (refers to law and legal system of the USA)
v. – Versus
VOB/B – German standard of construction contract procedures (2012)
YSE 98 – Finnish General Conditions for Building Contracts YSE 1998 (RT 16-10660)
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1. Introduction

1.1. General Statement and Background

This study investigates co-relation between legal doctrine of remedies and their practical application in most influential Western jurisdictions and international codifications in the context of current demands of international trade and suggests possible adjustments to the theory, satisfying existing economic needs.

The contract is an expression of voluntary agreement between the parties (two or more), sometimes called promise, with purpose of establishing legal obligation (rights and responsibilities) entered in written or oral form 1. Every legal order has own requirements to formation of the contract, offer and acceptance, which confirm the fact of conclusion of the mutual agreement. Contract law largely varies from jurisdiction to jurisdiction due to historical development in different local traditions and micro-economies. In response to contractual breach each state has developed own structure of remedies and enforcement procedure. This creates national borders to the worldwide trade. In the “era of industrial, economic and social expansion” 2 and world globalization occasional legal transplants no longer adequately protect conflicting social interests. Over 100 years ago it was noticed, “moral stigma to law violation has been… eradicated” 3. Legal theory has to adjust to the present social and economic realm in order to produce satisfactory results in serving overall progress.

In general contract law in Western jurisdictions is rooted in or otherwise influenced by the Roman law and derives from the principle pacta sunt servanda. Traditionally remedies, both statutory and contractual 4, played economic function of altering behavior of the party 5 to contract in order to ensure its performance, which was required irrespective of changes in subjective or objective circumstances. In order to preclude breach of moral promise the remedy of specific performance has been developed. Same deterrence

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3 Id., supra note 2.
5 In this work term “party” is used in relation to both parties of the bilateral obligation; terms “aggrieved party”, “non-breaching party”, “obligee”, “promisee”, “creditor” and similar are used as synonyms unless otherwise follows from the context; terms “breaching party”, “obligor”, “promisor”, “debtor” and similar are used as synonyms unless otherwise follows from the context; terms “seller” (“provider” and similar) and “buyer” (“purchaser”, “client” and similar) may be used in relation to either creditor or debtor depending on the context.
principle promotes punitive remedies, e.g. penalty, playing role of legal sanctions against the party in breach. Such remedies form group of so-called non-compensatory remedies.

Further development and growth of the market economy, enhanced progress of financial and legal theories, enhanced discussion of the non-performance or breach of a contract due to changes in economic or factual situation, when obliged party realizes that “the performance he will receive under the contract is no longer more valuable than the performance he must provide”\(^6\), so called by Goetz and Scott “regret contingency”\(^7\). Economic theory proposed that the contract should require performance unless non-performance (breach) would result in “greater joint wealth”\(^8\). Doctrine of “efficient breach” suggested that damages should be reasonable and sufficient alternative of due performance, able to compensate for the loss caused by the breach\(^9\). Hence the remedy became a substitute to the failed performance and gained compensatory function.

1.2. Statement of the Problem

The area of remedies is one of those in legal science, which are deeply grounded in the socio-economical motives. Ideally remedies should be shaped in a process where legal science provides form for the economical content; in response to social request correct formulation of the legal remedial terms should provide desirable economic impact on the business. Nevertheless legal science is not solely driven by economical mechanisms and incentives; major principles of law are historically based on moral and ethical doctrines and values. Law is a product of society and is intended to serve its good. Therefore products of legal science should be developed and studied in their integrity an interrelation with the economic and social prerequisites, and altered when required.

There is no unity and ultimate clarity between different views in the contemporary legal science on the nature of the contractual remedies and their functions. Plurality of views and difference in the approaches may be explained by adhering to postulates of

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different legal theories on contract and its role in the process of exchange and consumption. Apart from the academic disputes, enhanced complexity of international trade, elimination of borders in the world economy, processes of legal unification and harmonization require practical solutions implemented in the contractual terms, equal protection to the parties irrespective of the governing substantive law and procedural rules. Preference for either compensatory or non-compensatory remedies no longer serves needs of contemporary contract law or economic efficiency.

In the international commercial law remedies present an outstanding example of foundation created by virtue of legal transplantation, influenced by various legal orders, academic doctrines, and court precedents. Simultaneously remedies are significantly affected by tensions and contradictions persisting between legal systems. Hence the whole purpose of the remedies, serving protection of the contracting parties, may be hindered if the agreement incorporates system of remedies, which may not be fully enforced under governing law.

Traditional comparativistic studies elaborate on numerous differences and contradictions between similar remedies in different jurisdictions, preventing their productive utilization and creating impression of antagonistic collision. In this work I follow modern approach that focuses on finding zones of convergence between legal orders and remedies developed within, basis for further harmonization of remedial regime across jurisdictions and possible option of the productive utilization in the international contract.

1.3. Purpose of the Study

The purpose of this work is to explore potential for comprehensive and harmonized system of remedies across jurisdictions to benefit modern international contract. This purpose is achieved through understanding the nature and scope of remedies, available in the major Western legal orders, from the position of their resemblances and convergence. For the purpose of this work I only consider contractual liability expressed in the remedies, negotiated and implemented by the contracting parties, but not tort liability, in particular not product liability issues, which have separate mandatory regulation. In most of considered jurisdictions commercial liability is strict and does not depend on fault of the breaching party (intention, negligence, mistake), therefore reference to the liability grounds is made only when respective system specifies them, such as fault-base liability (Germany) or control-base liability (Finland). Judging general effects of respective legal order upon
contractual non-performance I make assumptions for alternative solutions, which may adjust existing disadvantages and improve status of contracting parties, if adopted in the legal theory and implemented in the contract. Necessity of such adjustment is presented in the current work as a part of legal science evolution and natural progress, which is supported by prospective analysis of historical development of both academic science and legal precedent in each considered jurisdiction.

All remedies are considered herein as integral elements in the systemic context, performing respective functions in restoration of justice and fairness. Each remedy is inspected from the angle of its economic effects, benefits and disadvantages for the contracting parties, or, in other words, “economic efficiency”. Additionally every remedy is evaluated in terms of its exclusive application or ability for cumulating with others, as well as from the position of freedom of choice or place in the hierarchy of remedies. Elements and functions of the research objects are considered in the historical continuum of their development in theory and court practice and compared to other legal orders and within successful attempts of European unification and international harmonization. Based on this analysis I propose possible ways of overcoming existing flaws in legal science and respective adjustments in the international contracts.

Effective utilization of the whole spectrum of remedies is demonstrated on the example of the standard construction contracts, intended both for international and domestic contracting. The latter are considered in conjunction of elements of sale of goods and provision of services with elaboration on respective outcome for the structure of available remedies.

I have selected construction contract standards as example for the carried our investigation due to the following reasons: 1) its complex nature, adopting elements of various contractual types, 2) its application to the long-term relationships, emphasizing context of the change in the parties’ circumstances, 3) its operation in the international environment, characterized by conflict of jurisdictions, 4) its codified nature, demonstrating integrity of elements from different legal systems and adopting them for the regulation of the same relationship.

Summarizing, the purpose of this study is not merely to understand how to avoid or cheat the law by creating contractual disguise for respective remedies and their application or to resolve the conflict of choice for the governing law of the negotiated contract. Main

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10 I refer to international codification example of Vienna Convention on Sale of Goods, 1980.
goal is to understand where in each respective legal system lays the area for convergence of the contractual remedies and how it can be used for further harmonization of the contract law in the universal and national format in order to benefit economy and society.

1.4. Research questions and methods

This work does not aim to provide detailed retrospective into historical background and specifics of each legal system or review all legal theories in the field of contractual remedies. This research is limited to general insight into the origins of each respective remedy, including both theoretical and practical aspects, as well as to rather broad overview of contract law essentials and principles in each respective legal order. Restrictions are made in order to understand which purpose each remedy is intended to serve and what place it occupies in respective jurisdiction. Investigation is focused on comprehension of nature of remedies, their economic and social benefits and flaws, options of implementation in the international contract and legal enforcement in case of contractual breach. Based on the received results I analyze compatibility and interrelation of remedies from various national laws, European unification and international codification, and attempt to offer adjustments in the current legal doctrine and international contract law, which would allow utilization of each remedy advantages and overcoming its drawbacks.

**Research questions** are:

1. What remedies are currently available under international contract;
2. How economic disadvantages of specific performance can be overcome;
3. Is termination of contract a remedy and how its economic efficiency can be enhanced;
4. What pitfalls compensation of damages may have and how they can be eliminated;
5. What is interrelation between penalty, liquidated damages, punitive damages and limitation of liability; and how efficiency of these remedies can be increased;
6. Is price reduction a functional remedy;
7. Is withholding a remedy and how it correlates with economic efficiency;
8. Shall construction contract be treated as sale of goods or performance of services; how qualification may affect remedial system;
9. Given all existing contradictions, is there a possibility to utilize all remedies and enhance their efficiency in one contract.
Methods of my research include general scientific methods and methods of legal research in particular:

i) induction, e.g. bringing specific evidence to the general conclusion-assumption that explicitly different remedies in opposite jurisdictions serve the same purpose and provide equal protection;

ii) deduction, e.g. forming a conclusion that even though generally accepted measure of damages is expectation, requirements set in practice for the establishment of the recoverable loss enforce the reliance measure instead;

iii) analysis of each respective remedy, its functions and place in the system;

iv) normative or legalistic, e.g. studying sources of law and court cases;

v) comparison of remedies in several legal systems and comparison remedies to each other;

vi) historical – following chronological development of the remedy within each policy and in time continuum in general;

vii) interpretation of terms and conditions of legal statutory and academic sources.

1.5. Structure and Sources

This work is divided into three main chapters, accompanied by introduction and final conclusion.

In the first chapter I provide definition of remedy, its functions and overview of contractual theories and general differences between Common and Civil law systems, explaining dissimilarities in formation of remedies in various legal orders. For this purpose I utilize legal dictionaries, articles on legal history, development of law and legal science in general, books and articles on legal theories of contract, law-and-economy studies, selected statutory acts and court cases. The chapter is followed by the intermediate conclusions in respect of definition and nature of remedy.

Second chapter is devoted to the specifics of each remedy in respective jurisdictions, including analysis of local statutory and case law. In the second chapter I also analyze economic effects and drawbacks of the remedy and illustrate its application in the international environment through the prism of European codification. My research is based on review and analysis of national Codes and statutory laws of France, Germany,
Finland, Great Britain, USA, international codifications in the area of contracts and sales; preparatory documents of legal reforms, official commentaries to the statutory law, extensive case law, legal statistics; articles and books regarding general studies of national legal systems and comparative legal studies; literature in respect of legal and economic analysis of each contractual remedy. Each subsection of the second chapter is followed by intermediate conclusions related to each reviewed remedy.

In the third chapter I study review history of development of the construction contract, combining elements of sale and service; application of each remedy in the standard construction contracts in their productive combination and ways of enhancing economic efficiency. This chapter is built on analysis of the international and national soft law codifications in the form of industrial standard contracts; articles and books on history and specifics of construction industry and construction contract standards in particular; interrelation between sales and services in the construction and application of the sales laws by default, respective case law; literature on application of each respective remedy in the context of construction contract, its role in the system of industry specific remedies as a whole, and particulars in the national and international environment. Third chapter is divided into two sub-chapters, each followed by intermediate conclusions.

11 For the purpose of this work provisions of Finnish law are considered in the chapters devoted to the analysis of the Civil law systems, nevertheless I have to mention that it is recognized fact that though Scandinavian/Nordic legal system was built on the principles of the Civil law, it gained certain specifics and current national laws include elements not pertinent to the Civil law order, for instance sales law include elements borrowed from Common law, as shown below.
2. CONTRACTUAL REMEDIES: DEFINITION AND NATURE

2.1. DEFINITION AND NATURE OF REMEDY

Origins of the word “remedy” can be found in Old French, Latin and Indo-European languages starting from the years 1175-1225 with the medical meaning of “cure”, “treatment”, “relieve” and “healing”\(^{12}\). Figurative use of the term begins approximately from the year 1300.

In legal science remedy is defined as a principle armored with different instruments to preserve the right, to prevent wrong and to counteract, as well as to correct and to rectify an evil/ fault/ error, and also to restore and to enforce good\(^{13}\). It is further considered as the “means to achieve justice in any matter in which legal rights are involved”\(^{14}\).

Remedy comprises an integral part of each right and is recognized as essential to the concept of “ordered liberty”\(^{15}\), enabling functioning of rule of law\(^{16}\). In other words remedies define exact value of abstract rights and enforce them\(^{17}\).

Legal remedy may have the following functions: preventive (protective), restorative and corrective, which can serve independently or be complementary to each other. But what is “right” or “wrong”, what shall be protected and how far the enforcement can go is defined by the particular legal order developed by science and practice.

Preventive function of the remedy is realized by virtue of rule of law or term of contract, providing for such remedy in case of breach; it is passive until the breaching action happens. Breach of right/obligation activates remedy. Corrective and restorative functions of remedy become vital through the legal enforcement, both private and public. Remedies may be granted under substantive/ material law (or contract) or procedural law (used to secure different stages of the court trial, e.g. extraordinary, provisional/ interim)\(^{18}\).


\(^{18}\) See for more on this issue Michael J. Cumberland, Separate, but Equal Treatment for Contract Damages,
There is no unity and clarity in the contemporary legal science between different views on the nature of the contractual remedies. Here is one example of the existing academic contradictions. On one side we have an opinion (Yehuda Adar, 2008) that in Anglo-American system remedy is principally defined as a legal response (action) to a “civil wrong” and the law of remedies intended to determine exact remedy (sole or cumulative) against respective group of civil wrongs, while in civil law system remedy is primarily understood as part of the obligation, “entitlement [right] arising out of the breach of an obligation (or duty) and taking the form of a burden [alternative duty] imposed on the person responsible for that breach”\(^{19}\). We can find opposite view (Ignacio Marín García, 2012), according to which these two legal traditions have distinctive concepts of contract liability: in common law remedy is just an alternative of the same obligation, while in civil law system remedy is effect from non-performance of obligation or sanction\(^{20}\). The confusion, probably, stems from mixing different contractual doctrines and their sources\(^{21}\) without giving proper consideration to the complexity of legal reality and the entire system of remedies. Study of single remedy outside of the systemic context will only render unfruitful debates and create further confusion, because things are not black-and-white in the modern legal science. Below we analyze that the traditional antagonistic contradictions between the compensatory and punitive functions of remedy have been ceasing, because they no longer satisfy needs of the modern diversified economy and trade. As Richard Craswell correctly noted, “to lawyers who think of remedies as protecting discrete, identifiable interests, the prospect of a continuum of remedies to choose from may seem odd. To economists who view remedies in instrumental terms, though, there is nothing at all odd about this”\(^{22}\).

Even though “no consensus has yet been attained as to the exact meaning and scope of the …basic concepts”\(^{23}\) of “remedy” and “law of remedies”, it is generally accepted that

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21 In §1201(1) USA UCC (version effective from 01.07.2013), sub-section (ff) defines “remedy” as any remedial right to which an aggrieved party is entitled with or without resort to a tribunal; in accordance with sub-section (hh) of the same section “right” includes remedy, http://www.michigan.gov/documents/entireuccbook_18831_7.pdf.
23 See Yehuda Adar, Gabriela Shalev, supra note 19, p. 4.
legal remedies are the measures of securing legal rights, *Ubi jus ibi remedium*24.

Undisputable that historically significant distinctions were developed in contract law in different legal orders25 (in our case most influential Common law and Civil law systems are considered), derived from the traditions, legal practice and academic science; many deviations could also be found between national legislations within the same legal tradition26. Nevertheless focusing on irreconcilable contradictions and blatant differences in both systems only shattered the existence of interdependence and mutual influence of legal institutions in the modern world. There is plenty of scientific material describing and analyzing divergence of remedies and their application in different legal orders and reflecting on difficulties of creation of a unified structure where they all will productively work for the purpose, moreover there is no consent on the common purpose.

In the current work instead of following the traditional analysis of the remedies I follow more recent trend27 and look at them from a different angle. I concentrate on

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24 Latin legal maxim that translates “where there is a right there is a remedy” and means that infringed right shall be protected or restored. This right exceeds traditional English view by including right to action. Therefore a right goes along with a remedy. See case *Ashby v. White*, supra note 15, and also http://www.oxfordreference.com/view/10.1093/oi/authority.20110803110448446.

25 See John W. Salmond, The History of Law, Law Quarterly Review, 1887, No X, p. 166. He noted more than hundred years ago: “general theory of contract is almost entirely of domestic origin”.


finding areas of convergence and common intentions between different legal approaches, as well as rationale, which predetermines and explains similar logic and reason behind obvious but superficial alterations. Understanding the background of the remedies helps finding available alternatives of their application, aiming at the same goal, and generates more clear vision of the latter. The results of such investigation in turn assist in finding way of applying elements from various systems to the general benefit of the international commercial transactions and their participants\textsuperscript{28}. At the same time we shall not ignore that individual perceptions of jurists from different systems may vary to great extent, and while externally congregating for objective reasons legal systems may remain internally deviating\textsuperscript{29}.

Often said that Common contract law and the system of remedies was highly promoted by economical contemplations and practical demands, while Civil law was rooted in academic science, elaborating on moral aspects of law, and hence - has more theoretical basis. Explanation of these differences can be found in historical background of the development of the each judicial system. When studying place and purpose of each remedy in its systemic context, we can better understand its logic and function.

It is widely accepted fact that origins of Civil law lay with ancient Roman law, which later was affected by Germanic customs, canon law and transformed into \textit{jus commune} under great influence of the Catholic Church and emerging legal academia. That explains why written law and its codification were at heart of the Civil law. French Civil Code (Napoleon Code) was enacted in 1804; German Civil Code – in 1900. Both Codes contemplated of general provisions, applicable to all types of contracts, and special norms, regulating different types of contract. Both French and German laws originally considered specific performance as a primary remedy, which court had to award if the plaintiff demanded it, with the exception of cases when it could not been performed. This approach was based on the understanding of the contract as moral, not only legal obligation. Such

\begin{itemize}
\item \textsuperscript{28} See Franz Wieacker, Foundations of European Legal Culture, American Journal of Comparative Law, 1990, Vol. 38, p. 1-29;
\item \textsuperscript{29} See Catherine Valcke, supra note 27, p. 6.
\end{itemize}
interpretation of the Civil law remedy doctrine was widely shared by professionals.

Common law starting from XII century was mostly developed by the Royal Courts into institute of different forms of action, creating legal precedents. Leading remedy was and is damages, which initially played the role of substitute performance. Secondary remedies of equity were derived from doctrines of cannon law and provided for the supplementary remedy of specific performance in case damages were unable to compensate for the breach of contract. Progress of contract law in England was enhanced by Industrial revolution (1770-1870). Serious legal reform occurred only in XIX century, when equity merged with Common law of actions, resulted at first in the general system of writs (case law) and providing for future development of contract law and remedies. This nevertheless did not mean that Common law was alien to doctrine of moral promise as an essence of a contract.

It would be incorrect to deny that economy and legal science, Roman law and legal customs, ecclesiastical and secular legislators affected both systems’ development. Correlation of legal sources, process of legislative borrowing, internalization of education and trade, all together explain why different legal orders share same general principles and overall structure of remedies. To certain extent major difference between legal orders may be explained in more simplistic way from the fact that court developed Common law, while Civil law directed court practice. That also may explain why contract law as a separate and solid branch was developed earlier in Civil law jurisdictions than in Common law countries.

Specific performance is only one example of how different ways in historical development in both legal orders brought to similar results in the modern state of affairs. As I demonstrate below courts in both Civil and Common law jurisdictions may refuse application of this remedy, if it would be unfair or would impose undue hardship on the respondent, or would cause unjust enrichment. I also show that there is more space for an award of damages in Civil law jurisdictions than it seems on the first sight, and both orders have room for substitute performance.

In the similar way I analyze all major remedies and their interrelation and interaction in the modern international trade.

Prior to forming better understanding of the existing system of remedies and their correct application in the contract law it is necessary to get general insight into different theories of contract (and its functions) per se. As it was correctly stated in one of the recent comprehensive researches on the matter, before reviewing how “the approach to
contractual remedies can differ …in the Common Law and French law it is first necessary
to understand how those remedies work within the wider context of the legal system as a whole.”30. Similarly in another respected comparative work it was noted: “the study of a
particular legal situation cannot be conducted in isolation from its institutional context”31.

2.2. NATURE OF REMEDY THROUGH THE CONTRACTUAL THEORIES32

2.2.1. Classic View on Contract as a Free Bargain (Holmes)33

Holmes was close in his views to positivists34, stating that law is an objective
standard evolved from subjective law (primitive notion of revenge and later notion of
morality). Theory promoted unity of civil and criminal liability. Breach of law is a breach
irrespective of the motives. True intentions of the party did not matter, but only
interpretation of the contract by “reasonable man”. Precondition of promise enforceability
was consideration, and asserted consideration was product of bargain. It promoted
indifference toward the intention to breach or to perform and provided for the strict
liability approach35. The theory simultaneously aimed at restriction of liability within the
contract in order to maximize contractual freedom36. Contractual damages should be low,
punitive damages should not be allowed. In Holmes’ view, liability for lost profit was
“dangerously liberal”37; such compensation must be justified only upon proof that the
breaching party knowingly and intentionally had anticipated the special risks of loss that
the promisee sought to recover. Reliance on representation was insignificant; no legal

30 See Thomas D. Musgrave, Comparative Contractual Remedies, University of Western Australia Law
31 See Donald Harris and Denis Tallon (eds.), Contract Law Today: Anglo-French Comparisons, Clarendon
32 There are various classifications of these theories available, and the purpose of this paper is not to present
them all, but only give insight into this matter within the scope, enough to understand difference in the
development of the systems of remedies; presented theories are liberal in nature, for more on this topic and
for some alternative theories See e.g. Mark P. Gergen, A Theory of Self-Help Remedies in Contract, Boston
theories, which are listed herein, mention that Melvin A. Eisenberg divided them into “autonomy theories”
(promissory theory, consent theory, reliance-based theory and rights-based/entitlement theory) and
“revealed-preference theories” (economic theories), See Melvin A. Eisenberg, The Theory of Contracts, in
33 See Juliet P. Kostritsky, When Should Contract Law Supply a Liability Rule or Term?: Framing a Principle
34 See Patrick J. Kelley, Critical Analysis of Holmes’s Theory of Contract, Notre Dame Law Review, 2000,
35 See Oren Bar-Gill, and Omri Ben-Shahar, An information theory of willful breach, Michigan Law Review,
37 Id. p. 406.
claim was justified unless bargained-for consideration could be shown. Classicists intended to restrict legal intervention in “free play...of human conduct”\(^{38}\). Freedom of contract was considered supreme.

2.2.2. **Contract as Tort (Grant Gilmore, 1974)**\(^{39}\).

Prof. Gilmore analyzed how classical theory of contract was eroded by modern concepts. He had shown that the courts generally appraised “expectation interest”, initially restrictively applied in case *Hadley v. Baxendale*\(^{40}\). Sec. 90 of the US First Restatement of Contracts established reliance as a precondition for the contractual enforcement, while keeping the Holmesian definition of bargained-for consideration in Sec.75 of the same act. Restitution has received continual development. Importance of commercial practices and the parties’ actual intentions became the new dimension of contract study, and liberal theory lost its influence\(^{41}\). Classical notion of contractual freedom surrendered to modern rules of equity; rule of the strong was substituted by the protection of the weak.

2.2.3. **Contract as a Promise and Expectation Damages (Charles Fried)**\(^{42}\).

Essential principles of promissory theory are: 1) strict not fault-based liability and 2) *ex post* approach to compensation\(^{43}\). According to the theory, the law (as moral and legal obligation) is built around three notions of trust: 1) reliance on the trustworthy representations of the counter-party and exposing the latter to liability if the representations are incorrect (tort law); 2) general motivation of performance towards the counter-party, making reliable representations and acting even to own detriment in order to fulfill the promise (contract law); 3) forming future expectations based on counter-party’s representations (fiduciary law).

Principle of expectation damages was implemented in US Restatement (Second) of

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38 *Id.*, p. 412.
40 9 Ex 341, 156 ER 145, EWHC Exch J70, 9 ExCh 341, 9 Ex Ch 341, 1854, [http://www.bailii.org/ew/cases/EWHC/Exch/1854/J70.html](http://www.bailii.org/ew/cases/EWHC/Exch/1854/J70.html).
41 *See* Timothy J. Sullivan, *supra* note 36, p. 414. However Holmesian views received new development in other theories, as shown below.
This remedy was intended to put the non-breaching party in the position she would have occupied had the contract been fulfilled. Damages in this case were calculated as difference between the performed and the promised, with addition of consequential and incidental losses.

Modern proponents of this theory (Markovits and Schwartz, 2012) reject critics from both defenders of specific performance, disgorgement and efficiency theory. They suggest that theory shall be understood as general promise of a seller to a buyer of either: to sell goods or services or to transfer money in the amount, which a buyer would receive from selling/using the goods, which they call “dual performance”. From law-and-economics theory position, expectation damages create incentives for obligor to behave efficiently, in particular to ensure performance that less expensive than the value a buyer places on the promised good.

It is interesting to note that prior to the latest reform German sales law, following Roman tradition, was entitling a buyer to the expectation damages. Nevertheless official comment to UCC stated: “the essential purpose of a contract

\[\text{44} \text{ The Restatement (Second) of Contracts (§ 344) identifies several promisee's interests contract law protects: expectation, reliance, and restitution-and announces a general preference for the expectation interest. It is still an influential academic work though certain aspects have been superseded in everyday legal practice by the Uniform Commercial Code, http://en.wikipedia.org/wiki/Restatement_(Second)_of_Contracts; See text of the Restatement at http://www.lexinter.net/LOTWVers4/restatement_(second)_of_contracts.htm.}
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\[\text{45} \text{ The pronoun “she” is used in this work to indicate a party to an obligation irrespective of the gender and combines references to both “she” and “he”, unless in citation, referred statutory act or other initial source pronoun “he” is used instead.}
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\[\text{46} \text{ See case Hawkins v. McGee, 84 N.H. 114, 146 A. 641, 1929, court stated that this damages measure will be the proper in this case, but does not insist that it is the only available, http://en.wikipedia.org/wiki/Hawkins_v._McGee; J.O. Hooker & Sons v. Roberts Cabinet Co., 683 So. 2d 396, 1996, “Court’s purpose is to put the injured party in as good a position as he would have been in but for the breach”, http://www.leagle.com/decision/19961079683So2d396_11078; Universal Life Ins. Co. v. Veasley, 610 So.2d 290, 1992, “Contract damages are ordinarily based on the injured party's expectation interest and are intended to give him the benefit of the bargain”, http://www.leagle.com/decision/1992900610So2d290_1900; Tongish v. Thomas, 251 Kan. 728, 840 P.2d 471, 1992, “While application of the rule may not reflect the actual loss to a buyer, it encourages a more efficient market and discourages the breach”, http://law.justia.com/cases/kansas/supreme-court/1992/66-771-3.html.}
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\[\text{49} \text{ German doctrine developed two ways of calculating damages in case of sales contract breach: i) “small expectation damages” – money to be paid in case of delivery of non-conforming good accepted by a buyer and ii) “large expectation damages” – those to be paid if the non-conforming goods rejected by a buyer, See Gerhard Wagner, Id.}
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between commercial men is actual performance and they do not bargain merely for a promise or for a promise plus the right to win a lawsuit”\(^\text{50}\).

### 2.2.4. Contract as Consent\(^\text{51}\).

Derived from the *promissory theory*, consent doctrine suggested justifying contract enforcement on the merits of the mutual willful consent of the parties hereof to be bound. Pitfalls of the *promise theory* are identified as: (1) incapacity to explain objective contract theory of assent as contractual\(^\text{52}\), (2) frustration to understand contract law’s “gap fillers” as contractual, (3) moralizing the enforcement from individual perspective\(^\text{53}\). In contract law the source of duty is not the law, as in tort law, not the undertaking party, as in promise theory, but “special sense of consent”\(^\text{54}\) – commitment to be legally liable, in the way it was communicated to another party, not in the way it was thought. Indication of the intention to be legally bound is presence of bargain. “Because we cannot read each other's minds… only the “reasonable” or objective interpretation of the commitment will establish the clear boundaries”\(^\text{55}\).

Some studies unite all above described theories under the title “*classic theory of contract*”\(^\text{56}\), characterized with freedom of contract, based on promise, bargain for consideration, and expectation measure of damages, distinguished from *reliance theory*, which dominated from mid-XIX century until early XX century, excluding consideration of morality or policy\(^\text{57}\).

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\(^{52}\) Pursuant to the objective theory assent should be determined solely from objective manifestations of intent, namely what a party says and does rather than what he subjectively intends or believes or assumes. The mental assent and intent of the parties is irrelevant. The objective theory has been dominant. A party's intention will be held to be what a reasonable person in the position of the other party would conclude his manifestation to mean, See e.g. case *Lucy v. Zehmer*, 196 Va. 493, 84 S.E.2d 516, 1954, [http://www.west.net/~smith/Lucy_v_Zehmer.htm](http://www.west.net/~smith/Lucy_v_Zehmer.htm).


\(^{54}\) Id, p. 655.

\(^{55}\) Id, p. 658.

2.2.5.  **Reliance Interest in Contract (Fuller and Perdue)**\(^{58}\)

This theory was the most influential in American legal thought and created basis for the current legislation. Founders of the theory defined three groups of interests, which can be harmed in case of contract breach: 1) expectation (expected by aggrieved party value of the performance); 2) reliance (value aggrieved party would receive by not-agreeing to the contract); 3) restitution (extra benefit of the breaching party resulting from the breach)\(^{59}\). They argued that reliance interest deserves most protection: it corrected an unjust loss by the aggrieved party and prevented overcompensation from the breaching party. Reliance damages put the injured party in the same foreseeable position as if the contract had never been made.

Theory disapproved shift from corrective justice to distributive justice and hence, the law intervention, and rejected measurement of the contract recovery by the value of the promised performance. This theory was strongly supported by normative and descriptive analysis.

“Modern legacy”\(^{60}\) was given to the doctrine in the §344 of the *Restatement (Second) of Contracts* stated that all remedies serve to protect one or more of the three interests of a promisee\(^{61}\). For many years it was academic standard of teaching law of remedies.

This theory was profoundly criticized on its merits on many occasions\(^{62}\). For instance prof. Craswell argued that postulates of reliance theory are outdated from the position of modern analysis\(^{63}\). Tested three interests against substantive policies and their goals, including economic efficiency, contractualism, retributivism, distributional goals, corrective justice and general ideological analysis of modern scholars, Craswell illustrated

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\(^{60}\) See Richard R. Craswell, supra note 22, p. 9.


\(^{62}\) Some even express view that reliance theory diminished contract to tort and restitution, *See* Peter Jaffey, supra note 56, p. 1.

\(^{63}\) See Richard R. Craswell, supra note 22, p. 4.
that legal science and practice went far beyond reliance doctrine and adopted division of protected interests; he also shown that the priority of the reliance damages is no longer supported by reality. R. Craswell offered new gradation: (1) remedies above expectation, (2) remedies that approximate expectation, and (3) remedies below expectation\textsuperscript{64}.

Prof. Craswell agreed that restitution and similar to it reliance can be awarded as remedies, but only among others, there are many interests, served by the remedies, and many other ways in which the remedy shall be calculated. Protection of the reliance interest owes more to tort than to contract: they both calculate effect of the breach \textit{ex ante}, while expectation remedy is calculated \textit{ex post}.

Some justification was made by R. Craswell to the general rules of the expectation damages’ calculation, e.g. the rule of proof of the latter with reasonable certainty, even though courts are also entitled to alter the grade of certainty they consider ‘reasonable’, depending on the circumstance of the case. He also noted that some losses and some profits might be difficult to prove\textsuperscript{65}. The cases, in which measuring expectation remedies based on the reliance interest, are often related to calculation of liquidated damages and lost profits\textsuperscript{66}. Some components of the expectation damages may be also suspended by the courts, if they were not reasonably foreseeable by the breaching party or could have been mitigated by the aggrieved party, or may be excluded by the material or procedural rules, i.e. legal fees or compensation for emotional distress.

Despite some court awards of the reliance damages, expectation damages still remain the standard remedy. If calculated in a proper manner, the latter creates a number of useful incentives: take precautions, efficiently choose between the breach and performance, and provide promise with desired level of insurance\textsuperscript{67}.

\textbf{2.2.6. Law-and-Economics Efficiency Theory.}

Application of economic methods to the legal research started in 1960’s in the US, and gradually spread to Europe though in a more resistant way (Michael Schilling, 2009; Qi Zhou, 2011). There are different types of economic analysis of law, which give way to

\textsuperscript{64} \textit{Id}, p. 85.
\textsuperscript{65} \textit{Id}, p.p. 60, 65.
\textsuperscript{66} \textit{Id}, p. 44.
\textsuperscript{67} According to R. Craswell, expectation damages have these effects only if they are measured so as to leave the non-breacher truly indifferent between receiving damages and receiving the promised performance, \textit{Id}, p.p. 83 – 84.
many streams in studies of efficiency: of reliance, of performance, of breach, and other. Despite the heavy critics of the shortcomings of economic analysis, there are sound explanations to the wide scope of its influence. Economists find interrelation between action/decision/remedy and incentives, and predict future behavior and effects (Craswell, 1999; Jolls, Sunstein & Thaler, 1998); they are forward-looking, not searching for the interest to be protected, but for increase in the general prosperity or utility by participation in respective welfare-enhancing transactions. Different aspects of contract law were evaluated from the efficiency perspective, but the most influential was theory of efficient breach.

This theory was built around novel interpretation of pacta sunt servanda principle given by Holmes as alternative obligation between performance and payment of (expectation) damages (default rule), compensatory, but not punitive in nature, because breach was no longer considered wrongful, as long as it met requirements of efficiency (not every breach). The breach was considered efficient when breaching party calculated better economic outcome from the alternative use of the resources/ deal than from performance and was prepared to compensate to the non-breaching party value equal to the performance. In the center of this doctrine, according to protagonist Richard Posner, positioned economic principle of the distribution/ allocation of the scarce resources to the

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69 Among those we can fine incentives to enter the contract, to breach or perform, to take precautions, to increase/decrease price, quality, insurance, to rely and invest, to mitigate losses, to share information and other.


71 Compare “The Theory of Efficient Breach is no more than a normatively-tinged description of one type of behavioral response to the expectation damage measure”, See Mark P. Gergen, supra note 32, p. 1434.


users that value them most\textsuperscript{74}. Economic efficiency was calculated by using two methods: Kaldor-Hicks-efficiency and Pareto-efficiency\textsuperscript{75}. As a result of the calculation in case of efficient breach and efficient compensation the non-breaching party suffered no losses, because she was placed in the position, it would have been should the contract been performed, and therefore not worse off, while breaching party was better off. It was even demonstrated that in some cases non-breaching party could also be better off upon the breach\textsuperscript{76}. Professors Goetz and Scott (as the theory proponents) employed category of efficient-man, who was always predictable and capable of making strictly efficient decisions. As a result of his actions efficient breach would lead to a merely just compensation – the one that “adequately mirrors the value of performance”\textsuperscript{77}. Accordingly, expectation measure provided incentives for efficient decision to perform or breach\textsuperscript{78}. Nevertheless it did not produce efficient levels of reliance, because stimulated the promisee to rely on the performance\textsuperscript{79}.

Despite the fact that Pareto-efficiency had theoretical advantages, it had serious practical drawbacks\textsuperscript{80}. For instance, courts would not be able to make award of damages

\textsuperscript{74} According to R. Posner, “In some cases a party would be tempted to breach his contract simply because his profit from breach would exceed his expected profit from completion of the contract. If his profit would also exceed the expected profit to the other party from completion of the contract, and if damages are limited to the loss of expected profit, there will be an incentive to commit a breach. There should be”, See Richard A. Posner, supra note 73, p.p. 89 - 90.

\textsuperscript{75} State of world is Pareto-efficient, if resources are allocated in the way that it is impossible to make anyone better off without making at least one individual worse off, where no further improvements can be made. Pareto-superior or Pareto-improvement happens when redistribution of the resources made at least one person better off and nobody is made worse off. Under ideal conditions (without external costs), voluntary exchanges are Pareto improving if they are beneficial for all parties involved (or at least nobody is made worse off). But this state is almost never achieved, because any change can always make at least one person worse off and external costs mostly exist, \url{http://en.wikipedia.org/wiki/Pareto_efficiency}.

Under Kaldor–Hicks efficiency, state of world is more efficient if a Pareto optimal outcome can be reached by arranging sufficient (theoretical, not necessary actual) compensation from those that are made better off to those that are made worse off so that all would end up no worse off than before. Hence more efficient outcome can in fact leave some people worse off.

While every Pareto improvement is a Kaldor–Hicks improvement, most Kaldor–Hicks improvements are not Pareto improvements. The Kaldor–Hicks methods are typically used as tests of Pareto efficiency rather than as efficiency goals themselves. They are used to determine whether an activity moves the economy toward Pareto efficiency. Any change usually makes some people better off and others worse off, so these tests consider what would happen if gainers were to compensate losers or vice versa.

Kaldor–Hicks criterion is the taking into account of only the absolute level of income, not its distribution, meaning difference between poor and rich and difference in utility change of both by affecting them in the same way, \url{http://en.wikipedia.org/wiki/Kaldor–Hicks_efficiency}.

\textsuperscript{76} See Daniel Markovits, Alan Schwartz, supra note 43, p. 812.

\textsuperscript{77} See Charles J. Goetz, Robert E. Scott, supra note 73, p. 558.


\textsuperscript{79} See Paul G. Mahoney, supra note 70, p. 123. He also notes that the reliance measure has the same flaw.

\textsuperscript{80} Pareto efficiency argues against specific performance and higher than expectation damages, as both
based on Pareto criteria, because it would always make defendant worse off. Many commentators challenged postulates and methodology of this theory. For instance, Ian Macneil (1982) saw major flaw of the theory in application of behavioral models of “man-outside-society” for predicting actions of a “man-in-society”; moreover it unreasonably simplified complex human behavior, ignored differences in types of contract, legal conflicts, and causes of breach, all commonly referred to as “externalities”. Another critical argument against this theory is limitation of damages, which can be recovered from the position of their certainty and foreseeability, exclusion of legal costs and transaction costs, breach of the freedom of contract principle and moral hazard.

Melvin Eisenberg also criticized expectation measure of damages, stating that the parties did not bargain for relief, but for performance. In his reasonable view, they always failed to make promisee indifferent between the performance and relief, being commonly measured as difference between contract price and market price (or the promisee’s lost profits, which was a rare case, because consequential damages were not generally awarded) given limitations of reasonability and foreseeability, excluding lost time and legal costs, and risk of insolvency. He stated, “The theory of efficient breach does nothing...
to promote efficiency” 86, and because the expectation damages were not based on cost, they were not compensatory in direct sense (could not ensure reliance and limit recovery, e.g. lost profit, legal costs) and not efficient 87. As he correctly affirmed, not always a seller was aware of the true value, which a buyer placed on the commodity, not always could predict changes in the buyer’s value (failure in Overbidder Paradigm) 88. Additionally instead of breaching the contract there was possibility to negotiate its termination and establish the real value, which the promisee would accept in lieu of performance 89. The problem ignored by Eisenberg was that termination in such case would require mutual will, and not always the promisee would agree to it, despite the “efficient” exit payment offered by the promisor. Undisputable though was that expectation measure created incentives for unnecessary precautions and excessive reliance.

Reliance theory proponents were naturally anxious to prove that the legal intervention of the state should merely extend to protection of reliance interest, covering expectation only in exceptional cases. They justified that the major difference between reliance and expectation damages was in the object each of them protected. Expectation measure intended to place a promisee in the position she would have been, if the contract had been performed, by offering substitute of the performance. Reliance measure on the contrary aimed to secure the non-breaching party’s position before the promise was made, by removing effects of the breach. Fuller and Perdue alleged that protection of the expectation interest should only serve better protection of the reliance 90. Consequently, the only uncovered by the reliance expectation loss was of an “extra advantage”, that the promisee would receive from the exact performance comparing to the substitute

86 See Melvin A. Eisenberg, supra note 70, p. 978. The only paradigm in which breach is justified is Mitigation Paradigm, Id, p.p. 1016, 1021 – 1024.
87 Eisenberg evaluated theory of efficient breach in assessment of three paradigms: 1) overbidder; 2) loss; 3) mitigation, - by application two major principles of efficient breach theory: 1) indifference of the promisee between performance and damages achieved by expectation damages compensation; 2) knowledge of the promisor on the value of the performance to the promisee. See Melvin A. Eisenberg, supra note 70, p.p. 981 – 1016. In his earlier works (1982) Eisenberg established “middle ground”, justifying expectation damages by non-exclusivity of the reliance protection, See Mark Pettit, Jr., supra note 80, p. 418.
88 Accordingly, theory of efficient breach eliminates certainty and security in a contract by inspiring a seller to search and accept overbids and a buyer to demand additional securities.
performance\textsuperscript{91}, which she had to prove first. Prof. M. Pettit (1987) declared that logic could not explain the choice between reliance and expectation. In his opinion, comprehensive protection of the reliance interest would ensure compensation of all losses sustained by a promisee. And the difference originated from the starting point of damages measure: 1) at the time when the promise was made (reliance fully compensated for the contract obtainable elsewhere and expectation damages were over-compensatory) or 2) the value of the promise itself (expectation damages compensated for the actual loss – full performance of the more favorable contract). From this point, expectation compensated for the wrong due to the breach, granting the promisee additional benefits, and reliance – only for the promise itself\textsuperscript{92}. Hence the final question was: should law award more or less extensive compensation?

Prof. Craswell responded: “compensatory remedies are never efficient. Remedy that is most efficient in serving one goal might not be most efficient in serving another”\textsuperscript{93}. In some cases, he continued, economic efficiency would not require fully compensatory damages. Referring to the efficient breach, he suggested dividing the breaches of contract into “willful” (deliberate decision, known, intentional, fraudulent, made in bad faith) and “accidental” (unintentional decision, affected by not deliberate events– increase in costs, incorrect work, and occurrence of a better offer). Most of accidental breaches were efficient, according to Craswell, and hence required more restrained compensations. Liability should increase, but remain limited, in case where efficient breach was willful. General rule on damages should assume strict liability and award of expected damages in high values. But the risk of liability should not prevent efficient breach, because it would give right incentives to renegotiate, increase the price or otherwise eliminate the deterrence of the efficient breach. In his opinion, it was easier for the court to evaluate optimal measure of damages under the strict liability rule rather than efficiency of the behavior (under fault rule)\textsuperscript{94}.

From the stand point of the corrective justice wrongdoer should compensate the

\textsuperscript{91} Mark Pettit, Jr. contended that two factors illustrate interrelation between expectation and reliance: 1) loss of expected benefit from the performance usually includes reliance loss; 2) reliance may also comprise some lost opportunities and expenditures. He further argues that expectation losses are caused by the breach, while reliance losses are caused by the contract formation, therefore they would occur in any case, except for litigation costs. See Mark Pettit, Jr., supra note 80, p.p. 418 - 422.

\textsuperscript{92} Id., p. 426.

\textsuperscript{93} See Richard R. Craswell, supra note 59, p. 1149.

wrong, but there was no clarity on the extent of the compensation. Economics offered method to measure remedy in principle\(^95\), which created best incentive to perform or breach, and best consequence of the latter. For the economists the compensatory nature of the remedy was irrelevant, only the efficient result, which may not require fully compensatory damages’ award\(^96\). Therefore optimal remedy could be above or below expectation damages. R. Craswell proposed optimal calculation for damages’ compensation by applying special “multipliers” and evaluating their efficiency. Same system was adopted by deterrence theory for calculation of penalties and punitive damages\(^97\).

Craswell also discussed compensation based on property rule, and the analysis of different remedial theories would be incomplete without mentioning it. Professors Calabresi and Malamed (1972) defined the property rule as protection of *ex ante* entitlement of its holder to set the price, enforce his terms and remain immune against forced transactions, while liability rule in their opinion, provided lower protection against trespass\(^98\). Modern development of this concept suggested following remedies: a) propertized compensation (of pre-trespassed asking price); b) disgorgement of the trespasser’s profit; or alternatively c) market-price compensation. According to Craswell, property rule was similar to penalty default rule, and any argument for property rule was against compensatory damages\(^99\).

Some of the recent developments of the economic theory, *i.a.* by Robert Scott and George Triantis (2004), promote the shift of the purpose of remedies from compensatory (which was borrowed in the XIX century from the tort law) to *contract-market difference option*, and argue that aggrieved party in non-consumer contracts shall not be placed in the position as if the contract have been performed, but shall only be awarded contract-market alteration as damages on default, which can be either over- or under-compensatory; they

\(^{95}\) It is accepted that economical methods are not flawless, and depending on application they can bring to different results. In one example, used by R. Craswell, he stated that the toaster caused a fire would induce greater consequential damages for the house-owners of the expensive and modest houses. And maybe if money-wise it is true, but in relation to their wealth the result may be the opposite: in both cases people lose their home, but for wealthy people it may be not as dramatic as for poor. This argument of cross-subsidization and adverse selection was also criticized by M. Eisenberg on its merits. See Melvin A. Eisenberg, supra note 70, p.p. 985 – 986.

\(^{96}\) See Richard R. Craswell, supra note 59, p.p.1137, 1157


\(^{99}\) See Richard R. Craswell, supra note 59, p. 1173.
particularly maintain enforcement of the agreed-to remedies, even though violation expectation principle\textsuperscript{100}. But new elaborations are not free from criticism as well\textsuperscript{101}.

\textbf{2.3. Intermediate Conclusions}

It is not possible to review all contractual theories, and it is not the purpose of this work. I further use results of this general overview for forming better understanding of the major differences between remedial systems in Common and Civil law by detecting influence of the respective theories on development of the latter.

Three essential categories of remedies under current investigation are – damages, specific performance and termination of contract – and all of them are available in both Common and Civil law systems; different is the weight each of them carries, interest it protects and purpose it satisfies. Other remedies that are under consideration in the current work: liquidated damages and penalty, performance withholding, and price reduction. Application of these remedies, their functional options and alternatives available in both legal orders also vary and I later review it in respect of each remedy separately.

\textsuperscript{100} See Robert E. Scott & George G. Triantis, supra note 89, p.p. 1435 - 1451

3. TYPES OF CONTRACTUAL REMEDIES

3.1. REMEDY OF SPECIFIC PERFORMANCE

3.1.1. Specific Performance in Civil Law

In Civil law specific performance has traditionally been a primer remedy for the breach of contract.

French Civil Code\(^{102}\) (FCC) defines contract as agreement by which a person(s) bind himself, toward another to transfer, to do or not to do something (Art. 1101 FCC); legitimate agreement becomes law for its counterparties (Art. 1134 FCC). To do or transfer something is considered as the equivalent of what is transferred or done and includes gain or loss for each party, depending on uncertain event (Art. 1104 FCC). Obligation to transfer or do defines value, for which contract is made (Art. 1106 FCC). One of the essential requisites of the contract validity is consent of the party (Art. 1108 FCC), which is absent if given by mistake, due to duress or deception (Art. 1109 FCC). In case of absent consent contract is not void just by the rule of law, but shall be established by the court (Art. 1117 FCC). Interesting that Art. 1118 FCC recognizes certain situations of contract invalidation due to loss. Agreements may be revoked by mutual consent or under provisions of law (Art. 1134 FCC). Agreements shall be interpreted based on common intention of the parties, not on the literal meaning of the terms (Art. 1156 FCC).

According to Art. 1136 FCC an obligation to transfer implies delivery of a thing to the creditor on pain of damages. Mere fact of an agreement makes the creditor the owner of the thing, with division of the transfer of the ownership and the risk (which transfers at actual delivery) (Art. 1138 FCC).

Consequences of non-performance of the obligation to do or not to do are damages (Sec. 1 Art. 1142 FCC). Nevertheless even though this rule reads as general, it is applied in small number of cases\(^{103}\), e.g. when the obligation of doing is essential or of personal nature, or when it will require interference with personal liberty in case of obligation not to do (undue judicial supervision), and the court will not order to perform. Primer rule is not that obvious and set forth in the Art. 1184 FCC on application of subsequent condition in case of non-performance: agreement stays partially in force and aggrieved party has choice to demand performance (if it is still available) or to dissolve the contract and demand damages and interest. Court decides whether to grant specific performance and provide


\(^{103}\) Thomas D. Musgrave, supra note 30, p. 336.
defendant with extension for performance or terminate the contract.

Specific performance also includes creditor’s entitlement to hire a third party to perform obligation at the expense of the defaulted party or to purchase from a third party (Sec. 2 Art. 1142, Art. 1144 FCC); that is called “surrogate performance”\(^\text{104}\) and plays role of indirect performance insuring. In order to establish default of a debtor she should be given a notice (Art. 1139 FCC); damages are due upon such notice (Art. 1146 FCC).

§311 of German Civil Code\(^\text{105}\) (BGB) states: “Unless otherwise provided by a statute, a contract between the parties is necessary in order to create an obligation by legal transaction or to alter the content of an obligation”. §241 BGB stipulates duties arising out of an obligation: performance or refraining from an action. BGB does not provide for a comprehensive concept of the contractual breach, but rather offers three types of non-conforming performance or “breach of duty” (Vertragsverletzungen): i) failure to comply with duties arising out of an obligation; ii) delayed performance; iii) impossibility of performance\(^\text{106}\). Distinctive principle of German law is fault-based liability: an obligor is liable for deliberate and negligent acts and omissions (§276, §280 (1) BGB). This rule used to have an exception:”…a debtor is responsible, unless it is otherwise provided”. Recent reform substituted this exception with “unless stricter degree of liability is available”. In all cases of failure to deliver, to deliver properly or of delay an obligor should not be liable for damages if she is not liable for the failure. Responsibility of an obligor for non-delivery without fault is repealed (§279 BGB).

Right to specific performance is implicit in §241 BGB. §275 BGB sets forth preclusions for specific performance: 1) performance is impossible for obligor or any third party; 2) it requires expenses, manifestly disproportionate to the obligee’s interests; 3) it is unreasonable or of personal nature. Notion of performance impossibility has long history, and BGB traditionally distinguishes different types of impossibility: objective (nobody can perform) and subjective (obligor cannot perform); initial (existing at the contracting stage) and subsequent (after conclusion of contract); partial and total. The old version of this term excluded specific performance irrespective of the debtor’s fault\(^\text{107}\). After reform of 2002

\(^{104}\) Id. p. 334.


initial and subsequent performance became equal and fault factor – actual. Nonetheless new version of BGB diverges between practical, economical and moral impossibility.

If obligor fails to perform, obligee should fix a reasonable period of time for due or substitute performance, unless there is clear refusal of obligor to perform or certain circumstances justifying resort to claim for compensation (§281 (1)-(2), §286 (2:3) BGB), or time of performance is determined by calendar date or can be defined in accordance with it. If type of breach of duty makes fixed period vain, warning notice shall be sufficient (§281 (3), §286 (2:4) BGB). Claim of performance excludes compensation in lieu of performance (damages) and vice versa (§281 (4) BGB). Previously BGB demanded that fixing the period would be combined with a warning that performance would not be accepted after expiration of the fixed period. Recent reform removed this additional criterion.\(^{108}\)

If in result of non-performance an obligor obtains a substitute for an object owed, an obligee may demand surrender of that object (§285 BGB). I consider this German version of surrogate performance.\(^{109}\)

In accordance with Finnish Sale of Goods Act (Kauppalaki, 355/1987)\(^{110}\) (“FSGC”) in case goods are not delivered or delivery is delayed, a buyer is entitled to require performance or declare the contract avoided and claim damages (Sec. 22 FSGA). The buyer may choose to hold to the contract and require performance, unless there is impediment the seller cannot overcome or performance would require disproportioned to the buyer’s interest sacrifices, or if the buyer defers her claim for unreasonable long time (Sec. 23 FSGA). A buyer has right to fix additional period for performance of a seller (Sec. 25(2) - (3) FSGA). Pursuant to Sec. 51 and Sec. 54 (2) and (3) FSGA a seller has right to similar remedies. In case a buyer cancels an order for specifically manufactured or ordered goods, a seller may demand the payment, if cancellation will cause her substantial detriment or uncertainty of compensation of sustained loss due to cancellation. The seller loses this right, if the goods have not yet been delivered and she defers her claim for unreasonably long time (Sec.52 FSGA). A seller is also entitled to demand from a buyer reasonable cooperation in fulfillment of performance, unless there is impediment preventing the buyer from doing so or unreasonable delay in the seller’s demand (Sec. 53


\(^{109}\) Id, p. 332.

Specific Performance in Common Law

In Common law specific performance is granted in exceptional cases, when damages are not adequate.\(^1\)

Section 52(1) of English Sale of Goods Act (1979)\(^2\) (English SGA) limits application of specific performance to the cases of “ascertained” goods, which are “clearly identified and agreed at the time of contract” formation.\(^3\) In any case discretion of application is with the court, including situations where a buyer is put in hardship, which means there is no legal certainty for the plaintiff applying for the remedy. If the goods are considered to be unascertained, equitable remedy as specific performance cannot be awarded, as established by the leading case Re Wait.\(^4\) In another case the opposite decision is reached, where in case of selling non-specific goods court has granted specific performance, considering the state of the market. Traditionally specific performance was considered as remedy claimed by the buyer only, but practice established right of the seller to demand acceptance of delivery and compensation of losses alongside.\(^5\)

US Uniform Commercial Code (UCC) distinguishes the agreement as bargain of the parties (§1-201 (b) (3) UCC) from the contract as total legal obligation between the parties, resulting from agreement (§ 1-201 (b) (12) UCC). Remedies intend to place

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\(^1\) Under Sec. 52(1) of UK Sales of Goods Act 1979 court may at own discretion in plaintiff’s action for breach of contract to deliver specific or ascertained goods (by judgment or decree) award specific performance without giving the defendant the option of retaining the goods on payment of damages, [http://www.legislation.gov.uk/ukpga/1979/54](http://www.legislation.gov.uk/ukpga/1979/54).


\(^4\) See case Société des Industries Métallurgiques SA v. Bronx Engineering Co. Ltd., 1 Lloyd’s Rep 465, 1975, where the court denied specific performance because substitute machinery could have been acquired even with delay from 9 to 12 months; See also case CN Marine Inc. v. Stena Line, 2 Lloyd’s Rep 336, 1982, specific performance can be awarded in respect of the ship, both cases cited at [http://books.google.es/books?id=Kp5kYHc0qZIC&pg=PA158&lpg=PA158&dq=case+CN+Marine+Inc.+v.+Stena+Line&source=bl&ots=9hFhxw9xro9937xJv9b9b7g&hl=es&sa=X&ei=Ux_DmU7myEOa-z0QWUo4HQAQ&ved=0CC0Q6AEwAQ#v=onepage&q=case%20CN%20Marine%20Inc.%20v.%20Stena%20Line&f=false].

aggrieved party in as good position as if the contract has been fully performed (§1-305 UCC) (expectation damages). Specific performance implements both bargain and indifference doctrines, which are basic principles of the contract law.\textsuperscript{120}

Under §2-716 UCC specific performance can be affected by the court where the goods are unique or in other proper circumstances; additionally court may order payment of the price, damages or other relief as my deem just. A buyer has right to receive identified goods, if he is unable to find substitute or under the reasonable circumstances such effort is not justified. Doctrine of specific performance is expounded by three subsidiary rules: 1) damages presumed inadequate when the subject of the contract is unique and 2) in respect of real property; 3) prevention of specific performance in respect of services of personal nature or causing undue judicial supervision. Current general opinion expresses that specific performance is awarded more often, than conventional policy prescribes\textsuperscript{121}. American legal doctrine of specific performance is divided into three mainstreams: 1) considering that specific performance should be granted routinely\textsuperscript{122}; 2) it should be more restricted (efficient breach theory); 3) it should be awarded, unless a special moral, policy or practical reason prevents is in a certain group of cases, or if a “virtual” performance is available (Eisenberg, 2005).

Major reasons in favor of specific performance are: 1) it is the best way to ensure indifference principle; 2) implementation of the bargain principle\textsuperscript{123}; 3) stimulates efficient information exchange.

\begin{footnotesize}
\begin{itemize}
\item 120 See Melvin A. Eisenberg, supra note 70, p.p. 977, 979.
\item 121 Id., p. 1017; Different opinion is expressed that application of remedies of equity – specific performance and injunction – are very limited in Common law, See Thomas D. Musgrave, supra note 30, p.p. 322-327, 336-337.
\end{itemize}
\end{footnotesize}
Objections against specific performance are: 1) pitfalls of enforcement process\textsuperscript{124} (from position of society specific performance is very intrusive and coercive and inherent of judicial error risk); 2) opportunism of a promisee: (i) the latter decides she sue for damages or performance\textsuperscript{125}; (ii) undermining the mitigation of damages rule\textsuperscript{126}; (iii) a seller, demanding specific performance or damages, is indifferent which remedy to apply, whereas a buyer can choose: to sue for damages only, which would be calculated at the time of breach or to sue for specific performance along with damages, which would be calculated at the time of award.

Prof. Eisenberg proposed (2005) to transform the principle of specific performance:

1) from the court-centered rule, where a court decides if damages are adequate or the goods are unique, to the promisee-centered, based on assessment of availability of the goods in the market as substitute for delivery;

2) from complicated and contradictory reasoning of damages’ adequacy to more credible evidences of availability of substitute performance\textsuperscript{127};

3) from unclear standard to legal certainty.

Eisenberg also elaborated on the idea of cover or “virtual” specific performance. The principle of cover transaction is implemented in §2-712 of UCC: after a breach a buyer may in good faith without undue delay purchase reasonable substitute and recover from a seller as damages difference between the price of substitute performance along with incidental or consequential damages minus expenses saved in consequence of breach. Hence “cover” is an act and a remedy. Cover provides four advantages over expectation damages and specific performance \textit{per se}:

1) buyer himself chooses substitute performance;

\textsuperscript{124} Damages awarded by judgment, enforceable from property or income by special organs; specific performance order is given in the form of decree, breach of which constitutes disgrace of court and results in imprisonment, civil fine or both.

\textsuperscript{125} A promisee is entitled to sue for damages in conjunction with specific performance. Suit for damages can be decided by the jury trial, while specific performance by a single judge. Therefore a promisor will be placed in unequal procedural position by not having option to choose, See Melvin A. Eisenberg, supra note 70, p. 1021.

\textsuperscript{126} Temporary injunction can be granted fast, but suit for specific performance can take long time. Duty of promisee to mitigate damages reduces social costs, but she can be awarded this remedy even without mitigation. Specific performance will involve significant social cost, because a breaching buyer values the seller’s performance less than the cost of production, by continuing performance a seller increases buyer’s costs without own benefit (seller covers his lost profit irrespective of performance, but buyer’s damages will increase), See Melvin A. Eisenberg, supra note 70, p. 1023.

2) cover damages are easier to prove;
3) minimizes social and private costs;
4) circumvent disadvantages of traditional specific enforcement.

This cover principle of Common law is analogous to the principle of surrogate performance in Civil law. We can see a good example of similarities of the end result, achieved in different legal doctrines; it also more precisely reflects practical aspect of the contract law in relation to current world economy. If to take a closer look on more recent instruments of International codification, we can see different ways of how divergence of specific performance in Civil and Common law doctrines was overcome.

3.1.3. Specific Performance in International Unification Sources

Draft Common Frame of Reference\(^ {128}\) (DCFR) divides remedies for breach of monetary\(^ {129}\) and non-monetary obligations. In the former case it adopts right to damages (III, Art. 3:302 DCFR) while in the latter case – specific performance (III, Art. 3:302 DCFR). Similar provision can be found in The Principles of International Contract Law\(^ {130}\) (PECL) Art. 9:101 and 9:102, with only difference: PECL precludes specific performance in case of availability of substitute transaction for both monetary and non-monetary obligations, while DCFR – only for monetary\(^ {131}\). In case where non-performance is excused, i.e. if a breaching party proves that it encountered unforeseen impediment beyond its control and notified another party within reasonable time (Art. 8:108 PECL), aggrieved party may not claim performance and damages (Art. 8:101 (2) PECL). Similar provisions are stipulated by DCFR (III, Art. 3:104 and Art. 3:101 (2) respectively).

Art. 28 of Vienna Convention on Sale of Goods\(^ {132}\) (CISG) provides for a right of a party to require specific performance of any obligation by the counterparty, but not for an obligation of a court to award it, unless it would do so under its own law\(^ {133}\). In accordance with Art. 46 (1) CISG a buyer may require specific performance, save she resorted to another exclusive remedy. But CISG doesn’t explicitly name this remedy available for the seller. A buyer may require delivery of substitute goods in case of fundamental breach

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\(^{128}\) \[http://ec.europa.eu/justice/policies/civil/docs/dcfr_outline_edition_en.pdf\]
\(^{129}\) In all reviewed legal systems contract price may be claimed when it is due and action in court for its recovery may be taken, See Art. 49 (1) UK Sales of Goods Act, §2-709 UCC, Art. 1184 FCC, § 241(1) BGB.
\(^{130}\) \[http://www.jus.uio.no/lm/eu.contract.principles.parts.1.to.3.2002/\]
\(^{131}\) On this subject See Gerard De Vries, supra note 26, p.p. 581-597.
\(^{132}\) \[http://www.cisg.law.pace.edu/cisg/text/treaty.html\]
regarding the goods conformity (Art. 46 (2) CISG). Violation of contract considered fundamental if it deprives the other party of what she is entitled to expect under the contract, unless the party (reasonable person) in breach did not foresee such result (Art. 25 CISG). A buyer may fix additional time for performance (Art. 47 CISG). Art. 48 CISG entitles a buyer to search for substitute performance without unreasonable delay and inconvenience and does not deprive her from claiming the damages alongside.

3.1.4. Intermediate Conclusions

French and German Civil Codes provide definition of a contract and arising out of it obligation to do or refrain from doing something. FCC refers to “non-performance” or default of obligation while BGB to breach of duty or non-conforming performance. BGB provides for fault-based liability. Both orders ensure resort to specific performance as the primer remedy, unless precluded by listed circumstances of impossibility. Both codes consider an option of “surrogate” or substitute performance. Resort to specific performance under FCC and BGB exclude claim of damages, which considered an alternative remedy together with contract termination or as a separate remedy in case of performance delay.

UCC distinguishes between agreement as result of bargain and contract as formalized obligation, providing for strict liability irrespective of fault. Common law treats specific performance as exceptional remedy. UCC allows cumulative application of specific performance and damages.

Court practice in both systems demonstrates that earlier established difference between awards of damages and specific performance is currently narrowing.

International unification sources prescribe different treatment of monetary and non-monetary obligations with award of specific performance. CISG allows this remedy as exclusive but leaves application to the local courts under their laws.

In Finnish law specific performance is an exclusive remedy, alternative to termination.

Specific performance is preferable remedy where a promisee faces difficulty in proving lost value of the performance and hence damages would be undercompensated. Advantages of specific performance are: 1) serving indifference principle; 2) implementing bargain principle; 3) stimulating exchange of information between the parties.

134 See Gerhard Wagner, supra note 48, p. 10.
Disadvantages are: 1) legal uncertainty, 2) opportunism of non-defaulted party. In all jurisdictions this remedy reasonably requires interference of the court.

All reviewed legal orders and codifications offer remedy of specific performance with alternative option of surrogate or cover performance, when a buyer can recover from the defaulting seller difference between original and substitute performance, acquired elsewhere. This alternative performance, if available, is capable of eliminating drawbacks of the specific performance as original remedy and enhances its economic efficiency.
3.2. REMEDY OF TERMINATION; RESTITUTION

3.2.1. Termination in Civil Law

In French law termination (avoidance/resolution) is possible in all cases of contract breach, including willful breach (non-performance or defective performance) and breach due to force majeure (equivalent to frustration in Common law) by virtue of Art. 1184 of FCC\textsuperscript{135}. It is available as alternative to claim of specific performance and coupled with claim for damages. It can be only enforced by the court order and depending on circumstances court can grant additional time for performance, unless parties explicitly agreed in the contract that breach of certain terms would encounter termination. Therefore it is for the court’s discretion to decide how serious is the breach to render termination or to adjust the contractual terms, or in case of partial performance decide if compensation of damages would be sufficient and contract can remain in force.

According to Art. 1610 FCC where a seller fails to deliver, a buyer may at her choice apply for avoidance of sale or for “being vested with possession”; in all cases she can claim damages if she has suffered the loss (Art. 1611 FCC). In case of sale of immovable thing, or of definite and limited thing, or with higher capacity and measure follows the sale, and the value of additional benefits is 1/12 higher than stated, a buyer has an option to pay excess of the price or repudiate the contract (Art. 1618-1620 FCC). In the latter case a seller has to return the price (if it was paid) and the costs of the contract (Art. 1621 FCC).

French law does not have same division of conditions and warranties as Common law, however it is interesting that it stipulates two warranties, which a seller implies: 1) against dispossession; 2) against defects. If warranty of possession was breached a seller can claim all together (Art. 1630 FCC): 1) return of the price (at least the price, if the thing was diminished); 2) price of the fruits (if he shall return them); 3) expenses related to warranty and contract; 4) damages minus profit, if he made any (Art. 1632 FCC). In case of latent defects a buyer has a choice to return the thing and get restitution of the price or keep the thing and get price reduction, assessed by experts (Art. 1644 FCC), and in case a seller knew of defect – also claim damages (Art. 1645 FCC).

If a buyer does not pay the price, a seller may apply for the avoidance of the contract (Art. 1654 FCC). In case of sale of commodities and movables, avoidance takes place by the virtue of law, for the benefit of a seller (art. 1656 FCC). Two additional reasons for avoidance and rescission are introduced in French law: 1) through the power

\textsuperscript{135} For the purpose of this paper I only consider situation of intentional breach.
of redemption (where a seller reserves such right in the contract, but only within five years, Art. 1659 FCC) and 2) due to loss of a seller in sale of immovable (cheapness of price, where the loss exceeds 7/12 of the price within two years, Art. 1674 FCC).

It is noteworthy that in contract of hire (service), an employer may terminate the contract at any time without any reason with compensating a contractor all his expenses, works and lost price (Art. 1794 FCC).

Court order for resolution of contract annuls it retrospectively as it has never been signed and provide for mutual restitution. However when the contract is successive or continuous in nature (e.g. lease) resolution will not be retroactive\(^{136}\).

Based on principle *pacta sunt servanda* Roman law has never recognized right to termination of contract, and stemming from it old version of BGB did not contain general statutory right to termination\(^{137}\). Predominant concept of performance impossibility implemented in BGB automatically releases the creditor from performance in certain cases. This doctrine through legislative reform is combined with a new notion – failure to comply with a duty\(^{138}\). Earlier party terminating a contract (meaning putting an end to the contract) could not claim damages, which considered continuation of the contractual obligation, based on the rule derived from German General Commercial Code 1861\(^{139}\). Amendments to BGB have changed this principle: under §325 termination of bilateral contract does not preclude right to claim compensation. Debtor’s liability in case of termination is still formally fault-based, even though by virtue of the reform fault became presumed (until proven otherwise). But remedy of termination does not longer depend on fault, and this is one of the significant changes upon the reform.

Right to terminate can be reserved in contract or statutory based. Pursuant to §323 BGB non-performance or failure to perform in accordance with contract gives right to an aggrieved party to terminate on notice with providing additional time, which may be

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\(^{137}\) See Reinhard Zimmermann, *supra* note 107, p. 15.

\(^{138}\) See Werner Lorenz, *supra* note 108, p.p. 318-319, 327. Under the doctrine of impossibility of performance and influence of two world wars German law adopted institute of the contract modification (due to fundamental and unforeseeable change in circumstances), developed by the German Supreme Court, *Id.*, p. 322. Same theory significantly affected development of the §§ 2-613 and 2-615 of UCC regarding frustration of contract and impracticability. Similar provisions though varying in their application were adopted in CISG and UNIDROIT principles of international commercial contracts (2010), *See* Sarah Howard Jenkins, *Exemption for Nonperformance: UCC, CISG, UNIDROIT Principles – A Comparative Assessment*, Tulane Law Review, 1998, Vol. 72, p.p. 2015-2030. Termination under German law is also possible for a “good cause”, which does not imply a breach, and happens on notice. But these theories are not subject to this paper, reference to them made to demonstrate example of legal transplants across jurisdictions.

\(^{139}\) Werner Lorenz, *supra* note 108, p. 325.
excluded in certain cases (implicit or explicit refusal to perform, inconvenience of notice, fixed date of performance, etc.), unless the breach was immaterial or an obligee drastically contributed to non-performance. According to §323(4) BGB an aggrieved party may terminate a contract before performance becomes due if it is obvious that the preconditions for termination will be satisfied, which is similar to the doctrine of anticipatory breach. Termination is effected by declaration to a breaching party (§349 BGB), and both parties are released from their duties to perform in perspective. Effects of termination are laid down in §346 BGB: any performance received shall be returned along with benefits derived from such performance, and any unjust enrichment must be returned; in addition to that an obligee may demand compensation for the loss due to the breach of duty (at least obligee must be reimbursed for necessary expenditure under (§347(2) BGB). Nevertheless termination does not annul the entire contract, which explains the specific restitution regime, preventing unjust enrichment.

If restitution in kind is impossible due to nature of the received, its consumption or transformation, deterioration or destruction, it has to be substituted with compensation for value. Right to compensation diminished, if defect that gives the right to termination: i) became apparent only during the processing or transformation (deterioration/destruction) of the item, ii) is due to obligee or iii) has occurred in the hands of a buyer who has taken the due care. The latter case is controversial, because in accordance with §346 BGB risk of accidental loss and deterioration passes to a buyer when the thing is handed over. Right to declare a contract void in such case transfers risk back to a seller. This risk reverse is justified by the fact that termination happens due to failure of an obligor, resulting even without a fault in breach of duty, which shall entail consequence of carrying the risk. In French law such risk would be borne by a buyer (Art. 1647 FCC). Under Common law general rule risk transfers along with the title on transfer (Art. 20 English SGA), and if the goods are perished before the transfer without fault of either party the contract will be avoided (Art. 7 English SGA).

In case of breach of sales contract for non-delivery general rules on termination will be applicable. In the event of defects right to termination is second available remedy after demand of specific performance with alternative of claim for price reduction (§437 BGB). In case a seller refused supplementary performance (removal of defect or supply of non-

\[140\] For more details on general rule and exceptions See William Tetley, Sale of Goods – The Passing of Title and Risk, 2008.
defective good) or repair provided by her failed twice it is not necessary for a buyer fix additional time before the termination ($440 BGB).

Terms of BGB regulating contracts for work/service play only limited role for construction of buildings, mainly regulated by instruments of soft law. According to §634 BGB a customer has as a third remedy termination of the contract with an alternative of price reduction. Only if supplementary performance (removal of defect or performance of the work again) is unsuccessful or unreasonable for the customer, she has right to terminate without fixing additional time (supplementary to the general exceptions for the same). A contractor also has right to terminate due to failure of the customer to cooperate in acceptance of the work performed subject to fixing additional time combined with declaration on termination in case of non-performance by the end of the fixed period ($643 BGB). Special right to terminate the contract on notice is reserved for the customer at any time without reason ($649 BGB); in such case the contractor is entitled to demand agreed remuneration minus expenses she saves due to termination or benefits she acquires from that.

In Finland under Sec. 25 of FSGA a buyer may declare contract avoided on notice within reasonable time (Sec. 29 FSGA) in case of the seller’s delay if a breach is substantial and a seller was aware of the buyer’s purpose. A buyer may fix additional time for performance and terminate only if seller declared unwillingness to perform. A buyer may declare a contract avoided on account of a substantial defect in goods by notice given within reasonable time (Sec. 37, 39 FSGA). A seller may declare the contract avoided in the similar way if delay in payment is substantial or a buyer fails to cooperate (Sec. 54, 55, 59 FSGA). For both parties avoidance is possible in installment contracts (Sec. 44, 56 FSGA). Anticipatory breach is regulated in chapter 11 FSGA. In case of avoidance both parties are released from the obligations and entitled to claim restitution of what have been received (Sec. 64 FSGA) and compensate acquired benefits (Sec. 65 FSGA) (reasonable compensation and interest on the paid price). Termination may be substituted by new delivery (Sec. 65, 66 FSGA).

3.2.2. Termination in Common Law

In Common law there are two types of termination: 1) for default (provided by

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141 See Werner Lorenz, supra note 108, p. 342.
contract or law) or 2) for convenience (provided by the contract only). We consider only the first one from the angle of the default law rules. Default law rule ensures right to terminate a contract where it is repudiated or fundamentally breached. Termination is always coupled with right to search damages’ compensation or alternatively restitution. Termination may be effectuated without reference to the court.

Repudiation takes place when one party indicates (explicitly or implicitly from conduct) that she no longer intends to be bound by the contract and will not perform, but unlike in case of breach, the reason for repudiation lays with inability, not readiness or unwillingness to perform, and gives an innocent party initiative to terminate or demand the performance.

Repudiation may also occur before performance is due or complete if a contracting party indicates, either expressly or implicitly from her conduct, that she will not perform her contractual obligations. This type of repudiation is known as anticipatory breach

Fundamental breach happens when non-breaching party has been significantly deprived of the benefit that was the purpose of the contract. Such breach has been traditionally defined based on division of contractual terms into warranties and conditions. It is not relevant that the defendant desires to perform his part of the contract, if she is unable to do so. In the early period termination was almost impossible and non-breaching party had a burden of proof; failures on the side of the breaching party related to quality of goods and time of performance, commonly defined as representations, only gave rise to sue for damages for dishonesty. Contract remained valid and breach of less important terms became known as breach of warranty. If the breach was so serious that destroyed the essence of contract, non-breaching party was entitled to terminate the contract and

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143 The concept of anticipatory breach was first formulated in 1853, in the case of Hochster v. De la Tour, 2 E&B 678, 1853, http://en.wikipedia.org/wiki/Hochster_v._De_La_Tour; See also Thomas D. Musgrave, supra note 30, p. 343.


claim money paid, as well as damages for the breached promise (*indebitatus assumpsit*).\(^{146}\)

Old Sale of Goods Act (1893, UK) implemented distinction between warranties and conditions, transferred into the current English SGA (1979).\(^{147}\)

Complicated and discretionary criteria of defining whether the breached term was a condition or a warranty and apparent injustice resulted from such approach brought to development of the third type of contractual conditions – intermediate term, which was not condition in the accepted sense, but serious breach of it could constitute a fundamental breach, and a new test of assessment was laid down by the Court of Appeal in 1962, in the case of *Hong-Kong Fir Shipping Co Ltd. v. Kawasaki Kisen Kaisha Ltd.*\(^{148}\).

It is obvious that due to complexity of the matter courts hear each case of termination on merits and investigate numerous circumstances (significance, consequences of the breach for parties, place and purpose of the contractual term breached). That explains why in Common law it is so important to draft contract termination clauses with wide consideration of possible circumstances and possible affecting factors and their consequences.

In this respect it is also important to make difference between termination and rescission of contract.\(^{149}\) Termination is a self-help remedy, allowing the injured party to

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\(^{147}\) §11 UK Sale of Goods Act:

(3) Whether a stipulation in a contract of sale is a condition, the breach of which may give rise to a right to treat the contract as repudiated, or a warranty, the breach of which may give rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated, depends in each case on the construction of the contract; and a stipulation may be a condition, though called a warranty in the contract.

(4) Where… the buyer has accepted [partial performance], the breach of a condition … by the seller can only be treated as a breach of warranty, and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is an express or implied term of the contract to that effect.


\(^{149}\) For the purpose of this work we only consider rescission as a contractual remedy and not cases of fraud or mistake.
cease own performance due to breach or repudiation of the other party, which is termination of contractual obligation for the future. Rescission on the other hand is retrospective termination of the contract, its complete avoidance, which fully nullifies the contract as if it has not been signed. Rescission is “hidden within restitution for breach” (Kull, 1994). Rescission hence can be enforced only by the court decree. In case of termination the plaintiff may elect damages for breach, measured by expectation or reliance; in case of rescission – demand restitution in *quantum meruit*, for the market value of his own partial performance, and extended through recent court practice to compensation from defendant’s economic benefit, resulted from profitable and also harmless breach.

Initially restitution for breach was available only when breaching party was “willfully or inexcusably in default” (Keener, 1893). In XX century it was accepted in cases where a breach was so significant that discharged the aggrieved party from her obligation (Corbin, 1964). The whole purpose of it was to prevent unjust enrichment by a breaching party. Pursuant to the traditional English approach, rescission is not available for the breach of warranty once the property has passed to a buyer. On the opposite, American doctrine allows that from the early period, and compromise is incorporated in UCC, which allows rescission after acceptance for the substantial nonconformity of goods. Restatement (Third) of Restitution and Unjust Enrichment permits rescission only in case of total breach - if delivered goods are sufficiently defective or wrongly non-delivered (§37 (1), 2011).

In accordance with UCC “termination” follows when either party has right by virtue of contract or law to put an end to the contract without its breach; as result all obligations for the future cease while right based on prior breach of performance survives (§2-106 (3) UCC). “Cancellation” happens when one party puts an end to a contract due to the breach by another party with the same end result, but cancelling party also preserves right to remedy due to the breach (§2-106 (4) UCC). In case of repudiatory breach (§2-610 UCC) aggrieved party may suspend her performance and may either await the performance or

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152 Id.
resort to remedy for breach. In such case a seller may withhold delivery, resell and cover damages, recover damages for non-acceptance or cancel (§2-703 UCC). A buyer in case of repudiation or non-delivery may cancel and claim the paid price, and in addition to that cover and claim damages or claim damages for non-delivery (§2-711 UCC). Damages for non-delivery will be calculated based on the proof of market price, as difference between it and contract price, including incidental and consequential damages less saved expenses (§2-713 UCC). §2-708(2) UCC provides that if the market price is inadequate to put a seller in as good a position as performance, then the measure of damages is the profit, including reasonable overhead, which the seller would have made from full performance plus incidental expenses and damages. §2-718 UCC establishes that the buyer’s right to restitution is subject to offset to the extent that a seller establishes a right to recover damages under this provision.

Restitution is not available if a seller fully or substantially performed his obligation (§373 (2) Second Restatement of Contracts) or in case delivering goods on credit (§§2-702, 2-703 UCC), but has not been paid, absent fraud by a buyer.

According to §374 Restatement (Second) of Contracts a breaching party is entitled to restitution for any benefit that she has conferred by way of partial performance or reliance in excess of the loss that she has caused by her own breach (guilty party restitution), unless parties agreed on liquidated damages, allowing a non-breaching party to retain part or whole benefit in two available forms – according to §371 Restatement (Second) of Contracts - either the reasonable value of the benefit conferred (measured by replacement cost) or amount the benefited party’s value has increased.

Rescission as a remedy is criticized for its economical inefficiency, moral hazard and allowance of opportunism on the side of the rescinding party. Contract enforcement

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154 Aggrieved party has also option to willfully affirm the repudiated contract, and then it shall perform as long as repudiating party is ready to perform its obligations, See case Fercometal SARL v. MSC Mediterranean Shipping Co. SA (the “Simona”), 2 All ER 742, 1988, http://www.docstoc.com/docs/52195124/Fercometal-Sarl-v-MSC-Mediterranean-Shipping-Co-SA-(The.
would lose sense if routine award of rescission and restitution become available. Nevertheless it is also argued that restitution can become an effective remedy, providing parties with incentives for due performance, only if it will be purely restorative of price, will cost cheaper than re-negotiation and will exclude damages beyond restitution\textsuperscript{160}.

3.2.3. Termination in International Unification Sources

Instruments of international unification also provide remedy of termination. Art. 9:301 PECL entitles the aggrieved party to terminate the contract if non-performance of the other party is fundamental or in case on non-fundamental delay additional time was fixed under Art. 8:106 PECL – after expiration of such time. Breach is considered fundamental if it substantially deprives non-breaching party of expected result (unless the breaching party have not foreseen and could not reasonably foresee such result); or non-performance is intentional or gives reason for non-reliance on the future performance; or otherwise the strict compliance is of essence (Art. 8:103 PECL). Pursuant to Art. 9:103 PECL aggrieved party may terminate a contract by notice, but loses its right if she has not given notice within reasonable time after becoming aware of the breach. The termination may take place automatically without sending a notice, if the breaching party is excused for non-performance under Art. 8:108 PECL. Art. 9:304 PECL provides for termination in case of anticipation of fundamental non-performance. Effects of termination (Art. 9:305 PECL): 1) parties are released from future performance and obligation, but rights and liabilities accrued prior to termination remain unaffected; 2) provisions on settlement of disputes and those intended to terminate after termination remain unaffected (for instance, confidentiality obligations). Terminating party may reject previously received property received, if its value reduced due to non-performance (Art. 9:306 PECL). Upon termination aggrieved party may recover money paid for non-received or properly rejected performance (Art. 9:307 PECL). Party who supplied property, which can be returned, may recover it, if it was not paid or other counter-performance was not received (Art. 9:308 PECL). If rendered performance cannot be returned and was not paid or compensated by counter-performance then reasonable value of it can be recovered (9:309 PECL). There is no clear notion of restitution in PECL.

In accordance with DCFR contract can be terminated at any time, if provided for by

the contract (III, Art. 1:108), or in case of breach - by notice within reasonable time (late notice invalidates right to terminate III, Art. 3:508 DCFR). Additional period for cure may not be served in case where the breach is fundamental, intentional or anticipated, or cure would be inappropriate in the circumstances (III, Art. 3:203 DCFR). Definition of fundamental breach is compatible with the one in PECL (III, Art. 3:502 DCFR). Termination is available on delay after fixing additional time (III, Art. 3:503 DCFR) and in case of anticipated non-performance (III, Art. 3:504 DCFR), and also if a creditor demands reasonable assurance of performance, but is not provided such (III, Art. 3:505 DCFR). Indivisible obligation can be terminated as a whole, but termination of the divisible obligation shall be more strictly grounded (III, Art. 3:506 DCFR). Effects of termination are regulated by III, Art. 3:509 DCFR and are similar to those provided for by PECL. Termination does not preclude claim for damages. Unlike PECL, DCFR sets forth notion of restitution in respect of benefits received by performance (III, Art. 3:510 DCFR): party received benefits from performance should return them, which can be reciprocal; money paid should be returned; return of a thing can be substituted by its value (measured at the time of performance), in case transfer would cause unreasonable effort or expense; reduction in value should be compensated (III, Art. 3:512, Art. 3:514 DCFR); improvement and usage should be reasonably reimbursed (III, Art. 3:513 DCFR). Restitution is excluded to the extent that conforming performance was reciprocal, unless further non-performance reduced value of performed part (III, Art. 3:511 DCFR).

In accordance with Art. 49 (1) CISG, a buyer may declare the contract avoided in case the failure by a seller constitute a fundamental breach or – only in relation to non-delivery – a seller do not deliver within additionally fixed period or declares unwillingness to deliver within that period. Nevertheless in cases where the goods have been delivered, a buyer loses right to avoid the contract unless she declares late delivery void within reasonable time before it’s made or in respect of other breach – if it’s been declared within reasonable time from the moment the breach is known or should be known, or expiration of additionally fixed time for rectification (Art. 49 (2) CISG).

3.2.4. Intermediate Conclusions

Judging by the functions termination plays in all researched orders, we may conclude that it is a remedy in case of contractual breach. Conducted study shows significant differences between French and German rules, but in both jurisdictions termination can be cumulated with damages. In France it requires court intervention, in Germany it is a self-
help remedy. In Civil law orders distinctive procedures provided in case of termination of sale contract and service agreement; the latter is more liberal, and the former is more restricted. In France breach of different warranties leads to different outcome, which reflects some similarities with breach of warranty and condition under English law.

American law combines rules similar to both Civil law policies, which however only available if substantial performance has not happened yet. Regular termination is a self-help remedy coupled with claim for damages or restitution, applicable in case of repudiation (performance inability or repudiatory breach) and in case of fundamental breach. UK and US laws engage divergent qualification of the fundamental breach: in English law breach of condition and intermediate term and in US law also breach of warranty in case of substantial non-conformity. Second Common law procedure is rescission (cancellation) – retrospective annulment of contract like in France, which can only be enforced by the court.

Analysis shows that court plays similarly significant role in permitting termination with damages’ compensation or preserving the agreement and awarding specific performance both in France and Common law jurisdictions. German law and unification rules do not require court intervention, but special preconditions should be fulfilled. In respect of remedy of termination significance of the principle pacta sunt servanda is recognized in all considered legal orders. And notice on termination is prescribed in all of them. All reviewed systems allow explicit incorporation in the contract right to termination without revert to the court and stipulation of own definition of fundamental breach. Although we have to admit that in Civil law jurisdiction court and law have wider competence in prescribing additional time for performance (adjusting the contract). Termination works in retrospective in French law and in case of rescission under Common law. In German law, in case of regular termination under Common law, and pursuant to unification rules termination affects obligation in perspective: i) a creditor is not precluded from claiming damages upon termination; ii) certain contractual terms stay in force; iii) past performance remains intact if the parties are willing so and termination is partial. German law though employs restrictive restitution principle, while other jurisdictions have more liberal approach to the return of the acquired benefits. German law insists on the fault based principle, even loosened during the latest reform, but other regimes in practice have the same effect by demanding a breach to be fundamental in order to grant termination, therefore the end result is the same. Claim of specific performance excludes remedy of termination in all policies.
This remedy is highly criticized for economic inefficiency, moral hazard and risk of terminating party opportunism. Therefore its application should be restricted to cases of fundamental breach, limited judicial supervision seems reasonable to prevent misuse, and best solution would be to regulate this right in the negotiated contract, and it should have perspective effect only.

3.3. REMEDY OF DAMAGES’ COMPENSATION

3.3.1. Damages in Civil Law

French law on damages was set by the XVII century, and then incorporated into the Code civil in 1804. Under the Art. 1147 FCC debtor should be ordered to pay damages due to non-performance or delay in performance, unless he proves that non-performance was caused by reason of force majeure (Art. 1148 FCC) or fortuitous event (equivalent to Common law frustration). Hence damages are divided into damages due to lateness (dommages-intérêts moratoires) and compensatory damages (dommages-intérêts compensatoires)\(^\text{161}\).

French lawyers often refer to damages as “equivalent performance”, or “substitute performance”\(^\text{162}\) (exécution en équivalent)\(^\text{163}\), which intends to put the aggrieved party into the same position as if the contract would have been performed (expectation). The court can award damages as primary remedy in lieu of performance in kind, or as a supplementary measure, in combination with either specific performance or termination of contract in order to ensure full compensation. Therefore damages in general case include actual loss the creditor has suffered and the profit she has been deprived of (Art. 1149 FCC), but the court is only required to award the total sum without explicit determination of each type of damages. Criteria for determination of damages are set forth in the Art. 1150 and 1151 FCC: causation and remoteness, established respectively as direct and immediate consequence of the non-performance that is foreseen or could have been foreseen at the time of the contract formation (ex ante). Lack of direct causal link between the breach and the loss precludes damages’ award. Criterion of foreseeability is not applicable in case of the debtor’s fraud (intentional breach). The court determines foreseeability on the objective basis of the reasonable man. Hence application of the two

\(^{161}\) See Thomas D. Musgrave, supra note 30, p. 350.

\(^{162}\) See Donald Harris & Denis Tallon (eds.), supra note 31, p. 273.

criteria is successive: first established direct causal link, and then foreseeability of damages. There is no obligation to mitigate damages in French law.

Pursuant to BGB obligee may claim compensation for the breach of duty arising out of the obligation to perform unless obligor is not liable for the failure (§280(1) BGB). BGB avoids term “non-performance”, because deficient or partial performance is not complete, but still performance; this adherence to traditional terminology approach causes many practical problems of law application. The claim for damages is still based on the notion of fault, but after reformative reversal of burden of proof to the debtor, fault is no longer considered as “requirement” for the claim. Damages are divided into: 1) in lieu of performance; 2) for delay; 3) “simple” damages.

Compensation in lieu of performance can be demanded in case of non-performance or undue performance upon termination of the contract. It is subject to additional requirements: obligee should fix additional reasonable time; in case of improper performance compensation in lieu could not be demanded, if the breach of duty is immaterial; claim for performance excludes claim for damages in lieu of performance (§281 BGB). If failed party disregards interests or rights of non-breaching party, the latter can demand compensation in lieu of performance, unless it is unreasonable to expect to accept the performance – the infringement of ancillary duties (§282 BGB). In case performance is impossible or unreasonably burdensome, an obligee may demand compensation in lieu of performance (§283 BGB). Instead of compensation the promisee may claim reimbursement for wasted expenses incurred as a result of a reasonable reliance on the performance, unless the purpose of such expenses would not have been achieved even in case of the due performance (§284 BGB).

Upon delay, while the contract remains intact, a compensation can be claimed subject to prior notice demanding performance, which places obligor in default after expiration of additional time (§§280 (2), 286 BGB). If the payment is late a creditor is entitled to the interest on the delayed sum (§288 BGB).

Reform intended to cover by the rules of the §280 (1) BGB the consequential loss, i.e. damage suffered by an obligee as a result of a breach of a contract. Old law called this “positive malperformance”. A creditor should be placed in the position in which she

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164 See Reinhard Zimmermann, supra note 107, p. 9.
165 Reform of the fault principle was intended to clarify complex situation, but the form of its incorporation still “leaves much leeway for a flexible adjustment of the standard of liability”, Id. p. 7.
166 Id. p. 10.
167 Id. p. 11.
would be as if a debtor has performed. On the other hand §281 BGB requires an obligee to provide additional time for the due performance, which makes impossible compensation of the consequential loss. Therefore development of the future practice in this respect is left to the courts.

Division of obligations to primary (specific performance) and secondary (damages) explains the complexity of obtaining damages compensation by necessity to balance conflicting interests of an obligor and an obligee168: gradual application of existing rules on fixing additional time and sending notice still protects interests of a creditor in case of non-performance by allowing to resort to the claim of damages, but on the other hand prevents placing unreasonable burden on the obligor, who may have made efforts to provide for the specific performance, and in some cases the latter can be easier to obtain than prove damages. During latest reform amendments to special norms for sales and service contracts were adopted regarding compensation of damages. If a seller procures goods with defects of quality (§434 BGB) or title (§435 BGB), and rejects or fails to perform supplementary duties (§239 BGB) a buyer may claim compensation or reimbursement for wasted expenses (§437 (3) BGB). Similar rules set forth regarding the service contracts (§§633, 636 BGB). Hence German policy adopts both expectation and reliance measures. Damages for failure to perform can be claimed only together with termination of the contract.

In Finland in accordance with Sec. 27 (1)-(2) and Sec.40 (1) FSGA a seller has a strict “control liability” for the buyer’s direct losses, while liability for indirect losses will require fault of the seller or warranty (Sec. 27(3)-(4) and Sec. 40(2)-(3)169. Sec. 67(1) FSGA introduces principle of full compensation based on the “adequate causation” principle (similar to German policy), but in practice elements of foreseeability are noted and other similarities with English law170. For instance, duty of mitigation is prescribed by Sec. 70(1) FSGA, according to which if the injured party fails to mitigate her loss, she should bear corresponding part herself.

Division between direct and indirect damages is based on the explicit definition of the indirect losses in Sec. 67(2) FSGA, namely losses as consequences of lost production/turnover, inability to use for the purpose, loss of contracts, damage to property, other similar losses, with explicit exception of mitigation losses (Sec. 67(3) FSGA).

Noteworthy is Sec. 70(2) FSGA, according to which awarded damages may be adjusted if the amount is unreasonable given possibility of the breaching party to foresee and prevent the loss and other circumstances.

Some researchers note that national courts in EU Member states demonstrate preference for expectation damages awards (measured *ex post*)\(^\text{171}\). Financial Economic Theory expressed in the doctrine of put/call option to default suggests that aggrieved party should be compensated on the reliance basis, which value is reflected in the contract price at the formation. Kraizberg and Arenst (2000) predict that European Court of Justice will tend to rule based on *ex ante* regime.

### 3.3.2. Damages in Common Law

English contract law began to develop only in the second half of the XVIII century, and rules on damages were not shaped until middle of the XIX century, before that records of decisions on damages were very rare\(^\text{172}\). By that time French legal academia has issued number of significant books, which were translated into English language, e.g. *Pothier’s Trait des Obligations*, published in 1761 and translated in 1806, and widely influenced legal science in Europe and overseas.

Finally in the year 1848 in the case *Robinson v. Harman*\(^\text{173}\) rule of remedy for contractual infringement was formulated: “…Where a party sustains a loss by reason of a breach of contract, she is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed”\(^\text{174}\). As I noted above, French and German policies are built on the same principle. The main purpose of the compensation was defined, but not its scope. Only starting from the XX century American legal theory significantly developed and produced number of sound and influential doctrines, forming modern contract law, extrapolating throughout the Common law countries and the rest of the world.


\(^{172}\) See Thomas D. Musgrave, supra note 30, p. 356.


\(^{174}\) See also case *Livingstone v. Rawyards Coal Co.*, 5 App. Cas. 25 at 29, 1880: “… you should as nearly as possible get at that sum of money which will put the party who has been injured, or who has suffered, in the same position as she would have been in if she had not sustained the wrong for which he is now getting his compensation or reparation”, [http://www.insitelawmagazine.com/ch9remedies.htm](http://www.insitelawmagazine.com/ch9remedies.htm).
Revolutionary for Common law criteria for damages’ compensation were formulated in 1854 in case Hadley v. Bexendale and “this limitation on liability for breach of contract to the ordinary level of losses, unless the promisee informed the promisor otherwise, has been accepted ever since in the common law world”. First rule stipulated that damages could be recovered by an obligee when her loss was a natural consequence of the breach as could be assessed by any reasonable person as a result of the breach (reasonability), thus dividing damages into direct (general) and consequential (special). And the second rule was a contemplation test – foreseeability by both parties of the loss, which did not arise naturally, at the time of the contract formation as a probable result of a breach, i.e. rule for the calculating ex ante damages, for which the breaching party should be liable. The principle of the remoteness of the damage was restated in 1949 in case Victoria Laundry (Windsor) Ltd. v. Newman Industries Ltd.: “In cases of breach of contract the aggrieved party is only entitled to recover such part of the loss actually resulting as was at the time reasonably foreseeable as liable to result from the breach. What was at that time so foreseeable depends on the knowledge then possessed by the parties, or at all events by the party who later commits the breach”. The rule of assessment foreseeability from the position of the breaching party was analogous to the provision of Art. 1150 FCC. Nevertheless further limitation of liability was adopted in 1969 in case Czarnikow Ltd. v. Koufos, stating that objective foreseeability cannot form the basis of the contemplation test, because it will imply liability for any type of damage, which is reasonably foreseen in the way it is regulated in tort law.

As is demonstrated above, Common law traditionally protects three types of interests (Restatement (Second) of Contracts §344 “Purposes of Remedies”):

1) expectation (“distributive justice”, measured based on the “successful transaction” method ex post) – secures benefit of the bargain and intends to place a promisee in the

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177 Claiming party should prove that its loss was reasonably foreseeable at the time of the contract formation, See Melvin Aron Eisenberg, supra note 175, p. 566.
179 This case is also called Heron II, 1 AC 350, 1969, http://www.insitelawmagazine.com/ch9remedies.htm.
180 Therefore the test of foreseeability must be limited to tort law, and that the contemplation test all be used to determine remoteness of damage in contract law, which is different and narrower test, See Thomas D. Musgrave, supra note 30, p. 361.
position as if the contract has been duly performed;

2) reliance (“restorative justice” measured using the “no-transaction” method) – prevents harm to the non-breaching party, securing the costs she may have incurred relying on the contract, intends to place a promisee in the position prior to the promise formation;

3) restitution (“corrective justice”) – prevents unjust enrichment by depriving promisor of the received benefits, intends to put a promisor in the position prior to the promise formation.

§1-106(1) UCC defines the purpose of the remedy as placing the aggrieved party “in as good position as if the other party had fully performed”, excluding consequential, special or penal damages unless specifically provided by UCC, hence favors expectation interest.

Sections 50, 51, 53 of English SGA (1979) also secure expectation measure (in cases of non-acceptance or non-delivery of goods and breach of warranty, including loss of profit, loss of bargain and of opportunity).

In the recent case Transfield Shipping Inc. v. Mercator Shipping Inc. (“Achilles”) House of Lords stated: “…it is no longer sufficient to show that the loss …suffered is a reasonably foreseeable consequence of the breach”, and recoverability of the loss may depend on acceptance of responsibility for the exact requested loss and the market expectation consideration.

§347 Restatement (Second) introduces limitation on the expectation interest claim, referring to respective sections of the act: §350 Avoidability, §351 Unforeseeability; §352 Uncertainty; §353 Emotional Disturbance. §349 Restatement (Second) provides aggrieved party with alternative to recover reliance interest (all incurred expenses less those which

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181 Hence each measure of damages equals respectively to the following: 1) loss in value (lost profit) added other loss cause by the breach, deducted cost avoided (§347 Restatement (Second) of Contracts and commentary); 2) all costs incurred in reliance (expenses in preparing to perform, in performing, or in foregoing opportunities to make other contracts), usually smaller than expectation, because does not include lost profit (§349 and commentary); 3) received benefit of the breaching party, may be equal to the expectation or reliance interest, but usually lesser due to exclusion of the promisee's lost profit or her expenditures in reliance that resulted in no benefit to the other party (§371 and commentary). See Randy E. Barnett, Contracts: Cases and Doctrines, 3d ed., Aspen Publishers, 2003, cited in Contracts Outline, https://www.law.upenn.edu/groups/salsa/Contracts/madison_03.doc; See also Restatement (Second) of Contracts with commentary, http://www.lexinter.net/LOTWVers4/remedies.htm#§344._PURPOSES_OF_REMEDIESTES.

182 From the position of the efficient breach theory the breaching party shall also have opportunity to sue for damages (“negative damages” or “expectation damages in case of the efficient/victimless breach”), but they are not legitimately available, See cases U.S. ex. Rel. Costal Steel Erectors, Inc. v. Algernon Blair, Inc., 479 F.2d 638, 640 (4th Cir.), 1973, http://openjurist.org/479/72d/638/united-states-v-algernon-blair-incorporated; Bush v. Canfield, supra note 154; See also on incompleteness of the efficient breach theory due to excluding negative damages from the scope Barry E. Adler, Efficient Breach Theory Through the Looking Glass, New York University Law Review, 2008, Vol. 83:6, p.p. 1679 – 1725.

would have been incurred anyway).

As was noted above, the expectation measure was more extensively employed in damages’ awards. Calculation methods for damages awards were categorized by prof. Cooter and Eisenberg (1985) into five groups: 1) substitute price; 2) lost surplus; 3) lost opportunity cost; 4) out-of-pocket costs; 5) diminished value. According to §2-712(2) UCC a buyer is allowed to recover difference between the cost of the cover transaction and price of the breached contract. §2-706 UCC procures a seller with recovery of difference between resell and contract price – both with incidental damages (reasonably resulted from the breach - §2-710 UCC and §2-715 UCC). In case of non-acceptance or repudiation §2-708 UCC entitles a seller to recover market price difference with incidental damages and lost profit; §2-709 UCC provides her with the right to initiate action for the price (and incidental damages). In case no damages resulted from the breach are proved, small sum can be fixed as nominal damages (§346(2) Restatement (Second)).

According to Sec. 432 of the Contract Code proposal (1993) drafted by English Law Commission, no action for damages should be allowed when no loss is incurred. Pursuant to Sec. 437 (foreseeability) and 438 (uncertainty) of the same proposal damages should be available only if are foreseeable at the time of contracting and such result is a serious possibility in case of breach, liability for which are reasonably asserted. Damages should be proven, lost chance evaluated at the time of the breach, uncertain loss should be limited to fair assessment of likelihood. Court may also compensate reliance interest under the Sec. 599 of the draft.

Another feature distinguishing development of Common contract law is doctrine of loss mitigation (§350 Restatement (Second); §2-706, §2-708, §2-7010 UCC): damages are not recoverable for loss that the injured party could have avoided without undue risk or burden. Its primary idea appeared in 1677 in case *Vertue v. Bird*, but was significantly developed starting from XVIII century, and in 1872 in case *Frost v. Knight*. Mitigation was declared a necessary factor affecting measuring the damages, as obligation of the aggrieved party to take reasonable measures in order to prevent increase of damages. Duty

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185 [http://translex.uni-koeln.de/450200/highlight_English_contract_code/](http://translex.uni-koeln.de/450200/highlight_English_contract_code/).


of mitigation is also proposed in Sec. 439 “Avoidable and avoided loss” of English Contract Code proposal.

Regarding cumulating matter, Sec. 384(1) Restatement (First) of Contracts (1932) states that damages and restitution are alternative remedies for a breach of contract. The bringing of an action for one of these remedies is a bar to the- alternative one, unless the plaintiff shows reasonable ground for making the change of remedy (Sec. 381(2) Restatement (First)). Contrary specific performance and compensation in money are not alternative remedies, thus both forms of relief may be given in the same proceeding, but not for the same injury (Sec. 384(2) Restatement (First)).

Compensatory nature of damages in Common law was axiomatic for a long time, but as many other institutions of the law, it has been affected by the development of the legal system, order and economy, and internalization. Notion of non-compensatory damages penetrated system of court precedent and triggered legal studies and discussions in professional literature. Polemics is built around the consequences of the non-compensatory damages for the Common legal system and its essentials. In the case Attorney-General v. Blake\(^{189}\) loss had no monetary value and compensatory damages could not be granted, however the House of Lords allowed financial recovery and noted that “…damages are not always a sufficient remedy for breach of contract…When the circumstances require, damages are measured by reference to the benefit obtained by wrongdoer.”\(^{190}\) In their nature such damages are usually qualified as restitutionary. If compensatory damages are measured based on the sustained loss, non-compensatory damages are constructed of the benefits received by an obligor as a result of the contractual breach\(^{191}\). Analysis of the

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\(^{190}\) See Joanna Khoo, supra note 122, p. 285.

recent cases, i.e.: *Esso Petroleum Co Ltd. v. Niad Ltd.*\(^{192}\), *Experience Hendrix LLC v. PPX Enterprises Inc. and another*\(^{193}\), and *World Wide Fund for Nature v. World Wide Wrestling Federation*\(^{194}\), shows exceptional nature of the awards of non-compensatory remedy – return of the fraudulent profits. Recognition of non-compensatory damages as a general remedy will certainly shake Common law system; it also will create legal uncertainty and practical difficulties in establishing the grounds and measure of such damages, but this is nothing new and identical deficiencies eminent to compensatory damages. Claim for compensatory damages is never ensured and certain. On the contrary, traditionally if no substantiated loss is demonstrated as a result of the breach, an obligee would be entitled only to nominal damages, which may seem unfair. In these circumstances calculation of the promisee’s loss by measuring the profit, earned by a promisor due to the contractual breach, can restore fair outcome under the compensatory damages’ doctrine without denying it. Acceptance of a non-compensatory remedy will destroy the doctrine of efficient breach and all rational in it by allowing surrender of all received profits as a result of the efficient breach. Simultaneously it creates hazard of opportunism: a promisee has an incentive to cause a promisor to breach the contract, because it would make the former better off than if the contract would have been performed. It may be argued that non-compensatory damages would serve contractual integrity best when specific performance is not available. Nonetheless the same purpose can be reached by simple understanding of a contract as twofold obligation: primary performance and alternative compensation (from position of economic theory). Irrespective of all benefits general award of non-compensatory damages would entail same objections as general award of specific performance.

Evident that damages’ doctrine in Common law currently requires alternation. Broadening of the notion of loss as well as varying measures of compensation would better serve system of justice and would eliminate theoretical contradictions within the existing policy. Concurrently balance between compensatory and punitive damages should be maintained and at all times should be measured against legal certainty and economic efficiency.

3.3.3. Damages in International Unification Sources

PECL, DCFR, UNIDROIT and CISG provide for similar rules with few deviations. Art. 9.501 PECL and Art. III-3:701 DCFR entitle a creditor to recover damages for non-performance, unless default is excused. In case of no loss no recovery is available. Loss in both cases includes future loss, which is reasonably likely to occur, and also non-pecuniary loss (PECL) or economic and non-economic losses (DCFR). Both codifications secure expectation interest (Art. 9:502 PECL and Art. III-3:702 DCFR), covering suffered loss and deprived gain. Foreseeability test is prescribed by Art. 9:503 PECL and Art. III-3:703 DCFR and Art. 74 CISG. However in case of PECL and DCFR (and UNIDROIT principles) foreseeability refers to loss, which breaching party “foresaw or reasonably have foreseen at the time of conclusion of the contract as likely result of its non-performance”. Methods for calculation are based on evaluation of the difference between contract price and the substitute transaction or current market price. Comparatively in Art. 75 CISG emphasis is on loss, which was “foreseen or ought to have foreseen in light of known circumstances … as a possible consequence of the breach”. Art. 5 CISG excludes non-pecuniary damages from the scope of CISG and refer matter to be dealt with according to national laws.

3.3.4. Intermediate Conclusions

Compensation of damages is the remedy that demonstrates great diversity of

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195 In two European jurisdictions damages awarded in case of no loss – UK and France, in the latter case under the Art. 1145 FCC – in case of breach of obligation not to do something, See notes to the Art. III-3:701 DCFR, supra note 128.


197 In French additional test of “immediate and direct” consequences is applied, but it is questionable if it adds value to assessment; nevertheless it excludes compensation of indirect damages in all cases. See notes to the Art. III-3:703 DCFR, supra note 128; Contri in Germany foreseeability test is rejected and adequate causation principle is applied instead – must be cause by the breach and occur in the ordinary course of things (foreseeability at the time of breach). Criterion of certainty is generally required by many systems, but its application is not strict across jurisdictions, including England, Id. See also Ole Lando, Foreseeability and remoteness of the damages in Contract in DCFR, European Review of Private Law, 2009, Vol. 17:4, p.p. 619–639.
implementation in all studied jurisdictions. Irrespective of many legal transplants formal difference is maintained, for instance in damages’ classification. In French law two main categories are of actual loss and lost gain; compensation covers damages due to lateness (delay damages) and in lieu of performance (compensatory damages in case of non-performance). In Germany damages are divided into: i) delay damages; ii) compensatory; and iii) “simple” damages. In French law, like in Common law policy, damages are interpreted as equivalent of performance, but the promisee is offered more liberal choice of remedy: specific performance or full compensation (actual loss and lost profit), hence hierarchy of remedies is more strict – specific performance plays primer role and damages are secondary, while it is reverse in Common law. Measure of damages under FCC is expectation, calculated ex ante. Applicable tests are: directness, causation, remoteness and foreseeability. Damages in France and Germany can be awarded separately or cumulated with other remedies except specific performance. No obligation of mitigation exists in both Civil law regimes. Pursuant to BGB claim of damages is subject to notice fixing additional time for performance. General measure is expectation, but party may choose reliance and reimburse wasted expenses. Applicable test is adequate causation; evaluation of foreseeability is rejected. Court practice indicates examples of ex post awards.

In Common law damages divided into compensatory (recovery of sustained loss), non-compensatory (recovery of benefits of breaching party) and nominal. Measures of calculation include reliance, expectation and restitution, with duty to mitigate in all cases. Both ex ante and ex post calculations can be found in the case law. Can be cumulated with specific performance, but exclusive with restitution. Establishing causation/directness of damages is pertinent to Civil law, while remains imprecise in the Common Law. Though connection between the defendant’s breach and the plaintiff’s loss is considered necessary, there are only few cases explicitly referring to it, mainly where chain of causation was affected by an intervening act or event. In the United States test of causation was fully

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198 Compare with tort law examples Greenland v. Chaplin, 5 Ex 243, 1850, (Pollock CB advocated a foreseeability test for remoteness); Smith v. The London and South Western Railway Company, LR 6 CP 14, 1870–71 (seven members of Exchequer Court uphold directness rule); Re Polemis & Furniss, Withy & Co. Ltd 3 KB 560, 1921; Glasgow Corp. v. Muir, AC 448, 1943, Cf in contract law Hadley v. Baxendale, supra note 39; Henderson v. Merrett Syndicates Ltd., 2 AC 145, 1995 (Lord Goff, 185, ‘the rules as to remoteness of damage… are less restricted in tort than they are in contract’), All cited at: http://en.wikipedia.org/wiki/Remoteness_in_English_law. For remoteness in contract law See cases Fletcher v. Tayleur, 17 CB 21, 1855 (compensation of lost profit resulting from delay); British Columbia and Vancouver Island Spa, Lumber and Saw Mill Co Ltd. v. Nettleship, LR 3 CP 499, 1868; Horne v. Midland Railway Co., LR 6 CP 131, 1873 (assumed liability); Simpson v. London and North Western Railway, Co 1 QBD 274, 1876 (requirement of special circumstances
substituted by the remoteness assessment, but in England and Australia the concepts of causation and remoteness have been kept separate.\footnote{See Thomas D. Musgrave, supra note 30, p. 365.}

Hence in both systems damage for breach of contract is recoverable if there is causal link whether it is established by directness (France), adequate causation (Germany) or remoteness (in variations of directness, contemplation, foreseeableability of a reasonable man, intent and assertion of risks).

PECL and DCFR promote principle: no loss – no recovery. Loss implies future loss. Measure of damages is expectation and applicable test is foreseeableability.

Finnish law protects direct losses, engaging both test of adequate causation similar to German with elements of foreseeableability, implying duty to mitigate from Common law.

It is not obvious that application of different tests of assessment brings the courts in Civil and Common law jurisdictions to dramatically different conclusions in their judgments regarding damages’ compensation (due to the tests themselves), more or less they all refer to what is considered just and fair. Despite general absence of mitigation duty in Civil law, based on reasonability criterion court may reduce damages for loss, to which a promisee has contributed. Development of the case law and international contract law brings closer notion of actual loss with reliance loss and lost profit with expectation loss. Therefore we again can see development of convergence between all legal orders in relation to the damages compensation.

Due to difficulty of predicting the amount of the actual damages at the time of contracting this remedy can create barriers to the efficient contracting and efficient breach, and may lead to over-performance of the contract, meaning that the party which considers itself better off the contract still proceeds with economically burdensome performance due

\textit{awareness); See also cases Seven Seas Properties Ltd v. Al-Essa (No.2) 1 WLR 1083, 1993; Balfour Beatty v. Scottish Power plc., SLT 807, 1994, accord Victoria Laundry (Windsor) Ltd v. Newman Industries Ltd., supra note 178; Czarnikow Ltd. v. Koufos, supra note 179 (while in tort any reasonably foreseeable damage is legitimate, in contract, the defendant must contemplate that the loss was “not unlikely to result from the breach” (higher degree of probability required); H. Parsons (Livestock) Ltd. v. Uttley Ingham & Co Ltd., 1 QB 791, 1978 (liability for all losses, as could have been reasonably foreseen at the time of the breach, as a possible consequence of it); The Pegase or Safet-Huttenes Albertus SpA v. Paloma Tercera Shipping Co SA, 1 Lloyd’s LR 175, 1981, South Australia Asset Management Co v. York Montague, 3 All ER 365, 1996 (on causation interpretation); Jackson v. Royal Bank of Scotland, UKHL 3, 2005, upholding twofold test from case Hadley v. Baxendale; Transfield Shipping Inc. v. Mercator Shipping Inc., supra note 183 (foreseeability based on individual circumstances, market situation, reasonable consideration of ascertained risks). See also case Brown v. KMR Services Ltd., 4 All ER 598, 1995 (foreseeability in respect of the type of loss, not the extent of it), all cited at: http://en.wikipedia.org/wiki/Remoteness_in_English_law. See also doctrine novus actus interveniens for breaking the chain of causation, http://en.wikipedia.org/wiki/Novus_actus_interveniens.\footnote{See Thomas D. Musgrave, supra note 30, p. 365.}
to low reliance factor\textsuperscript{200}. It also may lead to under-performance, because damages may exclude some of the losses\textsuperscript{201} and actual level may be hard to prove. Court play crucial role in award of this remedy, which is impossible, or at least highly unlikely, without judicial intervention; therefore costs of recovery may be quite high and legal certainty rather low.

Extending notion of compensatory damages by including additional measure of calculation based on recovery of unjustified benefits of the defaulting obligor may serve better fairness and continuity of the contract. At the same time there should be place for benefits of the efficient breach. Parties and judiciary should have possibility to choose between reliance and expectation, \textit{ex post} and \textit{ex ante}, depending on more just and fair outcome. Elimination of further inefficiency is possible by adopting tailored provisions on compensation in the negotiated contract.

3.4. \textsc{Penalty and Liquidated Damages; Limitation of Liability}

3.4.1. \textit{Penalty in Civil Law}

Penalty clause in the contract provides for \textit{ex ante} sanction for breach in the form of a fixed sum, which should be paid, not in lieu of performance, but to secure performance, therefore it is of the punitive nature, not compensatory\textsuperscript{202}. Application of this remedy reveals the most distinction in the Common and Civil judicial systems\textsuperscript{203}. Initially Napoleonic codes provided for the precise enforcement of the penalty clauses\textsuperscript{204}. Nonetheless consequently most of European jurisdictions incorporated principle of the judicial review and reduction of the disproportionate penalty clauses. New provisions of Italian Civil Code were enacted in 1942 (Art. 1384); the Portuguese – in 1966 (Art. 812); FCC – in 1957. Articles 1152 and 1226-1233 FCC regulate penalty, which can be adjusted (increased or decreased) by the judge “even of his own motion” on the grounds of equity. Only in Belgium (and England) courts are prescribed to set aside/declare void excessive contractual penalties, which are against public order\textsuperscript{205}. Spanish law

\textsuperscript{200} See Paul G. Mahoney, supra note 70, p. 123.
\textsuperscript{201} See Comments and Notes to Art. III-3:701 DCFR, supra note 128, p.p. 938 – 941.
\textsuperscript{202} Unlike specific performance that applicable in perspective only, penalties can be ordered in retrospective, for breaches in the past. See Gerrit De Geest, Filip Wuyts, Penalty Clauses and Liquidated Damages, 1999, p. 144, \url{http://encyclo.findlaw.com/4610book.pdf}.
\textsuperscript{204} Id, p. 101.
solely withholds position of penalty clauses enforcement (rejecting grounds of equality), with only exception of partial or irregular performance, where judge is allowed to intervene\(^{206}\). However it is noted that judicial intervention in France is restricted to the obvious disproportion without any justification\(^{207}\). French courts use in assessment retrospective (\textit{ex post}) test comparing stipulated penalty and actual damages or the scope of the partial performance. Art. 1229 FCC prohibits cumulative penalty, therefore aggrieved party has to choose it instead of the performance\(^{208}\), and is deprived of claiming statutory damages, unless penalty is provided for the delay. Exclusivity of penalty application was recommended by Council of Europe, Committee of Ministers Resolution (78) 3 Relating to Penal Clauses in Civil Law (1978).

Modern promoter of the penalty Ugo Mattei (1995) supports view that severe penalty gives incentive for correct and timely performance. He defines efficient contract through combination of penalty and “insurance premium”, reflected in the price\(^{209}\), following the path, earlier created by prof. Goetz and Scott\(^{210}\). “Efficient level” of penalty, in his opinion, lies between excessive and incentive, but always exceeds damages. That in turn creates efficient contract and supersedes need for efficient breach (which accordingly, is against Civil law tradition), because comparatively high price accompanied by penalty clause should cover the risk of rejecting subsequent offer. According to U. Mattei, penalty more, than other remedies, has potential for optimal (efficient) solution, as it ensures the risk of contractual breach and secures stability of contract, establishes the reliability of a seller and subjective value of performance, and prevents litigation. Protagonists of penalty are certain that in efficient system forfeited damages’ clauses should be treated as any other, derived from freedom of contract. General economic theory is based on strict enforcement
due for damages, and penalty clauses are presumed to be enforceable and judicial intervention is precluded, \textit{Id.}, p. 655.

\(^{206}\) According to Ignacio M. Garcia, Spanish Supreme Court rejects review of the penalty clauses on the grounds of equity (STS. 15.10.2008, RJ, No5692), however the tentative bill is pending, proposing the changes in line with other states and majority of the scholars supports the reform, \textit{See} Ignacio M. Garcia, supra note 203, p.102.

\(^{207}\) \textit{Id.}, p. 103. Additionally French courts may order and define quite high amount of penalty in case of prescribed specific non-performance, which to be paid to a promisee. In U.S. non-performing promisors may be obliged to pay fine too, but for the “court contempt” and fine is to be paid to the court, \textit{See} Gerrit De Geest, Filip Wuyts, supra note 202, p. 143.

\(^{208}\) \textit{Italian Civil Code} (Art. 1383), Portuguese (Art. 811) and Austrian (§1336.1) follow the French approach. The Spanish law (Art.1153 SCC) allows cumulative penalty, if such right has been given in the contract itself, \textit{See} Ignacio M. Garcia, supra note 203, p. 104.

\(^{209}\) If a risk prevention cost is below “insurance premium” and penalty risk, which creates situation where a buyer is risk averse and a seller is risk neutral. \textit{See} Ugo Mattei, supra note 20, p. 428.

\(^{210}\) Prof. Goetz and Scott proposed the model of the most efficient insurer of the contract. \textit{See} Charles J. Goetz and Robert E. Scott, supra note 73, p. 554.
of the contract, unless penalty was introduced unconscionably. Accordingly penalty safeguards buyer from non-performance and protects property rights, while liability limitation secures seller in case of underperformance and even provides incentive for such. Common law system, which declares penalties, as bargains in terrorem, null and void, and accepts limitation of liability clauses, according to U. Mattei, undermines freedom of contract, and hence is inefficient. French model, allowing penalty, as alternative to specific performance, is coherent with freedom of contract dogma, and thus close to efficient. He insists that traditional French doctrine separates penalties and damages entirely, because penalty serves as insurance of specific performance. It is true that Art. 1226 FCC states: “A penalty is a clause by which a person, in order to ensure performance of an agreement, bounds himself to something in case of non-performance”. However, U. Mattei completely omitted first part of the Art. 1229 FCC that states, “A penalty clause is a compensation for the damages which the creditor suffers from the non-performance of the principal obligation”. Nevertheless, even admitting that penalty enforces (ensures) due performance, it is hard to explain why it should be more than subjective value of the performance, reflected in the contractual price. It is similarly difficult to explain, why fear of penalizing should be the best incentive to perform a contract; the latter is expression of free will for the promised performance and if it ceases to exist, why it should be punished? U. Mattei creates an impression that a contract can only be performed if it has a penalty clause. In his opinion, efficient French model was eroded in 1975 by empowering the judge to reduce the excessive penalty. Consequently general convergence between French law and Common law regarding penalties creates only confusion in the courts and for the contracting parties, increasing legal uncertainty and enhancing litigation, as U. Mattei exaggerated.

According to §339 BGB penalty is payable in case of default, if provided for in the contract. §341(1) BGB allows cumulative penalty. Additionally promisee is entitled to claim statutory damages in excess of the amount of penalty according to §§ 340(2) and 341(2) BGB. Pursuant to §343 BGB the penalty may be reduced by the judge (prior to its payment) to reasonable amount if it is disproportionately high (upon consideration of all interests of the obligee).

Civil law courts in most of European jurisdictions have powers to reduce excessive

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211 “…In general the law was not concerned either with the fairness or justice of the outcome…” Patrick S. Atiyah, An introduction to the Law of Contract, 1989, 4th ed., p. 9 cited in Larry A. DiMatteo, supra note 205, p. 635.

penalties by adhering to the same principle of justice and fairness. Penalty can be awarded for breaches in the past – and can ensure specific performance; helps allocating risks and safeguarding *pacta sunt servanda* principle by protecting from third party bid\(^\text{213}\).

Concept of liquidated damages is also long recognized in Civil law doctrine\(^\text{214}\) along with the penalty, but ordinarily not incorporated in the state laws. It is quite common to distinct between penalties’ and liquidated damages’ clauses\(^\text{215}\). I review this matter in more details below.

Scandinavian laws in general\(^\text{216}\) and Finnish laws in particular, provide for the reformation/invalidation of the penalty clause, which is unfair, or application of which would lead to an unfair result (Sec. 361 Finnish Contracts Act (*Laki varallisuus oikeudellisista oikeustoimista*, 228/1929)\(^\text{217}\) and Sec. 70(2) FSGA). Nevertheless Finnish law impliedly confirms validity of the stipulated payment clauses\(^\text{218}\). Remedies that are not incompatible can be cumulated (e.g. termination along with damages or penalty)\(^\text{219}\). Limitation of liability is not precluded, unless it is contrary to mandatory provisions of law.

### 3.4.2. Penalty, Liquidated Damages and Limitation of Liability in Common Law

Commonwealth courts may often declare penalty clause unenforceable based on the principle of just compensation. They act in line with arguments some of the law-and-economics theorists\(^\text{220}\), seeing negative effect of this remedy in its supra-compensatory

\(^{213}\) Gerrit De Geest, Filip Wuyts, supra note 202, p. 154.

\(^{214}\) See J. Frank McKenna and Lisa P. Means, Liquidated damages and Penalty Clauses: A Civil Law versus Common Law Comparison, RedSmith, spring 2008, p.p. 4-5, [http://m.reedsmith.com/files/Publication/e5e3e826-0206-4d4d-85b1-ab1b8b0530f/Presentation/PublicationAttachment/085e07b6-e8f9-402c-b980-cc660a4956d2/0804crit.pdf](http://m.reedsmith.com/files/Publication/e5e3e826-0206-4d4d-85b1-ab1b8b0530f/Presentation/PublicationAttachment/085e07b6-e8f9-402c-b980-cc660a4956d2/0804crit.pdf); Ignacio M. Garcia, supra note 203, p. 114 – in reference to the definition given by UNIDROIT principles.


\(^{216}\) See Larry A. DiMatteo, supra note 205, p. 655.


nature due to over-performance, which is considered unjust and unfair, creation of additional transactional costs of excessive precaution and other externalities. Some proponents of the theory of efficient breach also serve as antagonists of the penalty. Accordingly it discourages efficient breach and creates barrier for efficient contract, because market does not provide enough information to balance the bargaining power of the parties and consequentially restricting competition, preventing new actors from entering the market by holding parties bond by the contract. At the same time theorists of the efficiency doctrine accuse traditional “penalty doctrine” of outdated judicial paternalism and inefficiency of invalidating liquidated damages clauses, proposing that courts should routinely enforce the latter and instead scrutinize unfairness in bargaining (as long as just compensation is provided to the obligee in case of efficient breach). I agree that routine enforcement of penalty would increase risk of legal error (court enforcement), being applied without consideration, and creates opportunism hazard, giving promisee an incentive to induce breach of the contract in order to get extra sanction or to abuse rights via unreasonable extension of the delay period prior to filing a claim.

The nature of penalty is punitive and the general idea of remedy in Common law is compensatory. Nevertheless in American tradition separately was developed the concept of

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225 David Brizzee, supra note 26, See also Larry A. DiMatteo, supra note 205, p. 637.
punitive damages\textsuperscript{229}, which as such is not generally accepted in Civil law, e.g. in Germany punitive damages were declared against public order and international arbitration awards in respect of punitive damages were denied\textsuperscript{230}. But under close review we can find similarities between penalty and punitive damages\textsuperscript{231}. Both remedies are directed at punishment, deterrence from future similar breaches and (private) legal enforcement\textsuperscript{232}. Punitive damages represent non-public fines equal to penalty for misconduct\textsuperscript{233}, and defined not based on the suffered loss, but based on the level and nature of misconduct\textsuperscript{234}. Hence they are action– and breacher–oriented and prospective (same as penalty). According to §355 Restatement (Second) and §1-106 UCC and §1-305 UCC punitive damages are not recoverable for the breach of contract unless the latter constitutes tort. In some US states part of the punitive damages’ awards may go not to the aggrieved party, but instead to the state or special organization\textsuperscript{235}. Recently new limitations on punitive damages were introduced on all levels of American judicial system: federal, state legislators and U.S. Supreme Court\textsuperscript{236}. Recent legal studies also determine victim-oriented compensatory function of the punitive damages. Additionally award of these damages covers legal costs of the aggrieved party in civil process, which are not commonly recoverable, because under American adjudicating rule each party bears its own costs, 

\textsuperscript{231} See e.g. Madeleine Tolani, Id, p. 206. It is interesting that despite current formal differences, both systems (US and German) passed through the identical development in attitude towards compensation of non-pecuniary damages, from total restriction to escalating the awards, See e.g. case Floyd v. Eastern Airlines, Inc., 872 F.2d 1462, 1989 (referring to the reluctance of awarding damages for mental disturbance), http://openjurist.org/872/f2d/1462/floyd-vs-eastern-airlines-inc; See also Volker Behr, Id, p.p. 127 – 136.  
\textsuperscript{235} See Volker Behr, supra note 230, p. 115.  
while in most of Civil law systems party losing the case shall cover procedural costs of the winning party. Traditional attitude of German courts towards punitive damages has also changed from German Federal Supreme Court judgment in 1955 declaring in relation to damages for pain and suffering, that ”tortfeasor owes the victim satisfaction for what he has done to him”\textsuperscript{237}. In famous cases of Princess Caroline of Monaco the same court has multiplied the damages\textsuperscript{238}. Later under pressure from European Court of Justice in relation to implementation of Directive 76/202/EEC article 611a BGB was introduced, legalizing punitive damages in cases for discrimination and harassment. Therefore we may conclude that punitive elements of remedies are acceptable in both Common and Civil law systems.

As alternative to the contractual penalty in the Common law system is usually considered a liquidated damages’ (LD) clause, which is meant for estimation of the damages in case of contractual default (originally \textit{ex ante}).

Primary Commonwealth courts evaluated liquidated damages (LD) clauses based on single-pronged test of parties’ intentions (e.g. case \textit{Frick Co. v. Rubel Corp.}\textsuperscript{239}): if it was punitive, it was non-enforceable, but if it was reasonable alternative to litigation, it was valid\textsuperscript{240}.

Later approach developed into contradictory twofold: 1) was the amount reasonable estimate at the time of the contract formation (“\textit{reasonability}”); 2) was the accurate amount difficult to estimate or prove (“\textit{uncertainty}”) (cases \textit{Ashley v. Dilworth}\textsuperscript{241}, \textit{Phillips

\begin{footnotesize}
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\item[\textsuperscript{237}] BGHZ 18, 149, at 3, 1955, \url{http://www.utexas.edu/law/academics/centers/transnational/work_new/german/case.php?id=838}.
\item[\textsuperscript{238}] BGHZ 128, 1, 1994, \url{http://www.utexas.edu/law/academics/centers/transnational/work_new/german/case.php?id=731}.
\item[\textsuperscript{241}] 147 F. 3d 715 (8th Cir.), 1998, \url{http://openjurist.org/147/f3d/715/ashley-v-e-dilworth-co-1}.
\end{itemize}
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v. Phillips. Restatement (Second) on Contracts states in §356 that damages for breach can be liquidated in the contract only “at the amount that is reasonable in the light of the anticipated or actual loss caused by the breach and the difficulties of proof of loss”. Unreasonably large LD are unenforceable “on grounds of public policy as a penalty”.

§2-718 UCC incorporates three-pronged test (case Berger v. Shanahan): 1) reasonable estimate of anticipated damages or actual harm caused by the breach; 2) difficulties to prove the loss; 3) inconvenience or non-feasibility of obtaining alternative adequate remedy.

Many researches note that Common law provides award of less than full damages based on the expectancy interest. Hence the denial of additional transactional costs and other subjective (incl. non-pecuniary) costs creates the basis for challenging efficiency and
fairness of Common law approach to damages’ compensation in the first place\textsuperscript{248}. Nevertheless some proponents of the efficiency theory see LD clauses as “double responsibility at the margin”\textsuperscript{249} providing promisor with incentive to take efficient precautions and promisee - with incentive to efficiently restrict reliance expenses.

Additional mechanism of liability limitation was introduced in Common law and generally accepted in contract laws across jurisdictions\textsuperscript{250}. In France invalidating LL for intentional and grossly negligent non-performance, as well as “a clause limiting liability which contradicts the essential obligation in a contract …, by application of article 1131 of the Code civil”\textsuperscript{251}, evaluation standard is established by the court precedent. Pursuant to §242 BGB LL clause shall be evaluated for good faith and intentional non-performance may not be excused according to §242 BGB, liability for intentional non-performance cannot be excluded according to §276(2) BGB. Sec. 36 of Finnish Contracts Act (228/1929) prescribes test of fairness and entitles courts annul LL in case of intentional non-performance.

Limitation of liability (LL) is regulated in §2-719 UCC, according to which parties may explicitly agree to limitation of recoverable damages or to exclusive remedy\textsuperscript{252}. Principle difference between LD and LL is that the former is intended to deal with over-liquidation and the latter with under-liquidation\textsuperscript{253}. Reasonability test is not generally applicable to the LL clauses\textsuperscript{254}. LL clause may be invalidated if limited or exclusive remedy fails to provide remedy consistent with the “essential purpose of the contract”\textsuperscript{255}.

\textsuperscript{248} See Larry A. DiMatteo, supra note 205, p. 648; Richard R. Craswell, supra note 48, p. 629. See also for inefficiency of compensatory damages and efficiency of penalties Daniel A. Farber, supra note 80, p.p. 1445, 1474 – 1478.
\textsuperscript{249} See Robert Cooter, supra note 48, p. 7.
\textsuperscript{250} See Comments and Notes to Sec. III-3:105 DCFR, supra note 128, p. 818.
\textsuperscript{252} Usually by including in the contract separate section on LL or by inserting after the proposed remedy that it shall be “exclusive and in lieu of other remedies” or “sole and exclusive” or by waiver of incidental, consequential, special, punitive or delay damages. It is important to remember that generally in Common law remedies for breach of contract and breach of warranty are cumulative hence LL does not necessarily exclude all other available to counterparty remedies. See James D. Fullerton, Uniform Commercial Code Sale of Goods, http://www.fullertonlaw.com/construction-law-survival-manual/uniform-commercial-code-sale-of-goods.html#ay.
\textsuperscript{255} Official commentary to UCC defines LL as “fair quantum of remedy” or “minimum adequate remedy”. It generally refers to new circumstances arising while performing, which are not envisaged in relation to the contract, e.g. in sales where a seller refused or unable to repair or failed to refund the payment and a buyer
This does not prevent the party to resort to another remedy provided for by the law. Consequential damages may be excluded under §2-719(3) UCC (except for personal damages in consumer cases). Therefore enforceable LL clause should guarantee minimum adequate remedy\(^{256}\). Sometimes it is called “reversed penalty”\(^{257}\). There is no similar enforceability standard for LD and LL, though courts generally enforce LL clauses\(^{258}\). For instance, generally accepted in sales law, LL imposes hierarchy of remedies and limits them to repair, replacement or refund. LL limits the amount of the recoverable damages, but damages still should be proved, unlike in case of LD. Additionally it was proposed that 


while reasonably high LD renders incentive to perform, LL discourages performance\textsuperscript{259}. But in our opinion, this can be true only in relation to unreasonably small maximum liability. LL clause can also be built based on the same principle as LD and respond to criteria of reasonability and fairness. According to R. Craswell, “optimal deterrence” of harmful behavior can also be reached by including a cap on the maximum award sum\textsuperscript{260}.

3.4.3. Penalty, Liquidated Damages and Limitation of Liability in International Unification Sources. Theoretical basis for harmonization

In 1979 Secretary-General of the UNCITRAL prepared the report on LD and penalty clauses, comparing implementation in both legal systems\textsuperscript{261}. Research revealed the following features in common: 1) payment of sum, defined at the formation (\textit{ex ante}) and excluding proof of actual loss, upon contractual breach; 2) motivation of performance; 3) limitation of liability, acceptable in all systems; 4) auxiliary nature (to be paid only in case of non-excusable breach of main obligation); 5) prevention of unjust enrichment provided for in every policy. Report emphasized the following distinctions: 1) conditions for validity depend on punitive nature; 2) calculation \textit{ex post} (penalty) and \textit{ex ante} (LD); 3) different approaches to accumulation with other remedies; 4) right of the court to reduce amount of penalty\textsuperscript{262}. Thus legal uncertainty is created in all considered orders: in Common law court may set aside the LD clause as excessive; in Civil law – court may reduce penalty.

Attempts for harmonization are made both in legal doctrine and practice. Theory of \textit{efficient penalty} elaborates views of U. Mattei and accepts judicial intervention only in the cases of “inefficient bargaining” (from position of the doctrine of unconscionability)\textsuperscript{263} and in the form of adjustment (based on certain criteria), but not rejection of the penalty clauses. Such development is intended to eliminate the LD law and substitute it with the efficient penalties. According to promoter of the theory L. DiMatteo, the clash between classical contract theory and theory of the efficient breach in essence comes to difference in perceiving the contract by the former as rational bargaining between fully informed,

\textsuperscript{260} See Richard R. Craswell, supra note 97, p. 2209.
\textsuperscript{262} In EU only in Belgium and England courts are completely prohibited from adjustment of penalty clauses.
\textsuperscript{263} Implemented in §2-302 UCC, according to which court may limit the application or refuse to enforce clause, which is unusually harsh and substantially unfair. See for more on the doctrine Larry A. DiMatteo, supra note 205, p.p. 637, 640, 712-720.
equal parties and by the latter as irrational bargaining between parties, who have lack of information and often unequal.

Common law penalty doctrine is reevaluated from position of game theory (Eric L. Talley, 1994) that suggests that over-compensatory (“over-liquidated”) or under-compensatory (“dramatically under-liquidated”) penalty annulment has positive effect by inducing more efficient contractual negotiations through reducing parties’ incentives for deceptive behavior and misrepresentation.

Prof. Craswell (1999) defines ideal penalty as equal “to the harm caused by the violation multiplied by one over the probability of punishment” and promotes multiplier principle (and its alternatives) and deterrence function of the punitive damages, demonstrating their acceptance in the court practice. Multiplier should be calculated on case-by-case basis, changing depending on fault variations; accordingly, that provides incentive to improve promisor’s behavior and facilitates general improvement of the performance. Number of theorists argues in favor of subjective behavioral tests while ordering for the punitive damages. It seems reasonable to assess fault in awarding penalties in contract law, as it accustomed in tort law, because the nature of punitive damages is punishment and it shall not be applied without fault evaluation and contribution of other factors.

UNCITRAL in the Text of Draft Uniform Rules on Liquidated Damages and Penalty Clauses allows cumulative penalty, when it was explicitly stated in the contract (1981). UNCITRAL Uniform Rules (1983, not adopted) provided for penalty clauses to be enforceable in any case with right of judicial reduction.

264 On advances in Game Theory See also Eric A. Posner, supra note 220, p.p. 875-877.
266 Richard R. Craswell, supra note 97, p. 2200.
269 Ignacio M. Garcia, supra note 203, p. 113.
Council of Europe adopted Resolution (1978) on Penal Clauses in the Civil Law, which stipulated judicial control over manifestly excessive penal clauses and reformation of the latter. Factors of determination included the following: 1) comparison of the pre-estimated damages with the actual damages suffered; 2) legitimate interests of the parties, covering promisee’s non-pecuniary interests; 3) category of contract and its standard nature; 4) circumstances in which contract was made, bargaining positions of the parties; 5) was the breach in good or bad faith.

PECL does not include explicit notions of either penalty or LD, defining “agreed payment for non-performance”. However Art. 9:509(1) PECL states that the aggrieved party should be awarded the sum, specified in the contract in case of non-performance, irrespective of its actual loss. Nevertheless the non-performing party is liable only for loss, reasonably foreseeable at the time of the contract formation (excluding the intentional or grossly negligent default) (Art. 9: 503 PECL). Similarly to BGB, Art. 8:102 PECL does not deprive a party of its right to demand cumulative remedy. The specified sum may be reduced to a reasonable, if is grossly excessive in relation to the actual loss and other circumstances (Art. 9:509(2) PECL). Art. 8:109 PECL allows clauses excluding or restricting remedies “unless it would be contrary to good faith and fair dealing”.

DCFR defines “stipulated payment for non-performance” (Art.III–3:712 DCFR) to which a creditor is entitled irrespective of the actual loss, which may be reduced to reasonable amount in a way, analogous to PECL. Notes to the article define purpose of the penalty to coerce performance of the principal obligation, while LD aim is to pre-estimate future creditor’s loss due to non-performance. Similarly to PECL, Art.III–3:703 DCFR limits liability to foreseeable loss “at the time when the obligation was incurred” (unless the non-performance was intentional, reckless or grossly negligent). Art.III–3:102 DCFR permits cumulative remedies (damages in addition to other), however in the official notes to the article it is stated that stipulated payment replaces damages. Art.III–3:703 DCFR incorporates LL clauses by implication, invalidating those that refer to damages for personal injury, caused intentionally or by negligence, as well as those which are unfair or contrary to good faith and fair dealing.

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270 Cited in Larry A. DiMatteo, supra note 205, p. 652.
273 Id, p. 979.
CISG does not have express penalty provisions. From one point of view, reference to penalty may be assumed under Art. 74 CISG: sum, which the party ought to have foreseen at the formation of the contract\textsuperscript{275}. Nevertheless traditional view is that under CISG (Art. 4) validity of penalty clauses shall be determined based on national laws\textsuperscript{276}.

### 3.4.4. Intermediate Conclusions

Both French and German law recognize penalty and allow judicial intervention, but in France court may order decrease or increase of stipulated penalty, while in Germany – only decrease. Under FCC cumulating of penalty with other remedies is not allowed, except case of delay. Council of Europe also supports exclusivity of penalty. On the opposite, BGB accepts application of penalty with other remedies.

Recognized benefits of penalty are: awards for breach in the past, allocation of risks, safeguarding contract stability and ensuring specific performance. Among acknowledged shortcomings of this remedy are named: supra-compensatory nature, stimulation of over-performance (against theory of efficient breach), creation of additional transactional costs and disproportionate precaution costs, basis for legal error and abuse of rights.

Penalty is rejected in Common law due to its punitive nature. Accepted alternative is remedy of liquidated damages (LD). UCC establishes three criteria for evaluation of LD: reasonability (\textit{ex ante}), uncertainty (difficulty to prove loss), and inconvenience of application for another remedy. While LD deals with over-liquidation and does not require establishing of actual losses, limitation of liability (LL) is intended to prevent under-liquidation and involves calculation of damages. LL may be invalidated if it is contrary to the purpose of the contract.

LL is also accepted across jurisdictions; FCC and BGB provide for invalidation of unfair terms. Indirectly LL is generally enforced in sale laws by introducing strict hierarchy of remedies: repair, replacement, and refund.

At the same time American system accepts concept of punitive damages, while German law completely denies it. Nevertheless close study shows that punitive damages are close to penalty (private law fines), enforceable in German policy. Elements of legal uncertainly are inherent in all orders.


As for economic efficiency of penalty, I can hardly share U. Mattei’s disappointment, because law modifications are always preceded by changes in economic and social sphere. Enhancing complexity of commercial reality explains difficulty with introducing a clear cut between penalty and limited liability clauses. Legal rules should serve the needs of contemporary economy and should adjust to the changes. U. Mattei admits that incompetent judges can misuse the efficient model, confirming that even good laws may not work in a corrupt system, and courts have always played and will play significant role in establishing justice. Contracts are generally made with purpose of performance, not breach or litigation. Economic reality has changed since the adoption of FCC; these days negotiating parties often have different bargaining power and transactional costs. At the same time it is not unreasonable to question entitlement of the state for judicial intervention in private contracts, which happens in case of invalidating contractual terms.

Recent proposals for modification and general development trends in American and English laws provide for stronger basis for LD / LL enforceability. Same liberalization of the traditional approach can be found in the late court decisions. Additionally legal gap is narrowing in relation to the punitive damages and general acceptance of punitive function of the remedy in addition to compensatory.

Despite still existing differences, it is obvious that common intention of the regulation in all reviewed systems is setting reasonable and fair amount of pre-negotiated

277 Ugo Mattei, supra note 20, p. 437.
compensation in case of breach of contract, which should reduce legal costs and prevent necessity of proving losses. In both cases courts intend to play safeguarding role reviewing LD and penalty clauses. In my opinion, implementation of the agreed damages clauses should be freely available, as long as they are negotiated by the parties, represent reasonable estimate of possible damages in case of contractual default and risk sharing between the parties, but they should not be excessive, covering reasonable and fair amount of various damages incurred by a promisee due to the promisor's breach. Grounds for determining disproportioned penalties are sufficiently established by Council of Europe in Resolution on Penal Clauses in Civil Law. It also seems reasonable that claim for penalty should exclude compensation of damages for the same breach.

Successful utilization in optimal and efficient way of all reviewed remedies: penalty, LD and LL - can be found in international industrial standards of contracts for building and construction, as demonstrated below.

3.5. REMEDY OF PRICE REDUCTION
3.5.1. Price Reduction in Civil Law

Price reduction is a monetary remedy for non-conformant performance, historically developed from Roman law concept of actio quanti minoris. Applying it an aggrieved party makes unilateral declaration to a buyer, accepts the defective performance and does not intend to terminate the contract or enforce its original terms. This remedy is legacy of the Civil law tradition, and is not generally accepted in Common law with some exceptions. Art. 1644 FCC entitles a buyer to recover part of the purchase price in the amount, determined by the expert, or alternatively - to rescind the contract and recover the

total purchase price\textsuperscript{286}. Price reduction is calculated \textit{ex ante} – at the time of the contract formation as \textit{ratio} between conforming and defective goods’ value according to BGB, but – \textit{ex post} according to Art. 50 CISG and Sec. III-3:601 DCFR, at the time of performance. Some consider it to be of the restitutionary nature and partial avoidance of the contract\textsuperscript{287}, others - set it aside as a separate remedy, explaining that it should be distinguished from contractual avoidance, right of set-off or damages, and should be treated as contract terms adjustment: quality/quantity vs. price\textsuperscript{288}, third – notify similarity with withholding\textsuperscript{289}. I agree that price reduction has similarities with restitution, but there are also certain differences in the circumstances and the order of its application from the standard restitution in case of contract rescission, which makes it stand apart and be alternative to damages.

Price reduction is preserved in most of the European jurisdictions, e.g. in Art. 1644 FCC (and Art. 1617 FCC for immovable property) and §437(2) and §441 of BGB as part of the seller’s warranty for the latent defect and alternative to the rescission of the contract. This remedy may be used without recourse to the court, is not dependent on the actual losses, and may be seen as self-help remedy\textsuperscript{290}. Difference in the value under considered statutory laws should be defined by the expert or by the court itself.

In Finland pursuant to the Sec. 37 – 38 FSGA if the remedy of the defect or delivery of the substitute goods is not available or not effected within a reasonable time after a buyer has given notice to a seller, the buyer is entitled to demand the price reduction (as an alternative to the avoidance of the contract), unless goods are second-hand or sold at auction.

\textsuperscript{286}Existing court practice has established precedent of court discretion in such cases and ordering price reduction in case difference in quality is not significant and does not make goods unfit for the purpose of their use, See Eric E. Bergsten & Anthony J. Miller, supra note 284, p. 18.
\textsuperscript{289}See Eric E. Bergsten & Anthony J. Miller, \textit{Id}, p. 2.
\textsuperscript{290}See Peter A. Piliounis, supra note 113.
3.5.2. **Price Reduction in Common Law**

English law has institutionalized this remedy in course of implementation of the Directive on certain aspects of the sale of consumer goods and associated guarantees (1994/44/EC)\(^{291}\), but similar results have been reached previously through other available measures\(^{292}\). Sec. 30 and Sec. 53 of English SGA imply price reduction regarding delivered goods defects in the form of the proportional payment for the quantity breach in the former case\(^{293}\) and breach of warranty or quality in the latter. In case of the contract frustration and force-majeure event court may order return of the paid amount and payment for the benefits received prior to discharge of the obligation, subject to deduction of incurred expenses, or payment of fair sum as determined by the court under Sec. 1(3) of the Law Reform (Frustrated Contracts) Act 1943\(^{294}\), which however is not applicable in case of contract frustration under Sec. 7 of English SGA with recognized uncertainty on these issues\(^{295}\).

Some similarities can be found in American Commercial Code. According to §2-508 UCC a seller (acting in good faith) is entitled to cure rejected non-conforming delivery under certain circumstances and Sub-sec.2 makes reference to the “money allowance” offered by the seller additionally to the cure, which may be treated as price reduction. §2-601 UCC establishes “perfect tender” rule, according to which a buyer may reject any part of non-conforming delivery or accept it in full. §2-608 entitles a buyer to revoke his acceptance within reasonable time in case of assumption of the cure of a latent defect by a seller and demand price refund pursuant to §2-711 UCC. According to §2-709(1a) and §2-607(4) UCC respectively burden of proof of the rejected goods’ conformity is with a seller, and non-conformity of the accepted goods – with a buyer. Therefore similar results may be reached by application of more complicated measures.


\(^{292}\) See Notes to Sec. III-3:601 DCFR, supra note 128, p.p. 929, 932.


\(^{295}\) See Peter A. Piliounis, supra note 113, p. 45.
While preparing amendments to UCC revisers pursued harmonization with CISG provisions and made several references base on that, but certain differences still remain.

3.5.3. Price Reduction in International Unification Sources

Art. 50 CISG is drafted from the perspective of a buyer and states: “If the goods do not conform with the contract and whether or not the price has already been paid, a buyer may reduce the price in the same proportion as the value that the goods actually delivered had at the time of the delivery bears to the value that conforming goods would have had at that time”, unless a buyer refuses to accept performance or a seller remedies lack of conformity (Art. 37 or Art. 48 CISG). Nevertheless the burden of proof in respect of the reduced value is on a buyer, therefore it is not extensively used. Under Art.45(1) and Art.45(2) CISG cumulative application of price reduction and damages is not precluded, unless under Art.79(5) CISG damages are exempt due to force-majeure event. Even though not frequently used, this remedy may protect a buyer in the situation that would not be adequately remedied by the damages’ compensation solely.

According to Sec. III-3:601 DCFR a party accepting non-conforming delivery may reduce the price proportionally to the decrease in the value of the performance at the time of performance, or, if price is paid, may recover the excess from the other party. Use of this remedy precludes recovery of damages for reduction in the value of the performance (but preserves entitlement to damages for any further loss).

Art. 9:401 PECL stipulates rules identical to DCFR.

Price reduction under CISG, DCFR and PECL does not require expert appraisal and available even when none-performance is excused.

3.5.4. Intermediate Conclusions

Actio quanti minoris is one of the earliest consumer protection remedies, which developed into more wide commercial contracts’ remedy. Currently most of the sale laws provide hierarchy of remedies, in which price reduction follows repair and rectification of

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298 See Moshe Gelbard & David Elkins, supra note 288, p. 141.
299 See Contra, Id, p.p. 148 – 149 (on the better position of a buyer in case of damages or rescission application instead of the price reduction remedy).
300 See Notes to Sec. III-3:601 DCFR, supra note 128, p. 930.
301 See Peter A. Piliounis, supra note 113, p. 48.
non-conformity, and precedes or alternates contract termination. International commercial practice demonstrates rather modest utilization of this remedy; nevertheless it has certain advantages.

Both French and German civil codes consider this remedy. Under FCC the value of reduction should be defined by an expert, according to BGB – by the court. Despite explicit absence of equal measure in Common law comparable goals are pursued by different means. English sales law is harmonized under EU. UCC stipulates compensation of “money allowance” under “perfect tender rule” (right to reject any part of non-confirming delivery). Hence it indicates that same interest is protected in both systems; namely in case of overlap with a claim for damages, where price reduction can provide a buyer with better protection as a self-help remedy, even though it “has limited utility” and usually will be superseded by other remedies, ordinarily – by damages’ compensation. CISG allows price reduction evaluated at the time of delivery, unless a buyer refuses entire delivery or a seller rectifies non-conformity; it also does not preclude cumulating with damages. DCFR and PECL also prescribe ex post calculation of the reduced value, but prevent cumulating with damages for the same loss.

Irrespective of certain ambiguities of international harmonization instruments their role is significant in reflection of most recent developments in various legal systems and in providing for bigger legal certainty than national laws, especially when dealing with international contracts. This remedy is implemented in building and construction standard contracts, and along with other remedies is available in case of contractual breach; such standards prescribe mechanisms for mutual determination of the price reduction value or third party assistance in case rectification is impossible within grace period.

Even though buyer’s opportunism is not mentioned in relation to this remedy, it seems reasonable to request expert appraisal of reduction value. We admit that involvement of the court and/or expert increases costs and removes benefits of the self-help remedy. In such respect mechanisms of price reduction calculation, as well as pre-negotiated LD or LL clauses may serve same purpose and improve inefficiency. Parties are not precluded from re-negotiating contract reformation, which may prevent further

302 See Moshe Gelbard and David Elkins, supra note 288, p. 141.
303 Id, p. 49.
304 See Clause 9.4 FIDIC; Clause 17.14 ORGALIME; Clause 17.14 ABA99; Clause 65 NLM02E; § 27(2), § 29(3) YSE 98.
litigation or arbitration costs. In any case, if initial agreement is reached by mutual consent, it seems reasonable to renegotiate change to the quality-price ratio. If a breaching party disagrees with the reduction value, application of this remedy may be challenged; in the latter case its self-help nature is hindered and it plays role similar to withholding. On the other hand, this remedy responds to the breach of contract by a promisor, and leaving this right with an obligee, acting in good faith, and willing to preserve the contract and not claim damages instead, also has rational grounds and creates incentives for the due performance. I agree with M. Gergen, stating that “contract law permits a party to act in response to breach to avoid suffering a loss that may not be adequately compensated with damages, even if the response inflicts a loss on the defaulter that is disproportionate to the party’s likely avoided loss”305. Such approach is in line with autonomy theories of contract. Some state that it is against theory of efficient breach, allowing “punishment” for the breach. But I disagree: efficient breach is not precluded and there is no penalizing per se, but aggrieved party is given a right to protect herself from potentially uncompensated losses. The main goal of the self-help remedies is based on expectation measure – placing the promisee in the position she would have been if the contract has been performed.

305 See Mark P. Gergen, supra note 32, p. 1433.
3.6. REMEDY OF WITHHOLDING PERFORMANCE

3.6.1. Withholding in Civil Law

Defence of unperformed contract (*exceptio non adimpleti contractus*, Latin) or exception for non-performance (*l’exception d’inexécution*, French) provides for the right of withholding/suspending own performance in the reciprocal obligation and other non-monetary remedy in addition to specific performance and termination. Essential feature of this remedy is that it does not require the non-performance to be fundamental and does not call for the court intervention, and therefore called self-help remedy or measure of private justice. It is also noted that this remedy goes against theory of efficient breach, since provides for the vindication of the right to performance\(^{306}\).

Pursuant to Art. 1612, 1613, 1653, 1707 FCC a creditor in a concurrent obligation (bilateral, but not necessarily synallagmatic) is entitled to withhold performance (delivery/payment) when a debtor has not performed as required under the terms of the contract or there is substantial risk of the debtor’s insolvency based on the proportionality/reasonability test\(^{307}\). The remedy is of temporary and provisional nature and withholding party should be ready to perform immediately upon other party’s performance or sufficient assurance of the respective performance. Some justify that withholding is thus not exactly remedy for breach, but temporary measure inducing performance from another side. If the aggrieved party wishes to bring the contract to an end in case the requested obligation remains unperformed and she incurs expenses due to delay, she has to revert to the court for an order of resolution intended to end her own duty.

In my opinion, withholding is a right and an action, intended to secure party’s interests and the contract, persuading its performance, and saving external costs of legal enforcement, which ensures risk of the contractual breach, hence it qualification as a remedy is not erroneous.

§320 BGB adopts similar rules for synallagmatic contracts only (party who has to perform first may withhold performance) subject to standard of good faith. §321 BGB (after legislative reform) additionally secures this remedy in case of anticipatory breach — when it becomes apparent that the claim for counter-performance is endangered by the other party’s lack of ability to perform. Pursuant to §323 BGB in case of fundamental non-performance the aggrieved party is not precluded from the termination and damages

\(^{306}\) “Breach is sufficiently blameworthy to justify allowing a party to act to protect herself… And a right-holder may withhold performance…”, Mark P. Gergen, supra note 32, p. 1433.

\(^{307}\) See notes to Art. III-3:401 DCFR, supra note 128, p. 867.
compensation\textsuperscript{308}.

In Finland withholding in case of anticipatory breach is provided under Sec. 61 FSGA and rules similar to French are adopted for withholding of goods and payment of price respectively in Sec. 10 and Sec. 49 FSGA.

3.6.2. Withholding in Common Law

In the Common Law there is no general equivalent to the French remedy of withholding performance. The distinction between two systems is originated from the earlier mentioned division of the terms in Common law into conditions and warranties, which provides for comparatively wide independence of the parties’ obligations from each other (unless they are made condition precedent or explicitly agreed otherwise). French doctrine of cause ensures interdependence of the obligations of both parties, so default of one temporary excuses the other, as a consequence of default. Common law separation of the breach into material (condition/ fundamental intermediate term) and less significant (warranty) provides for the generally available repudiation of contract without recourse to the court in the former case and claim for damages - in the latter.

Nevertheless in Common law comparable right to withhold performance is covered under the doctrines of material breach and substantial performance, unless parties agree otherwise\textsuperscript{309}. According to Sec. 28 of English SGA (default provision), delivery of the goods and payment of the price are concurrent obligations. Pursuant to Sec. 41 of English SGA unpaid seller is entitled to retain possession of goods (right of lien or retention). Hence withholding would be generally handled in English law by the rules relating to termination: party may withhold performance if: i) primary obligation to perform is explicitly or implicitly dependent on the performance of the second party; ii) court defines second obligation as condition for the contract performance; iii) second party non-performance would deprive first party from the benefit contracted for\textsuperscript{310}. Additionally aggrieved party may initiate action for the price and damages. English law also seem to be more safeguarding interests of the promisee, allowing her to complete own performance

\textsuperscript{308} See Reinhard Zimmermann, supra note 107, p.p. 18 - 19.

\textsuperscript{309} Material breach that can be rectified provides for the performance suspension/withholding (§242 Restatement (Second) of Contracts). Total breach discharges the non-breaching party from the reciprocal performance and allow withdraw from the contract (§§236, 243 (1)-(2) Restatement (Second) of Contracts), See Mark P. Gergen, supra note 32, p. 1409.

and then recover contract price, unless she has no legitimate interest in performance.\footnote{See case White & Carter (Councils) Ltd. v. McGregor, 2 WLR 17, 1962, http://www.bailii.org/uk/cases/UKHL/1961/1962_SC_HL_1.html; Continued performance is also disallowed if it requires cooperation of the breaching party, increases damages or does not protects interests of the promisee, See Mark P. Gergen, supra note 32, p.p. 1406, 1408.} Pursuant to §238 Restatement (Second) of Contracts if obligations fall due simultaneously, it is a condition of each party’s duties to render such performance that counterparty either renders or, with manifested present ability to do so, offers performance of her part of the simultaneous exchange. Determination of the material breach and hence the right to withhold is justified in U.S. based on the following factors of §241 Restatement (Second) of Contracts: i) extent of benefit deprivation of non-breaching party; ii) availability of adequate compensation for the latter; iii) extent of burden on the breaching party (proportionality test); iv) likelihood of due performance; v) willful or in bad faith nature of the default.\footnote{Id, p.1411.} Non-breaching party should meet additional (to the above stated) conditions in order to discharge its own obligation to perform, as prescribed in the §242 Restatement (Second) of Contracts: i) further delay may prevent/hinder reasonable substitute transactions; ii) extent to which agreement provides for performance without delay. In case of such total breach (excluded when partial performance takes place), followed by repudiation injured party should have right to claim damages for total breach, but only if value of the contract substantially impaired for her at the time of the breach, that allowing her to recover damages based on all her remaining rights to performance, would be just and fair according to §243 Restatement (Second) of Contracts. Pursuant to §251 Restatement (Second) of Contracts an obligee may demand adequate assurance of due performance subject to reasonable suspicions of non-performance; she also may suspend (if reasonable) own performance, for which she has not received agreed exchange until receipt of assurance. In such case failure to provide assurance may be justified as repudiation.

§2-717 UCC adopts liberal standard regarding sales’ contracts, allowing a buyer of goods withhold damages resulted from the seller’s breach, developing in turn standard of justified withholding when it is commercially reasonable. Withholding is subject to the sufficient notice\footnote{Within reasonable time from discovery, See William J. Geller, supra note 310, p. 180.} and can be applicable only regarding damages for breach under the same exact contract.

American courts engage several standards of defining legitimacy of the withholding
(in the absence of the contract provisions), providing for contradictory results and great legal uncertainty\(^\text{314}\). First case in which both parties have breached agreed terms by concurrent withholding is \textit{K&G Construction Co. v. Harris}\(^\text{315}\). Usually courts apply the doctrine of constructive conditions, submitting duty of each contractual party to perform on the other party’s substantial performance of the prior obligation; failure to perform substantially when due constitutes breach of contract and allows termination. In case substantial performance is rendered, the injured party can only seek damages for non-material breach. Withholding refers to the situation when aggrieved party demands from breaching party to continue performance. Performance suspension issue arises on two conditions: 1) contract and obligation is continuing and performed in shipments/ intervals (construction, long term sales, leasing, licensing, franchising); 2) breach and withholding should take place prior to substantial performance\(^\text{316}\). This constitutes first standard – withholding after material breach\(^\text{317}\). Second standard – withholding when justified\(^\text{318}\) – without investigation of the materiality of the breach and purely by evaluating facts of the

withholding\textsuperscript{319}. Third approach requires from an aggrieved party specific selection between contract cancellation and affirmation with full performance, meaning that withholding may not apply along with continuation of the obligation, and the court would treat withholding as cancellation of the contract\textsuperscript{320} (§253 Restatement (Second) of Contracts).

Handling of this matter by the courts turns to be even more complicated\textsuperscript{321} due to interference of other doctrines, e.g. voluntary payment doctrine, which precludes claiming overpaid amounts in the originally disputed claims\textsuperscript{322}.

Due to dissonance in court practice and lack of consistent legislative regulation withholding terms are usually incorporated in the contract. Nevertheless certain areas of American law provide for specialized payment withholding rules, e.g. real estate law has provisions on withholding rent as warranty of habitability or legality of the lease\textsuperscript{323}.

Withholding performance also forms part of the duty to mitigate, which was proclaimed in case \textit{Clark v. Marsiglia}\textsuperscript{324}. The rule is not applicable if an obligee has an interest in completing performance that damages cannot adequately compensate\textsuperscript{325}.

American doctrine offers further development to this remedy, which would allow injured party withhold damages caused by default, but only in good faith, and would encourage breaching party to continue performance, minimizing risk of incomplete

\begin{itemize}
\item \textsuperscript{319} See cases \textit{Morgan v. Singley}, supra note 314; \textit{See also Bart Arconti & Sons, Inc. v. Ames-Ennis, Inc.}, supra note 294 (withholding payment in response to constant delays).
\item \textsuperscript{321} See Mark P. Gergen, supra note 32, p. 1418.
\item \textsuperscript{322} It means that if a debtor disagrees with the amount she is required to pay, she should first challenge it, and only then pay. \textit{See Restatement (Third) of Restitution and Unjust Enrichment} §6 cmt.e, illus. 18 (Tentative Draft No. 1, 2001), \textit{cited in} Mark P. Gergen, supra note 32, p.p. 1423 -1430. Interesting that, for instance in Finland the order is reversed: one should first pay and then challenge in order to avoid liability for the late payment. Based on Sec.47 of FSGA a buyer is bound by the price indicated in the invoice, unless he notifies a seller within reasonable time on disagreement with the price or if the lower price was expressly agreed. According to Sec. 5 of Finnish Interest Act (\textit{Korkolaki}, 633/1982 with amend.) interest for the late payment shall be paid from the fixed date and in accordance with Sec. 4a for the whole “delayed amount”; separately in case of damages compensation (Sec. 7) only undisputable amount is considered for the interest calculation, but the section mentions difficulty to establish such. Therefore usually in Finland any invoice should be first paid and notification on disagreement served. On the overpaid amount then interest should be accounted to prevent unjust enrichment and it should be returned to the payee.
\item \textsuperscript{323} Withholding rights are provided in government procurement laws and some others, See William J. Geller, supra note 310, p.p. 165-166.
\item \textsuperscript{324} 1 Denio 317 (N.Y.), 1845, http://www.lawnix.com/cases/clark-marsiglia.html.
\item \textsuperscript{325} For this and other exceptions from the main rule See cases \textit{John A. Roebling’s Sons Co. v. Lock-Stitch Fence Co.}, 22 N.E. 518 (III), 1889 (the right of the contractor to complete), \url{http://www.forgottenbooks.org/readbook_text/Reports_of_Cases_Decided_in_the_Appellate_Courts_of_the_State_of_v28_1003570259/185}; \textit{Davis v. Bronson}, 50 N.W. 836; 1892 (contract-defaulter giving the order to stop performance shall not pay in full if the other party decided to complete), \url{http://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=8152&context=penn_law_review}. 
\end{itemize}
performance, and, at the same time, preserving continuation of the obligation/contract. In case of withholding or objection to such, the parties should exchange notices, which allow them both adjust performance\textsuperscript{326}.

3.6.3. Withholding in International Unification Sources

According to Art. 9:201 PECL the party may withhold performance until the other party tendered performance or performed, if she should perform simultaneously or after the counter-party.

Art. III-3:401 DCFR provides for the same situation and additionally – if a creditor should perform first, but reasonably believes that there would be no counter-performance, she may withhold – based on the reasonability test. This right will be lost when adequate assurance is provided by the other party.


3.6.4. Intermediate Conclusions

As demonstrated above, remedy of performance withholding is generally recognized in all analyzed jurisdictions and international codifications, despite the lack of statutory regulation in Common law. This is self-help, temporary and conditional remedy. After exercising of withholding usually one of two options will take place: mutual performance or termination of the contract, but it does not preclude its qualification as a remedy.

In France it is applicable to all bilateral contracts; in Germany only to sinallagmatic. Common law provides instead for right of lien or retention and also considers withholding as part of mitigation duty. In Common law policy withholding is usually exercised as step of repudiation process and is complicated by influence of other practices and doctrines. English law favors non-breaching party and allows her to perform and recover price. UCC adopts more liberal standard for sales contracts: withholding is available in case of commercially reasonable justification; but American courts engage various inconsistent standards. Finnish law combines elements of French and Common law systems (anticipatory breach). International codifications allow withholding in bilateral contracts under standard of reasonability.

Theory offers to expand withholding on contractual damages under certain

\textsuperscript{326} See William J. Geller, supra note 310, p.p. 197 – 203.
conditions. At the same time this remedy is criticized for economic inefficiency. In my opinion, on the contrary it saves both parties’ expenses: if the risk of non-performance exists, it is easier to withhold than perform and then recover damages; efficient breach is not precluded. Application of principles of good faith and reasonability seems crucial in this regard, as well as combining right of withholding with duty to mitigate damages, as implemented in Finnish sales law. In my opinion, despite temporary nature, this measure plays functions of remedy and therefore should be fully recognized as such.

Differences in application of this remedy in various legal orders do not preclude convergence of their elements in regulation of the same contractual relationships, as demonstrated below concerning standard construction contracts.

4. REMEDIES UNDER STANDARD CONSTRUCTION CONTRACTS

4.1. INTERRELATION BETWEEN CONTRACTS FOR SALE OF GOODS AND PROVISION OF SERVICE

In all reviewed jurisdictions contracts for sale of goods and contracts for rendering services/performing works have separate legal regulation (whether statutory or not). Such diversity pre-determines some variations of the respective remedies, which are available under those contracts, as it is shown above, and also presents a controversial issue for the international contracting.\(^{327}\)

Construction contracts in particular demonstrate a complex and challenging case of integrated sales and service.\(^ {328}\) In order to understand the extent, to which such contracts can be governed by sales’ law, including its international norms, and to which exempt


\(^{328}\) See e.g. from American Arbitration Association: “Construction disputes are fairly common, and they vary in their nature, size, and complexity. Mark Appel, senior vice president of the American Arbitration Association, stated that “[t]he construction industry…[is] really the industry that sponsors our work.” (ENR 2000). Although this statement may initially appear to be an indictment, it simply reflects the complexity of a contemporary construction project, which requires the orchestration of numerous interdependent components, including information, materials, tools, equipment, and a large number of personnel working for independent engineers, contractors, and suppliers. Construction disputes, when not resolved in a timely manner, become very expensive – in terms of finances, personnel, time, and opportunity costs”. Construction litigation expenditures in the US in 2003 approximated at 5 billion US dollars annually, with trend to increase 10% each following year, [http://www.americanbar.org/content/dam/aba/migrated/dispute/essay/constructiondisputes.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/migrated/dispute/essay/constructiondisputes.authcheckdam.pdf)
from it, I further refer to the provisions of CISG on the matter and their official interpretation. Significance of this example is especially important, because adoption of CISG has influenced most of the national sales’ laws and provided for their modification and/or harmonization in both Civil and Common law orders. Hence the national regulation of the respective matters or its certain parts may be relatively similar to the international and interpreted by analogy.

However it is important to remember that pursuant to Art.4 CISG governs only “the formation of the contract and the rights and obligations of the seller and the buyer arising from such a contract” Art.2 CISG also excludes certain types of contracts from its scope and Art.3 CISG establishes additional requirements for the application in two sub-sections. Under sub-section 3(1) CISG contracts for the supply of goods to be manufactured or produced are to be considered sales unless the party who orders the goods undertakes to supply a substantial part of the materials necessary for such manufacture or production. Pursuant to sub-section 3(2) CISG the convention does not apply to contracts in which the preponderant part of the obligations of the party who furnishes the goods consists in the supply of labor or other services. According to Secretariat’s commentary to the article 3 CISG (1978 Draft), two cases shall be distinguished and treated separately from the regular sales: 1) supply by a buyer of a substantial part of the necessary materials, from which the goods to be produced or manufactured by a seller; 2) supply of the labor or other services by a seller. According to section 1 of the CISG Advisory Council Opinion No.4 and sub-section 1.2 of the comments to it even though sub-sections 1 and 2 of the Art. 3 CISG govern different matters, in complex transactions there may be some reciprocal influence in their interpretation and application. The Convention adopts for each case dividing criteria: “substantial part” and “preponderant part”.

Regarding first case number of academics states that term “substantial” refers solely to economic value: in order to outlaw CISG byer-provided materials should be higher in value (price) than seller-supplied; such opinion is supported in some court awards, but
quantifying values are set at various rates: from 10 to 50%. CISG Advisory Opinion recommended disregarding fixed percentages, but rather base opinion on the overall assessment on case-by-case basis (sections 2.8 – 2.9). Some writers and courts justify necessity of “essential” criterion application, i.e. evaluation of quality/functionality of the provided materials; idea is invoked by different languages’ versions of the Convention: “substantial” in English and “part essentielle” in French. Section 2.5 of the commentary to the CISG Advisory Opinion notes that criterion “essential” has regained its ancillary role. The Opinion further establishes that “economic value” criterion should prevail (section 2.6) and criterion “essential” should be considered only where “economic value” impossible of inappropriate to apply (section 2.7).

Therefore three tests in determination of “substantial part” can be assumed under CISG: 1) dominant economic value (ex ante); 2) supplementary essential test (effect of the contribution to the end-product); 3) case-by-case approach, - all of which can be used individually, cumulatively, or successively. Additionally “necessity” of supplied materials for the end-product production as such should be assessed; materials for packaging, transportation and acceptance tests should be excluded from the consideration since they do not form part of the end-goods. Supply by a buyer of the designs, drawings, technical specifications, technology and formula, is questionable in terms of substantial material contribution; they may be accounted only if significantly increase end-product


334 See supra notes 14 – 19 to the comments to the CISG Advisory Council Opinion No4, supra note 327. See Ulrich G. Schroeter, supra note 330, p. 76; See also case A.M.D. Electronique v. Rosenberger, Appellate Court Chambery, France, 25.05.1993, schemes, standards and designs (“essential materials”) were provided by the buyer (later criticized for application of domestic doctrine to the international contract), http://www.cisg.law.pace.edu/cisg/wais/db/cases2/930525f1.html; See contra “Shoes Case”, Appellate Court Frankfurt, 18.09.1991, provision of technical instructions cannot justify exclusion from CISG, http://www.cisg.law.pace.edu/cisg/wais/db/cases2/910917g1.html.

335 See Jelena Perovi, supra note 327, p. 185.
value, but usually are covered by CISG scope\textsuperscript{337}.

Ancillary services, such as packaging, dispatching, transportation, unloading, insurance, waste management, even “major engineering effort and planning and conceptual work”\textsuperscript{338} etc. should be excluded from the consideration of the mixed contracts (second case). Dominant opinion in doctrine and case law is that “preponderant” should be qualified based on the overall assessment (not percentages or quantity), where economic value criterion\textsuperscript{339} (applied \textit{ex ante}) should prevail and “essentiality” may contribute when necessary\textsuperscript{340}.

Unlike Art. 3 CISG, §2-102 UCC does not separate assembly contract (where a buyer supplies material) (and hybrid contracts in general\textsuperscript{341}) from regular sale, and there are no unified statutory criteria for distinguishing sale from service. American and UK courts have developed significant amount of case law on the matter with no ultimate certainty on applicable rules\textsuperscript{342}. Growth of the controversial court precedent law could be

\textsuperscript{337} See sections 2.12 - 2.14 of the comments to CISG Advisory Council Opinion No4, supra note 327; See also cases applying CISG, where material supply is declared insubstantial e.g. “Waste Container Case”, Vb 94131, Budapest Arbitration proceeding, 05.12.1995, http://www.cisslaw.pace.edu/ciss/wais/db/cases2/951205h1.html; “Shoes case”, supra note 335.

\textsuperscript{338} See “Cylinder Case”, District Court Mainz, Germany, 26.11.1998, http://www.cisslaw.pace.edu/ciss/wais/db/cases2/981126g1.html.

\textsuperscript{339} “Value of the services has to be compared with the value of the whole contract and not with the price of the goods only”, See Jelena Perovi, supra note 327, p.p. 186 – 187.


explained by rudiment legislation: both contract types were treated by courts similar in all aspects but one – application of the Statue of Frauds (an Act of the Parliament of England for Prevention of Frauds and Perjuries, 1677)\(^\text{343}\), which was later repealed in British colonies, but allowed to avoid liability in certain circumstances while was effective.

In separating sales from services Common law courts often applied the following reasoning: in case of work, labor and a service the remuneration was given in return of certain skill or energy\(^\text{344}\), while in a sale the consideration was paid for the transfer of title or possession, or both\(^\text{345}\). When contracts were interrelated and mixed, e.g. when both parties contributed the material, quantitative test was largely applied, meaning that if manufacturer supplied less and mostly accessorials parts of the end-product, the contract was declared one for work, labor and services\(^\text{346}\).


\(^\text{344}\) See cases Carlson, Holmes & Bromstad, Inc., v. M.I. Stewart & Co., Inc., 147 Misc. 607, 264 N.Y. Supp. 277, 1932 (agreement to install fixtures, where supply of material is incidental to service); Gilbert v. Copeland, 22 Ga. App. 753, 97 S.E. 251, 1918 (farmer growing crop for another); Garvin Machine Co. v. Hutchinson, 1 App. Div. 380, 37 N.Y. Supp. 394, 1896 (manufactured tools are retained and used for assembly work for another); Babcock v. Nudelman, 367 Ill. 626, 12 N.E.2d 635, 1937 (lenses and frames furnished by optometrist are incidental to the professional service rendered); Granette Products Co. v. A.N. Neumann & Co., 200 Iowa 572, 203 N.W. 935, 1925 (court investigated if the party was mere a seller of the material or was obliged to supply service and incidental material and was bound to comply with plans and specifications); Mack v. Snell, 140 N.Y. 193, 35 N.E. 493, 1893; Austin v. Seligman, 18 Fed. 519, 1883 (was performance of services rendered in respect of the hiring party’s chattels or was it sale), All cited in Contracts for Services Distinguished from Those to Sell Goods, supra note 327.


intention (evaluation of the contract “essence”) - qualitative criterion - in addition to quantity and value: where bargain primarily assumed exercise of the special (professional) skill or the manufacture of the certain goods was not party’s primary business the contract was declared one for service\textsuperscript{347}.

Traditionally separate treatment is given to the contracts for building and construction. Dominant status of real estate in Common law makes it ultimately the prevailing contribution by principle of accession: passing of the title happens once the construction becomes immovable on the land, hence any material contribution by the laborer is considered accessorial and the consideration is only paid for the work, labor and service, not for the ownership transfer\textsuperscript{348}. This type of contract is distinguished from installing on the buyer’s property the commodity (goods) produced by the manufacturer, i.e. installation of the equipment in the house, which should be regarded as sale. In other words, Commonwealth courts were applying both quantitative and qualitative tests, examining different elements of the bargain. Currently in respect of the mixed service-goods contracts US courts usually apply “predominant-thrust” test, where prevailing fact in the contract is based on the most costly part (quantitate) and secondly - contract purpose (essence) is assessed\textsuperscript{349}. European writers and courts in various jurisdictions seem to share positive approach to the applicable tests\textsuperscript{350}.

Given the described complexity of the matter, the last but not the least issue is


whether turn-key construction contracts fall under CISG. Confusion is created by the commentary to the sub-section 3(2) CISG, providing as an example of exclusion a contract “where the seller agrees to sell machinery and undertakes to set it up in a plant in working condition or to supervise its installation. In such cases if the “preponderant part” of the obligation of a seller consists of the supply of labor or other services, the contract is not subject to the provisions of the Convention”. Many courts in reviewed European jurisdictions and US have refused to apply CISG in cases of installation or construction of the industrial plant, and other turn-key contracts. Other courts, however, treat them as sales of goods. Hence the matter of qualification of the turn-key contract is unsettled and requires case-by-case analysis, which creates high legal uncertainty. Therefore it is recommended to the parties resolve the matter in the contract by explicitly excluding application of the Convention pursuant to Art. 6 CISG.

Finnish sales’ law, adopting changes invoked by CISG, also incorporated elements of Common sales’ law, providing for the special solution to the described controversy. Sec. 2 FSGA states that the Act does not apply to a contract for the construction of a building or other fixed installation or structure on land or in water. By doing so regulation of the building industry in Finland is explicitly separated from sales and submitted to combination of the mandatory rules prescribed by special legislation and soft law norms, based on general terms and conditions, developed in cooperation between industry participants. Finnish legal order was influenced by German system, but does not have such level of codification. Provision of services in general has partial regulation under the Finnish Act on Services Provision (“Laki palvelujen tarjoamisesta”, 1166/2009), but

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351 See section 3.5 of the CISG Advisory Council Opinion No4, supra note 327.
354 Finnish Sale of Goods Act provides terms for the anticipatory breach (as in Anglo-American system), which gives the right to a party to suspend its performance in case the other party informed on possibility of his failure to perform (Section 61 (3)), there are also some possibilities to a party to declare contract avoided, if other party is in breach of the certain obligations (Sections 51, 54, 55).
mostly as implementation of European Parliament and Council Directive 2006/123/EC and for its purposes. Separate construction industry specific regulation is also introduced on EU-level. Special nature of this type of contract explains the need for the special development and diversity in its regulation.

4.2. DEVELOPMENT OF STANDARD CONSTRUCTION CONTRACTS

Started with industrial revolution in Europe in XVIII century and continued in XIX century development of the society and economy provided for the significant progress of the civil engineering contracts; increasing number and complexity of the objects, evolvement of the protection of the workmen rights, brought new elements to the content of the contracts, specific for the industry, e.g. new standards and specifications conditioned by new materials (iron), health and safety issues, time schedules and, of course, compensation for damages.

The avant-garde of construction contract case law was shaped in England in XIX century and first forms of non-standard and standard contracts progressed. The Royal Institute of British Architects (RIBA) developed one of the first standard contracts, and they received wide application in the early XX century. On their basis Joint Contracts Tribunal (JCT) later developed standard forms of 1963 and 1980. Institution of Civil Engineers (ICE) launched first edition of general conditions of contract in 1945.

The Associated General Contractors of America and the Federation of Americana de la Industria de la Construction in USA initiated probably the first contracts designated for the international construction.

Fédération Internationale Des Ingénieurs-Conseils (International Federation of Consulting Engineers), established in 1913 in Geneva by French, Belgium and Swiss association of engineers, with participation of wide number of new members published its first edition of the Conditions of Contract (International) for Works of Civil Engineering Construction in August 1957. The most often used in the construction of wind energy

357 See Reg Thomas, supra note 26, p.1.
358 Id. p. 46.
plants are Yellow Book, 1999 for design and construction of the plant in accordance with employer’s requirements, and Silver Book, 1999 for EPC/Turnkey projects.

There is number of other standard agreements in the industry, which have solid reputation and wide acceptance in the same business area. For instance ORGALIME (The European Engineering Industries Association, with headquarters in Brussels, representing the interests at the level of the EU institutions of the European mechanical, electrical, electronic and metal articles industries) published in 2003 Turnkey Contract for Industrial Works, which was claimed to be more balanced alternative to FIDIC Silver Book. FIDIC contract is subjected to respective national law, which unavoidably results in certain country-specific adjustments. Variety of effects, which each particular jurisdiction may have on FIDIC contract terms, their interpretation and applicability were researched in details by International Bar Association. For instance, in US and UK sales law may apply to these contracts, while in Germany (§631 BGB) and France (Art. 1779 FCC) they will be treated as a separate type of contract. In US in cases where the employer fails to grant an appropriate extension for the excusable delay or force the contractor to complete prior to the initially agreed date the doctrine of “constructive acceleration” should apply. In UK due to the “prevention principle” (doctrine “acts of prevention”), created by the extensive case law, in case the employer by valid act or omission (breach) creates delays in the performance, he cannot keep the contractor bound to the original specified completion date, on the contrary time becomes “at large”, meaning that completion should be performed within reasonable time, precluding claim of liquidated damages. In case of

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363 Id., p. 56, p. 90.
364 It may be express (when Employer explicitly directs the contractor to perform faster) or constructive (contractor effectively compelled to speed up the process irrespective of the excusable delays). Qualitative elements are: 1) the excusable delay exists on the side of the contractor; 2) timely notice on delay and request for the time extension shall be rendered to the employer; 3) extension shall be postponed or refused; 4) the owner must order fast performance (by director, coercion or otherwise, e.g. by indicating to claim LD for delay or other threats); 5) the acceleration shall take actual place and actual costs shall appear and be evidenced. For more details, historical development and case law examples see Geoffrey Creyke, Jr. and H. Randall Bixler, Constructive Acceleration under Government Contracts, Law and Contemporary Problems, 1964, Vol. 29, p.p. 137 – 159. See also Justine Sweet, Marc M. Schneier, Legal Aspects of Architecture, Engineering and the Construction Process, 9th ed., Cengage Learning, Stamford, 2013, p.p. 599 – 600; Michael T. Callahan (ed.), Construction Change Order Claims, 2nd ed., Aspen Publishers, Wolters Kluwer business, 2005, p.p. 108 – 116.
365 For more details, historical development and case law examples see Elizabeth Blackburn, Rachel Toney, The Prevention Principle, Liquidated Damages and Concurrent Delay in Shipbuilding Contracts,
two delay events, occurring within the same period of time and affecting the completion date, in UK and US precedent law is applicable regarding concurrent delay and calculation of related LD, and each of them has own specifics. At the same time English version of freedom of contract doctrine, providing for the literal (not purposeful) interpretation of the contract ensures risks of contract terms invalidation by the statute. In France public employer is always entitled to terminate the construction contract irrespective of the reasons; pursuant to Art. 1792-5 FCC ten years of strict and several liability of all the parties to the construction contract may not be limited in the contract.

As was described above, German BGB distinguishes work performance contract (Werkvertrag) – an exchange contract of services/works against money subject to two requirements: 1) services/works are successfully completed; 2) performance is accepted by the employer. Whenever construction is performed for public needs the contractual relationship is governed in addition to BGB by the VOB (2012) (Vergabe- und Vertragsordnung für Bauleistungen), which is a German standard of construction contract procedures (General Terms and Conditions) formed out of 26 documents with influence extending far beyond the state. Private parties (but not public) may apply VOB by the mere reference in the contract, as well as modify and adopt deviations or use other forms of contract, including FIDIC, which are also qualified as general terms and conditions (“GTC”) under German law. All GTC used within German legal policy should comply with special requirements of statutory law, previously the Law on Standard Conditions of Business (AGBG), which were replaced in 2002 by special section in BGB (§ 305 BGB et seq.). According to §307(1) BGB “provisions in standard business terms are invalid if, contrary to the requirement of good faith, they place the contractual partner of the user at an unreasonable disadvantage. An unreasonable disadvantage may also result from the fact that the provision is not clear and comprehensible”. Therefore there is a risk that number of


See FIDIC: An Analysis of International Construction Contracts, supra note 362, p. 78.

Id. p. 84.

Id. p. 90.

Id. p. 91.

See Manfred Pieck, supra note 106, p.134. See also German statutes in English translation http://www.iuscomp.org/gla/statutes/AGBG.htm.
FIDIC provisions will be void and null, e.g. risk transfer terms. Therefore if construction contract has close relation to Germany its mandatory rules will be applicable irrespective of choice of law and violation of moral principles, principle of good faith and public interests should be precluded at all times.

In Finnish construction industry is widely accepted General Conditions for Building Contracts YSE 1998 (RT 16-10660) (“YSE 98”), endorsed by the Finnish Association of Building Owners and Construction Clients. They apply if the parties expressly agreed to that, nevertheless some aspects of these terms have become part of good business practice and should be considered even by foreign contractors performing projects in Finland.

For instance, according to §29 YSE 98 guarantee (warranty) period for the built object is two years, but for hidden defects, as well as those caused negligently, by mistake or willfully, the liability will be extended for ten years.

Other standard contract form available in Scandinavia is General Conditions for the Supply and Erection of Machinery and other Mechanical, Electrical and Electronic Equipment (NLM 02E), issued in 2002 by the organizations for the engineering industries in Denmark, Finland, Norway and Sweden.

All contracts in this area can be divided into multi-party contract or network of related agreements with the sole purpose of building and constructing of an industrial object. Further specific (variety of participants and additional narrow regulation and standards) is conditional to the sector of construction: oil and gas sector, power sector (nuclear or renewable (solar, hydro, wind) energy), processing, other industrial facilities, buildings or infrastructural objects. Usually construction contract is made between the following parties: the employer (purchaser, owner of the plant/building); the contractor (supplier, general contractor, providing for the construction and supply of the building materials and equipment); the engineer (expert representing the employer, but having powers to settle disagreements and supervise the project); the subcontractors, performing separate functions of contractor; utility companies and authorities. Common law trend, established also in most of FIDIC editions, is on the side of three-party main (framework)

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agreement, with mandatory participation of the engineer, representing interests of the employer, which demonstrates the balance of interests shifted to the advantage of the plant owner, customer under the agreement. Continental law trend, reflected in the ORGALIME, insists on the strict two-party agreement, each of which has own representative (site-manager); disputes might be referred to adjudication by an independent expert.

In practice usually the standard terms or general conditions are used as a basis, auxiliary or supplementary contractual document to the main agreement, with stipulation of the special conditions or deviations from the general terms. Such main agreement between the parties is called in terms of FIDIC Silver Book (“FIDIC”) “Contract Agreement” and “Particular Conditions” (Sub-Clauses 1.1, 1.5 and 1.6) or in terms of ORGALIME Turnkey contract (“ORGALIME”) “Main Contract Document” (Sub-Clause 2.2).

It is worth mentioning that standard construction contracts, reviewed for the purpose of this research, use different terms in relation to the purchaser/employer: FIDIC refers to the “Employer” (Sub-Clause 1.1.2.2); ORGALIME utilizes term “Purchaser” (Main contract document); same term used in NLM 02E; YSE 98 names the “Client” (Glossary); and VOB/B engages the “Principal” (§1 No.3). Nevertheless all forms use term “Contractor” in relation to the counterparty, which clearly indicates separation from the “Seller” in the sales contract.

Most common in construction industry for many years has been engineering, procurement and construction (EPC) or so called turn-key contract, under which the contractor supplies to the employer complete and ready for operation/production facility376. It has certain drawbacks, noted as result of growing experience in utilizing EPC form, such as heavy losses on the side of contractors, caused high scale of bankruptcies in the industry world-wide, and as a consequence - increase in the construction insurance costs, problems with projects’ bankability and financing. But flexibility of EPC structure, possibility to finance works and deliveries from various sources, as well as utilizing payment guarantees and bonds, valuable features of available supervision and disputes settlement ensure its future application in the industry. Building and construction industry contracts present successful fusion of various remedies, each of which serves its special purpose. For the purpose of the current research we consider implementation of the said remedies in four

standard forms of the construction contracts: 1) FIDIC Silver Book Conditions of Contract for EPC/Turnkey Project, hereinafter in the text referred to as “FIDIC”, 2) ORGALIME Turnkey Contract for Industrial Works, hereinafter in the text referred to as “ORGALIME”; 3) General Conditions for Building Contracts YSE 1998 (Finnish standard), hereinafter in the text referred to as “YSE 98”; 4) The Construction Contract Procedures Part B (German standard), hereinafter in the text referred to as “VOB/B”.

4.3. **Intermediate Conclusions**

Performed study demonstrates that division between contract of sale and contract for service exists in all reviewed jurisdictions. Nevertheless in Civil law orders this separation is incorporated in statutory law, while in Common law it only follows from one part of the court practice. Therefore there is less legal certainty in qualification of the contract in Commonwealth system. Importance of this detachment becomes obvious when we analyze terms of CISG and governed by it system of remedies. CISG introduces hierarchy of remedies and restricts or conditions freedom of their application in respect of sale of goods. CISG excludes from its scope: 1) goods to be manufactured where substantial part of the material is supplied by the buyer; 2) preponderant part of the contract is labor or service provided by the seller. Qualification under CISG is based on the following criteria: 1) economic value (*ex ante*) as primer criterion; 2) essentiality as supplementary criterion; 3) case-by-case approach in all cases.

Civil law engages more liberal approach to termination of the service contract. Contract for building and construction often has additional specific regulation both on national and international level. In order to avoid qualification of the international construction projects under CISG or local sales laws and following uncertainty and instability, number of international and national industrial organizations developed respective standards of general terms and conditions directed at regulation of specific relationships in multiparty construction projects. The risk of national legal order interference still remains and parties need to pay close attention to the selection of law, governing the contract. Nevertheless soft law codifications play significant role in the industry and international contracting and their application along with settlement disputes under them have wide practice. These general terms and conditions provide high level of unification and harmonization of legal norms from various legal orders. Additionally they demonstrate successful fusion of borrowed rules into integrated system of remedies, serving both national and international contracting.
Below I review and analyze specifics of each earlier studied remedy in the context of several industrial standards, both domestic and global, and observe interplay between them as elements of the whole remedial system adopted within one contract.

4.4. SPECIFICS OF SOME REMEDIES UNDER STANDARD CONSTRUCTION CONTRACTS

4.4.1. Damages’ Compensation

Usually damages’ compensation is provided under the law as a default remedy in case the contract is silent in this matter, but may be specifically set forth in the contract in respect to its breach as a whole or regarding a particular term. Most of legal systems allow parties to agree in the contract the extent and measure of damages recoverable, but they usually provide default provisions, which may or may not be circumvent by the contract terms.

Given that one of the main disadvantages of this remedy, as described previously, is usual under-compensation, performed studies demonstrate that in certain circumstances Common law makes supra-compensatory damages available under the construction contracts based on the economic analysis reasoning. As was explained above, in Commonwealth courts breach of a contract is primary evaluated from the “substantial performance” doctrine position, and subsequently – from perspective of measure of damages for the contractor’s breach. Higher measure of damages is grounded in the

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379 In most cases the owner is awarded cost of completion, unless it exceeds diminution in market value, See cases Carter v. Quick, 263 Ark. 202, 563 S.W.2d 461, 1978, http://law.justia.com/cases/arkansas/supreme-court/1978/77-186-0.html; W. G. Slugg Seed & Fertilizer, Inc. v. Paulsen Lumber, Inc., 62 Wis.2d 220, 225-
difficulty for the owner to select subcontractors and supervise construction process, which in turn creates incentive for the general contractor to breach. Hence such measure is justified when main contractor intentionally or negligently fails to provide for commercially reasonable level of supervision or when exact damages are hard to calculate. However, as established above, downside of high damages is inefficient contractor’s overinvestment in monitoring and respective price increase.

Damages’ claims in construction from the contractor’s point of view may refer to delay, disruption, acceleration, differing site conditions, changes in scope, pass-through and termination claims; from the employer’s perspective claims often relate to liquidated damages, delay damages, defects damages and damages for termination.

Standard construction contracts regarding remedy of damages either specify it as a separate remedy (sometimes alternative) or joined with other remedies in the limited cases (usually when it comes to product liability and third party damage or injury). Typically standard contracts prescribe or limit damages’ compensation in the indemnities’ sections and limitation of total liability clauses. The latter is considered in a separate sub-section on limitation of liability below.

According to Sub-Clause 8.9 FIDIC “Consequences of Suspension” if the Contractor suffers Delay and/or incurs Cost as a result of the Employer’s instruction to suspend the Work, subject to notice on such, the Contractor should be entitled to extension of time and payment of the Cost (unless he contributes to reason for suspension by faulty design and similar); additionally under Sub-Clause 8.10 FIDIC the Contractor should be entitled to payment of the Plant and Materials which are delayed in delivery due to the suspension. If testing is delayed due to the Employer he should compensate the Contractor’s Cost and provide for extension of time if necessary (Sub-Clauses 4.4(5) and 10.3 FIDIC). Pursuant to Sub-Clause 15.4 (c) FIDIC “Payment after Termination”: “After a notice of termination [by the Employer]… the Employer may recover from the Contractor any losses and damages incurred by the Employer and any extra costs of completing the

26, 214 N.W.2d 413, 416, 1974.
382 Application of penalties or contracted liquidated damages and price withholding are justified in the similar cases, See Daniel A. Farber, supra note 80, p. 1477.
384 All capitalized terms are used herein as they are implemented in the respective standards.
Works… After recovering any such losses, damages and extra costs, the Employer shall pay any balance to the Contractor”. Sub-Clause 16.4 (c) “Payment on Termination” FIDIC: “After a notice of termination [by the Contractor] … the Employer shall promptly pay to the Contractor the amount of any loss of profit or other loss or damage sustained by the Contractor as a result of this termination”. All other sums due to the Contractor upon termination, including value of the Works, Goods and Contractor’s Documents, should be calculated according to Sub-Clause 3.5 FIDIC “Determinations”. Upon optional termination the Employer should pay to the Contractor for the performed works, ordered materials and works, other related reasonable costs, removal of the Temporary Works and Equipment, repatriation of the stuff employed specifically for the purpose of the Works (Sub-Clause 19.6 FIDIC).

ORGALIME refers to damages’ compensation in the following situations. Under Sub-Clause 5.4 the party submitted documentation with error or omission should bear the costs of additional work or material resulted from such error/omission. In a number of cases the Contractor should be compensated for additional cost and expense resulted from the delay, suspension or variation due to the Employer, and also from Force-Majeure or the Employer’s Risk events (Sub-Clauses 6.5, 7.6 and 10.3 ORGALIME). The Contractor should be liable for all defects due to incorrect design under Sub-Clause 17.7 ORGALIME (unless they are attributable to the Purchaser’s request). According to Sub-Clause 20.2 the Contractor should be liable for and should make good any damage to the Works prior to taking-over, unless it is caused by the Purchaser’s negligence or any of the Purchaser’s Risk events. Under Sub-Clause 20.4 “Liability for Personal Injury and Damage to Property”: “The Contractor shall be liable for damage to the Purchaser’s other property than the Works when such damage is caused by the Contractor’s negligence”. In accordance with Clause 22 “Confidentiality” ORGALIME: “A party who is in breach of [Confidentiality obligations] … shall compensate the other party for the damage caused by such breach”. In case the contract is terminated due to either party’s default, the aggrieved party is entitled to compensation for the loss she suffered with respective limitations considered below (Sub-Clauses 19.5 and 19.8 ORGALIME). In case of contract termination under the Purchaser’s

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385 Under Sub-Clauses 15.4 (a) and 15.4 (b) FIDIC the Employer may send a claim to the Contractor and withhold money based on such according to Sub-Clause 2.5 “Employer’s Claims”, as well as withhold further payments until the costs of design, execution, completion and remedying any defects, damages for delay in completion (if any), and other costs incurred by the Employer, have been established.

386 Sub-Clause 20.5 ORGALIME refers to an equal liability of the Purchaser in case of damage cause by its negligence.
discretion he shall compensate to the Contractor under Sub-Clause 18.3 ORGALIME: i) unpaid balance for the performed part of the Works; ii) all costs for the material purchase prior to the termination notice; iii) all reasonable costs and charges incurred by the Contractor due to termination; iv) other direct expenses of the Contractor and his subcontractors related to the termination.

YSE 98 refers to remedy of damages in case where impediment is created by the client, another contractor or due to a force-majeure event, and a threat of work suspension or delay appears, and the contractor believes that he is entitled to extension or compensation of his costs. In such case the contractor should notify the client and recommend him to carry out negotiations to reduce and duly calculate the loss or damage (§23 (2) YSE 98). If the contract is interrupted due to a force-majeure event, the client should compensate the contractor for the site security, heating and other energy costs, and the costs of protecting, servicing and maintaining the site as consequence of the interruption (§50 YSE 98). In case of justified termination by the client and prevention from the contractor’s side for the continuation of the work, he should be liable for compensation of all additional loss or damage caused by the delay; additionally damage caused by the fact of termination can also be deducted from remuneration to be paid by the client to the contractor for the completed part of the work prior to termination (§82(4), §83(2) YSE 98). The client in turn should provide compensation for the performed part of the work, use of material and equipment on the site taken over upon termination. In case of justified termination by the contractor he should be entitled to receive remuneration on pro-rata basis for the completed work and compensation for the “demonstrable loss or damage incurred from termination …including reasonable compensation for the lost profit” (§86(2) YSE 98).

According to §5 VOB/B in case of the contractor’s delay in completion the principal may demand compensation of damages while maintaining the contract or set the reasonable deadline for completion with threat of termination upon delay of the latter. Pursuant to §6 No.5 VOB/B if one party to contract is responsible for the obstacles to performance, the other party may claim verifiably incurred damage; additionally indemnification for loss of profit may be claimed in case of intentional act or gross negligence. In case principal rightfully terminates due to the contractor’s breach, he may demand damage compensation due to non-performance (§8 No.2(2) VOB/B).

Furthermore issue of damages’ compensation under standard contracts in construction arising out of the employer’s requested or otherwise necessary extra work or so called
“variations”. According to Sub-Clause 13.1 FIDIC the Employer prior to issue of the Turn-Key Certificate has right to initiate variations (changes to specifications or the ordered works) and in general the Contractor should carry them out. Pursuant to Sub-Clauses 13.3 and 13.5 FIDIC the adjustment to the Contract Price should be determined (including “reasonable profit”) and respective Provisional Sums should be paid. Under Sub-Clause 3.5 FIDIC regarding determinations, if the agreement is not reached between the parties, then “the Employer shall make a fair determination”.

Clause 8 ORGALIME obliges the Contractor to perform requested variations but only subject to reached agreement on respective changes to the Contract (price, completion time etc.); additionally the Purchaser should reimburse any costs of the Contractor for the evaluation of the variation. In both cases the Contractor has to perform variations necessary due to changes in law, and all disputes should be subject to dispute resolution.

YSE 98 provides for the mechanism of building plan, completion date and price alterations due to the modifications, demanded by the client, explaining which costs and overhead may be included and prescribing right of the client to approve subcontractor’s work and its additional costs. If an agreement on the proposed by the contractor tender is not reached, it should be carried out and compensated on the cost-price basis.

According to §2 No.2(2) VOB/B in case the agreed volume of the work during execution exceeds 10%, then a new price must be agreed. If requested work was not foreseen in the contract, the contractor is entitled to the additional compensation subject to notification prior to launch. If a lump sum is agreed and significant addition to the agreed performance follows, the reasonable compensation should be granted. Arbitrary deviations by the contractor should not be compensated, and such performance should be removed, unless the principal accepts such work and then should compensate for it. Additionally the principal should reserve the right to order changes in the construction plan; the contractor has to perform not agreed, but necessary for the project execution work under the principal’s request (§1 No.3-4 VOB/B).

All discussed above pros and cons of the damages remedy are relevant when it comes to the construction contract claims. As a general rule damages for the breach of contract can be awarded only if they represent actual loss suffered by the aggrieved party and would place her in the same position as if the contract was not breached. From the position of

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law unjust enrichment should be prevented and all excessive damages are not recoverable irrespective of the method of calculation and representation in the court. In Common law jurisdictions punitive or exemplary damages may be claimed as punishment to deter misconduct, but they are rarely awarded in construction claims. Additionally submitting punitive damages claims without substance in fact or in law, or lacking in merit can be sanctioned by the court. Improper damages’ calculation may result in failure to obtain remedy, e.g. error in damages’ calculation has resulted in award of only nominal damages to the contractor in case Indian River Colony Club, Inc. v. Schopke Construction & Engineering, Inc. Hence the diligent calculation of the damages prior to the claim is crucial. There are several general methods of calculation available: 1) actual cost; 2) estimated cost; 3) total cost, and 4) jury verdict (specific for US).

Courts are naturally favor actual damages method, also referred to as “segregated”

http://www.leagle.com/decision/1995128263F3d1169_11096.xml/PETEREIT%20v.%20S.B.%20THOMAS,%20INC;%20City%20of%20Vista,%20994%20F.2d%20650%20(9th%20Cir.),%201993.


http://openjurist.org/930/f2d/872/dawco

http://www.king-law.comArticles/03_TotalCost.pdf


See cases William Schwartzkopf, John J. McNamara, supra note 233, p. 6.

619 So.2d 6, 1993.


or “discrete” cost method, based on full documentation of the expenses and evaluation of their reasonableness. Hence lack of evidence in accounting records may result in denial of claims. Estimation requires rational accuracy and comparative analysis with similar situations.

Total cost method is the most preferable to the contractor, who would like to claim damages as difference between total actual costs incurred (plus overhead and profit) and the bid amount. Unfortunately often this measure is rejected by the courts due to the flaws in the following items: 1) the impracticability of proving actual losses directly; 2) the reasonableness of the contractor’s bid; 3) the reasonableness of the contractor’s actual costs; and 4) lack of the contractor’s responsibility for the added costs. Therefore four-prong test should be carried out in order to establish all above stated elements.

Despite challenges associated with the total cost method it is recognized and acceptable in certain circumstances, e.g. when actions of the employer prevent the contractor from the detailed bookkeeping and direct causal link is established between those actions and contractor’s damages, alternatively if other methods are difficult to utilize or they do not serve effective quantification of the damages.

It is important to keep in mind that not all the damages caused by either party may be limited or otherwise regulated in the contract because of the mandatory provisions of the governing law. Usually damages to parties’ property should be compensated pursuant to the applicable law, if they are caused by willful misconduct or gross negligence (Sub-Clause

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17.6 FIDIC; Sub-Clauses 20.4 - 20.5 ORGALIME). Personal injury damages and damages to third parties’ property are governed by the mandatory norms and in general cannot be limited or restricted, and are called “product liability”401 (Sub-Clause 18.3 FIDIC; Sub-Clause 20.6 ORGALIME).

In practice both parties should insure product liability risks in accordance with respective insurance terms and conditions of the contracts (Clause 18 FIDIC “Insurance”; Clause 21 ORGALIME “Insurance”).

4.4.2. Specific Performance and Substitute Performance

Not always compensation of damages is offered as a primer or alternative remedy under the standard construction contracts; often it is conditioned to initial request for the substitute performance or specific performance in the form of the remedial works/mandatory repairs.

Sub-Clause 4.1 FIDIC defines Contractor’s contractual obligation as follows: “design, execute and complete the Works in accordance with the Contract, and … remedy any defects in the Works”. Sub-Clause 11.1 FIDIC obligates the Contractor by the end of the Defects Notification Period to “execute all work required to remedy defects or damage, as may be notified by the Employer on or before the expiry of the” said period. According to Sub-Clause 5.8 FIDIC all defects in the Contractor’s Documents should be corrected at the Contractor's cost, notwithstanding any consent or approval under this Clause. If the Contractor does not comply with the Employer’s request for the Remedial Work, the Employer is entitled to employ and pay other persons (at the Contractor’s cost) to carry out the work (Sub-Clause 7.6 FIDIC). In case the Contractor fails to carry out Completion Tests within 21 days’ period upon notice from the Employer, the Employer’s personnel may proceed with the Tests at the risk and cost of the Contractor (Sub-Clause 9.2(3) FIDIC). Pursuant to Sub-Clause 11.2 FIDIC all defects in the design of the Works, Plant, Materials or workmanship, as well as improper operation or maintenance attributable to the Contractor should be remedied at the risk and cost of the Contractor. Sub-Clause 11.4 FIDIC provides the Employer with various options in case of the Contractor’s failure to remedy defects, including the possibility to carry out work himself or by others, in a

reasonable manner and at the Contractor’s cost (but in this case not his risk). If the Purchaser is in delay for removal from the Contractor’s premises of his materials upon termination, then the Contractor is entitled to remove them to the suitable location for storage at the Purchaser’s cost and risk (Sub-Clause 18.7 ORGALIME).

ORGALIME offers substitute performance in a limited number of cases, e.g. under Sub-Section 15.4 the Contractor may remedy defects not attributable to him and replace any wearing parts at the expense of the Purchaser prior to the Tests after Completion, if the Purchaser fails to do so. But if the Contractor fails to remedy a notified defect attributable to him within grace period, the Purchaser may himself take necessary reasonable measures to remedy it at the Contractor’s cost (Sub-Clause 17.14 ORGALIME). Specific performance as a primer remedy is considered on several occasions. If upon join inspection after Mechanical Completion the Purchaser notifies to the Contractor work, which should be additionally performed or corrected, the Contractor should perform under the request prior to the commissioning (Sub-Clause 12.3 ORGALIME), otherwise the expert shall resolve the dispute. In case Completion Tests fail the Contractor should immediately remedy the deviation (Sub-Clause 13.5 ORGALIME); if the Contractor declares himself unable to remedy such deviation, the Purchaser is entitled to the liquidated damages for performance. Prior to the Tests after the Completion the Contractor should be given chance to inspect, test and adjust Works and remedy the defects he is liable for (Sub-Clause 15.4 ORGALIME). If the Contractor fails to pass Tests after Completion he should immediately remedy the deviation (Sub-Clause 15.8 ORGALIME), but if unable to do so – pay the Purchaser liquidated damages. Pursuant to Sub-Clause 17.1 ORGALIME the Contractor should remedy any defects in the Works, which are due to faulty design, materials or workmanship.

§26 YSE 98 sets forth liability of the contractor for implementation of the building contract, as well as modification and additional work. Pursuant to §43 YSE 98 the contractor is obliged to implement modifications demanded by the client unless they significantly change the nature of the contract and it should be subject to the separate written agreement, excluding small and urgent modifications. In case the final result or any part of it does not meet the requirements of the contract it should be repaired or replaced by the contractor under §27(1) YSE 98, unless the correction is not necessary or its cost would be unreasonable, in which case the contractor should reimburse loss in value under §27(2) YSE 98. The contractor should at his own expense repair the defects emerging in the building work during the guarantee period, unless they occur due to reasons beyond his
control; if the contractor delays in carrying out the repair, the client may do the work at the contractor’s expense upon a written notice. According to §72 YSE 98 the contractor must without delay carry out measures, which are found during the handover inspection to be his responsibility. In general if the contractor neglects any of his contractual obligations the client has right to ensure that obligation is fulfilled at the expense of the contractor, unless the contractor performs within reasonable time upon the client’s request (§91 YSE 98).

VOB/B also refers to remedies of the specific performance and substitute performance. According to §12 No.3 VOB/B acceptance of the work may be denied by the principal due to material defects until they are remedied. Under §13 No.5(1) VOB/B the contractor is obliged to remedy at his own cost all defects appearing during limitation period for warranty claims, which are attributable to his performance. If the contractor fails to meet the request on remedy within reasonable time set by the principal, the latter may remedy defects at the contractor’s cost (§13 No.5(2) VOB/B).

UNCITRAL Guide to the construction contracts advises to provide for the obligation of the employer to send a written notice to the contractor on the engagement of the substitute contractor and terms of the agreement in all cases. Guide also instructs to divide between serious and not serious defects, and diversify available remedies based on that, escalating from the repair of the defects and entire change of the defecting part, refusal of acceptance and refusal of payment for defective part, demand modifications and of re-testing after modifications, price reduction, engagement of repairs by third party at the expenses of the contractor, up to termination of the contract and demand to remove defective works completely from the site at the expenses of the contractor.

4.4.3. Penalty

Alternative to the remedy of damages in certain cases is penalty, which does not require the proof of loss. These two remedies usually cannot be accumulated in relation to the same breach, as described above. In construction contracts penalty is typically incorporated in the form of the remedy for the late performance (delay).

For instance, penalty as interest for the late payment is stated in the Sub-Clause 14.8 FIDIC (called “financing charges”); Sub-Clause 9.3 ORGALIME (called “late payment interest”); §41 YSE 98 (rate defined under Finnish Interest Act). In case of delay FIDIC

403 Id., p.p. 204 – 212.
404 Id., p. 219.
and ORGALIME provide for the liquidated damages, therefore these two standards do not use term penalty and do not distinguish between penalty and LD, instead use various terms by defining other penal remedies separate from LD and damages (costs, losses) compensation.

§18 YSE 98 explicitly provides for the “penalty” calculated in the way similar to that used in order standards to calculate LD (0.05% of the contract price per contract day calculated for maximum of 50 working days unless the contractor acted willfully or in gross negligence). Reference to the agreed in advance penalty in case of delay caused by client is made in §35(1) YSE 98.

§8 No.7 VOB/B states that “a time-related contractual penalty incurred due to default may only be demanded for the period up to the termination date of the contract”. If penalties are provided in the contract, then pursuant to §11 VOB/B §§339-345 BGB shall apply. If the principal accepted the work, he may demand the penalty only if he reserved such right at the acceptance.

UNCITRAL Guide to the construction contracts recommends stipulating the amount, which simultaneously provides reasonable compensation to the purchaser and applies “moderate pressure” on the contractor, in order to prevent interference from different legal orders restraining penalties.

4.4.4. Liquidated Damages and Limitation of Liability

Liquidated damages (LD) and limitation of liability (LL) clauses widely utilized in the construction industry contracts. LD clauses are usually applied in the cases of delay and extension of time for the performance; LL usually considers total liability under the contract or its respective part (particular obligation).

Common law doctrine has developed three types of delay – i) “critical”, caused by the employer; ii) “culpable”, attributable to the contractor, and iii) caused by the “neutral” events, – and related system of concurrent and sequential delay. Nevertheless there are different approaches engaged in American and English law in respect of the concurrent delay and related award of LD. US contract law implies warranty that neither party may

405 Id., p. 218.
delay and hinder the due performance of the other party, therefore in case of concurrent delay both parties are in default. American courts and arbitration provide examples of three solutions to the issue: 1) “time but no money”; 2) apportionment; 3) liability based on the detailed delay analysis. First approach derives from the early cases, when apportionment was prohibited. Later this rule was abandoned due to popularity of the LD clauses, complexity of the actual contract relationships and principle of fairness. Under the modern rule in favor of apportionment American courts define ratio between each party’s fault, investigate bad faith in the owner’s actions, and based on the findings may award LD. In other words, where it is possible to separate costs resulting from each party’s cause, courts apportion delay damages. In case where segregation is not possible, no LD are awarded, but the extension of time is granted instead. It is important to mention that the contractor bears the burden of proof with reasonable degree of accuracy.

In English law the prevention principle is predominant, as was described above. First approach is based on a “dominant cause”, insisting that only one risk event is dominant for the project delay. However application of this approach is overruled in case

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H. Fairweather & Co. Ltd. v. London Borough of Wandsworth (1987)\textsuperscript{414} due to various drawbacks\textsuperscript{415}. Second approach is known as “Malmaison”\textsuperscript{416}, accordingly if there are two relevant events and one of them is the employer’s risk, the contractor should be entitled to time extension and other event(s) should be ignored. Principle of apportionment is not accepted in English courts.

Resolving conflict between penalty and LD is worth mentioning new emerging approach, expressed in the construction case Azimut-Benetti Spa v. Darrell Marcus Healey\textsuperscript{417}, where the court has not applied standard test of genuine pre-estimate, but instead – “commercial justification” rising from “professionalism” of both contracting parties (they have had access to the expert advice and terms have been entered freely) that makes unenforceability of the LD clause as penalty unarguable. Additionally dominant purpose of the clause has been evaluated and declared not deterring the breach. The court has upheld the agreement and the LD clause.

Standard construction contracts provide for LD clauses in various cases: delay, non-compliant performance, and non-performance. Specific for the industry is also a compensation for the lost productivity, which in English law is related to the late performance\textsuperscript{418}, and compensating for the surplus the employer would get, if the contract is performed on time. Additionally often guarantees/warranties provided by the Contractor under the construction contract are supplemented by the liquidated damages clauses and limitation of the aggregate (total) liability of the Contractor.

Pursuant to Sub-Clause 8.7 FIDIC the Contractor in delay should pay delay damages (“sum, stated in the Particular Conditions”), calculated for each day of default at the stipulated in the contract rate, however, the total amount of which should be limited to a stipulated maximum; these damages should be exclusive remedy for this type of default and keep the contract and obligations intact. Sub-Clause 12.4 FIDIC “Failure to Pass Tests after Completion” provides for possibility to recover damages for non-performance (“sum

\textsuperscript{414} 39 Build.L.R. 106, QBD (OR), 1987.
\textsuperscript{415} Difficulty with the choice of the prevailing event in practice; conflict with prevention principle and other, See Richard J. Long, supra note 366, p. 14; Kimberley Eyssell, supra note 366, p. 4.
\textsuperscript{416} Based on the case, which created precedent, Henry Boot Construction Ltd. v. Malmaison Hotel Ltd., BLR 509, 2000, \url{http://www.bailii.org/ew/cases/EWCA/Civ/2000/175.html}
\textsuperscript{418} See Reg Thomas, supra note 26, p. 149.
is stated in the contract or its method of calculation is defined”), which may be defined as liquidated damages, but the Contractor first should provide for the adjustments and modifications of the works, attempting to rectify non-performance. Total liability should be limited to the sum stipulated in the Particular Conditions (Sub-Clause 17.6 FIDIC).

Sub-Clauses 16.1 and 16.2 ORGALIME explicitly refer to respectively Liquidated Damages for Delay and Liquidated Damages for Performance; Sub-Clause 16.3 ORGALIME limits the Aggregate Liquidated Damages. Accordingly in case the Works do not fulfill the performance undertaking, requirements for testing or guarantee specified in the Contract and the Contractor declares himself unable to remedy the deviation (Sub-Clauses 13.5, 15.8, 16.2 ORGALIME) the Purchaser is entitled to LD, with limitation of Performance Liquidated Damages to 5 % of the contract price (Sub-Clause 16.3 ORGALIME). So called “termination fee” stipulated in case of the contract termination “for the Purchaser’s convenience”, in my opinion, can be treated as LD or a penalty: 4% of the Contract Price or 6% of the unpaid part of the Contract Price (Sub-Clause 18.4 ORGALIME).

YSE 98 does not explicitly mention liquidated damages.

§8 No.1(2) VOB/B refers to entitlement of the contractor to the “stipulated compensation” in case of the contract termination by the principal.

Limitation of liability (LL) is implemented in Sub-Clause 17.1 (b) FIDIC “Indemnities”: “The Contractor shall indemnify and hold harmless the Employer … against and from all claims, damages, losses and expenses (including legal fees and expenses) in respect of: damage to or loss of any property, real or personal (other than Works), to the extent that such damage or loss: (i) arises out of or in the course of or by reason of the design, execution and completion of the Works and the remedying of any defects, and (ii) is not attributable to any negligence, willful act or breach of the Contract by the Employer…” and the Sub-Clause 17.6 FIDIC “Limitation of Liability”: “Neither Party shall be liable to the other Party for loss of use of any Works, loss of profit, loss of any contract or for any indirect or consequential loss or damage which may be suffered by the other Party in connection with the Contract, other than under [Payment on Termination] and [Indemnities clauses]”. Additionally scope of liability is regulated by the provisions related to the warranty period, in terms of Sub-Clause 1.1.3.7 FIDIC “Defects Notification Period”, which by default should be limited to one year, unless Particular Conditions provide otherwise. Under Clause 11.3 FIDIC this period may be extended for the period when the Work or any Section of it may not be used due to defects, but not longer than for two years.
Liability of the Contractor is limited if the Tests After Completion were postponed for more than 180 days after the agreed time due to the reasons not attributable to the Contractor – the Works should be deemed passed the Tests in such case (Sub-Clause 15.5. ORGALIME). Sub-Clause 16.5 ORGALIME limits right of the Purchaser to collect LD not only by amount, but also by introducing limited period for the claim – 180 days from the prescribed date. In accordance with Sub-Clause 17.1 ORGALIME deviation from the performance guarantee should not be itself considered a defect. According to Sub-Clause 17.2 ORGALIME the Contractor’s liability should only cover defects, which appear within the warranty period, which may be extended not more than for one more year (Sub-Clause 17.4 ORGALIME). Pursuant to Clause 17.5 ORGALIME the Contractor is exempt from liability for defects caused by number of circumstances arising after taking over, such as improper operating conditions, incorrect maintenance etc. Additionally Sub-Clause 17.10 ORGALIME provides possibility for sharing expenses for remedying the defects between both parties. Clause 25 ORGALIME “Limitation of Liability” states: “The remedies for breach of contract which are specified in these conditions shall be the sole remedies available. Neither party shall, except as specified in the Contract, whether in contract, tort (including negligence) or otherwise, be liable for or obliged to indemnify the other party for any direct or indirect loss or damage such as, but not limited to, loss of profit, loss of use or production, loss of data and loss of contracts. This limitation of liability shall not apply, however, where such loss or damage has been cause by willful misconduct or Gross Negligence”.

Default provisions of §25 YSE 98 state that each party’s liability should include obligation to compensate all loss or damage caused by breach or act to another party, except for the loss or damage, which could have not been prevented “by taking the utmost care”. Failure of the client to notify obvious defect to the contractor shifts liability for the following additional loss or damage caused by the defect to him, unless it is caused by serious negligence or abandoned work (§62 YSE 98); therefore the contractor’s liability is limited, where the client contributes to the caused damage. In similar way if the client neglects contractor’s warning regarding non-compliance of the goods or contract documentation, provided by the former or the third party, the client bears the undertaken and notified risk (§33 YSE 98). Liability during guarantee period is limited to two years (§29 YSE 98), and to ten years in respect of hidden defects or defects caused by gross negligence (§30 YSE 98). If either party neglects participation in the necessary measurement, results carried out in the presence of one party becomes binding on both,
except for the obvious fault (§67 YSE 98). Neither contracting party is liable for loss or
damage which she could not have avoided even by taking the utmost case (§25(2) YSE 98)
or in case of a force-majeure even (§35(3), §85 YSE 98)

§10 VOB/B establishes that parties should be liable to each other for the own fault
and for the fault of their legal agents in line with German doctrine of culpable liability. If
the principal avoids acceptance, the work should be considered accepted twelve working
days after serving notice on acceptance by the contractor or upon utilization of the work by
the principal de facto (§12 VOB/B). If no limitation period for warranty claims is agreed in
the contract, it should be four years for construction work and two years for other related
work, machinery and equipment, and one year for accessories (§13 No.4 VOB/B). Additionally
contract may provide for restriction and extension of liability in “justified
special cases” (§13 No.4 VOB/B).

UNCITRAL Guide to the construction contracts recommends that the agreed sum of
the compensation (LD) is fixed by accessions and the limit to the escalation is introduced
(LL). Limitation may apply not in all cases and once it is reached, parties should optionally
agree on another remedy. It is essential to provide detailed conditions of
warranties/guaranties to avoid over- and under-performance. It is also important to
understand that LL clauses generally cannot circumvent provided indemnities, which
usually releasing the other party from all and any possible expenses and losses at the
expenses of the party committing to the indemnity419. Hence in order to avoid conflict
between desirable limitation of liability and total indemnities parties should pay special
attention to their drafting and careful utilization of total indemnification, which may not be
enforceable in certain jurisdictions.

4.4.5. Price Adjustment

Remedy of price adjustment in construction contracts may take form of either price
reduction or price increase, or definition of a “reasonable price”.

Reduction of price is usually provided in case of contractor’s inability to remedy the
defects which do not preclude exploitation of the result of the works.

Under Sub-Clause 9.4 FIDIC in case the Works or Section fail to pass the Tests on
Completion repeatedly, the Employer may issue Taking-Over Certificate and the Contract
Price should be reduced by the amount corresponding to the reduced value as result of the

419 See e.g. Sub-Clauses 17.1, 17.5 FIDIC; Sub-Clause 23.2 ORGALIME.
failure. If the Contractor fails to remedy notified defect or damage by the set date and the work is to be executed at the cost of the Contractor, the Employer may agree or determine a reasonable price reduction in the Contract Price (Sub-Clause 11.4 FIDIC).

Under Sub-Clause 17.14 ORGALIME if the Contractor fails to remedy remaining defect and the Purchaser chooses not to repair it at the Contractor’s costs or the defect persists after such repair, the Purchaser may demand price reduction corresponding to the reduction in value of the Works due to the defect, but not more than aggregate of 15% from the Contract Price.

Pursuant to §27(2) YSE 98 if the defect in the finished result is such that its correction is not necessary and the cost of correction would be unreasonable, the contractor, instead of affecting a repair or replacement, is obliged to reimburse the loss in value, the amount of which is defined in accordance with the principles of the contract or agreed additionally. In accordance with §29(3) YSE 98 for the defects which do not essentially inconvenience the use of the finished result, parties may agree on the reimbursement for the reduction in value.

Under §13 No. 6 VOB/B if the remedy of the defects is unreasonable for the principal or is impossible, or would require disproportionate expense and is therefore refused by the contractor, the principal may reduce the compensation by declaration to the contractor based on §638 BGB.

Price increase is usually considered in case of variation or suspension of works due to the Employer; but there are other reasons for increase as well. Suspension is interruption in the performance requested by the Employer and compensated by him.

Under Sub-Clauses 8.9 (1 b), 8.10 FIDIC and Sub-Clause 16.1 (4 b) FIDIC in case of suspension the Contractor is entitled to be paid value of the Plant and Material suspended in delivery for more than 28 days, other related costs and reasonable profit, which should be added to the Contract Price. If the Employer hinders performance of the Completion Tests more than 14 days the Contractor is entitled to the payment of the related costs plus reasonable profit, which should be added to the price subject to respective notice to the Employer (Sub-Clause 10.3 (2b) FIDIC). According to Sub-Clause 12.4 (3) FIDIC if the Employer hinders Contractor’s access to the site in order to investigate tests’ failure or carry out modifications, the Contractor should be entitled to the related costs and reasonable profit, added to the Contract Price (subject to notice).

Pursuant to Sub-Clause 10.3 ORGALIME in case of voluntary suspension the Purchaser should compensate to the Contractor “all necessary expenses arising from: a) de-
and remobilization of the personnel and equipment; b) safeguarding the Works and …related items; c) personnel, subcontractors, equipment kept available; d) moving the Works; d) other expenses…as a result of suspension”.

YSE 98 does not explicitly provide for the price adjustment due to suspension, nevertheless §35(1) YSE 98 states that if building contract work is completely or partially interrupted or delayed for a reason due to the client, the latter is obliged to compensate the additional costs indicated by the contractor if alternative penalty for delay was not agreed in advance.

In case of hindrance and interruption of execution §6 No.5 VOB/B provides for compensation of damages in accordance with statutory provisions.

Variations are changes in the scope, design or manner of the execution of the works, requested by the Employer and carried out by the Contractor.

Under Sub-Clause 13.3 (4) FIDIC in case of instructing or approving Variation the Employer should agree or determine adjustments to the Contract Price, including reasonable profit and Contractor’s proposal for the Contract Price; in case of Variations additional Provisional Sums’ payments are regulated under Sub-Clause 13.5 FIDIC. According to Sub-Clause 13.7 FIDIC the Contract Price should be adjusted to take into account increase or decrease in Cost from a change in the Laws.

According to Sub-Clause 8.3 ORGALIME in case of variations the Contract Price, the Time for Completion and other terms of the Contract should be amended to reasonable reflect the consequences of variation. Pursuant to Sub-Clause 8.6 ORGALIME the Purchaser should reimburse any Contractor’s costs due to examining the consequences of the requested variation.

Plan modifications and related price changes are regulated on general level in chapter 6 YSE 98.

According to §2 VOB/B in case of volume of works changing more than 10% respective changes to the price must be agreed prior to work execution.

Since the nature of this remedy is restoration of proportion between the value which the employer receives and the price to be paid for it\textsuperscript{420}, it is advisable that the contract prevents him from recovering simultaneously price reduction and damages for the same loss.

\textsuperscript{420} UNCITRAL Legal Guide, supra note 377, p. 200.
4.4.6. **Withholding performance**

Remedy of withholding performance under the construction contracts is usually expressed as a party’s right to suspend performance.

Under Sub-Clause 15.4 (b) FIDIC the Employer may withhold payment to the Contractor until establishment of all costs incurred by the Employer up to the moment of termination in his initiative. Additionally FIDIC provides for the instrument of “Retention money”, which can be withheld by the Employer and released upon due performance (Sub-Clauses 1.1.4.7, 14.3(2(c)) and 14.9 FIDIC). When the Employer fails to perform the Contractor may suspend performance subject to 21-days’-notice until the payment without prejudice to the interest for the late payment (Sub-Clause 16.1 FIDIC).

Pursuant to Sub-Clause 9.4 ORGALIME the Contractor is entitled to suspend performance upon 7-days’-notice, if the Purchaser fails to pay on time, until payment of the amount due and interest. According to Sub-Clause 9.5 ORGALIME the Purchaser is entitled to withhold part of the payment upon taking over for securing remedy of the defects appeared at taking over until completion of such remedy. Upon termination for his convenience the Employer may deduct from termination fee amount of his claims notified to the Contractor prior to termination (Sub-Clause 18.4(2) ORGALIME).

§42 YSE 98 entitles the client to withhold from the contract price: i) value of the repair for the defect attributed to the contractor until completion of repair; ii) penalty for delay and other applicable penalties; iii) sum corresponding to the value of the agreed security for the guarantee period until provision of the said security; iv) compensation for the loss or damage to third party, for which the contractor is liable; v) other client’s receivables falling due; vi) undisputable amount of the sub-contractor’s work without prejudice to the contractor’s right to present his views on the subject. In case of contract termination the client is entitled to withhold the price until final settlement of the accounts (§83(3) YSE 98). The contractor may withheld performance in case of delay in payment or provision of the security and be compensated by the client for the costs caused by the interruption in the performance (§84(3) and §86(3) YSE 98).

According to §16 No.1(2) VOB/B counterclaims can be withheld. “Other retentions may only be made in cases foreseen by the contract or the statutory provisions”.

Despite its temporary character this remedy is actively and effectively used in practice as mechanism of private enforcement of the counter-party obligations.
4.4.7. Termination

Industrial standard forms usually provide both parties with right to terminate the agreement (for convenience or default) and regulate the order of payment after termination.

According to Sub-Clause 11.4 (2b) FIDIC in case Contractor fails to remedy defect and it should be repaired by the third party at Contractor’s cost and the defect or damage substantially deprives the Employer of the whole benefit of the Works or their major part, the Employer may choose to terminate the Contract as a whole or in respect of the defective part and without prejudice to any other rights the Employer is entitled to recover all sums paid for such Works or the respective part, as well as financing costs and cost of the dismantling defective Works (restitution). Under Sub-Clause 15.2 FIDIC the Employer is entitled to terminate the contract i.e. in case the Contractor fails to perform its particular obligations and rectify defects within proposed time, assigns the agreement in avoidance of prohibition, becomes bankrupt or insolvent, or goes into liquidation in additional to his right to terminate for own convenience (Sub-Clause 15.5 FIDIC). Upon effect of the notice on termination the Employer may serve the claim on payments, withhold further payments and/or recover losses, damages and additional costs under Sub-Clause 15.4 FIDIC. The contractor is entitled to terminate the contract in case the Employer fails to fulfill his particular obligations, to rectify the breach in additional time, or substantially breaches his obligations, breaches the assignment order, keeps the unreasonable suspension, becomes bankrupt or insolvent, or goes into liquidation (Sub-Clause 16.2 FIDIC). Upon such termination the Employer has to pay to the Contractor outstanding balance, compensation of incurred costs, removal costs, some labor costs, and also – loss of profit or other loss/damage resulting from the termination (Sub-Clauses 16.4, 19.6 FIDIC).

The Purchaser may terminate the contract if the Contractor failed to remedy reappeared substantial defect (Sub-Clause 17.14 ORGALIME). In accordance with Sub-Clause 18.1 ORGALIME the Purchaser is entitled to terminate the contract for his convenience and then he should pay to the Contractor unpaid balance for the performed works, some costs, termination charges (LD/penalties), removal costs (Sub-Clauses 18.3, 18.4, 18.7 ORGALIME). The Purchaser is also entitled to terminate the contract in case of the Contractor’s default (Sub-Clauses 19.1 – 19.3 ORGALIME) and Contractor’s insolvency (Sub-Clause 19.4 ORGALIME). In this case the Purchaser is entitled to compensation of suffered loss (not more than 15% of the contract price) and in addition – liquidated damages (Sub-Clause 19.5 ORGALIME), minus the Contractor’s compensation.
for the completed part of the Works without defects (Sub-Clause 19.9 ORGALIME). The Contractor may terminate the Contract in case of voluntary suspension exceeding 180 days subject to 14-days’-period notice. The Contractor additionally entitled to initiate termination in case of the Purchaser’s breach of the payment terms and failure to remedy it within stated period of time (Sub-Clause 19.6 ORGALIME) and in case of Purchaser’s insolvency (Sub-Clause 19.7 ORGALIME). In these cases the Contractor is entitled to receive compensation for the suffered loss, not exceeding the Contract Price (Sub-Clause 19.8 ORGALIME).

According to §78 YSE 98 the client is entitled to terminate the contract: a) if the contractor does not observe the agreed starting date or working so slowly that he clearly would not finish by the agreed deadline; b) if the building works develop essentially against the agreed terms; c) the contractor has not provided the agreed security – subject to the notice with provision of the reasonable time to rectify the breach. The following reasons also entitle the client to terminate: i) bankruptcy or incapacity of the contractor (§79 YSE 98); ii) force-majeure (for long and indefinite period) (§80 YSE 98); iii) death of the contractor-physical person (§81 YSE 98). Upon termination the accounts should be settled in accordance with the rules prescribed in §§82 – 83 YSE 98. The contractor is entitled to terminate in case the client neglects his obligation to pay, is declared bankrupt or demonstrated his incapacity (§84 YSE 98); in the above cases the contractor instead may interrupt the work until the assurance from the client with compensation for the additional costs caused by interruption (withhold performance). In case of force-majeure for a long and indefinite period the contractor may terminate the contract (§85 YSE 98). Upon termination the contractor is entitled for the payment for the performed work and reasonable confirmed loss due to the termination (§86(2) YSE 98).

According to §8 VOB/B the principal may terminate the contract at any time prior to the completion subject to payment of the stipulated compensation to the contractor, which should be settled in accordance with §5 No.5 VOB/B. The principal is also entitled to terminate: i) if contractor fails to remedy the defect by repair or replacement subject to notice of warning (§8 No. 3(1) and §4 No.7 VOB/B); ii) if contractor delays the commencement of works or is in default with the completion subject to warning notice (§8 No. 3(1) and §5 No.4 VOB/B). After such contract withdrawal the principal is entitled to complete the work by own force of third party’s at the contractor’s expense without prejudice to right for claiming resulting further damages (§8 No. 3(2) VOB/B); he also may use equipment at the site against reasonable compensation (§8 No. 3(3) VOB/B).
Termination should be declared within 12 working days after the grounds for termination become known (§8 No. 4 VOB/B). The contractor may terminate if: a) the principal fails to perform act necessary for the performance; the principal in payment delay or other default. Termination may be subject to grace period if provided in the contract. Executed work should be settled in accordance with the contractual prices or reasonable prices in accordance with §642 BGB (§9 No.3 VOB/B).

UNCITRAL Guide calls termination – a remedy of last resort applicable in cases of incurable violation or failure, or irreversible financial circumstances, which may prevent works from normal continuation like bankruptcy or similar conditions (liquidation, insolvency, assignment of assets, reorganization, change of control etc.), and other impediments like force-majeure events in case they last for long periods of time. Additionally the employer should be able to terminate for his convenience. The Guide correctly states that general legal rules on contracts’ termination usually take into account mostly sales contracts and, therefore, less suitable for the construction contracts. Additionally some legal orders permit termination only if it is expressly stated in the contract as a remedy. Hence it is advisable to include detailed termination clauses into the respective agreement, given that both parties should primary resort to other available remedies (specific or substitute performance, suspending, demand of defects’ cure, renegotiation, price adjustment, damages’ claim). It is recommended to consider procedure of project site vacation, further utilization of the materials and equipment delivered to the site or purchased for the project performance, take-over performed part of the construction, including necessary documentation and design rights, further destiny of sub-contracting agreements and respective payments, and settlement accounts between the parties, including lost profits due to the premature termination depending on the cause for the termination. In order to ensure protection against interference of different legal orders it is advisable to describe which provisions of the contract shall survive termination, e.g. quality guarantees for the performed part of the works, remedies for the defects in the taken-over part, arbitration and confidentiality clauses.

4.4.8. Intermediate Conclusions

As demonstrated in this work damages are usually a default remedy under any law, but more precise terms can be stipulated in the contract.

421 Id., p. 267.
In the standard construction contracts contractor’s damages normally secure losses due to delay, interruption, speeding up, altering terms and termination. Employer’s damages are usually ensured in cases of delay, termination and defects. Compensation of damages may be independent or joined with other remedy. FIDIC refers to damages compensation in cases of suspension (together with time extension), termination and as product liability. ORGALIME offers wider scope of damages rectification: error, defects, product liability, confidentiality breach, termination. YSE 98 provides for compensation of damages in case of impediment for performance (with time extension), including situations of force-majeure (risk with the client), termination (including lost profit). VOB/B stipulates damages for delay, obstacle for performance and due to non-performance (including lost profits in case of intentional act or gross negligence). Additionally compensation of damages should be guaranteed in case of variations. In this case FIDIC leaves determination of the costs with the Employer. ORGALIME ensures mutual agreement. YSE 98 proposes cost-price basis if a separate agreement not reached. VOB/B combines mechanism of agreed compensation in one case and reasonable compensation – in other. Since award of damages always requires establishing of the actual losses, legal practice developed several methods of damages calculation. Mostly used are actual cost method, requiring detailed accounting and proof (preferred by the courts), and total cost measure, offering more liberal ways of establishing costs (beneficial to the claiming party). Usually damages may be limited in the contract, with exception of product liability issues, willful misconduct and gross negligence and provided indemnities. It is recommended to cover all damages with insurance.

Reflecting some similarities with sales law in certain limited cases construction contract standards incorporate hierarchy of remedies, conditioning claim of damages to the prior claim of specific or acquiring the substitute performance. FIDIC offers combination specific and substitute performances against Contractor in cases of defects rectification, tests’ failure and non-performance of the required modifications. ORGALIME does provide same remedies against both contractual parties in cases of failure to perform additional work, correction, modification, rectify defects or complete tests. YSE 98 offers specific performance remedy in case of modification, defects correction (with alternative of price deduction), and at the same time – general right of the client to engage third party at the cost of the failed contractor. VOB/B gives both option of the remedy in case of rectification of defects prior to acceptance. It is advisable to ensure written notice in every case of engaging third party for the substitute performance and division of remedies into
serious and simple with varying applicable remedies and utilizing hierarchy of remedies.

Penalty is often considered as simplified alternative to the damages. FIDIC, ORGALIME and YSE offer penalty for the late payment, but only YSE utilizes explicit term “penalty”. FIDIC and ORGALIME terminology-wise do not distinguish between penalty, LD and other charges in case of contractual breach. Additionally YSE 98 stipulates penalty for late performance of both parties. VOB/B also allows explicit penalty, subjected to statutory regulation in case parties are willing to include it in the contract.

LD are usually applicable in delay obligations along with extension of time. Common law adopted complex system of delay qualification, but UK and US approaches vary. US courts make awards of three types: i) time but no money; ii) apportionment; iii) case-by-case establishment of liability. In English law prevailing is “malmaisonian” approach of nullifying any other effects in case of employer's failure; slightly presented dominant cause doctrine and no apportionment. As recent practice shows problems of division between penalty and LD in Common law may be solved by application “commercial justification” evaluation in B2B contracts. In standard construction contracts LD are traditionally provided for delay, non-compliance, non-performance, and lost productivity. FIDIC does not use term “LD”, nevertheless prescribes them for delayed performance of the Contractor and declares exclusive remedy, coupled with LL clauses. Additionally LD applicable to tests defaults following failures of specific performance. ORGALIME explicitly names LD with LL in all cases of delay and failures in testing; it also establishes termination fee for the Employer’s convenience. VOB/B mentions “stipulated compensation” in case of termination. YSE 98 does not have explicit notion of LD, utilizing term “penalty” in all cases.

LL is stipulated in all standard forms in similar set of cases, but mostly limiting liability during warranty period. LL does not supersede total indemnity clauses.

Remedy of price adjustment in standard construction contracts is divided into price increase, decrease and definition of reasonable amount. Under FIDIC provided for defects and testing failure as determination of reasonable amount by the Employer. Pursuant to ORGALIME decrease should correspond to value in case of defects, in case of dispute it should be settled by a third party. Under YSE 98 decrease for defect should either be defined based on the terms of the contract or separate agreement on the matter. Right to define price decrease by declaration is reserved by VOB/B for the principal. Price increase is discussed in cases of variation and suspension. Price increase in case of suspension is not mentioned in YSE 98 and VOB/B, but provided indirectly. Price increase for variations
is ensured in all standards. It is recommended to prevent cumulating of the price adjustment with damages’ claim for the defects.

Withholding is provided under FIDIC for both contractual parties, but additionally subject to notice and grace period, if applied by the Contractor. ORGALIME stipulates the same, but grace period is shorter. YSE 98 also offers it for both parties, but the Employer has to compensate additional costs for interruption. VOB/B refers to withholding regarding counterclaims and other cases – if only prescribed in the contract separately.

Termination is ensured in all standards for convenience or default and available for both counter-parties. It is a remedy of last choice after failed primary remedies or in case of incurable defects, preventing use of the final result, or adverse financial change in circumstances of either party.
5. Final Conclusion

In simple terms, main incentive to enter an agreement is commercial assumption that the result of the agreement is mutually beneficial for the parties, and the performance, which each party should receive, is more desirable and has more value than the counter-performance. Therefore contractual parties usually bargain for the exchange of performance. But circumstances, both internal and external to the parties, tend to change, especially in the long-term relationships and international environment, in such as transnational construction projects, often involving many actors from different industries and jurisdictions. Hence the breach of a contract is inevitable reality of the market economy and contracting parties should be prepared to face it and deal with it.

If actors in the market intend to become contractual parties, have sufficient information about the performance and its value, wealth of the counter-party and have access to the expert advice, as well as comparable negotiating powers, they, in general, have better possibilities to conclude an efficient contract and have reasonable incentives for efficient post-contractual behavior. They can better evaluate the possible damages or provide for more efficient calculation of the liquidated damages.

However quite often, or even in most of cases, the parties have to deal with the lack of information and bargaining positions are unequal. Then there is a high risk of over- or under-compensatory measures, but even more importantly – inefficient, unjust and inadequate measures, implemented in the remedial terms.

All existing differences in Civil and Common law systems derive from reviewed specifics of the historical development of academic thought and legal practice and emphasis on the primer factors affected shaping of each legal order, such as moral and economic considerations.

In the contemporary state of affairs we can observe conflict between main principles of the contract law: freedom of contract against its binding nature; autonomy of personal will against legal enforcement; legal certainty against fairness, justice and reasonability. In this study I attempted to approach the contract in its dialectic complexity and to perceive remedies as system of checks and balances, enforcing simultaneously all principles in respective proportions and ensuring final social good in comparatively more economically efficient legal form. The entire concept of dividing remedies into compensatory and non-compensatory does no longer seem to be pertinent. Remedies have various functions and should create flexible system which may adjust to changes in circumstances and serve parties in case the obligation needs modification or termination in perspective.
Remedies constitute an important part of each contract; some of them intend to secure the contract when appropriate, the other – aim to end the entire obligation or any part of it when necessary. Most of legal orders make available system of remedies applicable by default; nevertheless relying on such solution in hope for fair or economically efficient outcome is not acceptable in the international contracting. Contract law is a flexible, autonomous sphere, thus the parties can and should undertake efforts to balance system of remedies by exploiting different combinations and approaches. Diligent approach will require clear understanding of unique features, advantages and negative outcomes of each remedy separately and its role in the system. Judicial intervention is still necessary regarding remedies with higher risk of party’s opportunism and/or in situations where fair bargaining could be impaired. Nevertheless this should not preclude parties from using self-help remedies when possible, even in cases where the last word of justification is with the court.

This study is dedicated to the following remedies currently available under an international contract: specific performance; damages’ compensation; termination of contract; liquidated damages and penalty; price reduction and performance withholding. International contract law offers wider variety of more diversified and detailed options, but essentially they all derive from the described types. For instance, ordinary sales contract provide for the remedy of repair or re-delivery of conforming goods. In my opinion, both these alternatives are covered under specific performance (substitute performance) and additionally secured by the enforceable hierarchy of other remedies.

All reviewed jurisdictions ensure possibility to claim specific performance under certain conditions. In all of them damages are considered as an alternative remedy (with slightly reversed general preference in Common law). Civil law policies contemplate these measures as exclusive for each other, but not Common law orders. Specific performance has obvious advantages: it secures entity of contract, serves economic principle of indifference, implements original bargain and stimulates information exchange. Nevertheless it also has drawbacks, creating legal uncertainty, tolerating misuse of right and precluding efficient breach. As response to economic needs many systems developed measure decreasing inefficiency of specific performance in the form of alternative (surrogate, cover, substitute) performance subject to reasonability standard.

Theory challenges nature of termination as a remedy. Based on the performed analysis I consider these objections irrelevant and unsubstantiated. Functions of termination and related restitution permit concluding that termination is a remedy. In
Germany and Common law jurisdictions it is a measure of private enforcement and in France it requires public interference, unless otherwise explicitly stated in the contract. Nevertheless according to legal statistics, court plays equally important role in upholding or rescinding agreement in all reviewed orders. It is always exclusive with specific performance, but often pairs with damages’. Termination is criticized for hindering stability of contract, moral hazard, and risk of opportunism. In order to enhance its efficiency it should be perspective (differ from the contract nullification) and should be restricted to the cases of fundamental breach, conditions of which advisable to clarify in the contract between the parties for avoidance of misinterpretations.

Qualification and application of damages has high diversity in all reviewed jurisdictions. In all policies we can find evidence that damages are generally divided into delay and non-performance, where the former easily cumulated with other remedies and the latter are usually exclusive in the Civil law jurisdictions. Damages are always secured by law as default remedy. Defining criteria for the acceptable losses vary in all legal orders (directness, remoteness, foreseeability), but causal link should be commonly established via various tests. Contractual liability is usually strict – not dependent on the fault (with variation in Germany)\textsuperscript{422}. Generally accepted measure of calculation is expectation, but both \textit{ex ante} and \textit{ex post} options may be applied. In all cases aggrieved party has to prove sustained loss in order to get award of damages, which brings notion of actual loss close to reliance. Some jurisdictions and international codifications allow recovery of lost profit and future losses and that brings notion of expectation close with expectation loss. General duty of mitigation has penetrated Civil law irrespective of explicit absence in the statutory laws. This remedy may lead to both over- and under-performance, is characterized by high legal uncertainty and extensive costs of recovery. Clarification of damages recoverable under the contract and agreed measures of their establishment, as well as flexibility in applicable measures for calculation on case-by-case basis may enhance efficiency. Although practice indicates that best way of elimination of flaws and pitfalls in application of this remedy may be achieved through the tailored contract terms such as LD clauses. Costs of pre-contractual negotiations in such case should be significantly lower than

\textsuperscript{422} This work does not investigate effect of the fault factor (negligence, willful misconduct, error and mistake, etc.) on the contractual liability. For instance, product liability may not be limited in the contract, as well as, according to the terms of the reviewed standard contracts, damages, defects, caused to the counterparty or non-performance otherwise due to negligence or willful misconduct, but the scope of this study does not permit investigation of this additional aspect. Hence related matters are only mentioned in the work and require separate research.
transactional and legal costs upon breach in case of default statutory damages’ rules given uncertainty of judiciary discretion.

Both penalty and LD are pre-determined at contract formation sums, excluding need to establish actual loss, to be paid only in case of non-excusable breach of the main obligation; stimulate performance of the initial bargain and limit liability in case of efficient breach, and preclude unjust enrichment. The following distinctions exist between LD and penalty: 1) conditions for validity depend on punitive nature attributable to penalty but not LD; 2) calculation \emph{ex post} (penalty) and \emph{ex ante} (LD); 3) different approaches to accumulation with other remedies; 4) right of the court to reduce amount of penalty. Thus legal uncertainty is created in all considered orders: in Common law order court may set aside the LD clause as excessive and in Civil law jurisdiction – court may reduce penalty. Penalty is accepted in Civil law orders, but banned in Common law, while notice of punitive damages has reversed acceptance; meanwhile, in my opinion, principle difference between them is not substantial, which should be recognized in respective legal orders and improve legal certainty. LD clause is intended to preclude over-liquidation, while LL clause prevents under-liquidation and requires establishment of the actual losses, unlike LD. Efficiency of LD and penalty clauses may be enhanced by evaluation of the factors of fairness and awareness at the contract formation, assessment of actual balance and risk sharing between the negotiating powers and reasonability of pre-estimate, shifting focus of judiciary attention from the appraisal of the stipulated amount. Nevertheless the excessiveness of the latter should be weighed based on: 1) comparison of the pre-estimated damages with the actual damages suffered; 2) legitimate interests of the parties, covering promisee’s non-pecuniary interests; 3) category of contract and its standard nature; 4) circumstances in which contract was made, bargaining positions of the parties; 5) was the breach in good or bad faith. Compensation of damages and award of penalty/LD should exclude each other.

Price reduction is wide-incorporated monetary remedy under sales laws, but statistically is not often referred to. By default, depending of the statutory terms, reduction value may be defined by a court, an expert and the aggrieved party itself. This remedy gains functionality when compensation of damages is not adequate or difficult to acquire and the party would like to accept performance with defect and time is of essence. Pre-negotiated mechanism of reduction value calculation should ensure legal certainty and increase efficiency. In my opinion, this remedy does not preclude efficient breach, providing response to the change of quality by ensuring corresponding change of the price.
Utilization of this remedy in building and construction contracts affirms its functionality under rationally negotiated conditions.

Performance withholding is self-help, temporary and conditional remedy, recognized in all reviewed jurisdictions albeit lack of legislative regulation in Common law. Withholding usually precedes either termination or consequential mutual performance or provision of performance security. As a right it is often stipulated in the sales laws and adopted in many international codifications. Despite critics of inefficiency, I think that this measure ensures interests of both parties and does not preclude economically reasonable termination of the contract, given that it meets standard of reasonability and good faith and is combined with mitigation duty.

Construction contract standards present an example of codified mixed contract, applied to the long-term relationships in both national and international sphere, which allows to research different angles of remedial system incorporated in it.

Based on the performed analysis of the building and construction contract, combining elements of sale of goods and provision of services, my conclusion is that generally it should be treated separately from the sales contract, as adopted e.g. in FSGA. Qualifying criteria introduced by CISG should be considered regarding other types of services when ratio between sale and service is unclear, but not the contracts regarding “construction of a building or other fixed installation or structure on land or in water”. This division is important because usually sales’ law is more restraining regarding remedy of termination and adopts stricter hierarchy of remedies, while statutory regulation of service, and construction in particular, is more liberal, flexible and more efficient, it also provides system of remedies, adopted for the needs of the industry, and better safeguards specific interests.

In the construction industry standard forms of the general terms and conditions (soft law codifications) illustrate good example of rational combination of different types of the remedies depending on each separate situation and for each particular breach of the agreement.

On the example of several international and national standards (FIDIC, ORGALIME, YSE 98 and VOB/B) I have analyzed effective fusion of liquidated damages and penalties for the delayed performance, defects in the performance and in case of termination for convenience; various damages’ compensation divided depending on the category of the breach and type of losses to be compensated in the respective cases, including fault factor, which increases liability; application of specific performance and substitute performance.
in certain situations of defective performance, along with suspension and other forms of withholding, price adjustment due to number of comprehensive causes and termination of the agreement in case of different breaches (failure of completion tests, guarantees, warranties); all rounded with the system of liability limitation in particular cases and under the contract in total. Standard construction contracts adopt system of balancing various breaches with the respective remedies, depending of the nature of the both and interests of the parties, requiring diversified protection in every case. The role of tailored agreement or agreed deviation from the general terms is to provide for specific measurements of liquidated damages, values of penalties and limitations of aggregate liability or liability under the particular clause.

Usually in this type of contracts resort to each remedy requires reasonable and fair attitude of both parties, which is incorporated in the standard terms, e.g. through the system of limitation periods for the presenting and settling claims, obligations to send mutual notifications and provide grace periods for the rectification in good will, implication of mitigation duty, introduction of the default chain or hierarchy of remedies and allowing termination of the contract in perspective when either other measures are exhausted or economic circumstances of the parties change. Such diversified and flexible approach, providing the parties with wide liberty of discretion and autonomy, at the same time balanced with numerous restrictions, self-help mechanisms and system of expedited settlement of disputes, utilizes all available remedies and enhancing their economic efficiency within one contract.

In summation, despite all visible contradictions in the remedial systems across jurisdictions we can see general trend of convergence between various policies and their elements. World events of the recent decades brought ratio between moral and economy and its influence on the formation of the legislation to approximately equal level in all orders. Harmonization within Europe is stimulated by the institutions of the European Union and increasing role of its judiciary power. Enhanced complexity and instability of the world economy demands unified and discrete solutions for the international trade and level of protection for foreign counterparties equal to national. Complete legal certainty is an ideal and cannot be reached, but it can be increased along with economic efficiency of the elements of the contract law, where remedies play key role.

Standard building and construction contracts present a successful example of harmonization and utilization of the whole specter of contractual remedies developed both on the international and national levels. These forms offer option of enhancing economic
efficiency of each separate remedy as well as productive interplay between all remedies as elements of integrated system, which allow contractual parties to divide various interests within one contract and diversify levels of protection for each respective area, utilizing one or another appropriate function of each remedy.
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