ARTICLES

CONSEQUENTIAL DAMAGES IN THE INTERNATIONAL SALE OF GOODS: ANALYSIS OF TWO DECISIONS

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1. INTRODUCTION

Two courts have applied consequential damage provisions found in international conventions. A court in the United States recently applied provisions of the United Nations Convention on Contracts for the International Sale of Goods ("CISG" or "Convention").[1] In 1980, the German Supreme Court applied a substantively similar consequential damage provision of the earlier Hague Convention on the International Sale of Goods ("ULIS")[2] in a decision that has predictive value for future applications of the CISG.[3]

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[1] *See* United Nations Convention on Contracts for the International Sale of Goods, U.N. Doc. A/CONF.97/18 (1980), S. TREATY DOC. No. 9, 98th Cong., 1st Sess. 22 (1983), 19 I.L.M. 671 (1980) [hereinafter CISG].

[2] *See* Convention Relating to a Uniform Law on the International Sale of Goods, July 1, 1964, 834 U.N.T.S. 107.

[3] ULIS Article 82 is the source of and is substantively similar to CISG Article 74. *See* ALBERT H. KRITZER, GUIDE TO PRACTICAL APPLICATIONS OF THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS 477 (1989). Germany and the United States are now signatories to the CISG. For commentary on the U.S. adoption of the CISG, see *infra* note 13. For commentary on the

This Article will analyze whether these two courts approached consequential damages in a manner that is more consistent with prior national law than with the development of a unified international approach to international sales disputes.[4]

Section 2 of this Article explores a U.S. district court's approach to damages under the CISG in the case of *Delchi Carrier, SpA v. Rotorex Corp.*[5] After analyzing the rationale behind the damage award in *Delchi*, Section 3 discusses a German Supreme Court decision applying a provision analogous to the CISG. Finally, Section 4 concludes that the U.S. court applied the international CISG provisions in a manner consistent with its national law, while the German Court elevated international principles over national law. Because of the U.S. court's inability to set aside its own national thinking, this case represents an unfortunate first decision on the subject of consequential damages under the CISG.

2. THE U.S. CASE: *DELCHI CARRIER*

In *Delchi*, the U.S. District Court for the Northern District of New York applied the consequential damages provisions of the CISG as the controlling law of the dispute. The *Delchi* plaintiff ("Buyer") was an Italian manufacturer and seller of air conditioners and the defendant ("Seller") was a New York corporation. In January 1988, Seller

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German adoption of the ULIS and later the CISG, see *infra* sections 3 and 4.

[4] The problem of differing interpretive approaches to international sales disputes has been predicted. *See* Patrick Thieffry, *Sale of Goods Between French and U.S. Merchants: Choice of Law Considerations Under the U.N. Convention on Contracts for the International Sale of Goods*, 22 INT'L LAW. 1017, 1021 (1988). For a discussion of damage terminology in civil and common law jurisdictions, see Ugo Draetta, *The Notion of Consequential Damages in the International Trade Practice: A Merger of Common Law and Civil Law Concepts*, 4 INT'L BUS. L.J. 487 (1991).

[5] *See* Delchi Carrier, SpA v. Rotorex Corp., No. 88-CV-1078, 1994 WL 495787 (N.D.N.Y. Sept. 9, 1994). The decision was appealed and cross-appealed. The court of appeals affirmed with little comment on the issues raised in this Article, but remanded on other grounds. *See* Delchi Carrier, SpA v. Rotorex Corp., Nos. 95-7182, 95-7186 (2d Cir. Dec. 6, 1995).

contracted to sell Buyer 10,800 Rotorex model compressors, which were to be delivered in three installments by May 15, 1988.[6] Buyer, apparently at the time of the contract, informed Seller that it was going to use the compressors to manufacture its "Ariele" line of air conditioners, a product which Buyer expected to sell in the summer of 1988.[7]

On March 26, 1988, Seller sent 2,438 compressors to Buyer and received a $188,923.46 payment by letters of credit.[8] Seller sent the second installment of compressors on or around May 9, 1988 and received $129,985.60, also in the form of letters of credit.[9] When the second installment was in transit, Buyer, while attempting to install the first shipment of compressors, discovered that the Rotorex compressors were nonconforming.[10] Buyer attempted to correct the nonconformity in various ways in order to avoid damages,[11] but ultimately Buyer rejected the compressors and cancelled the contract.[12]

After deciding that the CISG[13] governed this contract, the U.S. district court found that Seller breached the contract by failing to supply 10,800 conforming compressors.[14] The court then awarded Buyer "consequential"

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[6] *See id.* at *1.

[7] *See id.*

[8] *See id.*

[9] *See id.*

[10] *See id.*

[11] In an attempt to cure the defect, Delchi shipped substitute Rotorex grommets to its manufacturing plant, spent 790.5 hours to insert the special grommets, paid for a shipment of additional Rotorex connectors, and finally inspected and tested the compressors above what was normally expected. *See id.* at *2.

[12] *See id.* at *1.

[13] CISG is codified at 15 U.S.C.A. app. (West Supp. 1995). The CISG was ratified by the U.S. Senate on October 9, 1986, and took effect on January 1, 1988. "Disputes arising out of international sales contracts formed after January 1, 1988[,] between merchants from signatory nations may be governed by the [CISG] rather than the Uniform Commercial Code or foreign sales law, unless the parties specifically state otherwise." *See* Eric C. Schneider, *The Seller's Right to Cure Under the Uniform Commercial Code and the United Nations Convention on Contracts for the International Sale of Goods*, 7 ARIZ. J. INT'L & COMP. L. 69, 69-70 (1989) (footnotes omitted).

[14] *See Delchi,* 1994 WL 495787, at *4-5.

damages[15] for those costs incurred which were "a foreseeable result of [Seller's] breach" and which were "both commercially reasonable and reasonably foreseeable."[16] These foreseeable and reasonable damages included: (1) the costs of labor, materials, and shipping that Buyer incurred because of the unsuccessful attempt to remedy the nonconforming Rotorex compressors; (2) the costs Buyer incurred to expedite the delivery of previously ordered Sanyo compressors as replacements in its Ariele units; (3) the cost of handling and storage of the rejected Rotorex compressors; (4) the lost profit from lower sales volume of Arieles ordered in the summer of 1988; and (5) pre-judgment interest.[17] The court rejected Buyer's damage request for anticipated profits which Buyer claimed on orders which it could have filled if able to produce more Arieles.[18]

2.1. Background

2.1.1. The Delchi Court's Overview of the CISG

Before ruling on plaintiff's damage claims, the court made a few general statements about remedies available under the CISG. The district court noted that the CISG allows lost profit resulting from a diminished volume of sales.[19] Additionally, under CISG Article 74, Buyer was "entitled to collect monetary damages for [Seller's] breach in 'a sum equal to the loss, including loss of profit,' although not in excess of the amount reasonably envisioned by the parties."[20]

Contrary to the district court statement, however, CISG

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[15] Consequential damage generally is defined as "[t]hose losses or injuries which are a result of an act but are not direct and immediate." BLACK'S LAW DICTIONARY 390 (6th ed. 1990).

[16] *Delchi,* 1994 WL 495787, at *5.

[17] *Id.* at *5-7.

[18] *See id.* at *6 (holding that "Delchi [cannot] recover on its claim for additional lost profits in Italy because the amount of damages, if any, can not be established with reasonable certainty.").

[19] *See id.* (citing JOHN HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES § 415 (2d ed. 1991) and Jeffrey S. Sutton, Comment, *Measuring Damages Under the United Nations Convention on the International Sale of Goods*, 50 OHIO ST. L.J. 737, 747-48 (1989)).

[20] *Delchi,* 1994 WL 495787, at *5.

Article 74 does not in fact limit damages to an amount "reasonably envisioned" by both parties, but rather limits damages in terms of what the breaching party did actually foresee or could reasonably foresee.[21] Article 74 states:

> Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which *the party in breach foresaw or ought to have foreseen* at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.[22]

Instead of referring to the foreseeability language of the CISG, the U.S. district court stated the test in the narrower terms of New York law.[23] New York law or Italian law might have been the controlling law in a case involving diversity jurisdiction such as *Delchi* had the district court not already decided that the CISG was the controlling law of the case. New York law differs from the CISG by allowing consequential damages only when there is evidence that the defendant tacitly agreed to assume responsibility for such damages.[24] The *Delchi* court's use of the "in

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[21] *See* CISG art. 74, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 688.

[22] *Id.* (emphasis added).

[23] "[I]t may fairly be said that the New York courts have generally purported to follow the 'contemplation' test and that the application of this test has narrowed recovery of damages . . . more than the 'had reason to know' test of the Code." 1 STATE OF NEW YORK LAW REVISION COMMISSION REPORT, *Hearings on the Uniform Commercial Code*, 702 (1980). *But see* Arthur G. Murphey, Jr., *Consequential Damages in Contracts for the International Sale of Goods and the Legacy of* Hadley, 23 GEO. WASH. J. INT'L L. & ECON. 415, 435 n.103 (1989). Murphey believes the difference in the tests is only apparent since "[n]o case has been found in which recovery was denied because the injured party did not foresee the loss." *Id.* at 435.

[24] *See* Kenford Co. v. County of Erie, 493 N.E.2d 234 (N.Y. 1986) (Kenford I). In *Kenford II*, the New York position was further clarified: "In determining the reasonable contemplation of the parties, the nature,

contemplation of parties" limitation reflects a distinct development in U.S. law, not the language of CISG Article 74.

The CISG is meant to be interpreted and applied in a manner which promotes uniformity of application. Matters not expressly governed by the Convention are to be settled "in conformity with the general principles on which it is based."[25] The *Delchi* court correctly stated that CISG Article 74 is based on a general principle: that damages should provide the injured party with the benefit of the bargain, including expectation and reliance damages.[26] This Section examines whether the U.S. district court's decision in *Delchi* upheld this general CISG principle.

Although the district court cites CISG articles as the controlling law on each item of recovery, analysis of the decision reveals that the court was influenced more by a national legal tradition, as developed by state law, than by a policy favoring the unification of international sales law. In applying the traditional U.S. limitations on damages, the *Delchi* court used a more restrictive approach than most state courts and courts of other nations utilize when applying the CISG.

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purpose[,] and particular circumstances of the contract known by the parties should be considered, as well as 'what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made.'" Kenford Co. v. County of Erie, 537 N.E.2d 176, 179 (N.Y. 1989) (citations omitted). For a further discussion of the foreseeability limitation in U.S. courts, see *infra* note 42 and accompanying text.

[25] *See* CISG art. 7, *supra* note 1, S. TREATY DOC. NO. 9 at 23-24, 19 I.L.M. at 673.

[26] The provision of expectation and reliance damages is consistent with the philosophy of the drafters of the CISG. *See Commentary on the Draft Convention on Contracts for the International Sale of Goods, Prepared by the Secretariat*, U.N. Doc. A/CONF.97/5 (1979), *reprinted in* UNITED NATIONS CONFERENCE ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS, OFFICIAL RECORDS at 14, U.N. Doc. A/CONF.97/19, U.N. Sales No. E.81.IV.3 (1981) [hereinafter *Commentary*]. A similar principle is found in the U.C.C. and also underlies U.S. law generally. *See* U.C.C. § 1-106(1) (1991) ("The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law.").

2.1.2. Limitations on Damages in the United States

It is understandable that a U.S. district court, with its common law and statutory heritage, might apply the CISG differently than a court in a civil law jurisdiction. In the U.S. judicial system, unlike in civil law systems, only the parties are responsible for presenting evidence and must do so under more restrictive rules of evidence and according to varying levels and shifting burdens of proof.[27] In determining consequential damages, the trial judge or jury initially will take evidence and make findings of fact. As in most other countries, this evidentiary and fact finding process at early common law was entirely a determination of fact.[28] Judges did not try to control or limit the jury's award of damages.[29] In the late eighteenth century, however, when the perception developed that jury awards were disproportionate, judges developed a number of devices to limit the fact finding function of juries and to limit awards of consequential damages.[30]

In the United States, trial judges control damage awards through procedural mechanisms. For example, trial judges rule on the admissibility of evidence, instruct juries on the law and on the amount of damages allowed, and, if the

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[27] In Germany, a civil law jurisdiction, the evidentiary hearing is dominated by the court, not by the parties. A plaintiff does, however, usually have the burden of proving facts establishing a claim beyond a reasonable doubt, but relies on a general presumption that events generally occur in a normal way unless there is proof to the contrary. *See* GERHARD DANNEMANN, AN INTRODUCTION TO GERMAN CIVIL AND COMMERCIAL LAW 101-03 (1993); JOHN H. MERRYMAN, THE CIVIL LAW TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF WESTERN EUROPE AND LATIN AMERICA 111-23 (2d ed. 1985); William B. Fisch, *Recent Developments in West German Civil Procedure*, 6 HASTINGS INT'L & COMP. L. REV. 221, 279-82 (1983).

[28] *See* George T. Washington, *Damages in Contract at Common Law II*, 48 LAW Q. REV. 90, 108 (1932) ("In the early law the problem of compensation was treated as one of fact for the jury, subject to certain mechanisms for checking the abuse of discretion . . . . ") [hereinafter Washington, *Damages II*].

[29] *See* George T. Washington, *Damages in Contract at Common Law*, 47 LAW Q. REV. 345, 351-52 (1931); Washington, *Damages II*, *supra* note 28, at 90.

[30] *See* Washington, *Damages II*, *supra* note 28, at 90.

damage award is excessive, set aside jury verdicts after trial and order a new trial.[31] A trial judge's ruling on a motion for a new trial is a matter of law and subject to appeal and further analysis by appellate court judges.[32]

In addition to these procedural devices, U.S. courts also developed three substantive legal doctrines that limit damage awards: avoidability, foreseeability, and certainty.[33] Although each of the three traditional limitations on damages seem to involve factual determinations, U.S. judges routinely make findings "as a matter of law" on foreseeability, certainty, and avoidability, as well as causation in situations where reasonable persons could not differ.[34]

This process of ruling "as a matter of law" has led to two distinguishable practices. Under the first practice, a judge, after allowing a plaintiff's evidence on damages, may find the evidence inadequate to prove the plaintiff's case as a matter of law.[35] Under the second practice, a U.S. judge may bar the presentation of any evidence of certain types of damage as a matter of law.[36] This second practice of barring the presentation of evidence has led to stricter limitations on damages in U.S. courts than in courts of other countries.

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[31] E. ALLAN FARNSWORTH, CONTRACTS 873 (2d ed. 1990).

[32] *Id.*

[33] *Id.* at 873-74.

[34] *See id.* at 527 (stating that courts have the "general power to treat a question of fact as one of 'law' if the jury could reasonably find only one way"); Murphey, *supra* note 23, at 466 ("[C]ourts now have a practice of limiting recovery in the 'harsh' case solely by saying that damages [are] . . . 'unforeseeable' not as a matter of fact, but as a matter of fact and law."). As one observed stated:

> Nearly all cases cited . . . [in a study on the application of the foreseeability test] are decisions on appeal by defendant. Plaintiff often obtains satisfactory results at the trial, but loses all or part of his verdict when defendant appeals. Appellate courts will probably be inclined to sustain the trial court's judgment when the record discloses its logical, as well as evidentiary, basis.

Comment, *Lost Profits as Contract Damages: Problems of Proof and Limitations on Recovery*, 65 YALE L.J. 992, 1026-27 n.181 (1956) [hereinafter *Lost Profits*].

[35] *See* FARNSWORTH, *supra* note 31, at 537-38.

[36] *See id.* at 538-39.

An intentional result of these devices and practices is to limit damages to the amount of actual risk that a defendant undertakes at the time of contracting.[37] The practice of limiting damages to the risk undertaken was consistent with the historical trend of limiting damages in an age of industrialization, an age of eschewing damages which might be a disincentive to contracting.[38] Although the recent trend in most U.S. jurisdictions has been to relax the restrictions on damages — a trend more favorable to the injured party[39] — some states, such as New York, continue to restrict consequential damage awards. The influence of this restrictive view of consequential damages is evident in the *Delchi* court's application of the CISG articles.

2.2. Damages Awarded by the Delchi Court

2.2.1. Damages for the Costs of Attempting to Remedy

First, the *Delchi* court awarded damages to compensate Buyer for costs of labor, materials, and shipping incurred as a result of its unsuccessful attempts to remedy the nonconformity of Rotorex's compressors.[40] The court cited no article of the CISG to support this award, although it did seem to conclude that, under the criteria of CISG Article 74, the costs of labor, materials, and shipping "were [expenses] that would not have been incurred without Rotorex's breach," and that these expenses were "a foreseeable result of Rotorex's breach."[41]

The Uniform Commercial Code ("U.C.C.")[42] and the *Re-*

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[37] *See Lost Profits*, *supra* note 34, at 1020.

[38] The limitations on damages of causation, foreseeability, and certainty have been used by U.S. judges to limit "disproportionate damages [that] may induce defendant and other businessmen in similar occupations to shun bilateral contracts entirely or to insure against future losses by insisting on liquidated damages that fall short of full compensation, even when the loss would not be disproportionate." *Lost Profits*, *supra* note 34, at 996.

[39] The trend of awarding consequential damages now favors the injured party. *See* Murphey, *supra* note 23, at 422.

[40] *See Delchi,* 1994 WL 495787, at *5.

[41] *See id.*

[42] "Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation[,]

statement (Second) of Contracts ("*Restatement of Contracts*")[43] would characterize these labor, materials, and shipping expenses as "incidental" damages, not limited by the foreseeability test. According to the U.C.C. and *Restatement of Contracts,* the buyer must only show these damages are reasonable.[44] Under U.S. law, "incidental damages" include additional costs incurred after a breach in a reasonable attempt to avoid loss, even if the attempt is unsuccessful, while "consequential damages" include such items as injury to person and property, and lost profits caused by the breach.[45]

The CISG, however, does not provide for the awarding of incidental damages: it mentions only the recovery of consequential damages,[46] which, under CISG Article 74,

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and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach." U.C.C. § 2-715(1) (1991).

[43] "Subject to the limitations stated in §§ 350-53, the injured party has a right to damages based on his expectation interest as measured by . . . (b) any other loss, including incidental or consequential loss, caused by the breach . . . ." RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981).

[44] *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 266 (3d ed. 1988); *see also,* Ohline Corp. v. Granite Mill, 849 P.2d 602, 605 (Utah App. 1993) (stating that in order to recover incidental damages, "a buyer must show that the damages resulting from the breach were reasonable"); Sprague v. Sumitomo Forestry Co., 709 P.2d 1200, 1205-06 (Wash. 1985) (contrasting the difference between consequential damages and incidental damages). *But see also,* Mohler v. Jeke, 595 A.2d 1247, 1250 (Pa. Super. Ct. 1991) (stating that in order "to recover incidental damages under a breach of contract theory, the damages suffered must be direct and foreseeable").

[45] *See* FARNSWORTH, *supra* note 31, at 880-81; *see also* U.C.C. § 2-715(2)(a) (1991) ("Consequential damages resulting from the seller's breach include (a) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise.").

[46] *See* CISG art. 74, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 688. Nothing in the CISG suggests an intention to abolish incidental damages. *See* KRITZER, *supra* note 3, at 19; Murphey, *supra* note 23, at 459; *see also* WHITE & SUMMERS, *supra* note 44, at 266 (distinguishing between "incidental" and "consequential" damages).

must be "foreseeable" to be recoverable.[47] The lack of a foreseeability requirement in U.S. law for incidental damages[48] may explain why the judge in *Delchi* failed to state any facts that justified the finding that these labor, material, and shipping expenses were foreseeable.

2.2.2. Damages for the Cost of Expediting Delivery

Second, the *Delchi* court awarded Buyer damages under CISG Article 77 for the cost of expediting the shipment of previously ordered replacement Sanyo compressors as part of an unsuccessful attempt to replace the defective Rotorex compressors.[49] The district court found that such expedited action did not constitute "cover"[50] because Delchi had ordered the Sanyo compressors before the formation of the contract with Rotorex.[51] CISG Article 77 provides:

> A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss

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[47] *See* CISG art. 74, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 688.

[48] *See* U.C.C. § 2-715(1) (1991).

[49] *See Delchi,* 1994 WL 495787, at *5 ("Nonetheless, Delchi's action in expediting shipment of Sanyo compressors was both commercially reasonable and reasonably foreseeable, and therefore Delchi is entitled to recover 504,305,665 lire as the net cost of early delivery of Sanyo compressors . . . .").

[50] Cover is the right of the party claiming damages to recover "[i]f the contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods." CISG art. 75, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 689.

[51] *See Delchi,* 1994 WL 495787, at *5 ("The shipment of previously ordered Sanyo compressors did not constitute cover under []CISG [A]rticle 75, because the Sanyo units were previously ordered, and hence can not be said to have replaced the nonconforming Rotorex compressors.").

should have been mitigated.[52]

Article 77 is phrased in terms similar to the "avoidability" limitation on contract damages which developed in early common law.[53] The purpose of Article 77 is the same as the provisions of the *Restatement of Contracts*[54] and the U.C.C.[55] which deny recovery of damages that could have been reasonably avoided.[56]

Although the CISG, the *Restatement,* and the U.C.C. are phrased in terms of reducing damage awards to the extent a plaintiff could have reasonably avoided them, the judge in *Delchi* turned a shield into a sword and interpreted CISG Article 77 as requiring mitigation and allowing consequential damages for costs incurred in the mitigation process.[57] This application of Article 77 is reminiscent of some U.S. cases criticized for inferring that the injured party is under a duty to mitigate.[58] Requiring mitigation can result in a misleading interpretation of the CISG because Article 77 was not intended to place liability on the injured party for

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[52] CISG art. 77, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 689.

[53] *See* Vertue and Bird, 84 Eng. Rep. 1000, 1000 (1677) (holding that plaintiff in an assumpsit suit cannot collect damages because he did not attempt to avoid damage to goods).

[54] The *Restatement of Contracts* states:

> (1) Except as stated in Subsection (2), damages are not recoverable for loss that the injured party could have avoided without undue risk, burden or humiliation.
> (2) The injured party is not precluded from recovery by the rule stated in Subsection (1) to the extent that he has made reasonable but unsuccessful efforts to avoid loss.

RESTATEMENT (SECOND) OF CONTRACTS § 350 (1981).

[55] The U.C.C. states that "[c]onsequential damages resulting from the seller's breach include (a) any loss resulting . . . from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise . . . ." U.C.C. § 2-715(2) (1991).

[56] *See* E. Allan Farnsworth, *Damages and Specific Relief,* 27 AM. J. COMP. L. 247, 251 (1979).

[57] *See Delchi,* 1994 WL 495787, at *5 (allowing plaintiff to collect the cost of mitigating losses).

[58] *See* FARNSWORTH, *supra* note 31, at 897 ("It is sometimes said that in such cases the injured party is under a duty . . . to mitigate damages. This is misleading . . . .").

failing to avoid damages. Rather, the injured party is simply precluded from recovering damages which could have been reasonably avoided.[59]

It was unnecessary for the *Delchi* judge to base this recovery of mitigation expenses on a requirement to mitigate. Additionally, it was unnecessary to characterize the expedited delivery of Sanyo compressors as something other than cover.[60] Since the district court found, in summary fashion, that these mitigating expenses were "both commercially reasonable and reasonably foreseeable,"[61] such damages were recoverable as consequential damages under CISG Article 74.[62]

2.2.3. Damages for Handling and Storage Costs

Third, the *Delchi* court awarded damages for the cost of storage and handling of the rejected Rotorex compres-

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[59] Under U.S. law, the burden of proof for showing that the injured party has not taken steps to avoid damages is on the party in breach. *See* FARNSWORTH, *supra* note 31, at 897.

[60] The Court states in a somewhat circular way that the "Sanyo compressors did not constitute cover under □CISG [A]rticle 75, because the Sanyo units were previously ordered, and hence can not be said to have replaced the nonconforming Rotorex compressors." *Delchi,* 1994 WL 495787, at *5. CISG Article 75 defines "cover" goods as those "bought" within a reasonable time after avoidance. See *supra* note 50 for a definition of cover. Although the Sanyo compressors were "ordered" previously, it is not clear whether they were "bought," thus confusing their status as "covered" goods. *See Delchi,* 1994 WL 495787, at *5.

[61] *Delchi,* 1994 WL 495787, at *5.

[62] *See* CISG art. 74, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 688 ("Damages for breach of contract by one party consist of a sum equal to the loss . . . suffered . . . as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen . . . ."). Under the U.C.C., plaintiff can recover commercially reasonable expenditures for unsuccessful cover or avoidance as "incidental damages." U.C.C. § 2-715 (1991). Incidental damages include "additional costs incurred after the breach in a reasonable attempt to avoid loss, even if the attempt is unsuccessful." FARNSWORTH, *supra* note 31, at 880-81 (citing Coast Trading Co. v. Cudahy Co., 592 F.2d 1074 (9th Cir. 1979) (stating that a seller whose resale was not commercially reasonable cannot recover incidental damages of costs of resale)).

sors.[63] Damages for storing and handling the rejected product, to the extent that such damages were foreseeable, are clearly recoverable under CISG Article 74 as consequential damages.[64] Although the district court did not mention the foreseeability limitation, it did seem to limit the damages award to those costs which were reasonably incurred.[65] This use of a "reasonable" limitation, however, is how a U.S. court would treat "incidental" damages under the U.C.C., which does not require a showing of foreseeability,[66] rather than how a court should treat such damages under the CISG, which does require foreseeability.

2.2.4. Damages for Lost Profits

Fourth, Delchi claimed damages for lost profits.[67] This claim for lost profits actually involved two different categories of loss: (1) lost profits on "actual orders" placed with Delchi in the summer of 1988; and (2) lost profits on "indicated orders," or, in other words, orders that Delchi claimed would have been made had more Arieles been available.[68]

To determine whether the two categories of actual lost profits and indicated lost profits were recoverable from Rotorex, the court examined the evidence and made determinations regarding three aspects of Delchi's evidence: causation, foreseeability, and proof of damages with reasonable certainty.[69] Again, the district court analyzed causation, foreseeability, and reasonable certainty in a manner more consistent with New York law than with the policy underlying the CISG.

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[63] *See Delchi,* 1994 WL 495787, at *5 ("Delchi is entitled to recover 13,200,083 lire for the expenses incurred for handling and storage of Rotorex's nonconforming compressors.").

[64] *See* CISG art. 74, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 688; *see also supra* note 59.

[65] *See Delchi,* 1994 WL 495787, at *5 ("[T]he court holds that Delchi is entitled to 2,103,683 lire as a *reasonable* expense.") (emphasis added).

[66] *See supra* note 55.

[67] *See Delchi,* 1994 WL 495787, at *5-7.

[68] *Delchi,* 1994 WL 495787, at *6.

[69] *See id.*

2.2.4.1. Causation

With regard to lost profits from actual orders, the court allowed Delchi's damages to the extent that these losses were a "foreseeable and direct result of Rotorex's breach."[70] Applying this standard, the district court did not allow damages for lost profits resulting from actual unfilled orders due to factors beside the breach, including the cancellation of an order for 300 units by one buyer whose customers had cancelled, or the cancellation of a 50 unit order by Delchi before it knew of the nonconformity of Rotorex's compressors.[71] Delchi was allowed, however, to recover its lost profit on a 250 unit order by a British firm, even though the British firm canceled its order in August 1988 "due to a general lack of sales."[72] The court found Delchi's loss on this order recoverable because "those units would have been already shipped by Delchi in July but for the Rotorex breach . . . . Thus the lost sales to the British affiliate were a direct result of Rotorex's breach."[73] The district court did not find the late cancellation or the weak market for Arieles in Great Britain to be an intervening cause.[74]

The district court did not allow damages for lost profit on the "indicated orders," orders which Delchi claimed it could have received but for the breach, because Delchi failed to prove that the breach caused these losses and that such losses, if they occurred, were not proved with reasonable

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[70] *Id.*

[71] *See id.* at *3.

[72] *Id.*

[73] *Id.*

[74] *See* FARNSWORTH, *supra* note 31, at 841. When a contract is breached or a tort committed, resulting losses or damage may not be caused by the actual breach or the tort itself, but rather by multiple or intervening causes, such as the cancellation of an order by Delchi's British customer or the lack of demand for Arieles in Britain after Rotorex's breach. Such multiple or intervening causes are less likely to relieve a defendant from contractual liability than from tort liability. *See id.* at 841 n.7 ("Although the same problems of multiple cause and of intervening cause that enliven the law of torts also arise in connection with contract damages, they are relatively less important than in the law of torts.").

certainty.[75] With regard to a number of "indicated orders," the district court not only held that the evidence offered by Delchi was inadmissible because it was speculative, but also held that Delchi failed to prove that its "inability to fill such orders was directly attributable to Rotorex's breach."[76]

Article 74 of the CISG, which discusses causation, allows "[d]amages for breach . . . [for] the loss, including loss of profits, suffered . . . as a consequence of the breach."[77] The court applied the causation principles of Article 74 in a manner consistent with U.S. law, namely that to be recoverable, a loss must be caused in fact by the breach.[78]

2.2.4.2. Foreseeability

The district court found that Delchi's lost profits on actual orders were a foreseeable result of Rotorex's breach under CISG Article 74.[79] Although the court cited the CISG, it also stated, in general terms, a test of foreseeability more closely resembling New York law than the wording of the CISG.

The foreseeability limitation on contract damages in U.S. law developed at common law[80] from the English case of

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[75] *Delchi,* 1994 WL 495787, at *6.

[76] "Delchi's claim of 4,000 additional lost sales in Italy is supported only by the speculative testimony of Italian sales agents . . . . The number of additional units they might have ordered . . . is not in evidence, as the court sustained Rotorex's timely objections to the speculative nature of such testimony." *Id.*

[77] *See* CISG art. 74, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 688.

[78] The factual causation requirement in U.S. contract law is similar to the causation requirement in a tort claim, except that damages in tort are intended to put the plaintiff in a pre-tort position, while contract expectation damages put the plaintiff in the same position as he would have been had there been full performance. *See* FARNSWORTH, *supra* note 31, at 871 ("The basic principle for the measurement of [contract] damages is that of compensation based on the injured party's expectation."). For expectation damages, which include consequential damages, the plaintiff must also demonstrate what his position would have been with contract performance. *See id.* at 841.

[79] *See Delchi,* 1994 WL 495787, at *6.

[80] The English court in *Hadley v. Baxendale* referred to the French Civil Code's articles 1149-51, and one of the judges referred to the French requirement of foreseeability. *See* Guenter H. Treitel, *Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved), in*

Hadley v. Baxendale.[81] The foreseeability limitation is usually stated as comprising two rules:[82] (1) the injured party can recover for losses that "may fairly and reasonably be considered [as] arising naturally, i.e. according to the usual course of things, from such breach of contract itself;"[83] and (2) that there should be no consequential damage recovery except "such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it."[84] This test has evolved into the foreseeability limitation[85] now found in the U.C.C. and the *Restatement of Contracts*.[86] A similar foreseeability limitation on damages is found in many other legal systems, as well as in CISG Article 74.[87]

U.S. jurisdictions have not uniformly applied the foreseeability limitation. Many state courts interpreted *Hadley* as requiring evidence that, at the time of contracting, the parties contemplated the consequential damages later

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2 INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW 58 (Arthur von Mehren ed., 1976).

[81] Hadley v. Baxendale, 156 Eng. Rep. 145 (1854).

[82] *See* Murphey, *supra* note 23, at 432 ("The [foreseeability] rule is often discussed as being two rules or one rule in two parts.").

[83] Hadley v. Baxendale, 156 Eng. Rep. at 151.

[84] *Id.*

[85] "Whatever the connotation in *Hadley*'s day, in time, most authorities in the United States — and some in England — equated 'foreseeability' with 'in the contemplation of the parties' and concluded that *Hadley* established a rule of foreseeability." Murphey, *supra* note 23, at 438.

[86] *See supra* notes 54-55.

[87] "The principle of excluding damages for unforeseeable losses is found in the majority of legal systems." *Commentary*, *supra* note 26, at 59. Although numerous scholars claim that the rule of foreseeability in CISG Article 74 is derived from English common law, it has been forcefully argued that it is instead derived from French law. *See* Franco Ferrari, *Comparative Ruminations on the Foreseeability of Damages in Contract Law*, 53 LA. L. REV. 1257, 1263-69 (1993); Detlef König, *Voraussehbarkeit des Schadens als Grenze vertraglicher Haftung*, *in* DAS HAAGER EINHEITLICHE KAUFGESETZ UND DAS DEUTSCHE SCHULDRECHT, KOLLOQUIM ZUM 65, GEBURTSTAG VON ERNST VON CAEMMERER 74, 86-130 (Hans G. Leser & W. Frhr Marschall von Bieberstein eds., 1973).

sought.[88] Some states, such as New York[89] and Pennsylvania,[90] have held the obligor responsible for damages only to the extent that he "tacitly agreed to assume responsibility."[91] Although Pennsylvania later rejected the tacit agreement test,[92] New York courts continue to hold that, as a matter of law, a plaintiff cannot recover consequential damages without evidence demonstrating a defendant's tacit agreement at the time of contracting to accept responsibility for such damages.

The "tacit agreement" test has been rejected by most states and the U.C.C.,[93] but its underlying justification — that the obligor should not be responsible for damages beyond the risk assumed at the time of contracting — continues to affect decisionmaking in the United States. This approach of limiting risk to that assumed at the time of contracting seems to have received new life in 1981 when the *Restatement of Contracts* included section 351(3), stating:

> A court may limit damages for foreseeable loss by excluding recovery for loss of profits, by allowing

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[88] 1 ROBERT L. DUNN, RECOVERY OF DAMAGES FOR LOST PROFITS 23 (4th ed. 1992).

[89] *See* Kenford Co. v. County of Erie, 537 N.E.2d 176, 179 (N.Y. 1989) ("In determining the reasonable contemplation of the parties, the nature, purpose and particular circumstances of the contract should be considered . . . as well as 'what liability the defendant fairly may be supposed to have assumed consciously . . . .'") (citation omitted).

[90] *See* Keystone Diesel Engine Co. v. Irwin, 191 A.2d 376, 377 (Pa. 1963) (holding that contemplation exists where "buyer has communicated to seller . . . sufficient facts to make it apparent that damages . . . were within reasonable contemplation of the parties").

[91] Morrow v. First Nat'l Bank of Hot Springs, 550 S.W.2d 429, 430 (Ark. 1977); *see also* Western Indus., Inc. v. Newcor Canada Ltd., 739 F.2d 1198 (7th Cir. 1984) (stating in dicta that consequential damages are not recoverable unless specifically negotiated).

[92] R.I. Lampus Co. v. Neville Cement Prods. Corp., 378 A.2d 288, 288 (Pa. 1977) ("[B]uyer was not required to establish . . . that seller contemplated or tacitly agreed. . . .").

[93] *See* FARNSWORTH, *supra* note 31, at 914-15; U.C.C. § 2-715 cmt. 2 (1991) ("The 'tacit agreement' test for the recovery of consequential damages is rejected."); RESTATEMENT (SECOND) CONTRACTS § 351 cmt. a (1981) ("[T]he party in breach need not have made a 'tacit agreement' to be liable for the loss.").

> recovery only for loss incurred in reliance, or otherwise if it concludes that in the circumstances justice so requires in order to avoid disproportionate compensation.[94]

Commentary on this section of the *Restatement* indicates that this approach is to be used in only exceptional cases, and courts thus have made little use of it.[95] Nevertheless, many courts still resist holding a seller liable for damages for prospective lost profits, and the demise of the tacit agreement test is still uncertain in some states such as New York.

Another possible source of nonuniform application of the CISG in the United States is that the U.C.C. has not adopted the foreseeability limitation to limit breach of warranty damages involving an injury to person or property. Such breach of warranty damages are recoverable on a showing of proximate cause alone, regardless of foreseeability.[96] In this limited instance, contract damages, like tort damages,[97] are not limited by foreseeability. It is noteworthy that the CISG does not apply to claims for personal injury or death and does not adopt a different damage article for breach of warranty, but rather applies Article 74

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[94] RESTATEMENT (SECOND) OF CONTRACTS § 351(3) (1981).

[95] *See id.* § 351 cmt. f (1981) ("There are unusual instances in which it appears . . . [that] it would be unjust to put the risk on that party."); *see also* JOSEPH M. LOOKOFSKY, CONSEQUENTIAL DAMAGES IN COMPARATIVE CONTEXT 189 (1989) (explaining a study which revealed only three cases that cited § 351(3), the most relevant being All Points Towing, Inc. v. City of Glendale, 735 P.2d 145 (Ariz. App. 1987)). Lookofsky expressed the fear of some that the discretionary justice represented by § 351(3) goes too far, "posing a threat to commercial certainty and even to classical contract law." *Id.* at 291.

[96] *See* U.C.C. § 2-715(2)(b) (1991) ("Consequential damages resulting from a seller's breach include . . . injury to person or property proximately resulting from any breach of warranty.").

[97] In the United States, foreseeability is not a limitation on liability for tort damages. *See* RESTATEMENT (SECOND) OF TORTS § 435(1) (1965) ("If the actor's conduct is a substantial factor in bringing about harm to another, the fact that the actor neither foresaw nor should have foreseen the extent of the harm or the manner in which it occurred does not prevent him from being liable.").

to all damages for breach of contract.[98]

An area of further concern is the textual difference between the U.C.C., the *Restatement of Contracts*, and the CISG regarding the extent to which consequential damages should be foreseen. The U.C.C. allows "*any* loss resulting from general or particular requirements and needs of which the seller . . . had reason to know."[99] The *Restatement* allows damages for foreseeable *probable* damages,[100] while CISG Article 74 allows for damages "which the party in breach foresaw or ought to have foreseen . . . as a *possible* consequence of the breach."[101] Arguably, the CISG and the U.C.C. are closer in their textual standards.[102]

In the United States, courts have not asked whether, at the time of contract formation, the defendant foresaw or could reasonably have foreseen the manner or particular way in which the loss would result. But, in contract law, unlike in tort law, the extent of damages recoverable has been limited to the *type* of loss that was reasonably foreseeable at the time of making the contract.[103]

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[98] *See* CISG art. 75, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 689.

[99] U.C.C. § 2-715(2)(a) (1991) (emphasis added).

[100] RESTATEMENT (SECOND) OF CONTRACTS § 351(1) (1981) ("Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result . . . .").

[101] *See* CISG art. 74, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 688 (emphasis added).

[102] *See* Farnsworth, *supra* note 56, at 253. Although the *Restatement of Contracts* and the CISG also apply to seller's consequential damages, this Article only discusses a buyer's consequential damages. This approach is taken both because the CISG cases are about buyer's damages and because, in U.S. courts, seller's claims for loss of direct profits from defaulting buyers have received very favorable treatment, raising no important issues of foreseeability. In such cases, courts seem "to presume foreseeability and certainty rules have been met." STEWART MACAULAY ET AL., CONTRACTS: LAW IN ACTION 133 (1995). Commentators argue that this result is appropriate because there is little danger of damage awards disproportionate to the consideration defendant would have gotten from performance since "[c]ontract price is the ceiling of recovery, and the largest cost items to be deducted from that price are the most susceptible to proof." *Lost Profits*, *supra* note 34, at 1003 (citations omitted).

[103] *See* FARNSWORTH, *supra* note 31, at 916 ("One takes the risk . . . of those [consequences] that one ought reasonably to have foreseen."). This is unlike the test in tort law, which rejects the foreseeability limit

Another textual difference between the CISG and U.S. law concerns whether foreseeability is based on an objective or a subjective test. In the United States, foreseeability of consequential damages resulting from a breach of a contract for the sale of goods is determined by an objective test. The U.C.C. limits damages to those "of which seller . . . had *reason* to know."[104] The *Restatement of Contracts* also requires "*reason* to foresee."[105] Article 74 of the CISG, however, is written in terms of both an objective and a subjective test of "loss which the party in breach foresaw or ought to have foreseen."[106] In situations where the breaching party knows of unusual losses which might occur in case of a later breach, there is minimal difference between the objective and the subjective standards.[107]

Few U.S. courts have barred proof of buyer's lost profits on the ground that the lost profits could not be foreseeable. Judges in the United States apply various presumptions in making their findings, some of which derive from case law and some of which derive from comments to the U.C.C.[108] Courts begin with the assumption that cover is normally possible whenever a breach occurs because one can usually buy similar goods in a market economy.[109] Thus, if a contract is breached, it is usually not foreseeable to a seller at the time of contract formation that if he later breaches, the buyer will not be able to cover, thus preventing the

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on damages. Instead, if the defendant's conduct threatens *any* interest of the plaintiff, defendant is liable for any resultant injury to plaintiff unless that injury is extremely bizarre. *See* RESTATEMENT (SECOND) OF TORTS § 435 (1965).

[104] U.C.C. § 2-715(2)(a) (1991) (emphasis added).

[105] RESTATEMENT (SECOND) OF CONTRACTS § 351(1) (1981) (emphasis added).

[106] *See* CISG art. 74, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 688.

[107] *See* WHITE & SUMMERS, *supra* note 44, at 514-18; Sutton, *supra* note 19, at 744 (stating that a party "may want to make . . . dangers known to the other contracting party in order to implicate the subjective prong . . . Such notice, however, would also create objective foreseeability today under the [U.C.C.] and the *Restatement,* thus minimizing the differences between article 74 and American view of foreseeability.").

[108] *See* DUNN, *supra* note 88, at 36-43.

[109] *See supra* note 50.

buyer from performing his resale obligations. To recover lost profits, a buyer must show that the seller actually knew or should have known at the time of contract formation that cover would not be available upon breach.[110]

Additionally, in order to recover damages for lost profits a buyer must show that the seller knew or should have known that the purchase was for resale and that the resale would have earned the buyer a profit.[111] A buyer is assisted in his proof by the U.C.C., which states that if the seller knows that the buyer is purchasing for resale, then loss of profit within a normal range is foreseeable.[112] In these circumstances, a seller also is generally liable for foreseeable claims by third parties against a buyer for his failure to perform resale contracts involving the undelivered goods.[113]

2.2.4.3. Proof With Reasonable Certainty

The "reasonable certainty" limitation — that damages are recoverable only to the extent that they can be proved with reasonable certainty — is a creation of U.S. law[114] and does not exist in the CISG. The *Delchi* court did not cite any CISG authority supporting the proposition that damages for lost profit must be proved with reasonable certainty. Instead, the *Delchi* court imposed the common law damage limitation while still maintaining that the CISG was the controlling law of the contract. The district

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[110] *See* FARNSWORTH, *supra* note 31, at 918 ("Problems of foreseeability do not usually arise unless the injured party who is a buyer cannot cover . . . .").

[111] *See id.* at 919-20. Because most goods are readily available in a competitive market, the inability to cover is not foreseeable in the ordinary course of events. *See id.* at 878-79. *See also* RESTATEMENT (SECOND) OF CONTRACTS § 351(2)(a) (1981) ("Loss may be foreseeable as a probable result of a breach because it follows from the breach . . . in the ordinary course of events . . . .").

[112] *See* U.C.C. § 2-715 cmt. 6 (1991) (noting that damages resulting from loss of resale profits are included under consequential damages). Seller is not liable for extraordinary lost profit or losses from unusual terms of buyer's resale contracts or "other circumstances of which seller is ignorant." FARNSWORTH, *supra* note 31, at 919.

[113] *See* FARNSWORTH, *supra* note 31, at 920 n.33 (citing Verhagen v. Platt, 61 A.2d 892 (N.J. Super. Ct. 1948)).

[114] *See id.* at 921.

court stated:

> [i]n conformity with the common law, *see* RESTATEMENT (SECOND) OF CONTRACTS § 331 (sic);[115] 5 ARTHUR CORBIN, CORBIN ON CONTRACTS § 1020 (1951), and with the law of New York, *see Merlite Indus., Inc. v. Valassis Inserts, Inc.*, 12 F.3d 373, 376 (2d Cir. 1993), to recover a claim for lost profit under UNCCISG, a party must provide the finder of fact with sufficient evidence to estimate the amount of damages with reasonable certainty.[116]

The sources cited by the district court make no mention of the CISG, and *Merlite* involves a domestic sale. Some form of the reasonable certainty limitation on damages, even if not called for in the CISG, will be applied by courts everywhere.[117] If there is a gap in the CISG on this point, the *Delchi* court indeed was correct to apply the law of the forum in a purely procedural matter. As one commentator has stated, "[p]roblems of proof and certainty of loss are procedural matters which remain within the province of national law, and procedural conceptions may still serve as covert limitations on CISG consequential awards."[118]

If U.S. courts apply the certainty limitation to international sales in the same manner as domestic sales, however, then such courts may be exceeding procedural determinations. There is a distinction between a court determining that evidence is unreliable or uncertain and a court not allowing any evidence of a type of loss because the law of the jurisdiction refuses to allow damages for that type of loss as a matter of law. In the latter situation, barring evidence of damage from loss of goodwill is not merely a procedural determination. Such a restrictive approach could make lost profit from future sales and goodwill more

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[115] "Damages are not recoverable for loss beyond an amount that the evidence permits to be established with reasonable certainty." RESTATEMENT (SECOND) OF CONTRACTS § 352 (1981).

[116] *Delchi*, 1994 WL 495787, at *6 (footnotes added).

[117] *See* LOOKOFSKY, *supra* note 95, at 181-87.

[118] *Id.* at 283 n.158.

difficult to obtain in some U.S. jurisdictions than in the courts of other nations applying the CISG. At the very least, disallowing evidence of loss of goodwill damage as a matter of law undermines the predictability and harmonization of litigation results under the CISG.[119]

Another problem with the certainty limitation is a lack of predictable application by courts. Both the *Restatement of Contracts* and the U.C.C. agree that a party can only recover damages for breach of contract that can be shown with reasonable certainty.[120] It has been noted, however, that in cases where lost profit is sought on a collateral transaction, certainty, like foreseeability, is "a convenient means for keeping within the bounds of reasonable expectation the risk which litigation imposes upon commercial enterprise[s]."[121] Furthermore, "[i]f the test of foreseeability is met, but the court nevertheless concludes that liability would impose on the party in breach a risk disproportionate to the rewards that the party stood to gain by the contract, 'the test of certainty is the most usual surrogate.'"[122]

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[119] Commentators have noted:

> Because the legal principle of certainty [relating to damages for loss of goodwill] in the plaintiff's case is indivisible from factual questions about the amount and probity of plaintiff's evidence, it is difficult to make sensible and useful generalizations about that principle. Often cases cited under the certainty rubric could be as easily explained by saying that the 'plaintiff merely failed to prove his damages' or 'failed to prove his case.' So stated, the principle is reduced to a homily.

WHITE & SUMMERS, *supra* note 44, at 451.

[120] *See* RESTATEMENT (SECOND) OF CONTRACTS § 352 (1981); U.C.C. § 1-106 cmt. 1 (1991) (stating that damages "have to be proved with whatever definiteness and accuracy the facts permit, but no more"); U.C.C. § 2-715 cmt. 4 (1991) ("The burden of proving . . . consequential damages is on the buyer, but the section on liberal administration of remedies rejects any doctrine of certainty which requires almost mathematical precision in the proof of loss. Loss may be determined in any manner which is reasonable under the circumstances."); *see also* WHITE & SUMMERS, *supra* note 44, at 269 ("The 'fact-amount' doctrine, however, relaxes the burden of proof on the amount of loss once the buyer has proven the fact of a loss . . . .").

[121] CHARLES T. MCCORMICK, LAW OF DAMAGES 105 (1935).

[122] L.L. Fuller & William R. Purdue, Jr., *The Reliance Interest in Contract Damages*, 46 YALE L.J. 373, 376 (1937). It has been forcefully argued that the foreseeability rule should be abandoned because it

Numerous U.S. court decisions have determined whether evidence of damages for lost profits were allowed, and whether such damages were proved with sufficient certainty to be recoverable as consequential damages. Because these decisions have reached very different conclusions on similar facts, scholars, in an effort to make outcomes more predictable, have characterized these disparate results in three categories.[123] These categories, based on the nature of the buyer and the nature of the lost profit, include: (1) a middleman-buyer suing for lost resale profit on the goods seller promised to deliver ("middleman-buyer");[124] (2) a manufacturer-buyer claiming lost profit due to seller's defective performance of a promise to deliver goods necessary for production ("manufacturer-buyer");[125] and (3) a

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permits only all-or-nothing recovery and does not necessarily prevent disproportionate damages. *See Lost Profits*, *supra* note 34, at 1021-22. This is because what courts often determine to be foreseeable was not in fact foreseen or foreseeable since the test is based on a "fiction." *Id.* One commentator argues:

> [L]oss of profits resulting from breach is seldom foreseen by either plaintiff or defendant at contract time. Moreover, when the parties actually do foresee the risk of loss, they generally allocate that risk . . . by a contractual provision for liquidated damages . . . . But the foreseeability rule is not applied when the loss was in fact considered; the rule is invoked only when a court must effect an allocation for which the parties failed to provide . . . . As a result, the foreseeability rule penalizes one party for omissions made by both at contract time.

Id.

[123] *See* Roy Ryden Anderson, *Incidental and Consequential Damages*, 7 J.L. & COM. 327, 399-423 (1987); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 352 cmt. b (1981) ("The difficulty of proving lost profits varies greatly with the nature of the transaction.").

[124] Courts have commonly awarded lost profits in this category, including lost resale profits on goods purchased for inventory. Older U.S. cases required that the defendant seller had to have had notice at the time of contract formation of buyer's particular resale transaction. Recent cases have allowed that "knowledge that the buyer was a merchant or that the buyer was ordering quantities too large for its own use" is sufficient for foreseeability of lost resale profits. MACAULAY ET AL., *supra* note 102, at 133-34; *see also Lost Profits*, *supra* note 34, at 1009-10.

[125] In cases involving manufacturer-buyer's claims of profits lost because a seller default delayed or prevented the manufacture and sale of their final product, U.S. courts are reluctant to find that the lost profits were foreseeable or reasonably certain. This type of case holds

buyer in either category claiming loss of future sales due to customer dissatisfaction which resulted from seller's breach of a contract to sell goods ("loss of goodwill").[126]

Courts have been more hesitant to award lost profits to buyers in the second and third categories because "the provision of opportunities for gain may have a snowball effect: opportunities breed further opportunities."[127] In

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the greatest possibility of disproportionate damages. *See* MACAULAY ET AL., *supra* note 102, at 134.

[126] *See* Consolidated Data Terminals v. Applied Digital Data Sys., Inc., 708 F.2d 385 (9th Cir. 1983) (holding that a distributor of computer terminals can recover for loss of customer goodwill resulting from sale of faulty terminals furnished by manufacturer); Roundhouse v. Owens-Illinois, Inc., 604 F.2d 990 (6th Cir. 1979) (stating that although in some cases Ohio would allow a jury to consider loss of goodwill in a breach of warranty case, where plaintiffs are unable to show lost profits or attach any kind of goodwill value to it, such damages must be denied as purely speculative); R.E.B., Inc. v. Ralston Purina Co., 525 F.2d 749 (10th Cir. 1975) (finding that a hog breeder furnished with defective feed can recover for resulting damage to reputation); Texsun Feed Yards, Inc. v. Ralston Purina Co., 447 F.2d 660 (5th Cir. 1971) (holding that an owner of feed lot can recover for loss of customers in connection with use of defective feed supplement provided by feed company); Isenberg v. Lemon, 327 P.2d 1016 (Ariz. 1958) (stating that paint dealer can recover damages from manufacturer for loss of profits and goodwill where paint manufacturer provides dealer an unfit and inferior product for resale); Adams v. J.I. Case Co., 261 N.E.2d 1 (Ill. App. Ct. 1970) (explaining that a plaintiff's complaint for damages for loss of business should not have been dismissed); Delano Growers' Coop. Winery v. Supreme Wine Co., 473 N.E.2d 1066 (Mass. 1985) (commenting that a distributor of wine can recover for loss of goodwill when wine purchased was spoiled by mold); Hydraform Prod. Corp. v. American Steel & Aluminum Corp., 498 A.2d 339 (N.H. 1985) (finding that a manufacturer of wood stoves can only recover from steel manufacturer for loss of profits on sales which steel manufacturer should have foreseen under the terms of the contract and buyer cannot recover for diminished value of business because it is too speculative); Robert T. Donaldson, Inc. v. Aggregate Surfacing Corp. of Am., 47 A.D.2d 852, 366 N.Y.S.2d 194 (N.Y. App. Div. 1975), *appeal dismissed*, 337 N.E.2d 612 (N.Y. 1975) (noting that plaintiff, a surfacing company, is entitled to recover for loss of profits due to damage to its reputation sustained by a breach, but only to the extent that such damages are not speculative); Sol-o-lite Laminating Corp. v. Allen, 353 P.2d 843 (Or. 1960) (stating that because damage to goodwill does not require exact proof, plaintiff presented adequate evidence about the loss of goodwill to the jury by showing loss of business and refusal of customers to conduct subsequent business with plaintiff).

[127] *See* H.L.A. HART & TONY HONORE, CAUSATION IN THE LAW 312 (2d ed. 1985). One empirical study found that of approximately 200 cases decided between 1946 and 1955, buyer-middleman recovery was

category two, the manufacturer-buyer category, courts allowing damages for lost profit have no difficulty in finding such losses foreseeable.[128] When damages for lost profits are not allowed, it is usually because of the plaintiff's failure either to prove damages with reasonable certainty or to prove causation.[129] The "reasonable certainty" limitation has been less restrictive when applied to established businesses, which are better able to demonstrate the extent of injury by introducing records of past profits into evidence,[130] or even evidence of profit records from similar businesses.[131] On the other hand, new businesses have not fared as well. In some cases, courts have precluded new businesses, as a matter of law, from presenting evidence of lost profits, although now the trend has been to allow such evidence, but only upon meeting a higher standard of proof.[132]

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allowed in 75% of category one cases, but only in 50% of the buyer-manufacturer category two cases. *See Lost Profits*, *supra* note 34, at 1016 n.137.

[128] *See, e.g.*, Lewis v. Mobil Oil Corp., 438 F.2d 500, 510 (8th Cir. 1971) ("Where a seller provides goods to a manufacturing enterprise with knowledge that they are to be used in the manufacturing process, it is reasonable to assume that he should know that defective goods will cause a disruption of production, and loss of profits is a natural consequence of such disruption.").

[129] *See* National Controls Corp. v. National Semiconductor Corp., 833 F.2d 491 (3d Cir. 1987) (disallowing damages due to plaintiff's failure to prove defendant's breach was the "proximate cause of [plaintiff's] loss of profits"); General Supply & Equip. Co. v. Phillips, 490 S.W.2d 913 (Tex. Civ. App. 1972) (finding that plaintiff failed to prove with a "reasonable degree of certainty" that his loss of profits was due to defendant's breach).

[130] *See, e.g.*, Gurney Indus. v. St. Paul Fire & Marine Ins. Co., 467 F.2d 588 (4th Cir. 1972) (finding that "the effect of contractor's breach . . . upon owner's profits was too remote to warrant recovery of loss of anticipated profits"); *Lewis*, 438 F.2d at 511 (allowing recovery for lost profits where a "reasonable approximation" of amount lost could be calculated based on business record of past profit); Burrus v. Itek Corp., 360 N.E.2d 1168 (Ill. App. Ct. 1977) (allowing recovery of lost profits based upon testimony of previous productivity).

[131] *See, e.g.*, Cates v. Morgan Portable Bldg. Corp., 591 F.2d 17 (7th Cir. 1979) (allowing evidence of profit records from similar motel businesses into calculation of plaintiff's lost profits).

[132] *See* RESTATEMENT (SECOND) OF CONTRACTS § 352 cmt. b (1981) ("However, if the business is a new one or if it is a speculative one that is subject to great fluctuations in volume, costs or process, proof will be

U.S. judges confronted with category three, loss of goodwill, cases often disallow evidence of or deny damages for lost goodwill or profits.[133] Damages for lost goodwill or lost profits based upon potential future sales are not awarded either because the damages are unforeseeable, not proximately caused by the breach, or without proof with reasonable certainty.[134] Most claims for loss of goodwill

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more difficult. Nevertheless, damages may be established with reasonable certainty with the aid of expert testimony, economic and financial data, market surveys and analyses, business records of similar enterprises, and the like."); *see also* Frank L. Williamson, Comment, *Remedies — Lost Profits as Contract Damages for an Unestablished Business: The New Business Rule Becomes Outdated*, 56 N.C. L. REV. 693, 734 (1978) (urging the replacement of the new business rule with "a less intractable test" which "takes into account developing commercial and economic realities"); Eric J. Wittenberg, Comment, *The State of Lost Profits Damages and Punitive Damages for Breach of Contract in Pennsylvania*, 6 J.L. & COM. 531, 543 (1986) (explaining that while Pennsylvania has eased the restrictions of the new business rule, "certainty still remains the standard under Pennsylvania law").

[133] *But see* WHITE & SUMMERS, *supra* note 44, at 269 ("Claims for lost goodwill have generated a split of authority. We think goodwill losses should be recoverable, on proper proof, and provided there is no double recovery."); *see also* Anderson, *supra* note 123, at 420 ("As mercantile practice has moved toward defining parameters of meaning and recognizing methods for calculation of goodwill by economists and accountants, goodwill has become more widely accepted as a recoverable item of consequential loss.").

[134] *See* National Controls Corp. v. National Semiconductor Corp., 833 F.2d 491 (3d Cir. 1987) (describing proximate cause and speculative damages case); Dacor Corp. v. Sierra Precision, 753 F. Supp. 731, 733 (N.D. Ill. 1991) (Speculative-Manufacturer of scuba diving equipment could not assert claim for loss of potential customers against supplier of defective regulator hoses in action for breach of implied warranty of merchantability since such damages are speculative and are "unrecoverable in breach of contract" under Illinois law); Manuel Int'l, Inc. v. M.R. Berlin Co., 525 F. Supp. 90 (N.D. Ill. 1981) (stating as dicta that in a speculative contract claim within a federal anti-trust claim under Pennsylvania law (which did not apply to federal anti-trust action), damages to business reputation and loss of potential customers are speculative); Eastern Dental Corp. v. Isaac Masel Co., 502 F. Supp. 1354 (E.D. Pa. 1980) (disallowing damages for loss of goodwill in any action based on breach of contract); Hydraform Prods. Corp. v. American Steel & Aluminum Corp., 498 A.2d 339 (N.H. 1985) (Souter, J.) (stating that "[a]s a general rule . . . goodwill may be recovered as an element of consequential damages"); George H. Swatek, Inc. v. North Star Graphics, Inc., 587 A.2d 629, 631-32 (N.J. Super. Ct. App. Div. 1991) (explaining the issue of foreseeability where the trial court properly excluded evidence of lost profits and injury to goodwill and reputation as unforeseeable when date for delivery of the goods was not

fail because the court found the evidence insufficient to award damages. However, U.S. courts also have found, as a matter of law, that loss of goodwill damages was not subject to proof with reasonable certainty and that evidence of such loss should be excluded.[135]

The district court in *Delchi* applied Article 74 to a manufacturer-buyer situation and did not allow evidence on the amount of damages for future "indicated orders" on the basis that such evidence would be "speculative" and there was "no evidence that . . . Delchi's inability to fill those orders was directly attributable to [or caused by] Rotorex's breach."[136] Thus, the court denied damages for loss of "indicated orders," as have other U.S. courts, because the damages could not be established with reasonable certainty.

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certain).

[135] In Neville Chem. Co. v. Union Carbide Corp., 422 F.2d 1205, 1225 (3d Cir. 1970), the court made the "legal conclusion" that "plaintiff may not recover for loss of profits to a business because of customer dissatisfaction or loss of good will." *Id.* The *Neville* court distinguished this sort of loss of profits from "loss of profits . . . on the particular sale or contract for the performance of which the goods in question were purchased." *Id.* at 1225-26. In an earlier opinion applying the tacit agreement test, Armstrong Rubber Co. v. Griffith, 43 F.2d 689, 691 (2d Cir. 1930), Judge Augustus N. Hand declared that "[w]e can hardly doubt that such an uncertain and perilous risk as indemnification against loss . . . of customers was never contemplated by the plaintiff in this case. Nothing was said about it in the negotiations between the parties, and it seems quite unlikely that it ever should have been intended." Courts not applying the tacit agreement test have also held as a matter of law that loss of customers is not reasonably foreseeable. *See* Chrysler Corp. v. E. Shavitz & Sons, 536 F.2d 743, 744-45 (7th Cir. 1976) (finding that a seller was not liable for damages for breach of a contract for the sale of air conditioning equipment which resulted in a buyer losing customers because seller and buyer were not in a fixed contract covering a definite time period, "seller had no reason to know of any subsequent job opportunities [buyer] might have with customers" and no job opportunities with such customers were pending at the time buyer severed the relationship). The *Chrysler* court, however, would have allowed loss of profit on contracts in existence or those, "in the offing," at the time of the contract.

[136] *Delchi,* 1994 WL 495787, at *6. The court of appeals' opinion does not state that the district court would not allow evidence on the number of indicated orders. In affirming the district court's ruling on this issue, the Second Circuit held that finding such testimony to be speculative was not clearly erroneous. *See* Delchi Carrier, SpA v. Rotorex Corp., Nos. 95-7182, 95-7186, slip op. at 5 (2d Cir. Dec. 6, 1995).

Although most states will allow evidence of damages of loss of goodwill,[137] New York courts, still utilizing the tacit agreement test, are more likely to rule that such evidence is inadmissible.[138] Until recently, Pennsylvania courts also excluded "loss of goodwill" evidence. In 1990, however, the Pennsylvania Supreme Court, having abandoned the "tacit agreement" test in 1977,[139] seemed to change Pennsylvania law regarding goodwill damages.[140] The new standard would allow plaintiffs to pursue claims for goodwill damages under warranty theories, provided that evidence can be introduced to: (1) establish a causal nexus between the damages and the breach of warranty; and (2) provide the trier of fact with a reasonable basis for the calculation of damages.[141]

Anticipated profits do have a current discounted value. Such profits may involve some uncertainty of proof, but to disallow evidence of such damages as a matter of law is an unjust denial of compensation which may occur in a U.S. court applying the CISG.

2.2.5. Pre-Judgment Interest

The *Delchi* court awarded the plaintiff pre-judgment interest on its reliance damages as well as on its consequen-

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[137] Outside of Pennsylvania, "a majority of the cases have allowed for the recovery of lost goodwill in proper circumstances." Anderson, *supra* note 123, at 421 (footnote omitted). *But see* Robert P. Barbarowicz, Comment, *Loss of Goodwill and Business Reputation as Recoverable Elements of Damages Under Uniform Commercial Code § 2-715 — the Pennsylvania Experience*, 75 DICK. L. REV. 63, 63 (1970) (highlighting the Pennsylvania Supreme Court's refusal "to permit recovery for loss of goodwill").

[138] *See* Barbarowicz, *supra* note 137, at 74-75.

[139] In 1977, the Pennsylvania Supreme Court overruled the "tacit agreement test" and replaced it with a "had reason to know" test. This new standard requires that "[i]f a seller knows of a buyer's general or particular requirements and needs, that seller is liable for the resulting consequential damages whether or not that seller contemplated or agreed to such damages." P.I. Lampus Co. v. Neville Cement Prods. Corp., 378 A.2d 288, 292 (Pa. 1977). Thus, a plaintiff need only prove that damages were reasonably foreseeable at the time of entering into the agreement.

[140] AM/PM Franchise Ass'n v. Atlantic Richfield Co., 584 A.2d 915, 925-26 (Pa. 1990).

[141] *See id.* at 926.

tial damages for lost profits under CISG Article 78.[142] Because Article 78 does not specify the proper interest rate, the district court, in its "discretion,"[143] ordered that interest be paid at the U.S. treasury bill rate as set forth in 28 U.S.C. § 1961(a).[144] The district court then ordered the parties to submit the proper calculation of pre-judgment interest within fifteen days.[145]

Based on cultural differences between the signatory nations, CISG Article 78, more so than any other provision of the Convention, was the subject of disagreement.[146] Religious mandate prohibits interest in some countries and capitalist and communist societies have different theories about interest rates.[147] Article 78, as finally adopted, states that "[i]f a party fails to pay the price or any other sum that is in arrears, the other party is entitled to interest

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[142] *Delchi,* 1994 WL 495787, at *7.

[143] *Id. See also* James J. Callaghan, *U.N. Convention on Contracts for the International Sale of Goods: Examining the Gap Filling Role of CISG in Two French Decisions,* 14 J.L. & COM. 183, 198 (1995) (noting that the proper interest rate is generally determined according to the law applicable to the contract as a whole). Arbitrators have used conflicts rules to determine the rate of interest rather than the rule of the forum. Callaghan suggests that arbitrators should use a rate which indemnifies against the harm caused by the delay rather than the law of any particular state. *Id.*

[144] The *United States Code* states:

> Interest shall be allowed on any money judgment in a civil case recovered in a district court. Execution therefor may be levied by the marshal, in any case where, by the law of the State in which such court is held, execution may be levied for interest on judgments recovered in the courts of the State. Such interest shall be calculated from the date of the entry of the judgment, at a rate equal to the coupon issue yield equivalent (as determined by the Secretary of the Treasury) of the average accepted auction price for the last auction of fifty-two week United States Treasury bills settled immediately prior to the date of the judgment. The Director of the Administrative Office of the United States Courts shall distribute notice of that rate and any changes in it to all Federal judges.

28 U.S.C. § 1961(a) (1988).

[145] *Delchi,* 1994 WL 495787, at *7.

[146] Article 58 of the 1976 UNCITRAL Working Group's Draft Convention, which authorized interest only for sellers, was not included in the 1977 and 1978 drafts. *See* Sutton, *supra* note 19, at 749.

[147] *See id.*

on it, without prejudice to any claim for damages recoverable under article 74."[148] Article 78 is silent on whether it applies to unliquidated as well as liquidated damages. Additionally, Article 78 provides no guidance for calculating such interest and gives no indication of the circumstances under which pre-judgment interest should be awarded. There is, however, an indication in prior drafts of the CISG and in some of the comments by its drafters that pre-judgment interest should not be allowed on unliquidated damages.[149]

The CISG, as applied in *Delchi*, is federal law. "Whether or not to award pre-judgment interest in cases arising under federal law has in the absence of a statutory directive been placed in the sound discretion of the district courts"[150] if: (1) the cause of action arises under the laws and treaties of the United States; (2) the Convention is silent on the question of pre-judgment interest; and (3) the policy of the Convention is consistent with such an award.[151]

It is questionable whether the last two criteria for allowing a court discretion in this matter were met in *Delchi*. Furthermore, CISG Article 7(2) directs a court as follows:

> Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.[152]

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[148] CISG art. 78, *supra* note 1, S. TREATY DOC. NO. 9 at 37, 19 I.L.M. at 689.

[149] *See* Sutton, *supra* note 19, at 749. The 1976 draft of the CISG would not have allowed a buyer pre-judgment interest on unliquidated damages.

[150] *In re* Waterside Ocean Navigation Co., 737 F.2d 150, 153 (2d Cir. 1984) (quoting Lodges 743 & 1746, International Ass'n of Mach. v. United Aircraft Corp., 534 F.2d 422, 446 (2d Cir. 1975), *cert. denied*, 449 U.S. 825 (1976)).

[151] *See id.* at 154.

[152] CISG art. 7(2), *supra* note 1, S. TREATY DOC. NO. 9 at 23-24, 19 I.L.M. at 673.

Arguably, because of the general language of Article 78 as enacted and the prior rejections of specific language by its drafters, it is appropriate for a U.S. district court to order pre-judgment interest on unliquidated damages. CISG Article 78 does allow the award of pre-judgment interest. If one reads the language of Article 78 — "if a party fails to pay . . . any other sum in arrears" — to include consequential damages, Article 78 also would allow interest on unliquidated damages. The drafting history and the Article itself, however, seem to indicate that an award of such interest was not intended by the drafters, or perhaps that the drafters intentionally left the CISG silent on this issue.

Whether to give pre-judgment interest on unliquidated damages was arguably an issue that the drafters believed should be properly resolved by resort to the local conflict of law rules.[153] The district court in *Delchi* had diversity jurisdiction over a case involving a contract between U.S. and Italian corporations. In diversity cases like *Delchi*, a federal district court will follow the conflict of laws rules which prevail in its forum state.[154] Since *Delchi* did not involve the foreign relations of the United States, federal common law should not have been applied.[155] If the

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[153] *See* Sutton, *supra* note 19, at 750 ("If courts interpret article 78 in the context of their own legal traditions, then interest could conceivably be awarded under the Convention for liquidated as well as unliquidated damages, or for damages based on current price and substitute transactions.").

[154] *See* Klaxon Co. v. Stentor Co., 313 U.S. 487, 494 (1941).

[155] In Erie R. Co. v. Tompkins, 304 U.S. 64 (1938), the Supreme Court determined that there is no federal general common law. Since then, federal courts have developed a federal common law in certain limited fields, including the area of foreign relations. For example, in Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398 (1964), the issue was whether the "act of state" doctrine was governed by state or solely by federal law, which would be binding on state courts. The Court, in holding that federal decisional law controlled, stated that it "seems fair to assume that the Court did not have rules like the act of state doctrine in mind when it decided *Erie R. Co. v. Tompkins*." *Id.* at 425; *see also* ALAN C. SWAN & JOHN F. MURPHY, CASES AND MATERIALS ON THE REGULATION OF INTERNATIONAL BUSINESS AND ECONOMIC RELATIONS 1139 (1991) (stating that *Banco Nacionale de Cuba* "is most often cited in favor of a federal common law of foreign relations").

district court in *Delchi* found the CISG silent on the issue of awarding pre-judgment interest on unliquidated damages, the district court should have looked to New York conflict of laws rules in order to determine whether New York or Italian law controlled the issue. The *Delchi* court might have determined that under New York conflicts rules, New York had a "greater interest"[156] in this matter than Italy. Alternatively, the district court might have determined that the matter of pre-judgment interest is procedural rather than substantive,[157] and based its recovery on the New York Code, which allows pre-judgment interest on unliquidated damages for breach of contract.[158] The

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[156] *See* Joseph A. Zirkman, *New York's Choice of Law Quagmire Revisited*, 51 BROOK. L. REV. 579, 586 (1985) (highlighting a New York case in which the choice of law was determined by which jurisdiction had "greater interest in deciding the particular litigated issue"); *see also* Associated Metals & Minerals Corp. v. Sharon Steel Corp., 590 F. Supp. 18 (S.D.N.Y. 1983) (enforcing a contractual choice of Pennsylvania law where Pennsylvania had a "reasonable relationship" to the subject of the contract dispute).

[157] In O'Rourke v. Eastern Air Lines, Inc., 730 F.2d 842 (2d Cir. 1984), the court held that *calculation* of pre-judgment interest in a wrongful death action under a New York statute is considered a substantive issue, but the issue of *whether to award* such interest depended on whether pre-judgment interest was consistent with the goals of the Warsaw Convention and the Montreal Agreement. In *O'Rourke*, the Second Circuit found the award of pre-judgment interest was not consistent with those international agreements, but the Fifth Circuit in Domangue v. Eastern Air Lines, Inc., 722 F.2d 256 (5th Cir. 1984), found that pre-judgment interest was consistent with the Convention and was a valid exercise of the court's discretion.

[158] According to the New York Code:

> *Interest to verdict, report or decision: (a) Actions in which recoverable.* Interest shall be recovered upon a sum awarded because of a breach of performance of a contract, or because of an act or omission depriving or otherwise interfering with title to, or possession or enjoyment of, property, except that in an action of an equitable nature, interest and the rate and date from which it shall be computed shall be in the court's discretion.

N.Y. CIV. PRAC. L. & R. 5001 (McKinney 1992 & Supp. 1995). Pennsylvania has developed a similar rule in its courts. *See* United States v. Bethlehem Steel Corp., 113 F.2d 301, 308 (3d Cir. 1940) ("Likewise it is well settled in Pennsylvania that in an action to recover unascertained damages for a breach of contract the allowance of interest prior to judgment is discretionary."). One scholar found that courts consider the following laws applicable for the determination of the interest rate:

district court, however, engaged in no discussion about these issues, but instead disregarded CISG Article 7 and the legislative history of CISG Article 78. Although the *Delchi* court might have come to the same conclusion if it had analyzed the award under the CISG, a probing analysis of these issues would have more positively influenced the future application of the CISG.

3. THE GERMAN CASE

The German case concerning consequential damage provisions similar to CISG Article 74 involved a buyer who attempted to recover damages for future lost profits due to his customer's dissatisfaction with the delivered goods. The decision, handed down by the Federal Supreme Court of Germany in 1980,[159] addressed consequential damages for breach of a contract for the international sale of cheese.

3.1. Factual Background and Lower Court Decisions

Plaintiff ("Seller") was a Dutch exporter of cheese and

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(1) *law of place of payment*: ICC award no. 7153, 1992 J.D.I. 1005; (2) *law of creditor*: LG Stuttgart Sept. 5, 1989, 1990 IPRAX 317; LG Frankfurt Sept. 16, 1991, 1991 RIW 952; KG Berlin Jan. 24, 1994, 1994 RIW 683; OLG München Mar. 2, 1994, 1994 RIW 545: ICC award no. 7197, 1993 J.D.I. 1028; (3) *law of place of actual loss*: LG Aachen Apr. 3, 1990, 1990 RIW 491; (4) *proper law of contract*: AG Oldenburg Apr. 24, 1990, 1991 IPRAX 336; LG Hamburg Sept. 26, 1990, 1991 IPRAX 400; Belgian Cass., Nov. 29, 1990, 1990 RIW 1270; (5) *law of debtor or creditor*: OLG Frankfurt June 13, 1991, 1991 RIW 591; OLG Frankfurt Apr. 20, 1994, 1994 RIW 593.

HANS VAN HOUTTE, THE LAW OF INTERNATIONAL TRADE 147 n.25 (1995). *See also Interpretive Decisions Applying CISG, Journal of Law & Commerce Case I: Oberlandesgericht, Frankfurt Am Main*, 14 J.L. & COM. 201, 202 (1995) ("Pursuant to German international private law, to determine the interest rate under CISG Article 78, the court must refer to national law."). Legal scholars and courts in Germany have concluded that the conflict of law rules of the forum should determine which law will govern the awarding of interest under the CISG. *See* Peter Schlechtriem, *Anmerkung*, *in* SCHIEDSSPRÜCHE ZU STREITIGKEITEN AUS INTERNATIONALEN KAUFVERTRÄGEN: ANWENDBARKEIT DES CISG 590, 592-94 (1995).

[159] *See* Judgment of Oct. 24, 1980, BGH [Supreme Court], 1981 IPRAX 96-98; MICHAEL R. WILL, CISG — INTERNATIONAL BIBLIOGRAPHY 1980-1995 (4th ed. 1995).

Defendant ("Buyer") was a German importer of cheese who resold the cheese to customers, including wholesalers.[160] In December 1976, after lengthy negotiations, the parties finalized a contract for the cheese to be delivered to Germany in January 1977.[161] Seller delivered the cheese, but when Buyer did not pay the full contract price, Seller sued.[162] Buyer claimed that: (1) Seller had agreed to discount the sales price;[163] and (2) Seller had breached the contract because three percent of the cheese delivered was defective.[164]

As a result of this defective delivery, Buyer alleged the following damages: (1) four of Buyer's customers, who were bulk buyers, discontinued business with Buyer, costing Buyer 288,000 DM in lost profits over four years; (2) one of Buyer's customers, Firm H, lost customers as a result of the defective cheese, for which Buyer had to pay Firm H 80,000 DM; and (3) as a result of losing business relations with one customer, Firm I, Buyer lost a group delivery arrangement, which would increase Buyer's transportation costs by 62,400 DM over four years.[165] At trial, Seller argued that Buyer's customers left for other reasons.[166]

The trial court[167] found for Seller and denied Buyer's claims for consequential damages, but reduced the contract price by three percent for the defective cheese.[168] Buyer

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[160] *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 97.

[161] The contract was for 28-day-old Gouda Cheese at 5.59 DM/kg. *See id.*

[162] Seller claimed buyer owed 466,732.28 DM including interest. *See id.*

[163] Buyer claimed Seller discounted the price to 5.50 DM/kg. Thus, the contract price was 12,244.50 DM less than Seller claims. *See id.*

[164] The defective cheese lacked ripeness, had softened, and had salt deposits under their rinds. *See id.*

[165] *See id.*

[166] *See id.*

[167] The trial court in Germany is known as Landgericht.

[168] The trial court declared that Buyer owed Seller 453,812.28 DM plus interest. The intermediate court, in affirming the trial court, found that the contract price of the cheese was 5.59 DM/kg and that three percent of the delivered cheese was defective. Additionally, the court found that Buyer complained to Seller of the defective cheese in a timely manner each time a customer demanded damages. *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 97.

then appealed to the intermediate court of appeals[169] and renewed its claim for consequential damages.[170] After finding that three percent of the cheese delivered was defective, the court of appeals affirmed the trial court's judgment in favor of Seller.[171] The court of appeals held that Buyer's claims for consequential damages were to be determined under Article 82 of the Unified Law of the International Sale of Movable Things ("EKG"), the controlling law of the contract.[172] The EKG, however, was super-

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[169] The intermediate court of appeals in Germany is known as Oberlandesgericht.

[170] *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 97.

[171] *See id.*

[172] The German courts in this case applied Article 82 of the Unified Law of the International Sale of Movable Things as the controlling law of this contract for the sale of cheese between a German and Dutch merchant. This law is one of two German laws derived from the 1964 Hague Conventions on the Sale of Goods which were adopted in Germany on July 17, 1973. Article 82 of the Hague convention became part of German law as the "Einheitliches Gesetz über den Internationalen Kauf beweglicher Sachen," or "EKG." It is but one of five different sets of laws which German courts continue to apply to international sales contracts formed prior to January 1, 1991.

The second body of law derived from the 1964 Hague Conventions is the Unified Law of the Formation of International Contracts for Movable Things, known as the "Einheitliches Gesetz über den Abschluss von Internationalen Kaufvertragen über begwegliche Sachen" or "EAG." This body of law has been applied by German courts to contract disputes when the parties have branch offices in different contracting states and the contract in question involves a cross-border sale.

If a German court found that the EKG or the EAG did not apply to an international sales contract, it would use German conflict of law rules under Articles 27 and 28 of the Introductory Law to the German Civil Code ("BGB") to determine which law controlled the contract. These conflict of law rules could result in two other bodies of law controlling the contract. First, if the German court decided that German municipal law controlled, the court would look to the BGB and the German Commercial Code ("HGB"). However, if the German court decided that the law of a foreign country applied, it would apply the national law of that country. Of course, if that foreign country were a signatory to an international convention on the international sale of goods, such as the Hague Conventions or the CISG, then that convention as applied by the signatory country would control the contract in the German court. *See* Gerhard Manz & Susan Padman-Reich, *Germany Standardises Law on International Sale of Goods*, INT'L FIN. L. REV., Oct. 1990, at 14 (detailing the adoption of the CISG in Germany).

seded in 1990 in Germany by the CISG.[173] Since CISG Article 74 is substantively identical to EKG Article 82, decisions under EKG Article 82 are informative as to how German courts will treat consequential damages under the CISG.[174]

In denying Buyer's claims for consequential damages,[175] the court of appeals reasoned that a buyer can only recover lost profits under EKG Article 82(2) if the Seller can foresee at the time of the contract that Buyer's customers would discontinue relations as a consequence of a mere three percent rate of defective delivery.[176] Based on a survey of trade associations,[177] the court of appeals concluded that Seller could not reasonably have foreseen loss from discontinued relations.[178]

3.2. The German Supreme Court Decision

On further appeal, the German Supreme Court[179] pointed out that the court of appeals erred in its finding that the contracting parties affirmatively chose the EKG as

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[173] The complex formula governing the applicability of law as discussed in the previous note was changed when the CISG came into force in Germany on January 1, 1991. Because the CISG was self-executing, it automatically repealed the confusing array of law governing all contracts for the international sale of goods formed after January 1, 1991. Although the EKG and the EAG do not apply to contracts formed after 1990, the decisions of the German courts interpreting them are instructive as to the probable application of the CISG. These pre-CISG cases are particularly instructive because Germany has adopted the complete text of the CISG, which is quite similar to the EKG and the EAG. Indeed, some of the problems the German courts encountered with the Hague Conventions may continue under the German adoption of the CISG. As discussed *supra* note 172, Germany accepted some major changes to its traditional law of obligations in adopting the Hague conventions and the CISG. *See* Manz & Padman-Reich, *supra* note 172, at 14.

[174] *See* KRITZER, *supra* note 3, at 477 ("Because these ULIS articles are so similar [EKG Article 82 and CISG Article 74], [A]rticle 82 precedents may be regarded as relevant to interpretations of CISG [A]rticle 74.").

[175] *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 97.

[176] *See id.*

[177] The survey focused on the German-Dutch Trade Association and the Industrial and Trade Association of Düsseldorf. *See id.* at 98.

[178] *See id.*

[179] The German Supreme Court is known as Bundesgerichtshof.

the controlling law of this contract.[180] Nevertheless, the German Supreme Court agreed that the EKG applied to this contract because "there is nothing express or implied to rule it out."[181] Additionally, the German Supreme Court determined that Seller did not contest the fact that three percent of the cheese delivered under the contract was defective.[182] Finally, the German Supreme Court noted that the lost profits claimed by Buyer and Firm H might not have been caused by Seller's breach, but rather by Buyer's delivery of defective cheese that was in stock prior to the contract with Seller.[183] Seller, however, did not raise this issue. After reviewing the facts and legal analysis of the appeals court, the German Supreme Court held that the court of appeals erred in regard to the issue of foreseeability because it improperly used a survey of

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[180] *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 97.

[181] *Id.* at 97. Under German laws based on the Hague Conventions (EKG and EAG), the parties to the contract were allowed to choose which law controlled their contract, thereby avoiding application of the EKG or the EAG. In the cheese case, the German Supreme Court noted that the parties did not affirmatively choose the EKG as the controlling law of their contract. However, because the parties did not impliedly or expressly make a choice of law decision, the EKG would apply, specifically Article 3 of the EKG. After the cheese case, in 1986, the German Supreme Court went even further in applying Article 3 of the EKG when deciding that a German court, in hearing a dispute between United Kingdom and German partners, should apply the EKG even if the contract expressly provides that the German municipal law should apply. Although this 1986 decision allowed the contracting parties to exclude, either expressly or impliedly, the EKG under Article 3, the decision clarified that an implied exclusion will not readily be found. The fact that the parties did not mention the EKG in the contract was not held as an exclusion, presumably on the ground that the EKG was also a part of German municipal law. To be certain that the EKG will not apply to an international sales contract, the parties must expressly exclude the EKG. The German Supreme Court's affirmative exclusion was an interesting development because the United Kingdom, in adopting the Hague Conventions as its Uniform Law for the International Sales of Goods Act in 1967, provided in § 1(3) that the Uniform Law would control a contract of sale only if it was affirmatively selected by the contract parties. In almost twenty years, no case arose in the UK where the Uniform Law governed a contract. *See* F.A. Mann & Herbert Smith, *International Briefings: West Germany; When Uniform Sales Law Applies*, INT'L FIN. L. REV., June 1986, at 37.

[182] *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 98.

[183] *See id.*

trade organizations to determine trade custom.[184]

The German Supreme Court agreed with the court of appeals that under EKG Article 82(1) a seller is liable for lost profit damages resulting from a delivery of defective goods.[185] Damages for lost profits, however, are available only to the extent that the seller should have foreseen the lost profit at the time of contract formation, under the conditions that the seller knew or should have known would possibly result from a breach.[186] The test formulated by the German Supreme Court is what a "reasonable, ideally typical obligor would expect to happen under the circumstances."[187] Because Seller knew that Buyer was a middleman, the German Supreme Court determined that it was foreseeable that Buyer would intend to resell the cheese for a profit.[188] An industry survey could determine whether profits beyond those lost on the resale of the specific defective cheese were foreseeable to the Buyer.[189] In fact, the German Supreme Court cited a prior 1965 German Supreme Court decision approving the use of survey evidence of trade custom and knowledge.[190]

The German Supreme Court suggested that the proper survey question was: whether a seller who knows at the time of contract formation that a buyer will resell the goods should be liable for either a buyer's lost profits due to lost customers or for a buyer's damages resulting from the buyer's customer losing sales because of its lost customers, when three percent of a product delivered on the original contract was defective.[191] Furthermore, a proper survey question would indicate that, at the time of contract formation, both the seller and the buyer knew that Dutch imports saturated the German cheese market.[192] With such market saturation, a threat existed that the customers

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[184] *See id.*
[185] *See id.* at 97.
[186] *See id.*
[187] *Id.*
[188] *See id.* at 97-98.
[189] *See id.* at 98.
[190] *See id.* (citing Judgment of Dec. 1, 1965, 1966 NJW 502).
[191] *See id.*
[192] *See id.*

of middlemen-buyers might readily change suppliers, even for trivial reasons aside from the substantial defects complained of by Buyer.[193]

After reviewing the survey and the legal findings of the court below, the German Supreme Court found that the court of appeals addressed the correct legal issue.[194] According to the German Supreme Court, CISG Article 82 requires a subjective and an objective test that can conclusively be met by a survey demonstrating a trade custom of foreseeability.[195] The German Supreme Court, however, found that the court of appeal's survey was procedurally flawed because the survey did not allow Seller to know the contents of the basic survey questions, the people surveyed, or the competence of survey respondents.[196] The appeals court's decision was remanded for a re-examination of the foreseeability issue.[197]

Because German civil procedure allows a trial *de novo* in an appeal to the intermediate court,[198] a court of appeals can make its own determination of the facts and utilize a survey in order to determine foreseeability. The German Supreme Court hears appeals on errors of law only, and, in

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[193] *See id.*

[194] The German Supreme Court based its determination on the finding that lost profits were unforeseeable as informed by a written inquiry to the trade associations regarding the state of mind of merchants in the field on April 4, 1978. The survey inquired as to whether a Dutch importer in January 1977, who delivers cheese to a German importer, should have foreseen that customers of the German importer would discontinue business if three percent of the goods delivered by the Dutch importer were defective, as was the cheese in this case. Based on this survey, the court of appeals found the damages claimed by Buyer were unforeseeable. *See id.*

[195] *See id.*

[196] Most importantly, the court of appeals failed to disclose the survey questions. It was not clear to the German Supreme Court whether the court of appeals' survey asked about the foreseeability of the buyer's customers discontinuing business or about the foreseeable behavior of the customer's customers discontinuing business as a result of the defects. *See id.*

[197] *See id.*

[198] A "berufung" is an appeal on points of fact and law. *See* DANNEMANN, *supra* note 27, at 111-13; David S. Clark, *The Selection and Accountability of Judges in West Germany: Implementation of a Rechtsstaat*, 61 S. CAL. L. REV. 1795, 1808-14 (1988).

the instant case, found the flawed survey process to be an error of law.[199] The German Supreme Court, although it did articulate a rule of foreseeability, did not rule as a matter of law whether the damages Buyer suffered due to lost customers were foreseeable.

3.3. The Background of German Law on Consequential Damages

It is difficult to make generalizations about contract remedies in German law.[200] It is fair to conclude, however, that although German law, unlike the U.C.C., favors specific relief in theory, it shares a common principle with the U.C.C. and the CISG: a remedy is intended "to put the obligee in the same position, economically speaking, as he would have enjoyed had the breach not occurred."[201] This

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[199] *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 98. "Revision" is an appeal on points of law. *See* DANNEMANN, *supra* note 27, at 111. In the cheese case, the German Supreme Court cited a prior decision in which the BGH discussed the difference between unreviewable factual findings of trade usage and unsubstantiated official declarations which are subject to review. *See* Judgment of Dec. 1, 1965, 19 NEUE JURISTICHE WOCHENSCHEIFT [NJW] 502, 503. Although not referred to by the Court, the German Code of Civil Procedure § 139(1) states "[t]he presiding judge shall ensure that the parties completely disclose all relevant facts and make the pertinent motions, and especially also supplement insufficient particulars concerning asserted facts and describe the evidence . . . ." ZIVILPROZEßORDNUNG [ZPO] § 139, *translated in* THE CODE OF CIVIL PROCEDURE RULES OF THE REPUBLIC OF GERMANY OF JANUARY 30, 1877 AND THE INTRODUCTORY ACT FOR THE CODE OF CIVIL PROCEDURE RULES OF JANUARY 30, 1877 37 (Simon L. Goren trans., 1990); *see also* Hein Kötz, *Civil Litigation and the Public Interest*, 1 CIV. JUST. Q. 237, 242 (1982) ("[A] judge's failure to discharge his duties under section 139 constitutes a procedural error.").

[200] "The drafters of the German Civil Code approached the general problem of the relief available to an aggrieved party from three different perspectives: (1) a distinction between one-sided and two-sided contracts; (2) separate treatment of cases of delay (Verzug) and of impossibility; and (3) individualized handling of, and special rules for, various typical contractual regimes (e.g., sale, contract to make an object (Werkvertrag), contract to furnish services, (Dienstvertrag)). This approach results in an intricate and complex system which renders generalization difficult." ARTHUR T. VON MEHREN & JAMES R. GORDLEY, THE CIVIL LAW SYSTEM 1108 (2d ed. 1977) (footnotes omitted).

[201] *Id.* at 1109 n.27 (citing ERWIN DITTMAR, *Das Problem der Schadenersatzleistung* 218 (1946)).

underlying philosophy has led German courts to develop concepts of breach and remedies beyond what the BGB literally allows, particularly in the area of damages for a delivery of defective goods.[202]

Under the BGB, a buyer can obtain damages for delivery of defective goods for breach of warranty[203] in only two situations: (1) when the defect destroys or significantly diminishes the value or fitness of the goods for ordinary use or for the purpose provided for in the contract; or (2) when the goods lack the quality which seller expressly guaranteed.[204] Under BGB section 463, if the seller has guaranteed that the goods sold have a specific attribute, or if the seller fails to disclose a known defect, then a buyer may be able either to rescind the contract or seek a reduction in price and claim damages.[205] Implied guarantees or warranties are not easily established,[206] however, and without such a guarantee or without evidence of fraudulent conduct by the seller, the buyer's remedies under the BGB are limited to either rescission ("Wandelung") or a reduction of the sales price ("Minderung").[207] If the goods are fungible, then the buyer can demand substitute goods.[208] These remedies are exclusive, and the BGB does not otherwise

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[202] The BGB classifies breach as being of two possible types: delay in performance, "Verzug," or impossibility, "Unmöglichkeit." After the enactment of the BGB in 1902, the courts developed a concept of positive breach, "positive Vertragsverletzung," for defective performance. *See* NORBERT HORN ET AL., GERMAN PRIVATE AND COMMERCIAL LAW: AN INTRODUCTION 105 (1982). The discovery of the necessity for positive breach occurred in 1904; *see* E.J. COHN, MANUAL OF GERMAN LAW 117 (2d ed. 1968). *But cf.* Eyal Zamir, *Toward a General Concept of Conformity in the Performance of Contracts*, 52 LA. L. REV. 1, 9 n.12 (1991) (standing alone in dating the development of the doctrine to the 1920s). The most likely date is 1902, with the delivery of an influential paper by Staub on a German *Juristentag*. *See infra* note 209 and accompanying text.

[203] *See* BÜRGERLICHES GESETZBUCH [BGB] § 459.

[204] *See* HORN ET AL., *supra* note 202, at 125-26.

[205] *See* BGB § 463.

[206] *See* HORN ET AL., *supra* note 202, at 127-28. Whether a warranty will be implied may depend on the type of trade involved. German courts may readily find implied warranties when used car dealers state that a car is road-worthy or overhauled. *Id.*

[207] *See* COHN, *supra* note 202, at 134.

[208] *See* BGB § 480.

allow consequential damages.[209]

Since 1902, German courts have developed an alternative means to make a buyer whole for a partial breach resulting from a seller's delivery of defective goods. Buyers can now make a claim on the basis of a "positive breach," but in order to prevail there must be proof that the seller was at fault.[210] Section 287 of the Code of Civil Procedure sets the standard of proof as "mere probability," which is arguably a lower standard than reasonable certainty under U.S. law.[211]

The German Supreme Court in applying the EKG to the cheese case did not impose any of these BGB or court developed restrictions on Buyer's right to claim consequential damages. Instead, the German Supreme Court referred to EKG Article 82(1) which allows consequential damages without evidence of warranty, fraud, or fault.[212]

It is questionable whether the German Supreme Court used the principles of the EKG, or was influenced equally by national legal doctrines when stating the standards for determining the recoverable amount of consequential damages. BGB section 252 sets forth the German Code standard for calculating consequential damages. Section 252 provides that "damages to be recovered include lost profits . . . [p]rofit is deemed to be lost which could have been expected with probability according to the ordinary course of events or in view of particular circumstances, especially the preparations and provisions made."[213] Under the BGB, this probability determination is made at the time of breach.[214] Plaintiff must prove only that the circumstances referred to in the second sentence of BGB section 252, "ordinary course of events or particular circumstances," existed. After proving that these circum-

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[209] *See* HORN ET AL., *supra* note 202, at 126.

[210] *See* COHN, *supra* note 202, at 133; HORN ET AL., *supra* note 202, at 112-14.

[211] *See* VON MEHREN & GORDLEY, *supra* note 200, at 1114 n.49 (arguing also that certainty is a greater burden of proof in U.S. law than the normal burden of a preponderance of the evidence).

[212] *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 97.

[213] BGB § 252.

[214] *See id.* § 252.

stances existed, it is presumed that the profits would have been earned but for the occurrence of the breach.[215] Defendant, to avoid liability for lost profit, must then show that "his default [did not] appreciably increase the objective possibility of loss of a kind that in fact occurred."[216]

The BGB does not distinguish contractual liability from tort liability, and sections 241 through 304 apply to obligations arising from both.[217] The limitations on consequential damages set forth in these sections of the BGB include general principles of avoidability[218] and comparative fault.[219] Furthermore, the BGB does not limit the recovery of consequential damages to those which are foreseeable.[220]

Early commentary on the BGB suggested an interpretation of BGB section 252 that would limit lost profits to those foreseeable under the circumstances as a probable consequence of breach.[221] Until the late 1970s, this interpretation was rejected in favor of an approach which viewed section 252 as simplifying proof of causation rather than acting as limiting damages to those that were foreseeable. Section 252 was interpreted as permitting the use of objective market evidence, such as what damage reasonable sellers would expect a breach to cause under market conditions, rather than having to present evidence of the particular subjective intention the BGB. The traditional

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[215] *See* GUENTER H. TREITEL, REMEDIES FOR BREACH OF CONTRACT 164 (1988).

[216] *Id.* at 107.

[217] *See* BGB §§ 241-304.

[218] *See id.* § 254(2).

[219] *See id.* § 254(1). BGB §§ 251 and 254(2) provide that if the buyer knows of the potential of high damages, he must warn the seller or have his damages reduced on the basis of comparative fault. BGB § 242, which requires good faith, has been cited as precluding disproportionate damages, but this argument has been disputed. *See infra* note 233. The "expectation ceiling" concept is traced to German law. *See* LOOKOFSKY, *supra* note 95, at 183-87.

[220] *See* TREITEL, *supra* note 215, at 164 (stating that the legislative history of the BGB shows a deliberate rejection of the foreseeability test).

[221] *See* VON MEHREN & GORDLEY, *supra* note 200, at 1115 n.53 (citing II/1 PLANCK (-STROHAL), KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH 252 (4th ed. 1914)).

test for recovery of consequential damages was whether the obligor's breach, "as judged by ordinary human standards at the time of its occurrence, renders more likely damages of the kind actually suffered."[222]

In the late 1970s, as legal scholars again debated the necessity of adopting a foreseeability limitation on contract damages,[223] German courts began to apply the foreseeability limitation to certain types of contract damages.[224] The German cheese case has been cited as an early example of the development by German courts of the foreseeability limitation to cases where a defendant, after selling goods to a middleman, is sued for goodwill damages resulting in lost profits and lost customers because of the delivery of defective goods.[225]

3.4. The German Supreme Court's Interpretation of the EKG

In the cheese case, the German Supreme Court applied the EKG doctrine of foreseeability as a limit on damages for lost profit, using the time of contract formation, rather than the time of breach, as the vantage point from which to determine foreseeability.[226] Given the contemporaneous development by German courts of a foreseeability limitation, it is difficult to determine if the German Supreme Court's decision in the cheese case was a faithful application of the EKG, or merely an application of a developing doctrine of German national law.

As stated earlier, the German law for damages arising out of the domestic sale of goods initially "reject[ed] foreseeability as a method of limiting liability for default in the

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[222] *Id.* at 1115 n.57 (citing Judgment of Feb. 15, 1913, *in* 81 ENTSCHEIDUNGEN DES REICHSGERICHTS, ZIVILSACHEN [RGZ] 359).

[223] *See* Peter Schlechtriem, *Voraussehbarkeit und Schutzzweck einer verletzen Pflicht als Kriterium der Eingrenzung des ersatzfähigen schadens im deutschen Recht, in* LAW IN EAST AND WEST 505, 512 (Institute of Comparative Law ed., 1988).

[224] *See id.* at 514-15.

[225] *See id.* at 514 (noting that the EKG foreseeability limitation influenced the development of German case law for domestic sales).

[226] *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 97.

performance of a contract."[227] Instead, until several years before the cheese case, courts used a theory of "adequate causation" as the primary test to determine contract damages.[228] Under the "adequate causation" test, which German courts still apply,[229] a breaching party "is liable for a loss if his default appreciably increased the objective possibility of loss of a kind that in fact occurred."[230] A breaching party is not liable if the default was, in the ordinary course of events, a matter of indifference with regard to what actually occurred and only became a "condition of the occurrence of the loss as a result of unusual or intervening events."[231] Whether a breach is an adequate cause is determined by a court applying the objective standard of an:

> experienced observer at the time of the default, or even according to one formulation, that of the most experienced observer (optimaler Beobachter). To such an observer the court attributes knowledge of all the circumstances of which a person of that kind could have known, as well as any additional circumstances of which the wrongdoer himself actually knew.[232]

Thus, under the "adequate causation" test there is both an objective and a subjective test of causation, which does not limit, but rather, expands damage.

In applying the EKG, the German Supreme Court referred to the subjective and objective limitations of the foreseeability test.[233] The German Supreme Court held that the seller is liable for damages that a "reasonable, ideally typical obligor would know to be a serious conse-

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[227] LUDWIG ENNECCERUS & HEINRICH LEHMAN, RECHT DER SCHULDVERHAELTNISSE 73 (15th ed. 1958).

[228] *Id.*

[229] *See* Schlechtriem, *supra* note 223, at 507-08.

[230] TREITEL, *supra* note 215, at 163.

[231] *Id.* at 163.

[232] *Id.*

[233] *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 97.

quence of a breach in light of the circumstances."[234] In reaching its formulation of foreseeability, the German Supreme Court cited commentaries comparing the doctrines of foreseeability in numerous other legal systems.[235] Of primary influence were commentaries on EKG Articles 13 and 82 concerning the meaning of "what a party knew or should have known."[236] Based on these commentaries, the German Supreme Court determined that a judge should ask not "what the obligor in the situation knew or should have known, but what the 'ideal obligor' should have known,"[237] a test that seems to combine foreseeability with the Court's prior standard of adequate causation.

Whether there is really a significant difference between how German courts have applied the "adequate causation test" and the way in which most U.S. courts apply the foreseeability test is a question raised by legal scholars.[238] Both tests refer to the recovery of losses that occur "in the ordinary course of things," or according to the "common experience of mankind."[239] These formulations are similar to the first rule of *Hadley* — that the loss must flow naturally from the breach.[240] Both the German and the U.S. tests also seem to employ the second *Hadley* prong:[241] the German courts use an objective test to ask what an optimal obligor would expect to happen in the ordinary course of things, while U.S. courts ask what a reasonable person would expect to happen.[242] Both German and U.S. courts first attribute the knowledge of surrounding circumstances to the reasonable person, knowledge that an ordinary person could normally be

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[234] *Id.* at 97.

[235] *See id.*

[236] *Id.* at 97-98.

[237] HANS DÖLLE, KOMMENTAR ZUM EINHEITLICHEN KAUFRECHT 63 (1976).

[238] *See* TREITEL, *supra* note 215, at 164-65 (arguing that there is "a considerable degree of similarity between the two theories).

[239] *Id.* at 164 (citations omitted).

[240] Hadley v. Baxendale, 156 Eng. Rep. 145, 151 (1854).

[241] *Id.* (stating the loss as one "reasonably . . . supposed to have been in the contemplation of both parties, at the time they made the contract").

[242] *See* TREITEL, *supra* note 215, at 164-65.

expected to have, and then add the knowledge which the defendant actually had.[243] Despite the similarities, the German approach of adequate causation, in borderline cases, is thought to be more favorable to plaintiffs than the foreseeability limitation.[244]

At the time of the cheese case, the German Supreme Court also was aware that U.S. jurisdictions did not uniformly apply the test of foreseeability.[245] One author cited by the German Supreme Court concluded, after a description of the development of the "contemplation of the parties" test in the United States, that foreseeability "is not simply determined by empirical standards but involves a question of policy . . . [it is] essentially a question of allocating risks and losses."[246]

Clearly, the German Supreme Court did not use a "tacit agreement-contemplation of the parties" test of foreseeability under the EKG. The German Supreme Court's application of foreseeability more closely resembled that of the U.S. courts that do not use the tacit agreement test. Now that German courts take into account both the adequate causation test and the foreseeability test, one would expect that damages would be granted on a more limited basis in German judgments. Cases cited as evidence of the German development of the foreseeability limitation tend to be

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[243] *See id.*

[244] *See id.* at 165. The example given is a contract to sell a house to a purchaser who could have made an unusually high profit out of a resale of the house. It is argued that under the Anglo-American foreseeability test, the buyer could not collect for more than ordinary lost profit, while in Germany, "so long as the 'kind' of loss suffered satisfies the 'adequate causation' test the defendant is liable to the full 'extent' of the loss." *Id.* This state of affairs has led to reform movements in Germany to limit damages. *See id.* at 166. One suggestion, that BGB § 242 requiring good faith be used to limit damages, has been criticized as being too uncertain. *See id.* The criticism that German law does not recognize a principle requiring liability to be proportionate to the degree of fault led to a proposal for an amendment of the BGB that would make the degree of fault a relevant factor for reducing damages, which otherwise would be exceptionally high. An additional factor in German law that favors plaintiffs is that the expected consequences of a breach are determined at the time of the breach rather than at the time of formation. *See id.*

[245] Judgment of Oct. 24, 1980, 1981 IPRAX at 97.

[246] *See* König, *supra* note 87, at 130.

generous in determining what risks the ideal obligor has undertaken,[247] perhaps because of a lingering hesitancy to stray too far from a tradition based on adequate causation. It also is not surprising that a German court would apply the newly adopted foreseeability test of the ULIS or the CISG in a manner consistent with its prior national law, which is generally more favorable to the obligee than the obligor.

The German Supreme Court's decision in the cheese case does, however, clearly reflect German legal tradition in the manner in which foreseeability was proved. The proof used by both the court of appeals and German Supreme Court was a survey of trade associations.[248] The German Supreme Court justified this evidentiary device on the basis of a 1966 decision under German law.[249] This approach is compatible with German procedure, under which the intermediate court of appeals effectively conducts a trial *de novo*.[250]

An appellate court in the United States would not utilize a survey of persons in the cheese industry, as did the German Court of Appeals. In the United States, even at the trial court level, such evidence would be considered hearsay and likely would be excluded on either of two grounds: (1) it deprives the parties of the right to cross-examination and (2) it lacks probative value.[251] In the

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[247] *See* Schlechtriem, *supra* note 223, at 514-15.

[248] *See supra* notes 177-78 and accompanying text.

[249] *See supra* note 190.

[250] *See* NIGEL FOSTER, GERMAN LAW & LEGAL SYSTEM 156 (1993); *supra* note 198 and accompanying text.

[251] *See generally* Note, *Public Opinion Surveys as Evidence: The Pollsters Go to Court*, 66 HARV. L. REV. 498, 501-06 (1953) (identifying the hearsay rule and probative value as two major evidentiary problems surrounding the use of public opinion surveys in a court of law) [hereinafter *Public Opinion*]. In the United States, this type of polling evidence has been admitted in intellectual property cases to determine the similarity of products. *See, e.g.*, Tomy Corp. v. P.G. Continental, Inc., 534 F. Supp. 595 (S.D.N.Y. 1982) (allowing survey which showed confusion between similar products admitted in unfair competition case); Miles Labs, Inc. v. Frolich, 195 F. Supp. 256 (S.D. Cal. 1961) (allowing a survey which demonstrated confusion between trademark owner's name and that of an alleged infringer). The results of surveys have also been admitted in support of motions for change of venue. *See, e.g.*, United States v. Tokars, 839 F. Supp. 1578 (N.D. Ga. 1993)

United States, an expert may testify based upon a poll, but a party wishing to use a poll should have available "a complete record of the methods by which the universe and sample were selected, and of the techniques for selecting and instructing the interviewers."[252] Additionally, interviewers should be available for cross-examination.[253] The German Supreme Court is generally more willing to use opinion polls, in accordance with a German legal tradition that predates the adoption of the EKG. In the cheese case, however, the German Supreme Court indicated in its opinion that it had a healthy skepticism of the reliability of opinion polls, insisting that the party seeking to use the survey divulge the fundamental structure of the survey to the other party.[254]

4. CONCLUSION

In both of the cases discussed, courts denied a buyer's damage claims for both lost profit damages on prospective contracts and loss of goodwill because of lack of sufficient proof. That the courts arrived at similar conclusions was

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(admitting a survey into evidence to show that a substantial portion of potential jurors had already formed an opinion regarding a criminal defendant's guilt or innocence).

Although defendants in many cases, especially obscenity cases, often try to have surveys admitted to show that the materials at issue were not offensive when judged by contemporary community standards, such polls are infrequently admitted into evidence because it is difficult to fashion questions that will produce relevant responses. *See, e.g.*, United States v. Pryba, 678 F. Supp. 1225 (E.D. Va. 1988) (excluding a public opinion poll because questions were not designed to elicit information about whether there was community acceptance of materials in question); State v. Cooley, 766 S.W.2d 133 (Mo. Ct. App. 1989) (excluding survey offered to show that other neighborhood stores sold similar materials and that defendant's publications therefore did not offend community standards).

In administrative hearings, however, where there are less formal rules of evidence, such polls often have been admitted into evidence. *See, e.g.*, Arrow Metal Prods. Corp. v. FTC, 249 F.2d 83 (3rd Cir. 1957) (upholding FTC's admission of survey offered to show whether a term was capable of deceiving the public).

[252] *Public Opinion*, *supra* note 251, at 507.

[253] *See id.*, *supra* note 251, at 507.

[254] *See* Judgment of Oct. 24, 1980, 1981 IPRAX at 98; *supra* note 196 and accompanying text.

not, however, due to the identical application of the principles of similar international sales convention articles. The U.S. district court in *Delchi* referred briefly to scholarly comments[255] on the CISG before applying the CISG in a manner totally consistent with the law of New York, which was the seller's place of business. The district court did not use a more detailed analysis, which was readily available in the literature,[256] nor make any other attempt to "set aside national thinking."[257]

The German Supreme Court, in applying the ULIS through the EKG in the cheese case, made a greater effort to consult the available literature on the principles underlying the ULIS Convention. The German Supreme Court, in many particulars, followed international principles rather than its own national law. In accordance with the ULIS, the German Supreme Court was willing to allow damages for a delivery of defective goods amounting to only three percent of the total contract amount, without requiring proof of fault or an express guarantee of quality. The German Supreme Court cited numerous authorities on the ULIS and discussed the principle of foreseeability as a limitation on contract damages for lost profit. The German Supreme Court applied the foreseeability limitation at the time of contract formation rather than, as under national law, at the time of breach.

The German Supreme Court also discussed the subjective and objective nature of the foreseeability limitation under the ULIS, although it finally used an objective test that resembled both its national tradition of determining adequate causation and the emerging court-developed doctrine of foreseeability. The German Supreme Court's decision ultimately rested on a national approach to

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[255] *See Delchi,* 1994 WL 495787, at *5. The district court first cited JOHN HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES § 415 (2d ed. 1991) for the proposition that the "[]CISG permits recovery of lost profit resulting from a diminished volume of sales." *Delchi,* at *6. Second, the district court cited a Comment for the proposition that CISG Article 74 "seeks to provide an injured party with the benefit of the bargain." *Id.* at *4 (citing Sutton, *supra* note 19, at 742-43).

[256] For a recently published bibliography giving a detailed list of this literature, see WILL, *supra* note 159.

[257] Kritzer, *supra* note 3, at 109.

adequate causation, foreseeability, and manner of proof. Thus, because of Germany's less formal rules of evidence and its less limiting application of foreseeability, plaintiffs such as Delchi would more likely obtain damages for lost profit or goodwill under the CISG in a German court than in a U.S. court. Of course, this situation will lead to forum shopping, an outcome the CISG drafters sought to avoid.

CISG Article 7(1) stresses the "need to promote uniformity in its application."[258] The Secretariat Commentary to Article 7 states that "[n]ational rules on sales of goods are subject to sharp divergences in approach and concept. Thus, it is especially important to avoid differing constructions of the provisions of this Convention by national courts, each dependent upon the concepts used in the legal system of the country of the forum."[259]

Some argue that "[p]roblems of proof and certainty of loss are procedural matters which remain within the province of national law."[260] Article 7(2) states that any gaps in the CISG are to be "settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law."[261] Certainly, matters that are clearly procedural will not be subject to the CISG or any other rules besides those of the forum. In those U.S. jurisdictions where prospective lost profits and lost goodwill damages are not recoverable as a matter of law, however, such matters should be subject to the choice of law determinations in CISG Article 7(2).[262]

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[258] CISG art. 7(1), *supra* note 1, S. TREATY DOC. NO. 9 at 23, 19 I.L.M. at 673.

[259] *Commentary*, art. 6, *supra* note 26, at 17.

[260] LOOKOFSKY, *supra* note 95, at 283 n.158.

[261] CISG art. 7(2), *supra* note 1, S. TREATY DOC. NO. 9 at 23-24, 19 I.L.M. at 673.

[262] Articles 27 and 28 of the Einführungsgesetz zum Bürgerliches Gesetzbuch ("EGBGB") state that if no choice of law is indicated in the contract, courts should apply the law to which the contract has the most significant relationship. EGBGB art. 28(1). For another view, see DANNEMANN, *supra* note 27, at 54 (stating that German scholars are debating whether issues left to domestic law should be addressed by "applying the law that has the closest link with the particular question, or whether one should assume a hypothetical 'proper law of the

Perhaps the *Delchi* court should have applied CISG Article 7(2) to determine whether under New York conflict rules the law of Italy was the controlling law of the contract and, if so, how Italian law applies the foreseeability test to prospective lost profits under the Italian Code.[263]

That a German court fared better than a U.S. court in referring to and following the guidelines of legal scholars is, in part, due to the fact that Germany is a civil law jurisdiction, where courts traditionally give such literature more weight.[264] The U.S. court, accustomed to referring more often to code annotations or prior decisions, was able to rely on neither. By giving terse mention to the CISG articles at issue, by ignoring the extensive literature on the CISG, and by interpreting the CISG articles according to New York law without analysis of the Convention, the U.S. district court created an unfortunate first decision on the subject of consequential damages under the CISG.

The *Delchi* decision fulfills a "gloomy prospect,"[265] of which one scholar cited by the *Delchi* court warned. There is a "danger . . . that these tribunals will apply the Convention within the limited context of their own legal traditions," he cautioned, "exposing in the process the lack of consensus and resulting ambiguity of certain provisions."[266]

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contract'").

[263] *See* Codice Civile § 1225 (Italy).

[264] *See* DANNEMANN, *supra* note 27, at 5 (noting that "the influence of scholars on the interpretation and development of law is much greater in Germany than in most common law countries").

[265] Sutton, *supra* note 19, at 741.

[266] *Id.*