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RECOVERING LOST PROFITS IN INTERNATIONAL DISPUTES

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I. INTRODUCTION

Under the laws of many countries, the purpose of damages for breach of contract is to place the injured party in the position it would have enjoyed had the contract been performed.[1] That is, the injured party should receive the "benefit of the bargain." In theory, the injured party should be able to recover money for actual loss incurred as a result of the breach and any net gains prevented, including lost profits resulting from the respondent's actions.[2] Yet, in transnational contract disputes, awards of lost profits do not always achieve the goal of full compensation. As one commentator noted, claimants often receive only a fraction of what they seek.[3]

Awards of lost profits often seem inconsistent or arbitrary. For example, some tribunals have refused to award lost profits if the injured business was not a going concern at the time of the breach on the ground that the calculation of such profits could not be based on historical data and, therefore, would be wholly speculative.[4] By contrast, other tribunals have awarded lost profits in such circumstances, reasoning that an award of lost profits was needed to make the claimant whole.[5] And sometimes, in fixing the amount of lost profits, tribunals appear to be simply "baby splitting," awarding lost profits at the

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1. *See* Ugo Draetta et al., *Transnational Contract Law in* THE LAW OF TRANSNATIONAL BUSINESS TRANSACTIONS § 4:50, at 4-103 (Ved P. Nanda & Ralph B. Lake eds., 2003).

2. *See* HARVEY MCGREGOR, MCGREGOR ON DAMAGES ¶ 9, at 7 (14th ed. 1980).

3. *See* C.F. Amerasinghe, *Some Aspects of the Quantum of Compensation Payable upon Expropriation*, 87 AM. SOC'Y INT'L L. PROC. 477, 479 (1993); *see, e.g.*, S. Pac. Prop. (Middle East) Ltd. v. Egypt, 22 I.L.M. 752, 782-83 (1983) (rejecting claim for $42.5 million based on a discounted cash flow analysis and determining that "a fair sum to award would be $12.5 million").

4. *See, e.g.*, Levitt v. Iran, 14 Iran-U.S. Cl. Trib. Rep. 191, 209-10 (1987); *cf.* Asian Agric. Prod. v. Sri Lanka, 30 I.L.M. 577, 624-25 (1991).

5. *See, e.g.*, Sapphire Int'l Petroleums Ltd. v. Nat'l Iranian Oil Co., Arbitral Award, Mar. 15, 1963, *reprinted in* 35 I.L.R. 136, 183 (1967); Delagoa Bay & E. Afr. Ry. Co. (U.S. & Gr. Brit. v. Port.) (1900), *summarized in pertinent part in* 3 MAJORIE M. WHITEMAN, DAMAGES IN INTERNATIONAL LAW 1694, 1697 (1943).

mid-point between the claimant's and the respondent's respective valuations.[6]

Today, claims for lost profits raise arguably the most complicated issues for a tribunal deciding a transnational contracting dispute. The tribunal must first decide, under the sometimes-vague substantive law, whether a claimant is entitled to lost profits. If the answer is yes, then the tribunal fixes the amount of lost profits to be awarded. The process has proved troublesome for tribunals. It first requires the tribunal to select, from a number of methods, the method for calculating lost profits.[7] Then the tribunal must examine the data needed to calculate lost profits, such as the party's past profitability, as well as evidence and materials showing that, but for the breach, future revenues would have been earned.[8]

The tribunal must also factor in many uncertainties and work with complex calculations, where small changes in any one of the many variables can produce large swings in the amount of the award.[9] This process led one tribunal to comment, "[s]o far as the amount of . . . compensation is concerned, it cannot be established exactly."[10] Another added: "Lucrum cessans [lost profits] has always been an inexact science. . . . '[S]uch a computation made in advance on the basis of purely theoretical data cannot hope to be absolutely accurate but only comparatively likely'."[11]

This Article examines the practice of awarding future lost profit

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6. *See* Markham Ball, *Assessing Damages in Claims by Investors Against States*, 16 ICSID REV. 408, 426 (2001).

7. *See* 3 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.9 (2d ed. 1998); *see also infra* notes 163-64 and accompanying text (discussing various valuation methods, including the discounted cash flow method, the book value method, and the replacement value method).

8. One arbitral tribunal commented:

> The quantification of loss of future profits claims can present special challenges. On the one hand, a claimant who has succeeded on liability must establish the quantum of his claims to the relevant standard of proof; and, to be awarded, the sums in question must be neither speculative nor too remote. On the other hand, fairness to the claimant requires that the court or tribunal should approach the task both realistically and rationally.

Second Partial Award of 21 October 2002, S.D. Myers, Inc. v. Canada, ¶ 173, *at* http://www.dfait-maeci.gc.ca/tna-nac/documents/MyersPA.pdf.

9. Ball, *supra* note 6, at 424.

10. Sapphire Int'l Petroleums Ltd., 35 I.L.R. at 189.

11. Himpurna Cal. Energy Ltd. v. PT. (Persero) Perusahaan Listruik Negara, Final Award of 4 May 1999, 25 Y.B. COM. ARB. 13, 102-03 (2000).

damages in international commercial disputes. Part II provides an overview of damages for breach of contract. Part III reviews the circumstances under which lost profits may be awarded: (1) in common law countries; (2) in civil law countries; (3) under the United Nations Convention on the International Sale of Goods (CISG); and (4) under the International Institute for the Unification of Private Law (UNIDROIT) Principles of International and Commercial Contracts (UNIDROIT Principles). It concludes that the laws of all the countries studied, as well as the CISG and the UNIDROIT Principles, allow for the recovery of future lost profits in breach of contract cases, but the requirements that a claimant must meet in order to receive such profits vary from country to country. Part IV examines tribunal awards of lost profits. It finds a general consensus among tribunals that where a wrongful breach of contract has occurred, the injured party, in theory, is entitled to recover any net gain that was not realized because of the respondent's failure to perform its obligations. However, there are areas of potential concern. First, there are no universal rules to guide tribunals in calculating the amount of lost profits owed, leading to seemingly inconsistent awards. Second, as noted above, tribunals differ over whether future lost profits may be awarded when the injured business has not operated for a sufficiently long period of time to establish a performance record of profits. Third, some tribunals have recently invoked the doctrine of abuse of rights to preclude or eliminate a legitimate right to lost profits when these profits may cause the respondent severe financial hardship. Part V argues that neither the new business rule nor the abuse of rights doctrine should be used to deny a legitimate claim for lost profits and also sets out steps that parties may take to circumscribe arbitrary awards of lost profits. Part VI offers a brief summary.

II. Overview of Damages for Breach of Contract

The primary remedies for breach of contract differ between common and civil law countries. In common law countries, an award of damages is the usual remedy for breach of contract.[12] By contrast, in many civil law countries, when a breach of contract occurs, the claimant's primary remedy is specific performance, although many of these countries are increasingly permitting the recovery of damages as the

12. *See* Michael H. Whincup, Contract Law and Practice: The English System and Continental Comparisons 249 (2d ed. 1992); Farnsworth, *supra* note 7, § 12.8 at 187.

preferred remedy.[13] Damages in civil law countries are thus viewed as a secondary remedy.[14] However, in a number of civil law countries, claimants or courts may choose the remedy.[15] In both common law and civil law systems, the rules concerning damages for breach of contract are complex and vary greatly from country to country. In some countries, such as the United States and Canada, the applicable rules differ among states and provinces.

In common law countries, the purpose of damages is not to punish the respondent, but rather to place the party who has sustained a loss, in so far as money can do it, in the same situation as if the contract had been performed.[16] Therefore, damages are commonly awarded to protect a claimant's expectation interest.[17]

Common law systems classify damages for breach of contract into three categories: nominal, general, and special. Nominal damages may be awarded when the respondent is liable for a breach of contract but the claimant is unable to prove actual damages.[18] General damages are those "presum[ed] to result from the infringement of a legal right or

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13. *See, e.g.*, art. 918 ABGB (ALLGEMEINES BÜRGERLICHES GESETZBUCH) (Aus.); § 241 BGB (BÜRGERLICHES GESETZBUCH) (Ger.), *available at* http://www.iuscomp.org/gla/statutes/BGB.htm#b2s1t1st3; CIVIL ACT art. 389(1) (S. Korea), *translated in* 3 STATUTES OF THE REPUBLIC OF KOREA 68 (1997); *see also* Eugene Bucher, *Law of Contracts*, *in* INTRODUCTION TO SWISS LAW 105, 113 (F. Dessemontet & T. Ansay eds., 1983); Peter Schlechtriem, *The German Act to Modernize the Law of Obligations in the Context of Common Principles and Structures of the Law of Obligations in Europe*, OXFORD U. COMP. L. FORUM 2 (2002), *available at* http://ouclf.iuscomp.org/articles/schlechtriem2.shtml; JOSEPH M. LOOKOFSKY, CONSEQUENTIAL DAMAGES IN COMPARATIVE CONTEXT § 4.2 (1989). A claimant in a civil law jurisdiction may also seek damages if the breach has also caused a specific monetary loss. *See, e.g.*, § 918 ABGB; §§ 280-83 BGB.

14. *See* CIVIL ACT art. 395 (S. Korea); CIVIL CODE art. 213 (Taiwan); § 241 BGB; *see also* REINHARD ZIMMERMANN, BREACH OF CONTRACT AND REMEDIES UNDER THE NEW GERMAN LAW OF OBLIGATIONS 10, 17 (2002).

15. *See* ARTHUR TAYLOR VON MEHREN, THE CIVIL LAW SYSTEM 502 (1957) (noting that French courts have discretionary power over the appropriate remedy); C.C. art. 1124 (Spain) (Julio Romanach, Jr. trans., 1994) ("The injured party may elect between demanding specific performance or dissolution of the obligation, with damages and interest in either case.").

16. *See* Robinson v. Harman, 154 Eng. Rep. 363 (1848); The Unique Mariner [1979] 1 Lloyd's Rep. 37, 54; S.M. WADDAMS, THE LAW OF DAMAGES ¶ 536, at 310 (1983); Asamera Oil Corp. v. Sea Oil & Gen. Corp. [1979] 1 S.C.R. 663. In India, section 73 of the Indian Contract Act, 1872, provides that a party is entitled to be compensated for any loss or damage which arose in the usual course of things from a breach of contract, or which the parties knew at the time of making the contract to be likely to result from such breach. *See also* McElroy Milne v. Commercial Elecs. Ltd. [1993] 1 N.Z.L.R. 39 (C.A.).

17. *See* Robinson, 154 Eng. Rep. at 365.

18. *See* White Arrow Express Ltd. v. Lamey's Distribution Ltd. [1995] 15 T.L.R. 69, 72 (C.A. 1995).

duty."[19] They are characterized as the "natural and probable consequences" of the particular breach and include both pecuniary and non-pecuniary losses.[20] Special damages arise from "special or extraordinary circumstances beyond the reasonable prevision of the parties" and cannot be claimed unless "special facts [were] communicated by and between the parties."[21]

English courts have drawn a number of other distinctions between general and special damages. Special damages must be specifically pleaded and proved in order to be awarded.[22] By contrast, general damages are recoverable without proof of loss,[23] and the claimant need only aver "that such damage has been suffered."[24]

As noted, in common law jurisdictions, a claimant typically is entitled to its expectation interest. The claimant is entitled to be placed, in terms of money, in the same position it would have enjoyed had the contract been performed. The method of determining the sum of money varies depending on the circumstances of the case, including whether the claimant has terminated the contract and whether there has been a total or partial breach.[25]

Civil law systems base awards of damages on two Roman law concepts of compensation.[26] The first is *damnum emergens*, that is, compensation for actual losses suffered. For example, when a contract to build a ship is breached, the claimant may seek to recover damages for the value of the materials that the claimant purchased to construct the ship. The

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19. 1 CHITTY ON CONTRACTS ¶ 1672 (A.G. Guest ed., 25th ed. 1983); *see also* 12(1) HALSBURY'S LAWS OF ENGLAND ¶ 802, 812 (4th ed. reissue 1998).

20. *See* WHINCUP, *supra* note 12, § 13.3, at 249.

21. Monarch S.S. Co. v. Karlshamns Oljeabriker [1949] A.C. 196, 221 (Lord Wright).

22. Ratcliff v. Evans [1892] 2 Q.B. 524, 528; Bodley v. Reynolds, 115 Eng. Rep. 1066 (Q.B. 1846); *see also* Hayward v. Pullinger & Partners, Ltd., 1 All E.R. 581 (K.B. 1950) (loss of salary and commission); Int'l Mineral & Chem. Corp. v. Karl O. Helm A.G., 1 Lloyd's Rep. 81, 103 (Q.B. 1986).

23. Int'l Mineral & Chemical Corp., 1 Lloyd's Rep. at 103.

24. *See* HOK Engineering Ltd. v. Ives & Another, Ct. App., Civ. Div. (Transcript: John Larking), Feb. 16, 1996.

25. *See* DAN B. DOBBS, LAW OF REMEDIES § 12.1(1), at 6 (2d ed. 1993); CHITTY, *supra* note 19, ¶¶ 1591-1632.

26. *See, e.g.*, C.C. art. 1106 (Spain); C. CIV. art. 1149 (Fr.) (John H. Crabb trans., 1995); Civil Code art. 1149 (Belg.) (John H. Crabb trans., 1982); Burgerlijk Wetboek [BW] 6:96 (Neth.) (P.P.C. Haanappel & Ejan Mackaay trans., 1990) ("Patrimonial damage comprises both the loss sustained by the creditor and the profit of which he has been deprived."); Codice Civile [C.c.] art. 1223 (Italy) (Mario Beltramo et al., trans., 1991); Greek Civil Code art. 298 (Constantine Taliadoros trans., 1982); § 1293 ABGB; Swiss Code of Obligations [Co] arts. 195, 208; Civil Code art. 216 (Taiwan); Code of Obligations §§ 96 et seq. (Turkey).

second is *lucrum cessans*, or net gains prevented.[27] This concept relates to the expectation of putting the bargained-for performance to good use. For instance, in the above example, the claimant may also claim damages for the profit it would have made. As in common law countries, the goal of *damnum emergens* and *lucrum cessans* is to place the non-breaching party in the position it would have been in had the contract been performed.[28]

Some civil law jurisdictions classify damages for breach of contract into two categories called positive interest and negative interest.[29] Positive interest places the claimant in the financial position it would have been in had the contract been performed. This amount may include any profits it would have received if the breach had not occurred. By contrast, the purpose of negative interest is to restore the claimant to the position it would have been in had the transaction never taken place. In other words, the remedy furthers the claimant's reliance interest.[30]

All countries impose requirements and limitations on damages for breach of contract. These requirements may include causation,[31] foreseeability,[32] avoidability,[33] certainty,[34] fault,[35] and, in a few instances,

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27. *See, e.g.*, C. CIV. art. 1149 (Fr.); Código Civil para el Distrito Federal [C.C.D.F.] arts. 2104, 2108-09 (Mex.); *see* Denis Tallon, *French Report*, *in* CONTRACT LAW TODAY: ANGLO-FRENCH COMPARISONS 263, 274 (Donald Harris & Denis Tallon eds., 1989).

28. *See* Tallon, *supra* note 27, at 274; Draetta et al., *supra* note 1, § 4:50, at 4-103.

29. *See* SALE OF GOODS ACT § 67 (Fin.), *available at* http://www.finlex.fi/english/laws/index.php (defining positive interest as "expenses, price difference, lost profit and other direct or indirect loss due to the breach"); *see also* Antti Heikinheimo & Pekka Inkeroinen, *Finland*, *in* TRANSNATIONAL LITIGATION: A PRACTITIONER'S GUIDE, at FIN-69 (Richard H. Kreindler ed., 1997); Byung Suk Chung & Kwang Hyung Suk, *Korea*, *in* TRANSNATIONAL LITIGATION: A PRACTITIONER'S GUIDE, at KOR-59 (Richard H. Kreindler ed., 2000).

30. The most common form of recovery for breach of contract is positive interest. Negative interest is often awarded where the contract is void. *See, e.g.*, Eugen Bucher, *Law of Contracts*, *in* INTRODUCTION TO SWISS LAW 115 (F. Dessemontet & T. Ansay eds., 2d ed. 1995); G.H. TREITEL, REMEDIES FOR BREACH OF CONTRACT 89-90 (1988).

31. *See* WADDAMS, *supra* note 16, ¶¶ 1115A-1155; DONALD HARRIS ET AL., REMEDIES IN CONTRACT AND TORT 88-108 (2d ed. 2002).

32. *See, e.g.*, C. CIV. art. 1150 (Fr.); C.C. art. 1107 (Spain); Civil Code art. 1150 (Belg.); LOOKOFSKY, *supra* note 13, § 4.4.4.3.

33. *See, e.g.*, Co art. 44 (Switz.); FARNSWORTH, *supra* note 7, § 12.12; LOOKOFSKY, *supra* note 13, § 4.4.4.1; CHITTY ON CONTRACTS, *supra* note 19, ¶ 1715; *see also* C.C. art. 1227 (Italy).

34. *See, e.g.* CC art. 42 (Switz.); MCGREGOR, *supra* note 2, at 190; *see also* WADDAMS, *supra* note 16, ¶ 1051.

35. *See* Wolfgang Hahnkamper, *Austria*, *in* TRANSNATIONAL LITIGATION: A PRACTITIONER'S GUIDE, at AUS-77 (John Fellas ed., 2003); Lucien Simont et al., *Belgium*, *in* TRANSNATIONAL LITIGATION: A PRACTITIONER'S GUIDE, at BEL-63 (John Fellas ed., 2003); Markus Wirth et al.,

notice of an intention to seek damages.[36] As discussed in Part III, these requirements and limitations may also apply to the recovery of lost profits, but their application to lost profits may differ from their application to damages for actual losses suffered.

Parties may also agree upon the remedies available for breach of contract.[37] For example, the parties may limit the scope of liability in the event that a party terminates the contract because of certain events.[38] In addition, the terms may include a liquidated damages provision, which provides for a specified amount of damages to be paid by a party who repudiates the agreement.[39] Some jurisdictions, however, may refuse to enforce such a clause when the amount to be paid in damages is so grossly disproportionate to the actual loss or the loss that could reasonably arise under the circumstances as to constitute a penalty clause.[40]

III. RECOVERY OF LOST PROFITS

Because the main goal of damages for breach of contract is to give the injured party the benefit of the bargain, a respondent that has unlawfully failed to perform its contractual obligations is typically liable for actual losses suffered by the claimant as a result of the breach, as well as any net gains prevented. However, the requirements for recovering lost profits and the limitations placed on their recovery vary from country to country.

Switzerland, *in* TRANSNATIONAL LITIGATION: A PRACTITIONER'S GUIDE, at SWI-76 (1997); § 276 BGB; C.C. art. 1101 (Spain).

36. *See* C. CIV. art. 1146 (Fr.); *see also* Co arts. 102, 103 (Switz.); GIOVANNI CRISCUOLI & DAVID PUGSLEY, ITALIAN LAW OF CONTRACTS 208 (1991).

37. *See* Bem Dis A Turk Ticaret S/A TR v. Int'l Agri Trade Co. Ltd., 1 Lloyd's Rep. 729 (C.A. 1999); Civil Code § 398(1) (S. Korea); Civil Code art. 250 (Taiwan); *see also* MCGREGOR, *supra* note 2, ¶ 335 ("The parties to a contract may, as part of the agreement between them, fix the amount which is to be paid by way of damages in the event of breach."). If parties wish to abandon any remedies on breach, however, express words must be used. *See* Gilbert-Ash (Northern) Ltd. v. Modern Eng'g (Bristol) Ltd. [1974] A.C. 689 (H.L. 1973).

38. *See, e.g.*, Itel Int'l Corp. v. Soc. Sec. Org. of Iran, 24 Iran-U.S. Cl. Trib. Rep. 272, 288 (1990); Am. Bell Int'l, Inc. v. Iran, 6 Iran-U.S. Cl. Trib. Rep. 74, 90 (1984).

39. *See, e.g.*, Component Builders, Inc. v. Iran, Award No. 431-395-3, 23 Iran-U.S. Cl. Trib. Rep. 3 (1989); SEDCO, Inc. v. Iran, 15 Iran-U.S. Cl. Trib. Rep. 23 (1987).

40. *See* DOBBS, *supra* note 25 § 12.9(2), at 813; *see also* MCGREGOR, *supra* note 2, ¶¶ 335-349; WADDAMS, *supra* note 16, ¶ 916; Am. Bell Int'l, Inc., 6 Iran-U.S. Cl. Trib. Rep. at 90 (stating that "under principles of law acknowledged in many legal systems, limitation-of-liability clauses in general will not be given effect for a specific default when that default arose through an intentional wrong or gross negligence on the part of the one invoking the limitation").

A. *Common Law Systems*

The remedy of lost profits in breach of contract actions is well settled in common law countries, such as Australia, Canada, England, and the United States.[41] Lost profits are usually considered special or consequential damages. As a result, a claimant may be required to specifically plead and prove that profits were lost.[42] Among the most common requirements that a claimant must satisfy are causation, foreseeability, and certainty.

Causation. In order to obtain lost profits, there must be a causal connection between the respondent's breach and the claimant's loss of future revenues.[43] The issue here is whether the respondent's breach was so connected with claimant's loss or damage that "as a matter of ordinary common sense and experience it should be regarded as the cause of it."[44] A claimant is typically required to show that, if the respondent had not breached the contract, the claimant could have performed its obligations under the agreement, thus making a profit.[45]

Foreseeability. Even if the claimant is able to show that the respondent's breach of contract caused the claimant's loss, in common law countries, the claimant must still show that the recovery of damages for lost profits is not too remote. In general, common law jurisdictions limit the recovery of damages to losses that were within the contemplation of the parties when the contract was made or were foreseeable as a probable result of the breach.[46] The concept of foreseeability originates from the Court of Exchequer's landmark decision in *Hadley v.*

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41. *See* HUGH COLLINS, THE LAW OF CONTRACT 374-75 (2d ed. 1993); G.H.L. FRIDMAN, THE LAW OF CONTRACT IN CANADA 558-60 (3d ed. 1994); ROBERT L. DUNN, 1 RECOVERY OF DAMAGES FOR LOST PROFITS §1.1 (5th ed. 1998); J.W. CARTER & D.J. HARLAND, CONTRACT LAW IN AUSTRALIA ¶ 2105 (4th ed. 2002).

42. Ratcliffe v. Evans [1892] 2 QB 524, 528; Bodley v. Reynolds, 115 Eng. Rep. 1066 (Q.B. 1846); *see* Hayward v. Pullinger & Partners, Ltd., 1 All E.R. 581 (K.B. 1950); Int'l Mineral & Chem. Corp. v. Helm, 1 Lloyd's Rep. 81, 103 (Q.B. 1986).

43. *See* Galoo Ltd. v. Bright Grahame Murray, 14 T.L.R. 25 (C.A. 1994); Alexander v. Cambridge Credit Corp. (1987) 9 N.S.W.L.R. 310, 315, 350-51; March v. E. & M.H. Stramare Pty. Ltd., (1991) 171 C.L.R. 506; Monarch S.S. Co. Ltd. v. A/B Karlshamns Oljefabriker [1949] A.C. 196, 227-28 (P.C. 1948).

44. March, 171 C.L.R. at 522; *see also* City of New Orleans v. Firemen's Charitable Assn., 9 So. 486 (La. 1891).

45. *See* DOBBS, *supra* note 25, § 12.4(2).

46. *See* RESTATEMENT (SECOND) OF CONTRACTS § 351 (1981); HALSBURY'S LAWS OF ENGLAND, *supra* note 19, ¶ 1015; CHITTY ON CONTRACTS, *supra* note 19, ¶ 1691-1692; MCGREGOR, *supra* note 2, ¶ 184; ENID A. MARSHALL, GENERAL PRINCIPLES OF SCOTS LAW 327 (4th ed. 1982); WADDAMS, *supra* note 16, ¶ 1115A; CARTER & HARLAND, *supra* note 41, at ¶¶ 2108, 2123.

Baxendale.[47]

In *Hadley*, a miller contracted with carriers to deliver a broken shaft to the manufacturer for repair. The carriers failed to deliver the shaft to the manufacturer at the agreed-upon time, causing the miller to delay the reopening of the mill. The miller then sued the carriers for the profits he would have made had the mill been able to resume operations without the delay. The court held that the lost profits were not recoverable because the facts known to the carrier were not sufficient to "[show] reasonably that the profits of the mill must be stopped by an unreasonable delay in the delivery of the broken shaft by the carrier to the third person."[48] The court explained:

> [W]e think the proper rule in such a case as the present is this–[w]here two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or 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. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case; and of this advantage it would be very unjust to deprive them. Now the above principles are those by which we

47. 156 Eng. Rep. 145 (Ex. 1854).

48. *Hadley*, 156 Eng. Rep. at 151.

> think the jury ought to be guided in estimating the damages arising out of any breach of contract.[49]

There are two main principles underlying the *Hadley* decision. First, a loss is recoverable if it flows naturally from certain breaches of contract.[50] Second, if a loss does not flow naturally from the breach, the claimant must show that the respondent possessed the particular knowledge that would enable an ordinary person, at the time of the contracting, to foresee that an extraordinary loss would ensue from a breach of contract.[51] The main significance of these rules is to limit the availability of recovery for anticipated profits and consequential damages.[52]

In common law countries, foreseeability is evaluated in light of the special knowledge that the respondent possessed (actual knowledge), as well as any knowledge the respondent should have possessed (imputed knowledge).[53] Thus, an objective (reasonable person) and subjective (in light of the facts known) standard may be applied. In addition, the ability of a breaching party to foresee lost profits is evaluated as of the time the contract was made.[54]

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49. *Id.*

50. *See also* Balfour Beatty Constr. (Scotland) Ltd. v. Scottish Power Plc (1994) 71 BLR 20 (H.L. 1994); Factorset Ltd. v. Selby Dist. Council, 2 PLR 11 (1995).

51. HALSBURY'S LAWS OF ENGLAND, *supra* note 19, ¶ 1023.

52. *See* COLLINS, *supra* note 41, at 374-75; CARTER & HARLAND, *supra* note 41, ¶ 2119; DOBBS, *supra* note 25, § 12.4(1).

53. *See* CHITTY ON CONTRACTS, *supra* note 19, § 1571 (citing cases).

54. *See* Spang Indus. v. Aetna Cas. & Sur. Co., 512 F.2d 365 (2d Cir. 1975). In the United States, the Restatement (Second) of Contracts has slightly narrowed the principles set forth in *Hadley*. The Restatement provides: "Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made." RESTATEMENT (SECOND) OF CONTRACTS § 351 (1981). A loss may be foreseeable if "in the ordinary course of events, or . . . as a result of special circumstances, beyond the ordinary course of events, . . . the party in breach had reason to know." *Id.* By contrast, in the United Kingdom, a slightly different limitation of remoteness/foreseeability applies with regard to the sales of goods. Section 50(2) of the Sales of Goods Act, 1893, provides: "The measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the buyer's breach of contract." The U.S. Uniform Commercial Code provides a similar formulation to the Restatement (Second) of Contracts. It states inter alia that a "buyer . . . may recover as damages for any non-conformity of tender the loss resulting in the ordinary course of events from the seller's breach as determined in any manner which is reasonable." U.C.C. §2-714 (1991). It also provides 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

Certainty. Common law countries also require proving lost profits with reasonable certainty.[55] In many common law jurisdictions, the certainty rule applies only to proving that the breach resulted in claimant's loss of future revenues and does not require the claimant to prove with certainty the amount of profits it lost.[56] Thus, if the claimant provides sufficient evidence of loss or damage,[57] the difficulty in assessing damages usually does not bar recovery.[58]

Under Indian law, one tribunal explained, "an injured claimant is not required to prove the amount of damages with absolute certainty, where such certainty is not possible, as is the case with lost profits. Instead, [Indian law requires] a reasonable estimate of the loss, based on such elements as are available."[59]

In the United States, the trend among courts is to allow recovery of lost profits, even in cases of an unestablished or new business.[60] The traditional rule, known as the "new business rule," had been that lost profits could not be recovered in an action for breach of contract when the claimant was an unestablished or new business because there was no history of earnings upon which future profits could be calculated; lost profits in these circumstances were considered speculative and

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time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and (b) injury to person or property proximately resulting from any breach of warranty.

Id. §2-715(2).

55. *See* RESTATEMENT (SECOND) OF CONTRACTS § 352 (1981); *see also* DOBBS, *supra* note 25, § 12.4(3); MCGREGOR, *supra* note 2, at 190; WADDAMS, *supra* note 16, ¶ 1051; CARTER & HARLAND, *supra* note 41, ¶ 2105.

56. *See* Bagwell Coatings, Inc. v. Middle S. Energy, Inc., 797 F.2d 1298, 1307-09 (5th Cir. 1986); Locke v. United States, 283 F.2d 521, 524 (Ct. Cl. 1960); Kozlowski v. Kozlowski, 403 A.2d 902, 908 (N.J. 1979); *see also* CHITTY ON CONTRACTS, *supra* note 19, ¶ 1699; CARTER & HARLAND, *supra* note 41, ¶ 2117; DUNN, *supra* note 41, § 1.6.

57. If the claimant provides no evidence as to the loss or damage, courts will often limit recovery to a nominal sum. *See* CARTER & HARLAND, *supra* note 41, ¶ 2117; Andrew Beck, *Contracts*, 2000 N.Z. L. REV. 83, 96; *see also* MCGREGOR, *supra* note 2, at 190.

58. *See* Fink v. Fink, (1946) 74 C.L.R. 127, 143; Chaplin v. Hicks [1911-1913] All E.R. 224 (K.B. 1911); Simpson v. London & N.W. Ry., 33 L.T.R. 805 (Q.B. 1876); U.C.C. § 1-106 cmt. 1 (2003) (providing that damages need not "be calculable with mathematical accuracy").

59. Final Award in Case No. 8445 of 1996 (India v. F.R.G.), 26 Y.B. COM. ARB. 167, 175 (2001) (citing State of Kerala v. K. Bhaskaran, A.I.R. 1985 P.C. 55 (India)).

60. *See, e.g.*, Mid-America Tablewares, Inc. v. Mogi Trading Co., 100 F.3d 1353 (7th Cir. 1996); Cifone v. City of Poughkeepsie, 650 N.Y.S.2d 797 (1996); *see also* Robert I. Abrams et al., *Stillborn Enterprises: Calculating Expectation Damages Using Forensic Economics*, 57 OHIO ST. L.J. 809 (1996). *But see* Tex. Instruments, Inc. v. Teletron Energy Mgmt., Inc., 877 S.W.2d 276 (Tex. 1994).

incapable of being ascertained.[61] Over the years, U.S. courts began to view this rule as grossly unfair, especially since the breach of contract may have prevented the business from coming into existence and generating a track record of profits.[62] Today, most American courts allow recovery of lost profits of an unestablished business if the losses can be proved with "reasonable certainty."[63]

While U.S. courts typically follow a no-fault rule with respect to damages,[64] they have been less demanding in applying the requirement of certainty if the breach was willful.[65] For example, in *Super Valu Stores, Inc. v. Peterson*, the court not only rejected the new business rule as existing law in Alabama but also added that when the defendant has "wrongfully prevented the business from coming into existence and generating a track record of profits . . . . [T]he risk of uncertainty must fall on the defendant whose wrongful conduct caused the damages."[66]

Calculation of Lost Profits. In common law countries the assessment of lost profits is made by a judge or jury, who are both given broad discretion in fixing the amount of the lost profits awarded.[67] As one court remarked, "the assessment of damages is not an exact science."[68]

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61. *See, e.g.*, Cent. Coal & Coke Co. v. Hartman, 111 F. 96 (8th Cir. 1901); Kenford Co. v. County of Erie, 67 N.Y.2d 257 (1986); Murray v. Hadid, 385 S.E.2d 898 (Va. 1989).

62. *See* Super Valu Stores, Inc. v. Peterson, 506 So. 2d 317, 330 (Ala. 1987); Ferrell v. Elrod, 469 S.W.2d 678, 686 (Tenn. 1971); Chung v. Kaonohi Ctr. Co., 618 P.2d 283, 291 (Haw. 1980).

63. *See* Comment, *Remedies—Lost Profits as Contract Damages for an Unestablished Business: The New Business Rule Becomes Outdated*, 56 N.C. L. REV. 693, 712 (1978); Todd R. Smyth, Annotation, *Recovery of Anticipated Lost Profits of New Business: Post-1965 Cases*, 55 A.L.R. 4th 507, 536-40 (1987). In addition, the U.S. Court of Appeals for the Ninth Circuit has explained:

> Evidence to establish [lost] profits must not be uncertain or speculative. This rule does not apply to uncertainty as to the *amount* of the profits which would have been derived, but to uncertainty or speculation as to whether the loss of profits was the *result* of the [breach] and whether any such profits would have been derived at all.

Kyocera Corp. v. Prudential-Bache Trade Serv., Inc., 299 F.3d 769, 790 (9th Cir. 2002) (alteration in original) (citations omitted).

64. Some American courts have awarded punitive damages in breach of contract actions, particularly where the breach is accompanied by an independent tort. *See* Excel Handbag Co. v. Edison Bros. Stores, 630 F.2d 379, 384 (5th Cir. 1980); Griffith v. Shamrock Vill., 94 So. 2d 854 (Fla. 1957).

65. FARNSWORTH, *supra* note 7, at 267.

66. Super Valu Stores, Inc. v. Peterson, 506 So. 2d 317, 330 (Ala. 1987).

67. *See* Ugo Draetta et al., *supra* note 1, § 4:51, at 4-104.

68. Koufos v. Czamikow [1969] 1 A.C. 350, 425 (H.L. 1969).

B. *Civil Law Countries*

As in common law countries, the goal of damages in civil law systems is to fully compensate a claimant for losses resulting from respondent's breach of the agreement.[69] Thus, the codes in many civil law countries provide for the recovery of both losses incurred as well as gains that the claimant was deprived of as a result of the breach.[70]

For example, article 1149 of the French Civil Code provides that "[d]amages due to a creditor are, in general, from the loss which he incurred and from the gain of which he was deprived, apart from the hereinafter exceptions and modifications."[71] Similarly, the civil codes of Germany, Italy, Japan, and Spain allow for the recovery of lost profits in breach of contract actions.[72]

The Civil Code of Mexico provides that when a party fails to perform the contract, that party is liable both for the loss or detriment that the aggrieved party suffers and for the deprivation of any lawful profit that should have been obtained by the performance of the contract.[73] The Civil Code of the Russian Federation states that a breach of contract entitles a claimant to actual damages and lost profits, which are defined as income that could have been received by the injured party under ordinary circumstances had the respondent performed his or her contractual obligations.[74] In China, the new Unified Contract Law provides:

> If a party fails to perform its obligations under a contract, or rendered non-conforming performance, it shall bear the liabilities for breach of contract by specific performance, cure of non-conforming performance or payment of damages, etc.[75]
>
> Where a party failed to perform or rendered non-conforming

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69. *See generally* COMM'N OF EUR. CONTRACT LAW, PRINCIPLES OF EUROPEAN CONTRACT LAW: PARTS I AND II (Ole Lando & Hugh Beale eds., 2000) (explaining that the goal of all legal systems, including civil law systems, is to fully compensate claimant for respondent's breach).

70. *See* MINPE, art. 416 (Japan); C.C. art. 1223 (Italy); Civil Code art. 221 (Egypt).

71. *See* C. CIV. art. 1149 (Fr.); *see also* Civil Code art. 221 (Egypt); Código Civil art. 1,056 (Braz.).

72. *See* § 280 BGB; C.C. art. 1223 (Italy); MINPE, art. 416 (Japan); C.C. art. 1106 (Spain).

73. *See* C.C.D.F. arts. 2104, 2108-10 (Mex.).

74. GK RF art. 15(2) (Russ.), *translated in* Loeg Sadikov et al., *Russian Federation*, *in* TRANSACTIONAL LITIGATION RF-68 (1997); *see also* Djakhongir Saidov, *Cases on CISG Decided in the Russian Federation*, 7 VINDOBONA J. INT'L COM. L. & ARB. 1, 41-45 (2003).

75. CONTRACT LAW OF THE PEOPLE'S REPUBLIC OF CHINA art. 107, *available at* http://www.novexcn.com/contract_law_99.html.

> performance, thereby causing loss to the other party, the amount of damages payable shall be equivalent to the other party's loss resulting from the breach, including any benefit that may be accrued from performance of the contract . . . .[76]

As in common law countries, in order to recover lost profits in a civil law country, the claimant usually must satisfy several requirements, including causation, foreseeability, and certainty. In general, the claimant bears the burden of proof with respect to these issues.[77] A number of countries also require that the respondent be at fault in breaching the agreement. Some other countries provide that lost profits may be recovered only if the claimant does not terminate the contract.

Causation and Foreseeability. Many civil law countries require some form of causation or foreseeability, or both, before liability attaches.[78] In France, in order for the claimant to be able to recover damages, including lost profits, the damages must be a direct result of the breach and be foreseeable.[79] A direct result means that the claimant must provide evidence of "a causal connection between the fault and nonoccurrence of the event that would have generated the expected profit."[80] The Civil Code of Mexico similarly requires that losses and damages be the direct and immediate consequence of the default in the performance of the obligation, either already accrued or that must necessarily accrue.[81]

Foreseeability under French law means that a respondent is liable only for damages "which were foreseen or which could have been

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76. *Id.* art. 113.

77. *See* Bucher, *supra* note 13, at 114; Tallon, *supra* note 27, at 274; Christopher Osakwe, *Modern Russia Law of Contracts: A Functional Analysis*, 24 LOY. L.A. INT'L & COMP. REV. 113, 226-27 (2002); *see also* ZIMMERMANN, *supra* note 14, at 20.

78. *See* CO art. 97 (Switz.); C.C. art. 1225 (Italy); CONTRACT LAW OF THE PEOPLE'S REPUBLIC OF CHINA art. 113; *see also* Saidov, *supra* note 74, at 47-51 (discussing requirements of causation and foreseeability under Russian law); Heikinheimo & Inkeroinen, *supra* note 29, at FIN-70 (stating that in Finland recovery of damages is limited to those which were a direct result or reasonably probable consequence of the act and defining proximate cause as that which "can be reasonably anticipated or foreseen as a natural consequence of an act or omission").

79. C. CIV. arts. 1150-51 (Fr.); *see also* C.C. art. 1107 (Spain); VON MEHREN, *supra* note 15, at 508, 863; Civil Code art. 1150 (Belg.); C.C. art. 1209 (Italy).

80. Thierry Bernard & Hedwige Vlasto, *France*, *in* TRANSNATIONAL LITIGATION: A PRACTITIONER'S GUIDE, at FRA-107 (2003). The Italian Civil Code provides that damages for breach of contract (both nonperformance and delay) include loss sustained by the claimant and lost profits, insofar as they are a direct and immediate consequence of the breach. *See* C.C. art. 1223 (Italy).

81. C.C.D.F. art. 2110 (Mex.).

foreseen at the time of the contract," unless the breach was willful.[82] Notably, the French concept of foreseeability differs from that of England. Under French law, the foreseeability requirement is treated in an autonomous manner as a limit to the principle of full compensation, while in English law, it appears as an element relating to the directness or indirectness of the harm (remoteness of damage).[83] The Civil Code of Italy similarly provides that "if the non-performance or delay is not caused by the fraud of the debtor, compensation is limited to the damages that could have been foreseen at the time the obligation arose."[84] As in common law countries, the effect of the foreseeability requirement, which applies to both the type and the amount of damages, is to limit awards, especially for lost profits.

In many countries, such as France and Italy, the foreseeability requirement does not apply in cases of a willful breach or, in some jurisdictions such as Spain, a breach resulting from negligence.[85] In the case of a willful breach or, in some countries, one made with negligence, the respondent is typically liable for both *damnum emergens* and *lucrum cessans*, as long as the other statutory requirements are met.[86]

By contrast, German law does not recognize the concept of foreseeability.[87] Nevertheless, German law still limits damages through the concept of adequate causation. The test for whether adequate causation exists has been expressed as whether the obligor's default, as judged by ordinary human standards at the time of its occurrence, renders more likely damages of the kind actually suffered.[88] Under Austrian law, adequate causation exists if "the damage was not 'totally

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82. C. CIV. art. 1150 (Fr.). *See* Simont et al., *supra* note 35, at BEL-64 ("Foreseeable damage is understood as the damage which the contractual debtor was able to actually foresee at the time of the conclusion of the contract."). *See also* Franco Ferrari, *Comparative Ruminations on the Foreseeability of Damages in Contract Law*, 53 LA. L. REV. 1257, 1261 (1992-1993).

83. *See* Tallon, *supra* note 27, at 275; *see also* C.C. arts. 1104, 1107 (Spain); Civil Code art. 1150 (Belg.).

84. C.C. art. 1225 (Italy).

85. *See* C. CIV. art. 1150 (Fr.); *see also* C.C. art. 1225 (Italy) (providing that damages for breach of contract are limited to those which were foreseeable when the contract was made, unless the breach was caused by fraud or malice); C.C. arts. 1101-07 (Spain) (providing that the breaching party is liable for all damage caused in the event of a negligent breach).

86. *See* C. CIV. art. 1151 (Fr.); C.C. art. 1107 (Spain). In France, damages for mental distress may be claimed, but their award is discretionary. Bernard & Vlasto, *supra* note 80, at FRA-106.

87. *See* VON MEHREN, *supra* note 15, at 359; Ferrari, *supra* note 82, at 1262.

88. TREITEL, *supra* note 30, at 162, 164; KNUT RODHE, OBLIGATIONSRATT [The Law of Obligations] 544 (1956); *see also* VON MEHREN, *supra* note 15, at 359; Eric C. Schneider, *Consequential Damages in the International Sale of Goods: Analysis of Two Decisions*, 16 U. PA. J. INT'L BUS. L. 615, 660-68 (1995).

unforeseeable' in the normal course of events."[89] The civil codes of Japan and Korea also follow the adequate causation rule, limiting damages for breach of contract to those which would ordinarily arise from the nonperformance of the obligation.[90] Both civil codes also provide that the claimant "may also claim compensation for damage through special circumstances, if the parties have foreseen or could have foreseen such circumstances."[91]

Fault. In many civil law countries, there is no liability for damages unless the respondent was "at fault" in breaching the agreement.[92] This requirement can be satisfied by a willful breach or a breach resulting from negligence.[93]

In Germany, the fault principle is set forth in article 276 of the German Civil Code. The code provides:

> (1) The obligor is liable for deliberate and negligent acts or omissions, unless the existence of a stricter or more lenient degree of liability is specified or to be inferred from the other subject matter of the obligation, in particular the assumption of a guarantee or the acquisition risk. . . .
> (2) A person acts negligently if he fails to observe the relevant accepted standards of care.

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89. *See* Hahnkamper, *supra* note 35, at AUS-88. Under Belgian law, only the party directly injured by the breach of contract may bring a claim for damages. That is, parties indirectly damaged by the respondent's breach of contract typically may not bring a claim for damages. *See* Simont et al., *supra* note 35, at BEL-64.

90. MINPE, art. 416, *translated in* BASIC JAPANESE LAWS 99 (1997); Civil Code art. 393 (S. Korea).

91. MINPE, art. 416, *translated in* BASIC JAPANESE LAWS 99 (1997); Civil Code art. 393 (S. Korea).

92. *See* § 276 BGB; C.C. art. 1101 (Spain); GK RF art. 401 (Russ.), *translated in* WILLIAM E. BUTLER, CIVIL CODE OF THE RUSSIAN FEDERATION 151 (1997); Hahnkamper, *supra* note 35, at AUS-77; Simont et al., *supra* note 35, at BEL-63; Wirth et al., *supra* note 35, at 76.

93. *See, e.g.*, C.C. art. 1101 (Spain). *See* Hahnkamper, *supra* note 35, at AUS-77 (stating that, under Austrian law, "degrees of fault are: intent (*Vorsatz*) and (gross and slight) negligence (*Fahrlässigkeit*)"); Simont et al., *supra* note 35, at BEL-63 (Under Belgian law,

> fault consists of either the failure to perform an obligation of result ("obligation de résultat"), i.e. an obligation prescribing that a precise result must be reached, unless the defendant proves the existence of an exonerating fact or, where it is an obligation of best efforts ("obligation de moyen"), the failure to perform the obligation in such a way as it would have been performed by a sensible person acting with due diligence).

Wirth et al., *supra* note 35, at SWI-76 (stating that fault can be shown by either a negligent or willful breach).

(3) The obligor cannot be relieved in advance of liability for deliberate acts or omissions.[94]

In Austria, lost profits are not recoverable in breach of contract actions unless (1) the breach was caused intentionally or with gross negligence[95] or (2) the respondent is a merchant who caused the damage during the course of business.[96]

As noted, under French Civil Code article 1151, "in the case where the inexecution of the agreement results from the willfulness of the debtor, damages are to include, with regard to the loss incurred by the creditor and the gain of which he has been deprived, only what is an immediate and direct consequence of the inexecution of the agreement."[97] When the breach is not a result of the *dol* (fault) of the debtor, the "debtor is held only to damages which were foreseen or which could have been foreseen at the time of the contract."[98]

In some countries, such as Austria, the burden is on the breaching party to show the lack of fault.[99] By contrast, Belgian law places the burden to prove fault on the claimant.[100]

Certainty. The level of proof that a claimant must show in order to receive lost profits also varies among civil law countries. In Switzerland, a claimant "has to prove the damage."[101] One commentator noted that, while Swiss law allows for the recovery of lost profits in the event of a breach of contract, it is actually fairly difficult for a claimant to obtain such damages because there is a high standard of proof for recovery.[102] By contrast, in other countries, such as Belgium, the damage must be certain in existence, but not in amount.[103]

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94. *See* § 276 BGB, *available at* http://www.iuscomp.org/gla/statutes/BGB.htm#b2s1t1; *see generally* Peter Schlectriem, *The German Act to Modernize the Law of Obligations in the Context of Common Law Principles and Structures of the Law of Obligations in Europe*, OXFORD U. COMP. L.F. 2 (2002), *available at* http://ouclf.iuscomp.org/articles/schlechtriem2.shtml.

95. §§ 1323-1324 ABGB.

96. Art. 8, no. 2 HGB (Aus.).

97. C. CIV. art. 1151 (Fr.).

98. C. CIV. art. 1150 (Fr.).

99. Hahnkamper, *supra* note 35, at AUS-89.

100. Simont et al., *supra* note 35, at BEL-63.

101. CO art. 42 (Switz.).

102. Wirth et al., *supra* note 35, at SWI-77. It should be noted, however, that article 42 of the Code of Obligations states that "[d]amage not ascertainable by calculation is determined by the judge at his discretion, taking into account the ordinary course of events and measures taken by the damaged party." CO art. 42 (Switz.).

103. *See* Simont et al., *supra* note 35, at BEL-64; *see also Asser's Handbook* at 231-32 ("[I]f the amount of the damage claimed is disputed, the creditor must prove the amount.").

In Italy, if damages cannot be proved in their exact amount, they may be equitably liquidated by the judge.[104] Under article 6:105 of the Civil Code of the Netherlands,

> The judge may wholly or partially postpone the evaluation of damage which has not yet occurred; he may also immediately evaluate future damage after an assessment of the probabilities. In the latter case, the judge may order the debtor either to pay a lump sum or to make instalment payments, accompanied or not by an obligation to furnish security; this order may be subject to conditions determined by the judge.[105]

Continuing Contractual Relationship. In some countries, such as Switzerland, lost profits as a consequence of incorrect performance or nonperformance may be recovered by the claimant if he or she insists on the validity of the contract.[106] In this case, both parties are still held to the contract, but the breaching party will pay damages in place of the performance originally due. If the aggrieved party wishes to terminate the contract, the party in breach is liable only for the "negative interest," or reliance damages, which normally will not include lost profits.[107] One commentator notes that, while this is the technical rule, in practice the courts tend to grant full compensation, including lost profits, without regard to the aggrieved party's declarations.[108]

Calculation of Lost Profits. In civil law countries, judges typically are given broad powers in fixing damages.[109] For example, article 42(2) of the Swiss Code of Obligations states that "[d]amages which cannot be established in amounts shall be assessed by the judge in his discretion."[110] The code typically does not imply, however, that the decision is in equity. As one court explained, "[e]quity in deciding should be clearly distinguished from equity in awarding damages, which is after

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104. *See* C.c. art. 1226 (Italy); *see also* BARRY NICHOLAS, FRENCH LAW OF CONTRACT 228 (2d ed. 1992) (stating that under French law recovery is calculated as an estimate of the probability of success).

105. BW 6:105 (Neth.).

106. *See* Bucher, *supra* note 30, at 115.

107. *See id.*

108. *See id.*

109. *See* C.c. art. 1226 (Italy); CO art. 42 (Switz.); BW 6:105 (Neth.); Tallon, *supra* note 27, at 274; *see also* Final Award in Case No. 8423 of 1994 (Port. v. Fr.), 26 Y.B. COM. ARB. 153, 166 (2001); CODIGO CIVIL art. 566 (Port.); § 287 ZPO (Ger.).

110. CO art. 42(2).

all a decision according to the law."[111] It should also be noted that judges in civil law countries often base their award on "intuition and justice" and that "awards of damages are not accompanied by discursive explanations, and their theoretical basis thus is difficult to determine."[112]

C. *The CISG*

The CISG applies "to contracts of sale of goods between parties whose places of business are in different States: (a) when the States are Contracting States; or (b) when the rules of private international law lead to the application of the law of a Contracting State."[113] Under the CISG, if a party fails to perform its contractual obligations, the injured party has various remedies, including damages.[114]

The basic principle for the recovery of damages is set forth in CISG

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111. Virgilio De Aostini v. Milloil SpA, Corte di Appello, Milan (24 Mar. 1988), *reprinted in* 25 Y.B. COM. ARB. 739, 750 (2000).

112. Draetta et al., *supra* note 1, § 4:54, at 4-110, 4-111; *see also* NICHOLAS, *supra* note 104, at 229-32.

113. *See* United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, 19 I.L.M. 668 [hereinafter CISG]. For a discussion of the CISG, see FRITZ ENDERLEIN & DIETRICH MASKOW, INTERNATIONAL SALES LAW: UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (1992); JOHN HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION (2d ed. 1990); THE CONVENTION FOR THE INTERNATIONAL SALE OF GOODS: A HANDBOOK OF BASIC MATERIALS (Reed R. Kathrein & Daniel Barstow Magraw eds., 1987). As of April 16, 2004, sixty-three states had adopted the CISG. *See* http://www.cisg.law.pace.edu/cisg/countries/cntries.html.

114. *See* CISG, *supra* note 113, art. 45 (stating that

> [i]f the seller fails to perform any of his obligations under the contract or this Convention, the buyer may: (a) exercise the rights provided in articles 46 to 52 [i.e., require substitute performance, demand repair of defective goods, fix additional time for performance, avoid or cancel the contract, or reduce sales price]; (b) claim damages as provided in articles 74 to 77);

id. art. 61 (stating that

> [i]f a buyer fails to perform any of his obligations under the contract or this Convention, the seller may: (a) exercise the rights provided in articles 62 to 65 [i.e., require specific performance, fix an additional time for performance, avoid or cancel the contract, or have goods identified under the contract]; (b) claim damages as provided in articles 74 to 77).

While articles 74 through 77 set forth the rules concerning damages, numerous other articles can affect the right to or calculation of damages. *See id.* arts. 6-9, 66, 80, 85-88.

article 74.[115] The goal of this provision is to place the claimant in the same economic position it would have been in had the breach not occurred.[116] Article 74 provides that a claimant may recover, for breach of contract, "a sum equal to the loss, including loss of profit, suffered . . . as a consequence of the breach."[117] Article 74 does not provide specific guidelines for the calculation of damages. For example, there is no separate provision for the calculation of damages for breach of warranty. Instead, article 74 gives the tribunal the authority to determine the claimant's "loss . . . suffered . . . as a consequence of the breach" based on circumstances of the particular case.[118] Article 74 also explicitly provides that damages for breach of contract include lost profits. The Commentary to the CISG explains that the specific refer-

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115. *See id.* arts. 74-76. Articles 75 and 76 set forth guidelines on how damages are to be calculated in instances where the basic measure of damages set forth in article 74 may not adequately compensate the injured party. Article 75 provides a method for calculating damages when the contract has been avoided and the "buyer has bought goods in replacement or the seller has resold the goods." *Id.* art. 75. Here, the claimant "may recover the difference between the contract price and the price in the substitute transaction as well as any further damages recoverable under article 74." *Id.* However, a claimant may use this method only if the resale or cover purchase were made "in a reasonable manner and within a reasonable time after avoidance[.]" *Id.* The purpose of these requirements is to prevent the unfairness of having a party pay for loss which the other party caused through hasty or malicious conduct.

If the contract has been avoided but the injured party has not bought goods in replacement or resold the goods under article 75, article 76 provides a different method for calculating damages. It provides that, in this situation:

> If . . . there is a current price for the goods, the party claiming damages may . . . recover the difference between the price fixed by the contract and the current price at the time of avoidance as well as any further damages recoverable under article 74. If, however, the party claiming damages has avoided the contract after taking over the goods, the current price at the time of such taking over shall be applied instead of the current price at the time of avoidance.

Id. art. 76. The price to be used in determining damages under this article is "the price prevailing at the place where delivery of the goods should have been made or, if there is no current price at that place, the price at such other place as serves as a reasonable substitute, making due allowance for differences in the cost of transporting the goods." This method of measuring damages is called the "market-price-rule." *Id.* It basically allows the claimant to calculate its damages independently from any cover transaction.

116. For a detailed discussion of the CISG, see generally ENDERLEIN & MASKOW, *supra* note 113; HONNOLD, *supra* note 113; ALBERT H. KRITZER, GUIDE TO PRACTICAL APPLICATIONS OF THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (1989).

117. CISG, *supra* note 113, art. 74.

118. *See* Secretariat Commentary ¶ 4, *in Guide to CISG art. 74, available at* http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-74.html.

ence to loss of profit was included "because in some legal systems the concept of 'loss' standing alone does not include loss of profit."[119]

Unlike some civil law countries, the CISG does not limit damages to those situations involving a negligent or willful breach.[120] Similar to the practice in many common law and civil law countries, the CISG imposes upon the claimant the burden of providing evidence of damage and of causation between the breach and the loss suffered.[121] In addition, like many common law and civil law countries, the CISG limits recovery of damages pursuant to the doctrine of foreseeability.[122] The CISG employs both an objective and subjective test when considering foreseeability:

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119. *Id.* ¶ 4. With respect to lost profits, Professors Enderlein and Maskow note:

> It may be questioned whether the injured party is entitled to recover the loss of profit he actually suffered, the exact profit he could have expected, or an average profit to be expected at a certain time in a certain place. It is unclear also for which period of time the loss of profit can be measured . . . . Honnold holds that what matters is the *loss which the injured party in fact suffered* . . . . According to Knapp, one should proceed from the loss which the injured party suffered in fact or from the profit that could have been expected, setting no time limit but only the condition that the loss was foreseeable. He rejects a calculation of future profit by a lump sum. He does not exclude, however, that the injured party may repeatedly be adjudicated the loss of profit by the courts if the conditions of Article 74 apply.

ENDERLEIN & MASKOW, *supra* note 113, at 299-300.

120. *See* ENDERLEIN & MASKOW, *supra* note 113, at 298.

121. *Id.* at 300. However, the CISG does not expressly require that damages be proved with certainty. *See* Djakhongir Saidov, *Methods of Limiting Damages Under the Vienna Convention on Contracts for the International Sale of Goods* § 5 (2001), *available at* http://www.cisg.law.pace.edu/cisg/biblio/saidov.html.

122. As noted above, the concept of foreseeability has its roots in common law countries in *Hadley v. Baxendale*. *See* Delchi Carrier SpA v. Rotorez Corp., 71 F.3d 1024 (2d Cir. 1995) ("CISG requires that damages be limited by the familiar principle of foreseeability established in *Hadley v. Baxendale*."). It can also be found in many civil law countries, such as in article 1150 of the French Civil Code, which limits damages to those which were foreseen or which could have been foreseen at the time of the contract. *See* C. CIV. art. 1150-51. Under CISG article 39, "[T]he buyer loses the right to rely on a lack of conformity of the goods if he does not give notice to the seller specifying the nature of the lack of conformity within a reasonable time after he has discovered it or ought to have discovered it." CISG, *supra* note 113, art. 39. CISG article 43(1) also requires the buyer to give notice in the case of defective title. Notwithstanding the notice requirements in articles 39 and 43, the buyer may still be able to claim damages, among other things, if the buyer has a reasonable excuse for the failure to give the required notice. However, in such circumstances, the buyer would not be able to claim lost profits, only direct damages. *See* CISG, *supra* note 113, arts. 39-44.

> [D]amages 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."[123]

The latter (the objective test) asks whether a reasonable party in the same situation could expect the loss from non-performance.[124]

The relevant time to determine if the loss was foreseeable is at the conclusion of the contract. "The facts and matters must have existed at the time of the conclusion of the contract and/or must be foreseeable at the conclusion of the contract, like seasonal market fluctuations, difficulties in transport caused by bad weather etc."[125]

Article 74 also "gauge[s] foreseeability in terms of *possible consequences.*"[126] A claimant need not show that the loss was a "probable result" or a substantial probability,[127] only that it was a possible result of the breach.[128] As one commentator notes, "[t]he foreseeability does not refer to a certain sum of money equal to the loss, even though the wording of this rule may suggest it, but to the possibility of a loss as a consequence of the breach of contract as such and the extent of the possible loss."[129]

D. *UNIDROIT Principles*

The UNIDROIT Principles set forth general rules for international

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123. CISG, *supra* note 113, art. 74.

124. Liu Chengwei, *Remedies for Non-performance: Perspectives from CISG, UNIDROIT Principles and PECL*, § 14.2.5, *at* http://www.cisg.law.pace.edu/cisg/biblio/chengwei-74.html (Sept. 2003).

125. ENDERLEIN & MASKOW, *supra* note 113, at 301 (emphasis omitted).

126. KRITZER, *supra* note 116, at 477 (emphasis added).

127. *See* RESTATEMENT (SECOND) OF CONTRACTS § 351 (1981).

128. A number of commentators believe this broadens the scope of what is foreseeable. *See* KRITZER, *supra* note 116, at 479; J. Ziegel, *The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives*, *in* INTERNATIONAL SALES: THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS 9-38 (Nina Galston & Hans Smit eds., Parker School of Foreign and Comparative Law, 1984), *quoted in* KRITZER, *supra* note 116, at 587-88 (1990). *But see* E. Allan Farnsworth, *Damages and Specific Relief*, 27 AM. J. COMP. L. 247, 253 (1979) (noting that article 74's use of possible consequences "may seem at first to cast a wider net than the Restatement's '*probable* result,' [but] the preceding clause ('in light of the facts . . .') cuts this back at least to the scope of the . . . language").

129. ENDERLEIN & MASKOW, *supra* note 113, at 301 (emphasis omitted).

commercial contracts.[130] They may be applied when the parties have agreed that the contract shall be governed by the Principles or when the contract is to be interpreted in accordance with general principles of law, including *lex mercatoria*.[131] The Principles may also be used to interpret or supplement existing international instruments, such as the CISG.[132] Like the CISG, the UNIDROIT Principles provide that a party to a contract who has been aggrieved by the other party's non-performance of its obligations has a right to compensation for the full amount of the loss suffered as a result of the breach.[133] The goal of the damages provisions of the UNIDROIT Principles is to protect a claimant's expectation interest.

The main damages provision is set forth in article 7.4.2, which states, "The aggrieved party is entitled to full compensation for harm sustained as a result of the non-performance. Such harm includes both any loss which it suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance . . . ."[134] The Commentary to this article explains that loss suffered should be construed broadly and includes loss of profit. The Commen-

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130. The UNIDROIT Principles of International Commercial Contracts, at pmbl. [hereinafter UNIDROIT Principles], *reprinted in* THE UNIDROIT PRINCIPLES IN PRACTICE: CASE LAW AND BIBLIOGRAPHY OF THE PRINCIPLES OF COMMERCIAL CONTRACTS 27 (Michael Joachim Bonell ed., 2002), *available at* http://www.unidroit.org/english/principles/contracts/principles2004/blackletter2004.pdf (last visited Mar. 28, 2005). The UNIDROIT Principles were published in 1994 by the International Institute for the Unification of Private Law (UNIDROIT) "following years of intensive preparatory work and deliberations by a group of experts representing the world's most important legal systems, [and] are a typical example of soft law." *Id.* at ix.

131. *See id.* at 27.

132. *Id.* For a discussion of the use of the UNIDROIT Principles, see generally *UNIDROIT Principles of International Commercial Contracts: Reflections on Their Use in International Arbitration* [June 2002] ICC Int'l Ct. Arb. Bull. Special Supp. (Int'l Cham. Comm. Pub.); JEAN-PAUL BERAUDO ET AL., UNIDROIT PRINCIPLES FOR INTERNATIONAL COMMERCIAL CONTRACTS: A NEW LEX MERCATORIA? 9-10 (1995); Michael J. Bonell, *The UNIDROIT Principles of International Commercial Contracts: Why? What? How?*, 69 TUL. L. REV. 1121 (1995); Richard Hill, *A Businessman's View of the UNIDROIT Principles*, 13 J. INT'L ARB. 2, 163 (1996).

133. *See* UNIDROIT Principles, *supra* note 130, art 7.4.1 ("Any non-performance gives the aggrieved party a right to damages either exclusively or in conjunction with any other remedies except where the non-performance is excused under these Principles."); *id.* art. 7.4.2(1) ("The aggrieved party is entitled to full compensation for harm sustained as a result of the non-performance.").

134. UNIDROIT Principles, *supra* note 130, art. 7.4.2(1). If, after the breach of contract, the claimant makes a replacement transaction, article 7.4.5 of the UNIDROIT Principles measures the claimant's damages as the difference between the contract price and the price current at the time the contract is terminated, as well as damages for any further harm. *Id.* art. 7.4.5. This provision is similar to CISG article 75. *See* CISG, *supra* note 113, art. 75. Like in the CISG, article 7.4.5 requires

tary notes:

> [L]oss of profit or, as it is sometimes called consequential loss, is the benefit which would normally have accrued to the aggrieved party if the contract had been properly performed. The benefit will often be uncertain so that it will frequently take the form of the loss of a chance.[135]

The UNIDROIT Principles limit the right to damages in a variety of ways. Article 7.4.7, for example, limits the right to damages if the claimant has contributed to the harm. It states,

> "Where the harm is due in part to an act or omission of the aggrieved party or to another event as to which that party bears the risk, the amount of damages shall be reduced to the extent that these factors have contributed to the harm, having regard to the conduct of each of the parties."[136]

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the replacement transaction to have been made within a reasonable time and in a reasonable manner. UNIDROIT Principles, *supra* note 130, art. 7.4.5.

If, after the breach of contract, the claimant terminates the contract but does not make a replacement transaction, the UNIDROIT Principles article 7.4.6 provides that the claimant may recover the difference between the contract price and the price current at the time the contract is terminated, as well as damages for any further harm, provided that there exists such a current price. *Id.* art. 7.4.6. The "[c]urrent price is the price generally charged for goods delivered or services rendered in comparable circumstances at the place where the contract should have been performed or, if there is no current price at that place, the current price at such other place that appears reasonable to take as a reference." *Id.* The comment to article 7.4.6 states that the current price "will often, but not necessarily, be the price on the organized market." *Id.* art. 7.4.6 cmt. 2. In addition, "the place relevant for determining the current price is that where the contract should have been performed or, if there is no current price at that place, the place that appears reasonable to take as a reference." *Id.* The remedy provided by article 7.4.6 is similar to CISG article 76. *Id.* art.7.4.6 cmt. 1-2.

135. UNIDROIT Principles, *supra* note 130, art. 7.4.2(1) cmt. 2.

136. *Id.* art. 7.4.7. The comment to that article provides:

> The contribution of the aggrieved party to the harm may consist either in its own conduct or in an event as to which it bears the risk. The conduct may take the form of an act (e.g. it gave a carrier a mistaken address) or an omission (e.g. it failed to give all the necessary instructions to the constructor of the defective machinery). Most frequently such acts or omissions will result in the aggrieved party failing to perform one or another of its own contractual obligations; they may however equally consist in tortuous conduct or non-performance of another contract. The external events for which the aggrieved party bears the risk may, among others, be acts or omissions of persons for whom it is responsible such as its servants or agents.

The UNIDROIT Principles limit damages through the concepts of certainty and foreseeability, among others. They provide that "[c]ompensation is due only for harm, including future harm that is established with a reasonable degree of certainty."[137] If the claimant cannot establish the amount of damages with sufficient certainty, the UNIDROIT Principles give the tribunal the discretion to set the amount.[138] Additionally, the UNIDROIT Principles allow recovery of damages for the loss of chance in proportion to the probability of its occurrence.[139]

The UNIDROIT Principles also provide that "[t]he non-performing party is liable only for harm which it foresaw or could reasonably have foreseen at the time of the conclusion of the contract as being likely to result from its non-performance."[140] Like the CISG, the UNIDROIT Principles contain both subjective and objective tests for foreseeability. However, in contrast to the CISG, which requires that the foreseeable harm be a "possible" consequence of the non-performance of the contract, the UNIDROIT Principles state that such harm must be a "likely" result of the breach.[141] Thus, the UNIDROIT Principles appear to take a slightly more restrictive view on foreseeability than the CISG.

The Comment to the UNIDROIT Principles explains that the concept of foreseeability relates to the nature or type of harm and not to the extent of harm, unless the extent transforms the harm into one of a

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. . . .

> The conduct of the aggrieved party or the external events as to which it bears the risk may have made it absolutely impossible for the non-performing party to perform. If the requirements of Art. 7.1.7 (Force majeure) are satisfied, the non-performing party is totally exonerated from liability.
>
> Otherwise, the exoneration will be partial, depending on the extent to which the aggrieved party contributed to the harm. The determination of each party's contribution to the harm may well prove to be difficult and will to a large degree depend upon the exercise of judicial discretion. In order to give some guidance to the court this article provides that the court shall have regard to the respective behavior of the parties. The more serious a party's failing, the greater will be its contribution to the harm.

Id. art. 7.4.7 cmts. 2, 3.

137. *Id.* art. 7.4.3(1).

138. *Id.* art. 7.4.3(3).

139. *Id.* art. 7.4.3(2).

140. *Id.* art. 7.4.4.

141. A delegate to the Vienna Conference, which led to the CISG, explained the difference between a "likely result" and a "possible consequence" as follows: "[I]f one takes a well-shuffled pack of cards it is quite possible, though not likely, that the top card will prove to be the nine of diamonds even though the odds are 51 to 1 against." Ziegel, *supra* note 128.

different kind.[142] The Comment also clarifies that the requirement of foreseeability goes hand-in-hand with the requirement of certainty.[143] Consequently, a claimant is required to show that "it must have been foreseeable that harm will with certainty (is likely to) flow from such a breach."[144] Furthermore, the Comment explains that, unlike some civil law systems, a respondent is not liable for unforeseeable harm even if the breach was willful.[145] The Comment states:

> What is foreseeable is to be determined by reference to the time of the conclusion of the contract and to the non-performing party itself (including its servants or agents), and the test is what a normally diligent person could have reasonably foreseen as the consequence of non-performance in the ordinary course of things and the particular circumstances of the contract, such as the information supplied by the parties or their previous transactions.[146]

* * *

The above study shows that the laws of most countries provide that, in the case of a wrongful breach of contract, an injured party is entitled to recover any net gain that was not realized because of the respondent's failure to perform its obligations pursuant to the parties' agreement. Both the CISG and the UNIDROIT Principles also provide for the recovery of lost profits in such circumstances. This principle of recovery is so well settled that it can be said it has become a general rule of private international law.[147]

All countries require that a claimant satisfy certain requirements in

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142. UNIDROIT Principles, *supra* note 130, art. 7.4.4 cmt.

143. *Id.*

144. Sieg Eiselen, *Remarks on the Manner in Which the UNIDROIT Principles of International Commercial Contracts May Be Used to Interpret or Supplement Article 74 of the CISG* ¶ h (Dec. 6, 2002), *at* http://www.cisg.law.pace.edu/cisg/principles/uni74.html.

145. UNIDROIT Principles, *supra* note 130, art. 7.4.4 cmt.

146. *Id.*

147. *See* Sapphire Int'l Petroleums Ltd. v. Nat'l Iranian Oil Co., Arbitral Award (Mar. 15, 1963), *reprinted in* 35 I.L.R. 136, 182 (1967); Delagoa Bay and E. Afr. R. Co. (U.S. and Gr. Brit. v. Port.) (1900), *quoted in* MAJORIE M. WHITEMAN, 3 DAMAGES IN INTERNATIONAL LAW 1694, 1697 (1943); *see also* JOHN A. WESTBERG, INTERNATIONAL TRANSACTIONS AND CLAIMS INVOLVING GOVERNMENT PARTIES: CASE LAW OF THE IRAN-U.S. CLAIMS TRIBUNAL 190 (Int'l Law Inst.1991) ("The general rule recognized in all known legal systems of the world is that where a party to a contract breaches or repudiates the contract to the detriment of the other party, without a valid excuse, that other party may recover compensation in the amount of the actual damage suffered.").

order to be able to recover lost profits. Many countries allow only the recovery of lost profits that were directly caused by the respondent and that were foreseeable as a probable result of the breach.[148] The concepts of causation and foreseeability, however, vary among countries. While common law countries tend to base their foreseeability rules on *Hadley v. Baxendale*,[149] there are still many variations. Similarly, there is no uniform rule concerning foreseeability in civil law countries. For example, the French Civil Code contains a foreseeability requirement, but it is different in theory from that under English Law. By contrast, German law traditionally has not recognized the concept of foreseeability, but rather limits damages, including lost profits, through the concept of adequate causation. Both the CISG and the UNIDROIT Principles employ a foreseeability requirement that contains objective and subjective elements.

A number of jurisdictions also limit recovery to only those damages that can be proved with certainty. However, the level of proof that the claimant must show varies among countries. In general, the claimant must prove lost profits with reasonable certainty. In many countries, though, the certainty rule applies only to the fact that the breach resulted in claimant's loss of future revenues and not to the amount of profits it lost. The UNIDROIT Principles require that lost profits be established with a reasonable degree of certainty. By contrast, the CISG does not expressly mandate that damages be proved with certainty. However, the CISG imposes a burden on the claimant to provide evidence of damage.

As a prerequisite to the recovery of lost profits, a number of civil law countries require that the respondent be at fault in breaching the agreement. The requirement of fault can be satisfied by showing that the breach was willful or resulted from negligence. Common law countries typically do not impose such a requirement on the claimant. Similarly, the CISG and the UNIDROIT Principles do not limit lost profits to only instances involving a willful or negligent breach.

With respect to the calculation of lost profits, countries typically give the judge or, in the case of some common law countries, the jury broad authority in fixing lost profits.

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148. *See, e.g.*, Civil Code art. 1150 (John Crabb trans., 1982) (Belg.); C. CIV. art. 1150 (Fr.); C.C. art. 1107 (Julio Romanach, Jr. trans.) (Spain); DONALD HARRIS ET AL., REMEDIES IN CONTRACT AND TORT 88-108 (2d ed. 2002). LOOKOFSKY, *supra* note 13, § 4.4.4.3; WADDAMS, *supra* note 16, ¶¶ 1115A-1155.

149. 156 Eng. Rep. 145 (Ex. 1854).

IV. TRIBUNAL AWARDS

Tribunals deciding transnational contract disputes typically do not have much difficulty in determining whether a claimant is entitled to lost profits once they have found that there has been a wrongful breach of contract. Rather, it is the calculation of the profits that has proved to be a complex process resulting in different approaches and seemingly arbitrary awards.

Today, it is well recognized by international tribunals that a wrongful breach of contract entitles the injured party to the benefit of the bargain.[150] In theory, this allows the claimant to recover money for actual loss incurred as a result of the breach and any net gains prevented by the breach.[151] The arbitrator in *Sapphire* explained this principle as follows:

> According to the generally held view, the object of damages is to place the party to whom they are awarded in the same pecuniary position that they would have been in if the contract had been performed in the manner provided for by the parties at the time of its conclusion. . . . This rule is simply a direct deduction from the principle of *pacta sunt servanda*, since its only effect is to substitute a pecuniary obligation for the obligation which was promised but not performed. It is therefore natural that the creditor should thereby be given full compensation. This compensation includes loss suffered (*damnum emergens*), for example expenses incurred in performing the contract, and the profit lost (*lucrum cessans*), for example the net profit which the contract would have produced. The award of

150. *See Sapphire*, 35 I.L.R. at 185-86; Final Award in Case No. 9466 of 1999 (Liber. V. Russ.), 27 Y.B. COM. ARB. 170, 176 (2002); Final Award in Case No. 8445 of 1996 (India v. F.R.G.), 26 Y.B. COM. ARB. 167, 175 (2001); Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara, Final Award in an Arbitration Procedure Under the UNCITRAL Arbitration Rules 28, 40 (Dec. 18, 2000); Himpurna Cal. Energy Ltd. v. PT. (Persero) Perusahaan Listruik Negara, Final Award of 4 May 1999, 25 Y.B. COM. ARB. 13, 83 (2000); Arbitral Award No. A-1795/51 (Camera Arbitrale Nazionale ed Internazionale di Milano (Dec. 1, 1996), *reprinted in pertinent part in* THE UNIDROIT PRINCIPLES IN PRACTICE, *supra* note 130, at 409; *cf.* Second Partial Award of 21 October 2002, S.D. Myers, Inc. v. Canada, ¶¶ 140-160, *at* http://www.dfait-maeci.gc.ca/tna-nac/documents/MyersPA.pdf.

151. *See Sapphire*, 35 I.L.R. at 185-86; Final Award in Case No. 9466, 27 Y.B. COM. ARB. at 176; Final Award in Case No. 8445, 26 Y.B. COM. ARB. 167; Final Award in Case 8786 [Jan. 1997] 11 ICC INT'L CT. ARB. BULL. 2, 70, 73-74, *available at* http://www.cisg.law.pace.edu/cisg/wais/db/cases2/978786il.html; Arbitral Award No. A-1795/51 (Camera Arbitrale Nazionale ed Internazionale di Milano), *summarized in* THE UNIDROIT PRINCIPLES IN PRACTICE, *supra* note 130.

> compensation for lost profit or the loss of a possible benefit has been frequently allowed by international tribunals.[152]

In evaluating a claim for lost profits, a tribunal usually first looks to the applicable law to determine the requirements for awarding damages.[153] If these requirements, such as foreseeability and certainty, are met,[154] the tribunal then turns to calculating the damages.

The arbitral tribunal's decision in *Final Award in Case No. 8445 of 1996* illustrates this approach.[155] In that case, the tribunal ruled that a German manufacturer (the respondent) breached a technology licensing agreement that it had entered into with an Indian manufacturer (the claimant) by failing to provide the claimant with certain documents as provided for in the agreement. The tribunal then turned to the claimant's damages claims for lost profits and injury to reputation. The tribunal first addressed the issue of causation, noting that the applicable law, the Indian Contract Act, 1872, "provides that, in order to recover for breach of contract, the aggrieved party must show that such damage arose naturally in the usual course of things from such breach, or was damage which the parties knew when they made the contract would be likely to result."[156] The tribunal ruled that the claimant's loss of profits arose naturally from the respondent's breach of the agreement, explaining that

> [t]he claimant unquestionably expected to make a profit from the local manufacture and sale of products [resulting from the technology licensing agreement], and its inability to do so naturally led to a loss of profits, a result which both parties must have known at the time they entered into the Agreement.[157]

The tribunal then turned to the task of quantifying the lost profits and rejected the respondent's claim that the claimant failed to provide adequate proof of loss. It reasoned that under "Indian jurisprudence,

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152. *Sapphire*, 35 I.L.R. at 185-86.

153. For a discussion of choosing the applicable law, see Horacio A. Grigera Naón, *Choice of Law Problems in International Commercial Arbitration*, *in* RECUEIL DES COURS 13 (2001).

154. For an in-depth discussion of causation and forseeability in international disputes, see Second Partial Award of 21 October 2002, S.D. Myers, Inc. v. Canada, ¶¶ 140-160, *at* http://www.dfait-maeci.gc.ca/tna-nac/documents/MyersPA.pdf.

155. Final Award in Case No. 8445, 26 Y.B. COM. ARB. 167.

156. *Id.* at 175.

157. *Id.*

an injured claimant is not required to prove the amount of damage with absolute certainty, where such certainty is not possible, as is in the case of lost profits, and . . . [all that is required] is a reasonable estimate of loss, based on such elements as are available."[158] The tribunal determined that the claimant met this test by providing detailed and reasoned estimates of the costs of manufacturing the products, the prices at which they could be sold, its prospective market share and projected sales growth, and the ensuing profit that would have been made.[159] As a result, the tribunal awarded the claimant lost profits for the duration of the agreement, adjusted to the present value and discounted by 15% to take into account the "uncertain nature of the calculations."[160] The tribunal, however, rejected the claim for damages for loss of reputation, ruling that "claimant's proof of such loss, and especially the quantum of any such loss, is too speculative and too uncertain to serve as a basis for an award of damages."[161]

The cases that are most troublesome for tribunals involve claims for lost profits arising from breaches of long-term contracts. This is particularly true in those situations where the respondent's breach has not just injured the claimant's business but destroyed it, and the tribunal must determine the value lost. Here, the claimants often seek *damnum emergens* and *lucrum cessans*. Determining these damages is particularly difficult because tribunals must calculate damages based on projected future earnings that may be greatly affected by ever-changing and often unpredictable economic circumstances, such as interest rates and energy prices.[162]

The generally accepted way for parties and tribunals to determine the value of a business that has been destroyed by the respondent's breach of contract (which would include lost profits) is the discounted cash flow (DCF) method.[163] The DCF method determines the value of

158. *Id.* (citing State of Kerala v. K. Bhaskaran, A.I.R. 1985 P.C. 55 (India)).

159. *Id.* at 175-76.

160. *Id.*

161. *Id.* at 177.

162. *See, e.g.*, *Himpurna*, 25 Y.B. COM. ARB. at 83.

163. *See* COPELAND ET AL., VALUATION: MEASURING AND MANAGING THE VALUE OF COMPANIES 73-87 (2000) (discussing advantages to DCF approach to valuation); RICHARD A. BREALEY & STEWART C. MEYERS, PRINCIPLES OF CORPORATE FINANCE 77 (6th ed. 2000) (stating that DCF works for shares of common stock as well as for valuing entire businesses); SCOTT GABEHART & RICHARD BRINKLEY, THE BUSINESS VALUATION BOOK 123 (2002) (recognizing that "[a] business is worth the present value of all future net free cash flows accruing to equity holders . . . over the life of the investment, including the terminal value of the company."); Ball, *supra* note 6, at 419 ("It is well settled in the world of finance that the accepted way of valuing prospective earnings is the

the business by projecting the net cash flow for a certain time period into the future and then discounting it back to present value as of the date of the breach. It uses a discount rate that may include an inflation component and a risk factor.[164] Because the DCF method values the asset lost according to its income-producing capabilities, in theory, the method fully compensates the claimant by awarding an amount that reflects both the loss incurred and the gain of which the claimant was deprived.[165]

The problem with the DCF method is that it is difficult to apply.

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discounted cash flow method . . . ."); *Propositions and Conclusions on Compensation for Business Losses: Types of Damages and Their Valuation*, U.N. Comp. Comm'n Governing Council, 4th Sess., 23d mtg. para. 18, U.N. Doc. S/AC.26/SER.A/1 (1992) (arguing that, where market value cannot be ascertained based on some open market transaction, discounted cash flow method is a proper way to value an asset).

Other valuation methods include the book value method and the replacement value method. The book value method calls for the tribunal to measure the going concern by reference to its costs. The replacement value method requires a tribunal to set damages at the market value of similar properties or entities. The book value method has been criticized as not accurately reflecting the value lost because it is based on historic and not actual costs, does not account for intangible assets, and it fails to take into account the future profitability of the business. On the other hand, the shortcomings of the replacement value method are that there may be no comparable businesses or opportunities to which a tribunal may look in calculating damages. *See* Paul D. Friedland & Eleanor Wong, *Measuring Damages for the Deprivation of Income-Producing Assets: ICSID Case Studies*, 6 ICSID REV. FOREIGN INVESTMENT L.J. 400, 405-06 (1991).

164. *See* S. Pac. Prop. (Middle East) v. Arab Republic of Egypt, 8 ICSID REV. FOREIGN INVESTMENT L.J. 328, 380-82; STEPHEN ROSS ET AL., FUNDAMENTALS OF CORPORATE FINANCE 132-60 (4th ed. 1998); Brice Clagett, *Just Compensation in International Law: The Issues Before the Iran-U.S. Claims Tribunal*, *in* 4 THE VALUATION OF NATIONALIZED PROPERTY IN INTERNATIONAL LAW 31, 91-96 (Richard Lillich ed., 1987). The report of an expert witness in *Phillips Petroleum Co. v. Iran* explained the DCF method as follows:

> Standard economic theory holds that market value of an asset equals its expected future cash flows discounted to present value at the opportunity cost of capital. . . .
>
> An Assets's market value stems from its expected ability to generate cash returns over time. Market value ultimately depends on the amount, timing, and risk of future cash flows. Prompt, safe cash flows are naturally more valuable than delayed, risky ones.
>
> The relation of future cash flows to current market value is expressed in the discounted cash flow formula, in which forecasted cash flows are discounted to obtain present value. The appropriate discount rate is the opportunity cost of capital, that is, the expected rate of return from investing in other assets of equivalent risk . . . .

Report of Stewart C. Myers *in* Phillips Petroleum Co. v. Iran, 21 Iran-U.S. Cl. Trib. Rep. 79 (1989).

165. *See* Brice Clagett, Remarks at the American Society of International Law 92d Annual Meeting (Apr. 1-4, 1998), *in* 92 AM. SOC'Y INT'L L. PROC. 303, 305 (1998); William C. Lieblich, *Determinations by International Tribunals of the Economic Value of Expropriated Enterprises*, 7 J. INT'L ARB. 1, 37, 38 (1990).

Currently, there are no universal rules for determining the future cash flows of a business or setting an appropriate discount rate.[166] The first task a tribunal faces is to project the company's earnings based on a wide variety of factors, including the company's past earnings history, its projected outlook, and the industry outlook, all of which necessarily involve many assumptions, estimates, and other subjective elements.[167] The second task, setting the discount rate, requires an even more complex calculation that takes into account multiple variables, including the expected rate of inflation, the real rate of return, and the riskiness of the income stream.[168] Accordingly, parties often employ experts to make a DCF valuation, and tribunals sometimes employ their own experts to assist in evaluating the parties' claims concerning lost profits using the DCF method.[169] Nevertheless, the lack of clear rules for determining the most important factors used in the DCF method has caused one commentator to remark that

> [d]amages in complex businesses relying on calculation of future cash flows (quite speculative) discounted to present value by applying a specific discount rate (itself very uncertain as the risk factor added to the risk-free discount rate is inevitably highly subjective) can be reasonably and plausibly determined within a very wide range.[170]

Other commentators have referred to the DCF analysis as more of an art form than a science.[171]

Not surprisingly, awards using the DCF methods sometimes seem arbitrary.[172] For instance, in one case, a tribunal appeared to "split the

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166. *See* COPELAND ET AL., *supra* note 163, at 131.

167. *See* Thomas Walde, *Introductory Note to SVEA Court of Appeals: Czech Republic v. CME Czech Republic B.V.*, 42 I.L.M. 915, 917-18 (2003).

168. *See* Phillips Petroleum Co. Iran v. Islamic Republic of Iran, 21 Iran-U.S. Cl. Trib. Rep. 79, 124 (1989); Friedland & Wong, *supra* note 163, at 407.

169. *See* Starrett Housing Corp. v. Islamic Republic of Iran, 16 Iran-U.S. Cl. Trib. Rep. 112, 220 (1988); Himpurna Cal. Energy Ltd. v. PT. (Persero) Perusahaan Listruik Negara, 25 Y.B. COM. ARB. 13 (2000).

170. Walde, *supra* note 167, at 918.

171. *See* GABEHART & BRINKLEY, *supra* note 163, at 124.

172. *See, e.g.*, Starrett Housing, 16 Iran-U.S. Cl. Trib. Rep. at 235-36. Although the expert appointed by the tribunal itself had generated an award calculation of $41 million based on the DCF method, the tribunal adjusted the amount to $37 million without any calculation explaining its reduction. *See* Phillips Petroleum, 21 Iran-U.S. Cl. Trib. Rep. 79; Ball, *supra* note 6, at 422. In this case, the tribunal adjusted the valuation provided by the claimant's expert substantially lowering

baby," setting damages exactly halfway between the claimant's and respondent's valuations.[173] In other cases, tribunals have struggled with the DCF method, leading to inconsistent applications. In *ICC Final Award in Case No. 5946*, the tribunal determined that the duration of the income projection should last for the entire term of the contract, which was 40 months.[174] By contrast, in *Final Award in Case No. 7006*, the tribunal calculated lost profits based on an income stream for one year after the contract was breached because the tribunal felt that the claimant could have mitigated its losses after the year.[175] In *MINE v. Republic of Guinea*, the tribunal limited the income generated by a shipping business to 10 years of a 30-year contract because it viewed that time period as being reasonable, particularly in light of provisions allowing for the early termination of the contract.[176]

A number of tribunals have refused to award lost profits where the business was not a going concern.[177] These tribunals reason that because the business did not have a sufficient earnings history, determining lost profits in such circumstances would be too speculative. For example, in *Levitt v. Islamic Republic of Iran*, Chamber One of the Iran-U.S. Claims Tribunal ruled that Iran breached its contract for the construction of a housing project and awarded the claimant his expenses incurred as a result of the breach.[178] Although the tribunal recognized that, in principle, lost profits may be awarded in the case of a breach of contract, it denied the claim for such profits. The tribunal reasoned:

> [T]he basis of the [lost profits] claim . . . is highly speculative. . . . By the time the Contract came to an end only initial stages of clearing and grading had been completed, and no construction work had begun on buildings. The project had therefore

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the valuation. It based these adjustments not on its own DCF calculation, but rather on an underlying asset valuation not advocated by either party. *Id.* ¶ 158.

173. *See* Compania Del Desarrollo De Santa Elena, S.A. v. Republic of Costa Rica, 15 ICSID REV. FOREIGN INVESTMENT L.J. 167, 199-200 (2000) (involving an award of damages for an expropriation of property).

174. Final Award in Case No. 5946 of 1990 (Fr. v. U.S.), 16 Y.B. COM. ARB. 97 (1991).

175. Final Award in Case No. 7006 of 1992, 18 Y.B. COM. ARB. 58 (1993).

176. *See* MINE v. Republic of Guinea, 4 ICSID REP. 61, 75-76 (1997).

177. *See, e.g.*, Levitt v. Iran, 14 Iran-U.S. Cl. Trib. Rep. 191, 209-10 (1987); *see also* Ball, *supra* note 6, at 422-24 (discussing cases); *cf.* Asian Agric. Prod. v. Sri Lanka, 30 I.L.M. 577, 624 (1991); Metaclad Corp. v. Mexico, *reprinted in* 16 ICSID REV. 168, 199 (2001), *available at* 40 I.L.M. 36, 52 (ICSID 2001).

178. Levitt, 14 Iran-U.S. Cl. Trib. Rep. at 203.

> reached only a very early stage. . . . For these reasons the Tribunal finds that the Claimant has not established with a sufficient degree of certainty that the project would have resulted in a profit.[179]

A number of tribunals deciding damages in expropriation cases have also reached similar conclusions.[180] For instance, in *Metaclad Corp. v. United Mexican States*, an arbitral panel ruled that because the business that was expropriated was not a going concern, "any award based on future profits would be wholly speculative."[181]

By contrast, other tribunals have awarded lost profits even where the business that has been destroyed is not a going concern.[182] For example, in the *Delagoa Bay and East African Railway* arbitration, the tribunal dealt with the annulment of a railroad concession that provided for a railroad to be built in Portugal's African territories. According to the tribunal, the annulment gave rise to damages "according to universally accepted rules of law, the *damnum emergens* and the *lucrum cessans*: the damage that has been sustained and the profit that has been missed," even though the annulment took place before the railroad had begun to operate.[183] The tribunal, inter alia, calculated the amount of profits the concessionaire would have received, recognizing that its computations were based on "purely theoretical data [that is, expert reports, and that it could not] hope to be absolutely accurate but only

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179. *Id.* at 209-10.

180. *See* Wena Hotels Ltd. v. Egypt, 6 ICSID REP. 89, 125 (2000); S. Pac. Prop. (Middle East), 8 ICSID REV. FOREIGN INVESTMENT L.J. at 381-82; Sola Tiles, Inc. v. Iran, 14 Iran-U.S. Cl. Trib. Rep. 224, 240-42 (1987); Phelps Dodge Corp. v. Iran, 10 Iran-U.S. Cl. Trib. Rep. 121, 132-33 (1986); *see also* Metaclad Corp. v. Mexico, 40 I.L.M. at 52. These cases involved damages for expropriations of the claimants' properties as opposed to damages for breach of contract. In expropriation cases, a claimant is entitled to fair or reasonable compensation for the value of the expropriated property. *See* C.F. Amerasinghe, *Some Aspects of the Quantum of Compensation Payable upon Expropriation*, 87 AM. SOC'Y INT'L L. PROC. 459, 477 (1993) (recognizing that foreign investments have to be protected from Draconian acts of host state in order to encourage investment within foreign lands); *see also* M.H. Mendelson, *AGORA: What Price Expropriation?*, 79 AM. J. INT'L L. 414, 415 (1985) (recognizing that when alien property is lawfully taken by a state, the state is required to pay full compensation to the claimant). In breach of contract cases, the claimant is typically entitled to the benefit of the bargain. Nevertheless, in both cases, tribunals face the same problems in trying to determine the value of a business that was destroyed as a result of the respondent's actions.

181. Metaclad Corp. v. Mexico, 40 I.L.M. at 52; *see also* United Mexican States v. Metalclad Corp., 2001 BCSC 664 (partially setting aside award on other grounds).

182. *See Delagoa Bay*, *in* WHITEMAN, *supra* note 147, at 1697; *Sapphire*, 35 I.L.R. at 187-88.

183. *Delagoa Bay*, *in* WHITEMAN, *supra* note 147, at 1697.

comparatively likely."[184]

Similarly, in the *Sapphire* arbitration, the arbitrator ruled that the claimant was entitled to lost profits for the breach of an oil concession even though the area that was the subject of the concession had not yet been prospected. The arbitrator explained:

> It is not necessary to prove the exact damage suffered in order to award damages. On the contrary, when such proof is impossible, particularly as a result of the behaviour of the author of the damage, it is enough for the judge to be able to admit with sufficient probability the existence and extent of the damage.[185]

The arbitrator relied on an expert's report and testimony and ruled that the claimant met the burden of showing sufficient probability of success of the prospecting if the breach had not occurred. With respect to the amount of lost profits owed, the arbitrator noted that the ability of the claimant's expert to provide only a rough estimate of the loss was not fatal to the claim. The arbitrator had been given the authority to decide *ex aequo et bono* and thus concluded that he had wide discretion to fix the amount of lost profits, even though the extent and existence of the amount of lost profits were not certain. The arbitrator awarded $2 million for lost profits, stating that that amount was both "reasonable and equitable."[186]

Recently, tribunals have dealt with an additional emerging issue: the invocation of the abuse of rights doctrine to deny lost profits even though the non-breaching party is entitled to such profits under the contract. This issue arose in the now controversial decision of *Himpurna California Energy Ltd. v. PT. (Persero) Perusahaan Listruik Negara.*[187] There, Himpurna California Energy Ltd. entered into a contract with the Indonesian state electricity corporation, PLN, to explore and develop geothermal resources in Indonesia, including building two power plants in the country and selling the power generated to PLN.

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184. *Id.* at 1699.

185. *Sapphire*, 35 I.L.R. at 187-88.

186. *Id.* at 190.

187. *See* Final Award of 4 May 1999, 25 Y.B. COM. ARB. 13 (2000). The case generated much controversy because, according to the tribunal, the Republic of Indonesia tried to sabotage the proceedings by, among other things, detaining its party-appointed arbitrator and by allegedly pressuring him to withdraw from the arbitration. *See* Final Award of 16 October 1999, 25 Y.B. COM. ARB. 186, 187 (2000).

When PLN failed to purchase the energy Himpurna generated, Himpurna submitted a request for arbitration, claiming that PLN breached the contract, resulting in $2.3 billion in damages. An ad hoc arbitral tribunal agreed that PLN breached its contract with Himpurna.[188]

Turning to the issue of damages, the tribunal initially noted that under the Indonesian Civil Code (the applicable substantive law) damages may include "the loss which the creditor has suffered and the profit he has been made to forego."[189] Himpurna claimed both *damnum emergens*, which consisted of capital invested and expended plus interest, and *lucrum cessans*, which amounted to its expected future revenue stream, discounted to reflect the time value of money and the risk premium.

With respect to *damnum emergens*, the tribunal stated that Himpurna was entitled to reimbursement for monies that Himpurna could prove that it spent in reliance on the contract.[190] As a result, the tribunal awarded Himpurna $273,757,306 as *damnum emergens*.[191]

Regarding the claim for *lucrum cessans*, the tribunal looked to the applicable law, noting that

> Art. 1246 of the Indonesian Civil Code—echoing its precursor Art. 1149 of the French *Code civil*—provides for the recovery of lost profit. . . . But the Code goes on to set out limiting factors which, again, are quite familiar. Art. 1247 (congruent with Art. 1152 of the *Code civil*) restricts recovery to damages foreseeable at the time of contracting; and Art. 1248 (congruent with Art.

188. The Tribunal determined PLN breached the contract "by failing to provide Himpurna with assurances that it would honour its contractual obligations; by preventing Himpurna from completing the development of additional units; and by failing to pay invoices and issue standby letters of credit." *Himpurna*, 25 Y.B. COM. ARB. at 14.

189. *Id.* at 70-71 (quoting Civil Code of Indonesia art. 1246).

190. This burden, the tribunal explained, does not mean that Himpurna had to establish damages with scientific certainty. Himpurna "need[ed] to show only that it has made expenditures; it [was] for PLN to show that they have no reasonable connection with the pursuit of contractual objectives." *Id.* at 78-79. In addition, the fact that such expenditures may not have been judicious or providential was irrelevant at this stage. The tribunal determined that Himpurna provided sufficient documentation that it spent significant amounts building the plants and exploring and drilling wells, all of which were made pursuant to and in reliance on the contract and were thus foreseeable damages. *See id.* at 73.

191. This amount consisted of $254,502,586 in historical costs plus $19,254,720 to reflect the present value. *See id.* at 83.

> 1284 of the *Code civil*) requires that damages be the "immediate and direct result of the breach."[192]

While the tribunal recognized that Himpurna was in principle entitled to lost profits, it ruled that the calculation of such profits should not be performed in a way that would impoverish the host state. To do so, the tribunal stated, would constitute an "abuse of right." According to the tribunal, the abuse of rights doctrine is a general principle of international law that requires parties to observe good faith in the exercise of their rights. As a principle of international law, the tribunal stated, the doctrine overrides the right to the benefit of the bargain under substantive law. The tribunal explained that

> this is a case where the doctrine of abuse of right must be applied in favour of PLN to prevent the claimant's undoubtedly legitimate rights from being extended beyond tolerable norms, on the ground that it would be intolerable in the present case to uphold claims for lost profits from investment not yet incurred.[193]

The tribunal thus refused to calculate lost profits "as though the claimant had an unfettered right to create ever-increasing losses for the State of Indonesia (and its people) by generating energy without any regard to whether or not PLN had any use for it[, e]ven if such right may be said to [have] derive[d] from explicit contractual terms."[194] Accordingly, the tribunal awarded Himpurna $117,244,000 in lost profits, which was less than 10% of the amount claimed. The tribunal settled on this amount by calculating Himpurna's after-tax net cash flow projections, discounted to the present value applying a discount rate (19%) that took into account the perceived risks of the project, and by limiting the recoverable profits to 36% of the total claim for lost profits (so as to exclude lost profits on investments not yet made).[195]

Similarly, in *Patuha Power Ltd. v. PT. (Persero) Perusahaan Listruik Negara*, an arbitral tribunal encountered another case arising from Indonesia's breach of an agreement for the exploration and development of geothermal resources. The tribunal denied the claim for lost profits on the ground that it would be an abuse of rights to award

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192. *Id* at 84.
193. *Id.* at 93.
194. *Id.* at 90.
195. *Id.* at 103.

millions in lost profits in light of the state of the economy in Indonesia.[196]

It also should be noted that the abuse of rights doctrine was not invoked to reduce or preclude profits in *Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Das Gas Bumi Negara*, a third arbitration arising from failed power projects in Indonesia, in which the tribunal awarded the claimant lost profits.[197] Karaha Bodas Co. (KBC) entered into a contract with Pertamina, the Indonesian state owned oil company, to finance, build, and operate geothermal facilities in the Karaha area of Indonesia, and in exchange Pertamina agreed to buy energy generated by KBC. Indonesia subsequently suspended the projects because of the country's financial crisis. KBC filed for arbitration, seeking (1) a declaration that the contracts were terminated, (2) damages of $96 million for expenditures already made on the projects, and (3) $512 million for the present value of expected future profits over the life of the contract.[198] The tribunal determined that Pertamina had breached its agreements with KBC and awarded KBC $111.1 million for lost expenditures and $150 million for lost profits without any discussion of the abuse of rights doctine.[199]

Karaha Bodas subsequently filed actions to enforce the award in the United States, as well as in Hong Kong and Canada.[200] The United States District Court for the Southern District of Texas, affirmed by the United States Court of Appeals for the Fifth Circuit, ordered the enforcement of the award. In both courts, Pertamina claimed that enforcement should be denied because, inter alia, the damage award was contrary to public policy.[201] Specifically, Pertamina argued that the "award of lost profits in this particular case, when KBC never finished

196. *See* Patuha Power Ltd. v. PT. (Persero) Perusahaan Listruik Negara, *summarized in pertinent part in* Mark Kantor, *The Limits of Arbitration*, TRANSNAT'L DISP. MGMT. (May 2004), *available at* http://www.transnational-dispute-management.com/samples/welcome.html. It should be noted that Patuha and Himpurna, however, were not completely without lost profit compensation. Both had obtained equity political risk insurance that specifically covered the refusal to recognize an international arbitration award. *See id.*

197. The arbitral tribunal's decision in the Karaha Bodas arbitration is summarized in pertinent part in Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Das Gas Bumi Negara, 364 F.3d 274, 282-85 (5th Cir. 2004).

198. *See* Louis T. Wells, *Double Dipping in Arbitration Awards? An Economist Questions Damages Awarded to Karaha Bodas Company in Indonesia*, 19 ARB. INT'L 471, 472 (2003).

199. *Id.*

200. *See* Karaha Bodas, 364 F.3d at 281.

201. *See id.*; Karaha Bodas v. Perusahaan Pertambangan Minyak, 190 F. Supp. 2d 936, 955 (S.D. Tex. 2001).

construction on the Project and the Indonesian economy was in ruins, constitutes an abuse of rights in violation of United States public policy."[202] Both courts rejected the argument. The Fifth Circuit noted that the abuse of rights doctrine was not well established in U.S. law. Furthermore, the court stated that an action violates the abuse of rights doctrine only if one of the following three factors is present:

(1) the predominant motive for the action is to cause harm;

(2) the action is totally unreasonable given the lack of any legitimate interest in the exercise of the right and its exercise harms another; [or]

(3) the right is exercised for the purpose other than that for which it exists.[203]

The Fifth Circuit concluded that none of the factors were present in the instant case.[204]

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The above study confirms that there is an almost universal consensus among tribunals that the goal of damages for breach of contract is to place the injured party in the position that it would have been in had the contract been performed. Consequently, tribunals recognize that the injured party is typically entitled to recover both losses incurred as well as gains of which it was deprived because of the breach. This is not surprising. As the survey in section III discloses, the laws in a vast majority of countries recognize these principles.

While national laws may differ over the requirements and limitations concerning the entitlement to lost profits, these differences have not been problematic for tribunals. However, the calculation of lost profits has proved more troublesome for tribunals. Again, this is not surprising. The laws of most countries provide little or no guidance on how lost profits should be calculated.[205] Indeed, most countries simply give the judge or jury broad discretion to fix damages, including lost profits.[206] In addition, the assessment of lost profits is not an exact science, and some of the methods used to calculate lost profits are complicated.[207] Thus, the fact that awards of lost profits by tribunals deciding transnational contract disputes seem to vary greatly is not

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202. *Id.* at 955.

203. *Karaha Bodas*, 364 F.3d at 306.

204. *Id.*

205. *See supra* notes 57-67, 109-12, and accompanying text.

206. *See* Draetta et al., *supra* note 1, at 4-104, 4-110.

207. *See* BREALEY & MEYERS, *supra* note 163, at 79-80; GABEHART & BRINKLEY, *supra* note 163, at 124.

in-and-of-itself a cause for concern.[208] As one tribunal explained:

> There is no reason to apologise for the fact that [the approach used to calculate lost profits, in this case the DCF method,] involves approximations; they are inherent and inevitable. Nor can it be criticised as unrealistic or unbusinesslike; it is precisely how business executives must, and do, proceed when they evaluate a going concern. The fact that they use ranges and estimates does not imply abandonment of the discipline of economic analysis; nor, when adopted by the arbitrators, does this method imply abandonment of the discipline of assessing the evidence before them.[209]

V. ANALYSIS AND RECOMMENDATIONS

While variety in tribunal decisions is to be expected, two actions exhibited by tribunals deciding transnational contract disputes remain causes for concern: first, the application of the new business rule and, second, the adoption of the abuse of rights doctrine as a principle of international law to deny a legitimate claim for lost profits. The rule prohibiting the recovery of lost profits whenever the injured business is not a going concern is inappropriate and should be discarded. Moreover, while the abuse of rights doctrine is a settled international legal principle, that principle does not preclude a legitimate claim for lost profits simply where such damages would cause the breaching party financial hardship. Instead, there are several steps that parties can take to avoid these difficult issues and to assist tribunals in fixing the amount of lost profits.

A. *Eliminating the New Business Rule*

As noted, some tribunals and commentators advocate that lost profits are not appropriate when the claimant is an unestablished or a new business because the lack of an earnings history makes such profits speculative.[210] This new business rule is contrary to the rules and laws

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208. Of course, I do not advocate baby-splitting in fixing lost profits; that result seems to be the exception to general practice.

209. Himpurna Cal. Energy Ltd. v. PT. (Persero) Perusahaan Listruik Negara, *reprinted in* 25 Y.B. COM. ARB. 13,103 (Berm.-Indon. 2000); *see also* DOBBS, *supra* note 25, § 3.3(8), at 317-18.

210. *See* Wena Hotels Ltd. v. Egypt, 6 ICSID REP. 89, 125 (2000); Metalclad Corp. v. Mexico, 40 I.L.M. at 52; Phelps Dodge Corp. v. Iran, 10 Iran-U.S. Cl. Trib. Rep. at 132-33; Ball, *supra* note 6, at 422; Wells, *supra* note 198, at 474-75; *see also World Bank, Guidelines for the Treatment of Foreign*

of many countries concerning remedies for breach of contract and incorrect from a policy standpoint.

It is a fundamental aspect of contract law in most, if not all, countries that a party that has been injured as a result of a wrongful breach of contract is entitled to the benefit of its bargain, including any gain of which it was deprived.[211] Denying lost profits simply because the injured business is new would leave the injured claimant less than whole and would fail to achieve the goal of full compensation.

It is true that many countries require that damages, including lost profits, be proven with reasonable certainty.[212] The requirement, however, often applies to the fact that the breach caused the claimant a loss of some amount of profit, and not to the amount of damages.[213] That is, in many countries, the claimant must show with reasonable certainty that, had the contract been performed, the claimant would have enjoyed some profits. If the claimant is able to do so, then the fact that lost profits are difficult to calculate or that the claimant is only able to approximate the amount of profits lost should not bar recovery of such damages.[214] Indeed, where the amount of lost profits is not capable of precise calculation, a number of countries confer upon judges or juries broad discretion to fix the amount of the lost profits award.[215]

A rule prohibiting the recovery of lost profits whenever the claimant

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Direct Investment, *in* IBRAHIM F.I. SHIHATA, LEGAL TREATMENT OF FOREIGN INVESTMENT: THE WORLD BANK GUIDELINES 162 (1993) (stating that it is reasonable to value an investment on the basis of the discounted cash flow value of the asset—but only if it is a going concern with a proven track record of profitability).

211. *See supra* notes 16-17, 26-28, and accompanying text.

212. *See* Hahnkamper, *supra* note 35, at AUS-88; Simont et al., *supra* note 35, at BEL-64; Wirth et al., *supra* note 35, at SWI-75 (citing P. Gauch & W. Schluep, 2 Schweizerisches Obligationenrecht, Allgemeiner Teil 2624, 2630, 2726 (6th ed. 1995)); BGB art. 276 (Ger.); C.C. art. 1101 (Spain); RESTATEMENT (SECOND) OF CONTRACTS § 352 (1981).

213. *See* Bagwell Coatings v. Middle S. Energy, 797 F.2d 1298, 1312 (5th Cir. 1986); Locke v. United States, 283 F.2d 521, 524 (Ct. Cl. 1960); Kozlowski v. Kozlowski, 403 A.2d 902, 908 (N.J. 1979); *see also* CHITTY ON CONTRACTS, *supra* note 19, ¶ 1562, at 733; CARTER & HARLAND, *supra* note 41, ¶ 2117; DUNN, *supra* note 41, § 1.6; Beck, *supra* note 57, at 96; Simont et al., *supra* note 35, at BEL-64.

214. *See* WADDAMS, *supra* note 16, ¶ 1053 ("[I]f the plaintiff establishes that he has probably suffered a loss, the difficulty of determining the amount of it can never excuse the wrongdoer from paying damages. If the amount is difficult to estimate, the tribunal must simply do its best on the material available . . . .") (footnote omitted).

215. *See* C.C. art. 1226 (Italy); CO art. 42(2) (Switz.); BW art. 6:105 (Neth.); NICHOLAS, *supra* note 104, at 228; *see also* Draetta et al., *supra* note 1, § 4:54, at 4-111. In *Final Award in Case No. 7181 of 1992*, the Tribunal appointed an expert to determine the amount of lost profits to be awarded *ex aequo et bono*, noting that, "[a]ccording to an established jurisprudence of the Belgian Supreme Court, the judge can assess the damage *ex aequo et bono* provided that, as in this case, he indicates

is a new business also would result in a windfall to the wrongdoer and could even provide an incentive for a party to breach its contractual obligations. As one arbitral tribunal explains,

> if recovery were limited to what a claimant has spent in reliance on a contract which has been breached, an incentive would be created which is contrary to the contractual morality: obligors would generally find it in their interest to breach contracts which turn out to be valuable to their co-contractant. Parties do not enter into contracts involving risk in order to be repaid their costs. To limit the recovery of the victim of a breach to its actual expenditures is to transform it into a lender, which is commercially intolerable when that party was at full risk for the amount of the investments made on the strength of the contract.[216]

Furthermore, because the respondent's wrongful act caused the difficulty in proving damages with certainty, from a policy standpoint, the respondent should not be able to escape liability on the ground that lost profits are inappropriate because they are uncertain.[217] As one American court noted, "[i]t is particularly in the area of quantifying the amount of lost profits that courts impose the risk of uncertainty on the breaching party whose breach gave rise to the uncertainty."[218]

Accordingly, instead of a rule prohibiting lost profits whenever the claimant is a new business, tribunals should construe the requirement that damages must be proved with reasonable certainty to place upon the claimant the burden of proving that it was reasonably certain that profits would have been made had the respondent fulfilled its obligations under the contract. If the claimant is able to do so, then it should be entitled to some amount of lost profits if there is a rational basis for the claimant's calculation of lost profits, even if the claimant is a new

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why the assessment proposed by the parties cannot be accepted and why the damages can only be assessed *ex aequo et bono*." Final Award in Case No. 7181 of 1992, 21 Y.B. COM. ARB. 99, 111 (1996).

216. *Himpurna*, 25 Y.B. COM. ARB. at 83-84.

217. *See* Southwest Battery Corp. v. Owen, 115 S.W.2d 1097, 1099 (Tex. 1938) ("A party who breaks his contract cannot escape liability because it is impossible to state or prove a perfect measure of damages."); Super Valu Stores, Inc. v. Peterson, 506 So. 2d 317, 330 (Ala. 1987) ("[T]he risk of uncertainty must fall on the defendant whose wrongful conduct caused the damages.").

218. Mid-America Tablewares, Inc. v. Mogi Trading Co., 100 F.3d 1353, 1367 (7th Cir. 1996).

business.[219] That is, once a claimant is able to show with reasonable certainty the fact of loss of profits, the claimant then needs only to provide a basis upon which a tribunal can reasonably estimate the extent of the claimant's loss of profits.[220] A claimant might be able to do so through, for example, the use of expert testimony, economic and financial data, market surveys and analyses, and business records of similar enterprises.[221]

The above procedure would essentially replace a practice or principle with a rule of evidence, which is the trend in many U.S. jurisdictions.[222] One commentator explains the benefit of such a procedure as follows:

> It is impossible for anyone . . . to foresee all of the possible situations in which meritorious claims could be asserted for lost profits even though the business to which those profits might accrue had not yet commenced operation. Nor is any worthwhile end to be achieved by permitting one party to breach its contracts with impunity—giving that party an option, as it were—because the other party has not yet commenced operation.[223]

The proposed procedure also strikes a balance between the need for evidence upon which a tribunal may base an award of lost profits and

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219. This assumes, of course, that the claimant has met all other applicable legal requirements, such as foreseeability, for the recovery of lost profits.

220. *See* ARTHUR L. CORBIN, 5 CORBIN ON CONTRACTS 124 (1952).

221. *See* Butler v. Westgate State Bank, 596 P.2d 156, 165-66 (Kan. 1979); Alliance Tractor & Implement Co. v. Lukens Tool & Die Co., 281 N.W.2d 778, 782 (Neb. 1979); Edwards v. Container Kraft Carton & Paper Supply Co., 327 P.2d 622, 626-27 (Cal. App. 1958); Houston Exploration, Inc. v. Meredith, 728 P.2d 437, 439 (Nev. 1986); RESTATEMENT (SECOND) OF CONTRACTS § 352 cmt. b (1981). In *Interim Award of 17 July 1992 & Final Award of 13 July 1993*, the claimant calculated the claimed lost profits on the basis of detailed forecasts of expected results during the relevant time period, including the forecasted production capacity of a factory that the respondent failed to complete, and the forecasted sales of the product that was to be made at the factory (based largely on statements from the claimant's customers that they would have bought certain quantities of the product at prices that were competitive with those offered by the claimant's competitors). The Tribunal "accept[ed] that the claimed amount of loss of profit fairly represents what the claimant would have earned during the relevant period of time, if production according to the Agreement had been performed." Interim Award of 17 July 1992 & Final Award of 13 July 1993 (Arbitration Inst. of Stockholm Chamber of Commerce), *reprinted in pertinent part in* 22 Y.B. COM. ARB. 197, 209 (1997).

222. *See* DUNN, *supra* note 41, § 4.3.

223. *Id.* § 4.3, at 357.

the recognition that the difficulty in proving damages stems from the respondent's wrongful breach. In contrast, the principle forbidding a new business lost profits favors the breaching party. As the tribunal in *Final Award in Case No. 8362 of 1995* points out:

> With respect to the calculation of the amount of damages, counterbalancing factors are taken into account under the law: on the one hand, there must be a sound basis upon which alleged damages are to be calculated. They cannot be the product of sheer speculation unsupported by tangible evidence. On the other hand, the law will not reward a party in breach by depriving the other party of compensation merely because no precise basis for determining the amount of damages exists.[224]

It also should be noted that the proposed procedure would not apply if the parties' contract or the law chosen by the parties to govern the merits of any dispute explicitly imposed a different burden on the claimant. This exception would give effect to the intent of the parties concerning the calculation of lost profits in the event of the breach of contract.[225]

B. *Reining in the Abuse of Rights Doctrine*

The recent invocation of the abuse of rights doctrine as a principle of international law in two high-profile international contract disputes to deny in whole or in part legitimate claims for lost profits is unprec-

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224. Final Award in Case No. 8362 of 1995, 22 Y.B. COM. ARB. 164, 177 (1997).

225. The cornerstone of international arbitration is the principle of party autonomy. *See* JULIAN D.M. LEW, APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION 71-75 (1978). Through consensual agreement, the parties to an international contract have the power to designate, among other things, the remedies, the substantive law to be applied to any dispute, the procedural rules to be followed, the place of arbitration, etc. *See* FOUCHARD, GAILLARD, GOLDMAN ON INTERNATIONAL COMMERCIAL ARBITRATION ¶¶ 46-52 (Emmanuel Gaillard & John Savage eds., 1999). Parties to transnational commercial contracts often quite consciously select which substantive law will govern any future dispute. *See* John Y. Gotanda, *Awarding Punitive Damages in International Commercial Arbitrations in the Wake of* Mastrobuono v. Shearson Lehman Hutton, Inc., 38 HARV. INT'L L.J. 59, 96-97 (1997). If parties choose to have disputes governed by a law that imposes high requirements on the claimant, that choice should be respected. *See* Mark A. Buchanan, *Public Policy and International Commercial Arbitration*, 26 AM. BUS. L.J. 511, 517 (1998).

edented and inappropriate.[226] The doctrine should not be used to circumvent the remedies to which an injured party is entitled under the agreement and applicable law, or to give a tribunal the power to decide in equity when the tribunal has not been granted the authority to do so.

The abuse of rights doctrine has been recognized in principle by the International Court of Justice.[227] The doctrine can also be found in the laws of many countries, such as England, France, and the United States.[228] Swiss law states that "every person is bound to exercise his rights and fulfill his obligations according to the principles of good faith. The law does not sanction the evident abuse of a right."[229] By contrast, the Greek Civil Code provides that "the exercise of a right shall be prohibited if such exercise obviously exceeds the limits imposed by good faith or morality or by the social or economic purpose of such right."[230]

In France, the abuse of rights principle was invoked by the Court of Appeals of Paris to prevent a U.S. parent company from requiring its French subsidiary to cancel a contract that violated United States law because the cancellation of the contract would "ruin the financial equilibrium and the moral credit of [the subsidiary] and provoke its disappearance and the unemployment of more than 600 workers."[231]

However, the abuse of rights doctrine is much narrower in the

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226. *See* Himpurna Cal. Energy Ltd. v. PT. (Persero) Perusahaan Listruik Negara, *reprinted in* 25 Y.B. COM. ARB. 13, 91-96 (Berm.-Indon. 2000); Patuha Power Ltd. v. PT. (Persero) Perusahaan Listruik Negara, *summarized in pertinent part in* Kantor, *supra* note 196, at 4.

227. *See, e.g.*, Fisheries Case (U.K. v. Norway), 1951 I.C.J. 116, 142 (Dec. 18); *see generally* BIN CHENG, GENERAL PRINCIPLES OF LAW 121-36 (1987). In public international law, the doctrine prohibits (1) the exercise of a right for the sole purpose of causing injury to another, (2) the fictitious exercise of a right for the purpose of evading a treaty obligation, and (3) the exercise of a State's rights in a manner incompatible with its treaty obligations or obligations from the general law. In the situation where the owner of a right enjoys discretionary power, it would constitute an abuse of rights for a State not to exercise them "reasonably, honestly, in conformity with the spirit of the law and with due regard to the interest of others;" an abuse of discretion can be found "[w]hen either unlawful intention or design can be established, or the act is clearly unreasonable." *Id.* at 134, 136.

228. *See* Joseph M. Perillo, *Abuse of Rights: A Pervasive Legal Concept*, 27 PAC. L.J. 37 (1995); NETHERLANDS CIVIL CODE PATRIMONIAL LAW: PROPERTY OBLIGATIONS AND SPECIAL CONTRACTS (P.P.C. Haanappel & Ejan MacKaay trans., 1990); RUDOLF B. SCHLESINGER ET AL., COMPARATIVE LAW 825-52 (6th ed. 1998).

229. The Swiss Civil Code: English Version, Preliminary Chapter, art. 2.2 (Siegfried Wyler & Barbara Wyler trans., 1987).

230. Greek Civil Code §281 (Constantin Talidoros trans., 2000).

231. Societe Fruehauf Corp. v. Massardy [1968] D.S. Jur. 147 (Ct. App. Paris May 22, 1965), *summarized in pertinent part in* ANDREAS F. LOWENFELD, TRADE CONTROLS FOR POLITICAL ENDS 93, 96 (1983), *available at* 5 I.L.M. 476 (1966).

United States. One study determined that the doctrine has been applied in three situations in the United States:

(1) where the predominant motive for the action is to cause harm;

(2) where the exercise is totally unreasonable given the lack of any legitimate interest in the exercise of the right and its exercise harms another; and

(3) where the right is exercised for the purpose other than that for which it exists.[232]

While a thorough comparative study of the doctrine is beyond the scope of this Article,[233] it seems that the tribunal in *Himpurna* misapplied the abuse of rights doctrine.[234] It is not, as the tribunal stated, a general principle of private international law that precludes the awarding of lost profits whenever awarding such profits would cause a severe financial hardship to the party that has breached the contract.[235] While it is true that courts in some countries, such as France, may apply the abuse of right doctrine to preclude a private party from legitimately exercising its contractual rights where such exercise may cause severe financial hardship to the breaching party, that view is not shared with such convergence so as to constitute a principle of international law.[236]

To be sure, circumstances may radically change between the time of contracting and the completion of the contract. These changes may significantly affect the ability of the parties to perform their obligations under the agreement or the commercial equilibrium in their con-

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232. Perillo, *supra* note 228, at 47.

233. For a comparative study of the abuse of rights doctrine, see SCHLESINGER ET AL., *supra* note 228, at 825-52.

234. *See supra* notes 187-95 and accompanying text.

235. The arbitral tribunal in *Himpurna Cal. Energy Ltd.* stated that the abuse of rights principle was "universal." Himpurna, 25 Y.B. COM. ARB. at 91. It should be noted that the tribunal in *Himpurna* ruled that, under Indonesian law, the economic crisis in the country did not excuse PLN's breach of contract. In fact, the tribunal also noted that the parties' contract unambiguously allocated the risk of economic downturn in the country to PLN. *See id.* at 59-60.

236. *See* Emmanuel Gaillard, *Use of General Principles of International Law in International Long-Term Contracts*, 27 INT'L BUS. LAW. 214, 216-20 (1999) (stating that to identify a general principle of international law it is necessary to establish that national laws converge on the issue); *see also* Perillo, *supra* note 228, at 40-47 (discussing the differences between abuse of rights doctrines under French, English, and American law). As noted, in the public international law arena, the doctrine requires a State, when holding discretionary power, to exercise it "honestly, sincerely, reasonably in conformity with the spirit of the law and with due regard to the interests of others." CHENG, *supra* note 227, at 136. However, it does not necessarily follow that a principle of public international law applies in the same manner as a rule of private international law, particularly when national laws differ on the scope of the doctrine.

tract.[237] Parties to such contracts often understand the risks involved and can take steps to minimize these risks, such as including in the contract a *force majeure* clause, a hardship clause, or a renegotiation and adaptation clause.[238] Parties might also consider providing for the application of the UNIDROIT Principles, which state that "[i]f the court finds hardship[239] it may, if reasonable, (a) terminate the contract at a date and on the terms to be fixed, or (b) adapt the contract with a

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237. International investment contracts are especially vulnerable to changes in the commercial balance agreed to, or assumed by, the parties at the outset of the contract. *See* Klaus Peter Berger, *Renegotiation and Adaptation of International Investment Contracts: The Role of Contract Drafters and Arbitrators*, 36 VAND. J. TRANSNAT'L L. 1347, 1348 (2003). This vulnerability exists because these "contracts typically are of long duration [and] the political, economic and social climate could change radically during this period and dramatically alter the economic benefits that the parties originally envisioned would flow from the agreement." John Y. Gotanda, *Renegotiation and Adaptation Clauses in Investment Contracts, Revisited*, 36 VAND. J. TRANSNAT'L L. 1461, 1462 (2003).

238. *See* Dionysios P. Flambouras, *The Doctrines of Impossibility of Performance and* Clausula Rebus Sic Stantibus *in the 1980 Convention on Contracts for the International Sale of Goods and the Principles of European Contract Law—A Comparative Analysis*, 13 PACE INT'L L. REV. 261, 278-79 (2001) (quoting Karl Heinz Böckstiegel, *Hardship, Force Majeure and Special Risks Clauses in International Contracts, in* 3 ADAPTATION AND RENEGOTIATION OF CONTRACTS IN INTERNATIONAL TRADE AND FINANCE 159 (Norbert Horn ed., 1985) ("Experienced businessmen . . . normally insert in their contract documents force majeure, hardship clauses, or special risks clauses, thus 'attempting to anticipate and deal with the situation where unforeseen circumstances fundamentally change the contractual equilibrium such that an excessive, normally economic, burden is thrust upon one of the parties.'"). *Force majeure* typically involves a supervening event or change in circumstances (such as acts of God, acts or war, civil commotions, strikes, etc.) that prevents performance or makes it impossible. INT'L CHAMBER OF COMMERCE, PUB. NO. 421, FORCE MAJEURE AND HARDSHIP (1985). By contrast, hardship describes some "change . . . that causes serious economic consequences to a contracting party, thereby rending more difficult performance of his contractual obligations." UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW WORKING GROUP ON NEW INTERNATIONAL ECONOMIC ORDER, LEGAL GUIDE ON DRAWING UP INTERNATIONAL CONTRACTS FOR CONSTRUCTION OF INDUSTRIAL WORKS 242 (1988). For a discussion of renegotiation and adaptation clauses, see Berger, *supra* note 237.

239. The UNIDROIT Principles define hardship as follows:

> There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party's performance has increased or because the value of the performance a party receives has diminished, and
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> (a) the events occur or become known to the disadvantaged party after the conclusion of the contract;
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> (b) the events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract;
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> (c) the events are beyond the control of the disadvantaged party; and
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> (d) the risk of the events was not assumed by the disadvantaged party.

UNIDROIT Principles, *supra* note 130, art. 6.2.2.

view to restoring its equilibrium."[240] And in some circumstances, applicable national law may provide relief in cases of hardship.[241] Concepts such as *force majeure* and hardship would apply to the dispute either pursuant to the parties' contract or as part of the applicable governing substantive law, rather than as a rule of private international law, the substance of which is obligatory in international arbitration.

Moreover, if parties wish to give tribunals the power to do equity, they can confer upon the tribunal the power to decide as *amiable compositeur* or *ex aequo et bono*. This would allow the tribunal to decide "in equity" and enable it to "apply the relevant rules or law to the dispute, but ignore any rules which appear to operate harshly or unfairly in a particular case before it."[242] The abuse of rights doctrine should not, however, be used to circumvent the requirement that "[t]he arbitral tribunal shall decide as *amiable compositeur* or *ex aequo et bono* only if the parties have expressly authorized the tribunal to do so and if the law applicable to the arbitral procedure permits such arbitration."[243] As one tribunal pointed out:

> It is not for the Arbitral Tribunal to question the motives or judgment of the Parties, but to assess their rights and obligations in light of their legally significant acts or omissions. That is all; that is enough. To go beyond this role would be to betray the legitimate expectations reflected in the Parties' agreement to arbitrate, and indeed to impair the international usefulness of the arbitral mechanism.
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> . . .
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> The arbitrators cannot usurp the role of government officials or business leaders. They have no political authority, and no right to presume to impose their personal view of what might be an appropriate negotiated solution. Whatever the purity of

240. UNIDROIT Principles, *supra* note 130, art. 6.2.3(4).

241. *See* Joseph M. Perillo, *Force Majeure and Hardship under the UNIDROIT Principles of International and Commercial Contracts*, 5 TUL. J. INT'L & COMP. L. 5, 27 (1997) (noting that the duty to accept equitable adjustment "approximates the law in countries such as Argentina, Germany, and Italy" (citations omitted)).

242. ALAN REDFERN & MARTIN HUNTER, LAW & PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 127 (3d ed. 1999).

243. U.N. COMM'N ON INT'L TRADE LAW, UNCITRAL ARBITRATION RULES art. 33.2 (1977); *see also* INT'L CHAMBER OF COMMERCE, ICC RULES OF ARBITRATION IN FORCE AS FROM JANUARY 1, 1988, art. 17.3 (1988); LONDON COURT OF INT'L ARBITRATION RULES art. 22.4, *reprinted in* REDFERN & HUNTER, *supra* note 242, app. G; AM. ARBITRATION ASS'N, INTERNATIONAL ARBITRATION RULES art. 28(3), *reprinted in* REDFERN & HUNTER, *supra* note 242, app. D.

> their intent, arbitrators who acted in such fashion would be derelict in their duties, and would create more mischief than good. The focus of the Arbitral Tribunal's inquiry has been to ascertain the rights and obligations of the parties to the particular contractual arrangements from which its authority is derived. [244]

C. *Assisting Tribunals in Calculating Lost Profits*

There are steps that the parties can undertake to assist a tribunal in determining awards of lost profits. For example, parties can set forth in their contract how lost profits are to be calculated in the event of a wrongful breach of contract.[245] Alternatively, parties can use final offer arbitration, also known as baseball arbitration, with respect to the amount of any award of lost profits.[246] This approach calls for each party to propose to the tribunal the amount of lost profits that the claimant should be entitled to; the tribunal would then choose between the two totals. (This procedure would only apply if the tribunal determined that the respondent was liable to the claimant for lost profits.) The advantage of this process is that it forces parties to be more reasonable in their positions (or more realistic in their assessment of their positions) and, in theory, should narrow the difference between the parties concerning the amount of lost profits owed.[247] This procedure may also facilitate settlement of the dispute. As one commentator explains:

> When the only dispute between parties is a numeric value, [as in final offer arbitration,] reasonable final offers provide a midpoint and a range of numbers on which to focus negotia-

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244. UNCITRAL Award of May 4, 1999, *reprinted in* 25 Y.B. COM. ARB. 13, 61 (2000); *see also* Kuwait v. Am. Indep. Oil Co. (AMINOIL), 21 I.L.M. 976, 1015-16 (1982) ("[T]here can be no doubt that, speaking generally, a tribunal cannot substitute itself for the parties in order to . . . modify a contract—unless that right is conferred upon it by law, or by the express consent of the parties . . . [and] arbitral tribunals cannot allow themselves to forget that their powers are restricted.").

245. *See* DOBBS, *supra* note 25, § 12.9, at 247 (stating that parties may agree on a formula for figuring damages, but "may not stipulate for damages that would be a 'penalty'").

246. *See* Loukas A. Mistelis, *ADR in England and Wales*, 12 AM. REV. INT'L ARB. 167, 203 (2001).

247. *See* Jonathan M. Conti, *The Effect of Salary Arbitration on Major League Baseball*, 5 SPORTS LAW. J. 221, 230 (1998); James B. Dworkin, *Salary Arbitration in Baseball: An Impartial Assessment After Ten Years*, ARB. J., Mar. 1986, at 63, 65; *After Successful Use of Baseball Arbitration, Apple, IRS Both Declare Themselves Winners*, 11 ALTERNATIVES TO HIGH COST LITIG. 163, 163 (1993).

> tions. Each side can assess the likelihood that the arbitrator will value the disputed item as worth more or less than the midpoint. This analysis helps the parties predict which offer the arbitrator will choose. . . . [T]his midpoint analysis promotes settlement. Close final offers usually settle because a compromise number is easy to reach. Final offers which are far apart often settle as well because each side fears that the arbitrator will choose the other's offer.[248]

Tribunals also may consider a greater use of experts to assist in evaluating claims for lost profits.[249] As noted, a few tribunals have done so.[250] Employing experts may help the tribunal better understand the complexities involved in calculating damages and may lead to a more reasoned decision.[251] Of course, the drawbacks are that employing experts may increase the cost of resolving the dispute and may slow the process. These potential drawbacks, however, may be outweighed by

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248. Elissa M. Meth, *Final Offer Arbitration: A Model for Dispute Resolution in Domestic and International Disputes*, 10 AM. REV. INT'L ARB. 383, 389-90 (1999) (citations omitted); *see also Companies, Their Insurers, and Coverage Baseball Arbitration Explained, Critiqued and Applied January 2004*, 22 ALTERNATIVES TO HIGH COST LITIG. 95 (2004).

249. The rules of most widely used arbitral institutions, as well as the UNCITRAL Arbitration rules, provide for the use of experts. *See* AM. ARBITRATION ASS'N, *supra* note 243, art. 22; INT'L CHAMBER OF COMMERCE, *supra* note 243, art. 20(4); LONDON COURT OF INT'L ARBITRATION RULES, *supra* note 243, art. 21; U.N. COMM'N ON INT'L TRADE LAW, *supra* note 243, art. 27; *see also* ICC RULES FOR EXPERTISE (Jan. 1, 2003), *reprinted in* 13(2) INT'L CT. ARB. BULL. 15 (Int'l Cham. Comm. Pub. Fall 2002). *See generally* INST. OF INT'L BUS. LAW AND PRACTICE, ARBITRATION AND EXPERTISE (Louise Barrington ed., 1994). The authors of one of the leading treatises on international arbitration note:

> In international commercial arbitration, the arbitration tribunal is usually composed of lawyers. Where matters of a specialist or technical nature arise, such an arbitral tribunal often needs expert assistance in reaching its conclusions, in order "to obtain any technical information that might guide it in the search for truth." For example, . . . [e]xpert help may be needed to investigate the quantification of a claim.

REDFERN & HUNTER, *supra* note 242, at 323-24 (citations omitted).

250. *See, e.g.*, Starrett Housing Corp. v. Islamic Republic of Iran, 16 Iran-U.S. Cl. Trib. Rep. 112, 113 (1988); Final Award in Case No. 7181 of 1992, 21 Y.B. COM. ARB. 99, 111 (1996); *see also* Lieblich, *supra* note 165, at 76 (noting a trend of economists and specialists in finance in valuation matters).

251. *See* Ball, *supra* note 6, at 418; *cf.* Richard Posner, *An Economic Approach to the Law of Evidence*, 51 STAN. L. REV. 1477, 1539 (1999) (stating that a "way to deal with the problem of the unintelligibility of complex expert testimony would be more frequent appointment of court-appointed experts").

the benefits, especially when substantial sums are involved.[252]

Tribunals also should be mindful that, where the claimant seeks both *damnum emergens* and the *lucrum cessans*, they need to be careful to avoid double counting to ensure the claimant obtains the benefit of the bargain and no more.[253] As one tribunal explained,

> future net cash flow generally includes all amortization of investment there will ever be. To ask for the full amount of the future revenue stream when also claiming recoupment of all investment is wanting your cake and eating it too. If the DCF method is applied in a contractual scenario to measure nothing but net cash flow (thus excluding the accrual accounting notion of 'income' which may cover non-cash items such as depreciation), there is no room for recovery of wasted costs. In other words, when the victim of the breach of contract seeks recovery of sunken costs, confident that it is entitled to its *damnum*, it may go on to seek lost profits only with the proviso that its computations reduce future net cash flows by allowing a proper measure of amortization.[254]

VI. CONCLUSION

Today, there is a universal consensus that a party who has been injured by a wrongful breach of contract is entitled to be placed in the

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252. *See* REDFERN & HUNTER, *supra* note 242, at 326 (stating that while "it would be very expensive . . . for parties to produce evidence from independent experts, and then for the arbitral tribunal to appoint one or more experts of its own . . . to assess th[e] evidence[,] . . . where the technical issues involved are sufficiently complex, or where the amounts at stake are sufficiently large, this possibility cannot be ruled out").

253. *See* Wells, *supra* note 198, at 477.

254. Himpurna Cal. Energy Ltd. v. PT. (Persero) Perusahaan Listruik Negara, *reprinted in* 25 Y.B. COM. ARB. 13, 73 (Berm.-Indon. 2000). The arbitrator in the *Sapphire* case noted:

> "[The plaintiff should be] put . . . in the same pecuniary position as they would have been in if the contract had been performed. But the repayment of the expenses incurred in concluding the contract would tend to put them in the position they would be in if the contract had never been concluded (negative damages). . . . Undoubtedly, the plaintiff was justified in hoping to recover the expenses of making the contract out of the profit which they were expecting. But this is an element included in the compensation for loss of profit. Adding positive and negative damages together is a contradiction, and cannot be allowed."

Sapphire Int'l Petroleums Ltd. v. Nat'l Iranian Oil Co., Arbitral Award (Mar. 15, 1963), *reprinted in* 35 I.L.R. 136, 186-87 (1967).

position the party would have been in had the contract been performed. Therefore an injured party is entitled to recover both losses incurred as well as gains of which it was deprived because of the breach. While national laws impose different requirements and limitations on the recovery of lost profits, the differences, in general, have not been problematic for tribunals deciding transnational contract disputes. Rather, it is the calculation of lost profits that has proved troublesome and has resulted in different treatment for similarly situated parties. Of particular note has been conflicting tribunal awards resulting from the application of the new business rule and the abuse of rights doctrine as an international legal principle. Neither should limit a legitimate claim for lost profits. To do so would leave the injured party less than whole, fail to achieve the goal of full compensation, and provide a windfall to the wrongdoer. The current problems associated with the calculation of lost profits also could be reduced if parties set forth in their agreement the method that the tribunal is to use to calculate lost profits in the event of a breach of contract and if tribunals more actively employ their own experts to help understand the complex process of calculating damages.