Availability of the Disgorgement of Profits Under the CISG

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ABSTRACT

The United Nations Convention on Contracts for the International Sale of Goods (CISG or the Convention) does not expressly state whether the remedy of disgorgement of profits can be awarded in cases of breach of contract. In this article, we argue that the disgorgement of profits is available both as a method for the calculation of damages under Art. 74 and as a remedy on its own when the remedy of compensatory damages fails to fulfill its functions. Therefore, we argue that the disgorgement of profits is in line with Art. 7(1) and Art. 7(2) of the Convention. However, the availability of the disgorgement of profits shall not be understood as undermining the primacy of compensatory damages and should be accepted only in exceptional cases, namely where second sales of non-substitutable goods and breaches of certain contractual stipulations make the calculation of loss impossible or impracticable.

1. INTRODUCTION

When looking at the remedies system of the United Nations Convention on Contracts for the International Sale of Goods' (CISG), typical contract law remedies that can generally be found in national legislations are apparent, such as avoidance, specific performance, damages, the right to withhold performance and the right to ask for repair or replacement. However, the remedy of disgorgement of profits is nowhere mentioned in the Convention, *travaux préparatoires*, or initial commentaries.[1] This should not come as a surprise because the disgorgement of profits has only recently become a popular academic and judicial topic,[2] and when the Convention was drafted, it was not thought of as a remedy in case of a breach.[3] The primary remedy for a breach of contract in common law systems has traditionally been damages and, in civil law, specific performance;[4] therefore, the theoretic race between the remedies has concerned these two, leaving the disgorgement issue out of the discussion. It follows that the (unconscious) absence of the disgorgement of profits alone does not allow us to claim that the

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[1] Nils Schmidt-Ahrendts, 'Disgorgement of Profits under the CISG', in Ingeborg Scwenzer and Lisa Spagnolo (eds), *State of Play: The 3rd Annual MAA Schlechtriem CISG Conference (International Commerce and Arbitration)* (Eleven International Publishing 2010), 96.

[2] Mathias Siems, 'Disgorgement of Profits for Breach of Contract: A Comparative Analysis' (2003) *7 Edinburgh Law Review* 27, 43.

[3] See Schmidt-Ahrendts (n 1), 96.

[4] See for example Jacob S. Ziegel, 'The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives', in Galston & Smit (eds), *International Sales: The United Nations Convention on Contracts for the International Sale of Goods* (Matthew Bender 1984), Ch. 9, 8-9.

Convention excludes this remedy.[5] Therefore, it becomes imperative to discuss from a theoretical and practical perspective whether there is any scope for allowing the disgorgement of profits under the CISG because, as Schwenzer and Hachem have correctly stated, if the CISG fails to adapt to the new circumstances and dynamic nature of international trade, it is doomed to lose popularity and uniform application.[6]

The purpose of this article is to discuss whether and how the aggrieved party may be granted the profits made by the breaching party under the CISG. The discussion is two-pronged. The first question we will try to answer is whether the disgorgement of profits can be inferred from an interpretation of the CISG's existing stipulations, particularly Art. 74, in accordance with Art. 7(1) of the Convention. The second question is whether there is an internal gap within the Convention and, if so, whether this gap can be filled in light of Art. 7(2) of the Convention in a way that allows for the disgorgement of profits realized by the aggrieved party.

Before analyzing whether the breaching party can be successfully stripped of their gains under the relevant provisions of the CISG, it would be helpful to understand what is meant by the disgorgement of profits through a comparative lens.

2. UNDERSTANDING THE REMEDY OF DISGORGEMENT OF PROFITS

The remedy of disgorgement of profits can be briefly summarized as stripping the breaching party of the gains they made through the breach of contract. Its contrast with the ordinary remedy of damages is clear: the former takes into account the change in the economic position of the breaching party, whereas the latter is based on the loss that the innocent party has suffered.[7] In other words, the first impression that the disgorgement remedy gives is that it is not concerned with the position of

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[5] Milena Djordjevic, 'Article 74', in Stefan Kröll, Loukas Mistelis and Pilar Perales-Viscassilas (eds), *UN Convention on Contracts for the International Sales of Goods (CISG)* (2nd edn, Beck Hart Nomos 2018) para 61.

[6] Ingeborg Schwenzer and Pascal Hachem, 'The Scope of the CISG Provisions on Damages', in Djokhongir Saidov and Ralph Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (Hart Publishing 2008), 93.

[7] Djordjevic (n 5), para 62; Schmidt-Ahrendts (n 1), 93; Lionel Smith, 'Disgorgement of the Profits of Breach of Contract: Property, Contract and Efficient Breach' (1994) *24 Canadian Business Law Journal* 121, 122; Onni Rostila, *Disgorgement and the CISG - Comparative and Future Perspectives*, Thesis, University of Lapland, Finland, 2017, 13. The disgorgement of profits has even been described as the mirror image counterpart (*das spiegelbildliche Gegenstück*) of the damages. See Tobias Helms, *Gewinnherausgabe als haftungrechtliches Problem* (Mohr Siebek 2007) 3.

the aggrieved party but rather that of the breaching party. There are two crucial questions following this first impression. The first question is whether this first impression can be misleading in certain cases. The second question is whether the correctness of this first impression should completely exclude the possibility of the disgorgement of profits under the CISG. In other words, even though the remedy of disgorgement of profits may contradict the main principles of compensatory damages, should this contradiction be interpreted as meaning that there is no room for disgorgement?

The general approach to the disgorgement of profits implies a certain prejudice that this remedy is of a punitive character[8] and therefore has no place in a system that does not give rise to punitive or preventive remedies in the field of private law.[9] In fact, this bias can also be seen in comparative findings. Generally speaking, the systems that regulate the disgorgement remedy one way or another usually permit it only in exceptional circumstances and usually in tortious liability cases or in cases of *negotiorum gestio*.[10] However, it is usually disregarded that the disgorgement does not have to be understood as a *sui generis* and possibly punitive remedy, but also as a way of calculating damages.[11] In the latter case, the disgorgement of profits is renamed by some authors as "gain-based damages,"[12] and this choice phrase (which is perhaps at first glance surprising or even oxymoronic) articulates that the objective is compensating the aggrieved party, even though the position of the breaching party is taken into account. When analyzing whether there is a place for disgorgement within the Convention's system of remedies, this distinction always has to be kept in mind. Nonetheless, the line between the punitive and compensatory types of disgorgement of profits is not always easily drawn.

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[8] Djordjevic (n 5), para 65.

[9] See e.g., Nils Schmidt-Ahrendts and Mark Czarnecki, 'Article 74', in Christoph Brunner (ed), *UN Kaufrecht- CISG* (2nd edn, Stämpfli Verlag 2014) para 18.

[10] For a comparative overview of the disgorgement of profits under various legal systems, see Ewoud Hondius and Andre Janssen (eds), *Disgorgement of Profits - Gain-Based Remedies throughout the World* (Springer 2015). For a detailed and comparative study of the concept of *negotiorum gestio*, see Duncan Sheehan, '*Negotiorum Gestio:* A Civilian Concept in the Common Law?' (2006) *55 The International and Comparative Law Quarterly* 253.

[11] Helms (n 7) 5–6, Marius Jan Stucki, *Vorteilsherausgabe nach vorsätzlichen Vertragsverletzungen im nationalen und internationalen Recht*, Thesis, Universität Bern, Switzerland, 2018, 83.

[12] See e.g., Djordjevic (n 5), para 63; James Edelman, *Gain-Based Damages: Contract, Tort, Equity and Intellectual Property* (Hart Publishing 2002) 21; Jessica Rickett, 'Disgorgement for Breach of Contract: My Loss, Your Gain' (2001) *9 Auckland University Law Review* 375, 376.

Independent of the punitive/preventive or compensatory nature of the disgorgement remedy, the goal remains the safeguarding of the principle of *pacta sunt servanda*. In other words, the disgorgement of profits is thought to motivate the parties to fulfill their contractual obligations.[13] From this perspective, the disgorgement remedy seems to be in line with CISG Art. 7(1), which sets the observance of good faith in international trade as a general goal.[14] Due to its limited scope, this article is not the right place to discuss what is meant by good faith, as the issue represents an eternal debate. However, it would not be wrong to assume that the philosophy of the Convention is to prevent or deter opportunistic behavior; therefore, Art. 7 may be considered an argument in favor of allowing the remedy of disgorgement of profits.[15] Nevertheless, another important provision that should be considered is Art. 74, which embodies the principle of full compensation.[16] At first glance, the disgorgement remedy appears to contradict Art. 74 of CISG because the former takes into account the profits made by the breaching party, whereas the latter depends on the loss suffered by the other party. However, there may be circumstances in which it is impossible or impracticable to calculate the loss, or there may be no way other than the disgorgement of profits to assure the performance of the contract.

To assess whether there is any scope for allowing the disgorgement of profits under the CISG, this article will take into consideration two different scenarios as a starting point. The first is the second sales cases in which the seller breaches the contract by selling the promised goods (naturally at a higher price) to a third party. The other scenario is the cases in which one of the parties breaks a contractual clause related to an issue other than the delivery of goods and the payment of the purchase price (e.g., a non-compete clause). Some authors refer to the latter as "agency problem cases" because they almost always stem from a principal–agent problem where the party to the contract is not in an optimal position to monitor a potential breach by the other.[17] At the risk of reducing the excitement of the reader, perhaps it should be stated that the remedy of

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[13] Schmidt-Ahrendts (n 1), 93.

[14] Edgardo Muñoz and David Obey Ament-Guemez, 'Calculation of Damages on the Basis of the Breaching Party's Profits under the CISG' (2017) 8 *Journal of International Commercial Law* 201, 208; Florence Eicher, 'Pacta Sunt Servanda: Contrasting Disgorgement Damages with Efficient Breaches under Article 74 CISG' (2018) *LSE Law Review* 29, 33.

[15] See Eicher (n 14), 35.

[16] Schmidt-Ahrendts and Czarnecki (n 9), para 8.

[17] Katy Barnett, *Accounting for Breach of Contract: Theory and Practice* (Hart Publishing 2012), 4.

disgorgement of profits finds meaning (and more importantly, legitimacy) only in cases where the damages become dysfunctional or inadequate to remedy a breach,[18] which is, in fact, the common characteristic shared by these two scenarios.

3. THE CASE OF SECOND SALES

A frequently encountered breach of a sales contract is when the seller resells the goods that were promised to the first buyer beforehand. The seller does this knowing full well that they will have to compensate the buyer's loss, but they proceed with a second sale anyway because they will most likely profit despite the compensation obligation.[19] In other words, the seller — usually a merchant who is supposed to be a *homo economicus* — breaches the contract because they believe it is economically profitable or efficient to do so. In principle, in the case of such a breach of contract, the compensation of the buyer for the loss suffered is the sufficiently adequate remedy, and the disgorgement of profits is not necessary at first sight.[20] However, there may be situations in which the compensatory damages fail to remedy the breach and put the buyer in an equivalent economic position as if there had been no breach. It is in those cases exactly that the remedy of disgorgement of profits may be allocated a compensatory role.

The typical situation wherein the criterion of "loss suffered" fails to provide adequate compensation for the buyer in the case of a second sale is when the goods are of a unique nature.[21] It goes without saying that the concept of uniqueness can be understood in different ways and there is no universal guide for its interpretation. In our view, uniqueness shall always be correlated with the possibility of substitution.[22] The possibility of substitution means that the goods are purchasable from another seller, even if they might be sold at a higher price and/or under less favorable contractual conditions. If the goods are bought at a higher price than in the original contract, the difference in the price constitutes at least part of the damages. A custom-designed energy turbine, a special type, and vintage of wine or a piece of art may all be non-substitutable. In all of these cases, the price of the resale contract may be thought of as equal to

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[18] See also Ernest J. Weinrib, 'Punishment and Disgorgement as Contract Remedies' (2003) *78 Chicago-Kent Law Review* 55, 55–6.

[19] Muñoz and Ament-Guemez (n 14), 205.

[20] Barnett (n 17), 94. See also Anne Florence Bock, *Gewinnherausgabe als Folge einer Vertragsverletzung* (Helbing Lichtenhahn Verlag 2010), 56.

[21] Barnett (n 17), 94.

[22] See Barnett (n 17), 94 ff.

the loss that the aggrieved party has suffered because there is no other way to calculate the loss.[23]

Granting the aggrieved party the chance to strip the seller of the profits made from the second sale is (in exceptional cases such as these) in line with the principle of full compensation embodied in Art. 74. The principle of full compensation - usually put forward as a counterargument for the disgorgement of profits[24] - requires that the aggrieved party not be overcompensated because of the breach of contract. In other words, if the breaching party has made a profit, even though they are obliged to compensate the aggrieved party, such an economically efficient transaction should be respected.[25] Nevertheless, as much as the principle of full compensation can be interpreted as an obstacle to the possibility of granting the disgorgement of profits, the opposite reasoning can also be deduced in exceptional cases. That is because the mirror image of the prevention of overcompensation is the prevention of undercompensation. As expressly noted by the CISG Advisory Council in their 6th opinion, Art. 74 of the CISG aims to "compensate the aggrieved party for all the disadvantages suffered as a result of the breach."[26] Hence, if not taking into account the gains made by the party in breach of contract will result in undercompensation of the aggrieved party, such a path should be allowed. This is, as mentioned above, first and foremost the case in the sale of unique goods. In these cases, the remedy of disgorgement of profits is not only in line with the principle of full compensation but also the most efficient way of calculating damages.[27] The basic idea is that if the seller was able to find an alternative purchaser at a higher price, the buyer could have too.[28] This reasoning alone proves that the compensation-only dogma (as Burrows puts it) is not corroborated by either the principles or policies of the Convention.[29]

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[23] See Djordjevic (n 5), para 62.

[24] Djordjevic (n 5), para 63; Schmidt-Ahrendts (n 1), 93.

[25] It is usually stated that the disgorgement of profits is an inefficient remedy in contract law according to cost analysis because it prevents a more efficient allocation of resources. For a thorough discussion on this topic, see Sidney DeLong, 'The Efficiency of a Disgorgement as a Remedy for Breach of Contract' (1989) *22 Indiana Law Review* 737.

[26] CISG-AC Opinion No. 6, Calculation of Damages under CISG Article 74. Rapporteur: Professor John Y. Gotanda, Villanova University School of Law, Villanova, Pennsylvania, USA.

[27] DeLong (n 25), 747. See also Muñoz and Ament-Guemez (n 14), 212.

[28] DeLong (n 25), 748.

[29] Andrew Burrows, 'Are "Damages on the Wrotham Park Basis" Compensatory, Restitutionary, or Neither?', in Djokhongir Saidov and Ralph Cunnington (eds), *Contract Damages: Domestic and International Perspectives* (Hart Publishing 2008), 175 ff.

We believe that the uniqueness of the resold goods would not be the problematic part of assessing the possibility of substitution. What is more challenging is to decide whether the disgorgement of profits shall be allowed in cases where the goods are not of a unique nature, but they are also not easily substitutable due to special circumstances. The famous *Adras* case before the Supreme Court of Israel represents an interesting example of the latter scenario.[30] It should be noted that even though the *Adras* case was not governed by the CISG but by its predecessor, the Convention relating to a Uniform Law on the International Sale of Goods ('ULIS'), and the decision regarding the disgorgement of profits was not based on ULIS but on national law on unjust enrichment, the facts remain interesting for our discussion.

In the *Adras* case, an Israeli buyer and a German seller agreed on the sale of 7,000 tonnes of iron. The delivery was delayed and ultimately only partially performed due to the outbreak of the Yom Kippur war. The seller then sold the remaining iron to a local buyer at a higher price. The buyer succeeded in stripping the seller of the profits made through the resale of the goods. The grounds on which the judgment was given will not be discussed here as they are principally concerned with the availability of recourse to domestic rules on unjust enrichment despite the presence of a contract, rather than the availability of the disgorgement of profits in case of a breach of contract in the context of the ULIS itself. Allow us to twist the facts of the case slightly in order to demonstrate what is problematic in terms of the issue of substitutability.

In our hypothetical *Adras*-like case, the German seller agrees to sell 7,000 tonnes of iron to an Israeli buyer, and due to the outbreak of war, no one else can either produce or sell iron to the buyers in this country. The German seller opportunistically breaches the contract and sells the iron to another buyer at a higher price. Could the buyer in the first contract have a claim on this sale's price? We believe that the answer to this question should be affirmative, not because the goods are unique (they are, in fact, qualified as generic goods), but because they are not easily substitutable from elsewhere under the given conditions. Therefore, as it is not possible for the buyer to prove their loss based on a concrete or abstract cover transaction, the second sale shall be taken as a handle point in assessing the quantum of loss.[31]

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[30] *Adras Chmorey Binyan v. Harlow & Jones GmbH,* Supreme Court of Israel, 2 November 1988, available at http://cisgw3.law.pace.edu/cases/881102i5.html.

[31] It should be noted that, in the context of second sales, restricting the application of the remedy of disgorgement of profits to cases in which the goods are not easily substitutable is in line with the principle of mitigation of loss embodied in Art. 77 of the CISG, which

The comparative findings also support allowing the disgorgement of profits as a means of calculating loss (i.e., the gain-based damages). We see perhaps the most explicit recognition of gain-based damages in Dutch law.[32] Under the Dutch Civil Code Art. 6:104, in case of compensation for loss arising from contractual or tortious liability, if the judge deems it fair, they may allow the disgorgement of profits on the condition that the aggrieved party makes such a request. This rule is especially important if the amount of the loss cannot be proved and/or if the aggrieved party has incurred significantly less loss compared to the gains made by the breaching party.

However, it should be noted that the stipulation under the Dutch Civil Code is exceptional.[33] For instance, neither the German Civil Code (BGB), the Swiss Code of Obligations (OR)[34] nor the Turkish Code of Obligations (TCO)[35] expressly approves this method of calculating loss. According to Art. 50/II of the TCO and Art. 42/II of the OR, "Where the exact value of the loss or damage cannot be quantified, the court shall estimate the value at its discretion in the light of the normal course of events (…)." On the other hand, these provisions that give significantly wide discretion to judges do not prohibit taking into account the profits made by the breaching party when assessing the quantum of damages. Therefore, it would not be wrong to conclude that a judge may use their

stipulates that "a party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss....". In the case of second sales, this means that the aggrieved party shall, within an appropriate period of time and at a reasonable price, purchase substitute goods in order to keep their loss as low as possible. It has been (in our view rightfully) put forward that the general availability of the disgorgement of profits in cases of second sales would disincentivize the aggrieved parties to mitigate the loss. Therefore, the principle of mitigation requires limited recourse to the remedy of disgorgement of profits, as suggested by this article. In common law scholarship, one may encounter another distinction, namely the one between contracts concerning particular or determined goods and those concerning indeterminate instances of a type of a thing. According to this distinction, if the contract of sales was related, the disgorgement remedy does not apply (e.g., in the sale of bushels of merchantable wheat, because no particular wheat was promised). See, e.g., Nicholas W. Sage, 'Disgorgement: From Property to Contract' (2016) 66 *University of Toronto Law Journal* 244, 253–5. We believe that this distinction cannot be applied either in principle or authority to the CISG.

[32] Stucki (n 11), 84.

[33] Stucki (n 11), 84; Bock (n 20), 135.

[34] Bock (n 20), 135; Ece Baş Süzel, *Gerçek Olmayan Vekaletsiz İş Görme - Menfaat Devri Yapturım* (On Iki Levha 2015), 157 ff.

[35] Other than Art. 50/II of TCO, there are special regulations regarding gain-based damages under Turkish law. See Baş Süzel (n 34), 157 ff.

discretion to strip the breaching party of the profits made through the breach in the name of compensation[36].

When it comes to German Law, §285 BGB sheds light on the possibility of the disgorgement of profits in the case of second sales.[37] According to this section, if the seller has sold the unique or nonfungible goods initially promised to the buyer to a third party, the original buyer has a right to claim the substitute performance (i.e., the profits made by the breaching party).[38] However, it should be recognized that, in cases beyond the scope of impossibility and §285 BGB, the current standing of the German doctrine seems rather in opposition to the disgorgement of profits.[39]

In English law, the disgorgement of profits for breach of contract can be considered a rather recent development following the groundbreaking decision made by the House of Lords in 2000.[40] However, it should not go without saying that, in English law, one of the main requisites for gain-based damages is the inadequacy of the remedy of compensatory damages.[41] In other words, the disgorgement of profits is considered a subsidiary remedy or supplementary method that adds to the already existing and conventional remedies.[42]

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[36] See, e.g., Stucki (n 10), 83–5 for Swiss law and Baş Süzel (n 34), 157 ff for Turkish law.

[37] See Helms (n 7) 310; Franz Hofmann, 'Gewinnherausgabe bei Vertragsverletzungen' (2013) 213 Archiv für die civilistische Praxis 469, 477 ff.; Reinhard Zimmermann, 'Damages and Interest', in Reinhard Zimmermann and Nils Jansen (eds), *Commentaries on European Contract Laws* (OUP 2018), 1464.

[38] Siems (n 2), 36 ff.

[39] In German law, the principle is the same as in Turkish/Swiss law, which is full compensation and a sum equal to the loss. According to §249 BGB, "A person who is liable in damages must restore the position that would exist if the circumstance obliging him to pay damages had not occurred." Regarding the loss of profits, there is a special regulation in §252 BGB: "The damage to be compensated for also comprises the lost profits. Those profits are considered lost that in the normal course of events or in the special circumstances, particularly due to the measures and precautions taken, could probably be expected." To ask for a loss of profit, the aggrieved party only needs to prove the circumstances that give rise to the probability of profit without a loss event. The prevailing view suggests that the profits of the breaching party cannot be claimed as damages.

[40] *Attorney General v. Blake and Another* [2000] UKHL 45; [2000] 4 All ER 385; [2000] 3 WLR 625 (27th July, 2000).

[41] Edelman (n 12), 154; Solène Rowan, *Remedies for Breach of Contract: A Comparative Analysis of the Protection of Performance* (OUP 2012), 157.

[42] Rowan (n 41), 158.

4. THE CASE OF BREACH OF OBLIGATION OTHER THAN THE DELIVERY OF THE GOODS AND PAYMENT OF THE PURCHASE PRICE

The other scenario in which the disgorgement of profits may be used as an efficient and adequate remedy in case of a breach of a sales contract is when one of the parties breaches an obligation other than the primary obligations, namely the delivery of the goods and the payment of the purchase price. Such a breach usually (but not necessarily) occurs when one of the parties breaches a negative provision of the contract, such as the obligation *not* to resell the goods within a certain time limit or, in certain areas, the obligation *not* to violate fair-trade standards or the obligation *not* to employ children during the production process, etc. As mentioned before, some authors refer to them as "agency problem cases" because they almost always include problems of information asymmetry and monitoring difficulties, which are inherent in the general concept of the principal–agent problem.[43]

Correlating cases of this type with the remedy of disgorgement of profits seems more controversial than the previous category of second sales. That is because the preventive character of the disgorgement of profits makes its presence more strongly felt, and these cases bring into mind what common law lawyers refer to as "restitution for wrongs,"[44] which is based on the idea that no one shall be permitted to profit from their wrongdoing.[45] More clearly, it invites notions of prevention and punishment.

The obvious commonality between this line of cases and the previous category of second sales is the difficulty in calculating and proving the loss. If the seller breaches the negative contractual stipulation of non-compete and sells the goods to someone else, could the buyer claim the disgorgement of the profits the seller made through the sale? If the seller violates a contractual clause foreseeing that the seller has to comply with certain fair-trade rules or a prohibition regarding the

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[43] Barnett (n 17), 118.

[44] Rickett (n 12) 376. For a similar expression, see Smith (n 6) 121 ff.

[45] John D. McCamus, 'Disgorgement for Breach of Contract: A Comparative Perspective' (2003) 36 Loyola of Los Angeles Law Review 943, 945; Edelman (n 12), 81. See also CISG-AC Opinion No. 6 (n 25) para 2.4: "Furthermore, from a policy perspective, the breaching party should not be able to escape liability because the breaching party's wrongful act caused the difficulty in proving damages with absolute certainty." Even Posner, who is one of the pioneers of the efficient breach doctrine, has stated that an exception should be made for opportunistic breaches of contract and disgorgement of profits shall be allowed in these cases. See Richard A. Posner, *Economic Analysis of Law* (5th edn, Aspen Law & Business 1998), 130–1.

employment of children, could the buyer strip the seller of any gains that are equal to the savings the seller made as a result of this breach? Allow us to make a circular argument and start the reasoning from the result. Assuming that the parties have not agreed on a penalty or liquidated damages clause in their contract, if the aggrieved party fails to prove or fully calculate the loss that they have suffered following the breach of such a contractual stipulation, unless the judge or arbitrator allows the disgorgement of profits the breaching party has made, the violated contractual clause has no economic value and is no different from a mere compilation of words with no legal force. The contractual stipulation only has an economic value if the aggrieved party is substantially compensated one way or another. In other words, the remedy of disgorgement of profits in these cases seems in line with the hypothetical intention and agreement of the parties, which admittedly lends some weight to the implied contractual clause argument.[46]

The parties to an international sales contract are by definition merchants.[47] That means that if the parties have agreed on a contractual clause providing for a non-compete deal or prohibiting the use of child workers, for example, this should be considered as reflected in the contract price.[48] It follows that the buyer or the seller, upon agreeing to a contractual stipulation related to an issue other than the delivery of the goods and the payment of the price for the goods, has paid an extra premium. The presumed existence of this premium indicates that the parties also wished for this obligation to be performed or, in the case of non-performance, for an adequate remedy to be granted. The parties are in principle free to contract a penalty clause or liquidated damages, but even if they fail to do so, this shall not mean that they have waived any pecuniary outcome for the breach.[49] Therefore, the remedy of disgorgement of profits seems perfectly in line with the hypothetical intention of the parties, which begs the question: is it in line with the general principles of the Convention?

It would not be wrong to say that the question of the availability of disgorgement of profits is only one part of the wider problem of the

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[46] See, e.g., Richard O'Dair, 'Restitutionary Damages for Breach of Contract and the Theory of Efficient Breach: Some Reflections' (1993) 46 *Current Legal Problems* 113, 122 ff.

[47] Article 2/1(a) of the CISG excludes consumer sales.

[48] See Schmidt-Ahrendts (n 1), 101.

[49] See also Hofmann (n 37), 503–4.

applicability of what is referred to as the performance principle.[50] The developing recognition of the enforcement of performance interests has also given rise to the broader availability of the disgorgement remedy, especially in common law countries.[51] Unlike the economic benefits principle, the performance interest principle takes into account what the creditor could have reasonably expected from the performance of the contract.[52] The traces of this principle can be easily found in various articles of the Convention, such as Art. 46, which provides for a claim for repair or replacement in case of defective performance. This indicates that the Convention does not simply reduce the contractual claims to pecuniary loss but adopts a wider approach that lends support to the performance interests of the aggrieved parties.

This deduction is also closely related to the preferred philosophical approach to the concept of a contract in a given system. If a system looks at contracts from the perspective of Holmes,[53] which assumes that a contract gives the breaching party an option between performing or paying damages, it would be difficult to argue that the remedy of disgorgement of profits has a leg to stand on in this system — at least not as a remedy for a breach of contract *simpliciter*.[54] However, if a system adds a moral element to the contract or makes the safeguarding of the contract one of its principal objectives, either to increase trust in the system or to reduce transaction costs and overall economic waste, then the disgorgement of profits may have a place in the given system. This principle, also known as *pacta sunt servanda* (which is one of the general

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[50] See Brian Coote, 'Contract Damages, Ruxley, and the Performance Interest' (1997) 56 *The Cambridge Law Journal* 537, 541; Schwenzer and Hachem (n 5), 93 ff; Ingeborg Scwenzer, Pascal Hachem and Christopher Kee, *Global Sales and Contract Law* (OUP 2012), paras 44.22 ff. For a critical approach to the relationship between the performance principle and gain-based awards, see Rowan (n 41), 160 ff.

[51] Sage (n 31), 244.

[52] See also Schwenzer, Hachem and Kee (n 50) paras 44.27 ff. The fact that the damages for a breach of contract under the CISG are based on the expectation interest principle supports this view. See Rostila (n 6), 3.

[53] Oliver Wendell Holmes, 'The Path of the Law' (1897) 10 *Harvard Law Review* 457, 462: "the duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it,- and nothing else."

[54] Our anaylsis in this article is limited to cases of breach of a *sales* contract, thus a contract *simpliciter*. This is important because it essentially takes the morality argument out of the equation, unlike the breach of a fiduciary relationship. Even though the concept of an opportunistic or cynical breach can also appear in sales contract cases, making a distinction between different types of breaches seems in line with neither the principles of the Convention nor the practicability requirements. See also McCamus (n 45), 961.

principles of the Convention),[55] necessitates the refusal of the first view that oversimplifies the contract as an option between performance or compensation and provides for at least a *prima facie* approval of the disgorgement of profits as a remedy available under the CISG.[56]

As noted earlier, in case of a second sale of unique or non-substitutable goods, the disgorgement of the profits made through the breach does not in itself contradict the damages-only perspective (in other words, the economic benefit principle). However, the issue becomes more complicated in case of a breach of a contractual stipulation other than the delivery of goods or the payment of the price because determining the economic benefit tied to the specific contractual clause can be difficult unless the parties have agreed on a penalty clause or liquidated damages.

Schwenzer and Hachem argue that almost every contractual clause has a determinable market value.[57] According to them, if the seller breaches a contractual stipulation, such as the prohibition of employing children, the loss suffered can be easily determined, as there is also a market for goods sold by the sellers who employ children. This may seem correct at first sight; however, it begs the question of how such market value is to be proven. It is one thing to accept that the buyer has a performance interest that should be safeguarded, and the disgorgement of the profits made by the breaching party assures this; it is another thing to look for the market price of the goods produced or sold under the circumstances that were meant to be avoided in the contract.

The value allocated to contractual stipulations of this kind does not always constitute a competitive element; hence, it is not always calculable. More clearly, the existence of an assumed premium paid by the parties does not always mean that this premium is quantifiable or equal to any similar commercial transaction. We believe that the difficulty and sometimes impossibility of determining the market value of the breach is the main reason why the disgorgement of profits should be considered the most suitable remedy in this category of cases. However, the difference between this line of thought and the one put forth for the first category of cases should be underlined. This theoretical distinction is further elaborated below.

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[55] Ulrich Magnus, 'Die allgemeinen Grundsätze im UN-Kaufrecht' (1995) 59 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 469, 480.

[56] See Schmidt-Ahrendts (n 1), 93.

[57] Schwenzer and Hachem (n 5), 96.

5. DISGORGEMENT OF PROFITS AS A WAY OF CALCULATING LOSS OR AS A REMEDY ON ITS OWN

The disgorgement of profits as the odd one out is a direct result of the fact that the concept of disgorgement is insufficiently understood by the courts, lawyers, and scholars.[58] There is no general consensus on when it can or should be awarded and under what conditions. In this part, we try to clarify that there are two possible (and not mutually exclusive) ways of understanding and adapting the disgorgement of profits under the Convention. Before moving forward with these explications, it should be underlined that the inadequacies of compensatory damages represent the point of origin for both. In other words, as Weinrib has correctly stated, the disgorgement of profits cannot be considered in isolation from the goals and the possible ineffectiveness or insufficiency of the remedy of damages.[59]

As mentioned above, the discussion of the compatibility of the disgorgement of profits with the CISG may follow two possible paths. The first possibility is to accept that the availability of the disgorgement of profits can be deduced from an in-depth and accurate interpretation of the Convention's articles in light of Art. 7(1).[60] To be more precise, this part of the discussion is concerned with the fitness of the disgorgement of profits in one of its articles, which in our case is Art. 74 on damages.[61] The question is, therefore, whether the wording and the *ratio legis* of Art. 74 permit the judge or arbitrator to award the disgorgement of profits made by the breaching party. We have concluded that such an interpretation of Art. 74 is possible; however, it should be restricted to exceptional cases.[62]

The most typical example of this set of cases is when the seller sells the promised goods to a third-party buyer, often at a higher price than in the first contract. In this type of case, the loss suffered by the aggrieved party is generally calculable, either through the price of a cover transaction (which is also referred to as the concrete method)[63] or the market price

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[58] On the same view for common law systems, see Sage (n 31), 245.
[59] Weinrib (n 18), 55.
[60] See e.g. Schmidt-Ahrendts (n 1), 92.
[61] See Muñoz and Ament-Guemez (n 14), 205 ff.
[62] Muñoz and Ament-Guemez (n 14), 205–6.
[63] See Article 75 of the CISG. On the issue of whether the price difference between the first contract and the cover transaction could be claimed even if the contract were not avoided, see Peter Schlechtriem and Petra Butler, *UN Law on International Sales* (Springer 2009), 216 ff.

(the abstract method).[64] If a convincing calculation through one of those methods is possible, then there is no need to discuss whether the profits made through the breach can be taken as a starting point for the quantification of loss. This would only be relevant if the loss were incalculable without taking the second sale price into account. As mentioned above, in an economic world where almost every type of good that can be the subject of an international sales contract has a determinable price, only the second sales of unique or non-substitutable goods would be relevant for assessing the applicability of the disgorgement of profits.

Even though the observance of good faith in international trade is one of the main objectives of the Convention, it does not follow that it aims to deter every kind of breach of contract. In other words, if the buyer is put in the same economic position as they would have been had the breach not occurred, despite the undercompensation risk that is embedded in the remedy of damages,[65] the wording and the rationale of Art. 74 require damages to be the primary and default remedy. However, when it comes to goods that cannot be the subject of a cover transaction or those without a market price (in other words, in those cases where the aforementioned common methods of calculation of loss fail to function), the interpretation of Art. 74 in light of Art. 7(1) of the Convention, which requires that good faith in international trade shall be observed, permits us to conclude that the profits made by the breaching party can also be taken into account as a subsidiary procedure.

On the other hand, the same justification cannot always be easily made for the second category of cases, where one of the parties breaches a contractual stipulation related to an issue other than the delivery of goods or the payment of the price. That is because the loss suffered by the aggrieved party may not always be determinable unless they have agreed on a specific sum for the breach. Needless to say, every case has to be assessed on its own and with regard to the specific circumstances. For instance, even though the disgorgement of profits and the damages remedy under Art. 74 seem reconcilable in case of the violation of a non-compete clause, the same is not true for the violation of a clause against the employment of children. That is why, in this line of cases, the disgorgement of profits shall be considered a remedy on its own or as a subsidiary remedy separate from the remedy of compensatory damages.

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[64] See Art. 76 of the CISG.

[65] Bock (n 20), 115 ff.; Steve Thel and Peter Siegelman, 'You Do Have to Keep Promises: A Disgorgement Theory of Contract Remedies' (2011) 52 *William and Mary Law Review* 1181, 1185.

In the case of a breach of a non-compete clause, the same argument that is usually made for the second sale of unique goods can be convincing, which is that if the seller sold it to a third-party buyer at a higher price, the buyer could have too.[66] Therefore, the difference between two contract prices (which is practically equal to the profits made by the seller) is equivalent to the hypothetical loss suffered by the aggrieved buyer. Similar reasoning can be applied to the breach of a non-compete clause. However, for the breach of a non-compete clause, the aggrieved party could have sold or bought the goods in the relevant market or during the relevant period at the price of the contract with the third party. Hence, the profits made through the breach may be considered equal to the loss suffered by the contracting party. More clearly, the broad interpretation of Art. 74, which permits the profits made by the breaching party to serve as a starting point for the calculation of loss, is again applicable in this line of cases.[67]

However, as Smith puts it, "so long as we remain convinced that the compensation is the only response available for breach of contract, intractable problems arise."[68] Since the CISG is only concerned with international sales contracts, the number of these intractable problems is naturally lower than in the general contract law, but they exist nonetheless. If the rules of compensation fail to address this type of problem, then the solution must be sought elsewhere. Our view is that the disgorgement of remedies, as a remedy on its own, can be awarded under the CISG without having recourse to national laws. In other words, the non-regulation of the disgorgement of profits under the CISG indicates that there is an internal gap within the Convention and this gap should be filled in accordance with the general principles on which the Convention is based, in accordance with Art. 7(2).

Various underlying reasons for allowing the disgorgement of profits may be identified. One of the cornerstones of this remedy is the fairness and equitable concerns that it satisfies.[69] The *laissez-faire* approach is shared by the Convention only to the extent that the aggrieved party is provided with an adequate remedy. In other words, in cases where the damages or other legal remedies fail to safeguard a reasonable balance between the parties, the disgorgement of profits may step in as a subsidiary remedy in order to reinstate the disturbed contractual balance. One can think of at least three arguments in favor of this standpoint.

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[66] See Schmidt-Ahrendts (n 1), 98–9; Stucki (n 11), 83.

[67] Ingborg Schwenzer, 'Artikel 74', in Peter Schlechtriem, Ingeborg Schwenzer and Ulrich Schröter (eds), *Kommentar zum UN-Kaufrecht* (7th edn, CH Beck 2019), para 43.

[68] Smith (n 6) 125.

[69] Bock (n 20), 100; Hofmann (n 37), 484.

First of all, claiming otherwise would easily cloud the uniform application goal of the Convention. The CISG is currently applied to international sales contracts concluded between buyers and sellers located in 93 countries.[70] This constitutes a significant segment of the globe, and the number of contracting states continues to rise. It follows that the disputes arising from the Convention can be brought before the courts of 93 jurisdictions in addition to the arbitral tribunals. Therefore, the uniform application of the Convention (which is also expressly mentioned in Art. 7(1)) is imperative for the Convention to serve its purpose and remain functional.[71] In other words, claiming that there is an external gap in the CISG that should be filled in accordance with national law rules should be considered the very last resort.[72] If an alternative solution can be found within the limits of the Convention, this should be the principal path to take. Claiming that the disgorgement of profits cannot be found within the set of rules of the Convention would undermine its comprehensive character. Therefore, considering the issue of disgorgement of profits as a question governed by (but not expressly settled by) the Convention would be in line with the goal of promotion of uniformity.

Furthermore, allowing the breaching party to gain from the breach to the detriment of the aggrieved party and leaving the latter worse off would also be against the *spirit* of the Convention. It would not be wrong to state that the CISG is based on the idea of finding an effective and fine balance between parties' interests. For instance, while Art. 46 gives the buyer the right to require performance, Art. 48 gives the seller the right to a cure. While Art. 49 gives the buyer the right to avoid the contract, it also restricts it crucially through the doctrines of fundamental breach and *Nachfrist*. An overall evaluation of the rights and remedies regulated under the Convention shows that it tries to walk a thin line between the interests of both the seller and the buyer. If the disgorgement of profits is not allowed, and in cases where the ordinary compensation mechanism fails to function (either because the loss is incalculable or unprovable), that would mean that the breaching party is allowed to keep all the gains made through the breach and the aggrieved party has to be consoled with merely non-pecuniary remedies (e.g., avoidance of the contract).

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[70] https://uncitral.un.org/en/texts/salegoods/conventions/sale_of_goods/cisg/status

[71] Schmidt-Ahrendts (n 1), 95.

[72] See also Felix Hartmann, 'Ersatzherausgabe und Gewinnhaftung beim internationalen Warenkauf: Zugleich ein Beitrag zum Einfluss des UN-Kaufrechts auf die Entwicklung eines künftigen europäischen Vertragsrechts' (2009) Internationales Handelsrecht 189, 190.

Last but not least, allowing the disgorgement of profits may also manifest as a matter of justice.[73] The remedy of disgorgement of profits is based on the idea that the breaching party shall not benefit from their own wrongdoing.[74] Corrective justice considerations, which also form the basis for the remedy of damages,[75] may make it necessary to disgorge the breaching party of the profits in certain cases. As is well known, the main logic of corrective justice dictates that a given remedy should aim to undo the breach and correct it in a preferred way, usually in terms of monetary compensation in contract law.[76] To be deemed fair from the corrective justice perspective, the damages must also "be the measure of the wrong," which is broadly the breach of contract.[77] Therefore, if the injustice stemming from the breach of contract cannot be sufficiently remedied through the award of damages (as in the aforementioned examples), then another remedial form representing the rights and interests of the aggrieved party shall come into play. In other words, in cases where the compensatory damages fail to remedy the breach, it makes sense from the perspective of corrective justice to allow the disgorgement of profits as a subsidiary remedy in order to correct the disturbed contractual balance. As Edelman has said, "to do otherwise would be to legitimate the wrong."[78]

One might think that allocating a preventive and corrective role to the contractual remedies would make sense only in a system that takes the presence and the degree of the breaching party's fault into account.[79] Therefore, the preventive purpose may never stand under the Convention since it adapts a strict liability approach and, in principle, rejects the assessment of fault. However, when further consideration is given to this deduction, the opposite conclusion seems also possible. Even though the Convention's remedial system is not based on the fault element, there are some breaches of contract that are by their very nature linked to wrongful behavior. The breach of a negative covenant would be a prime example of this. How can the debtor violate a contractual stipulation where they promise *not* to do something without any fault? It requires a high level of imagination to think of such a breach. Therefore, we believe that the

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[73] Siems (n 2), 49.
[74] Weinrib (n 18), 73.
[75] Rostila (n 6), 29.
[76] See Weinrib (n 18), 59–60. See also Rostila (n 6), 27.
[77] Weinrib (n 18), 75.
[78] Edelman (n 12), 81. See also Hofmann (n 37), 491–3.
[79] Schwenzer, Hachem and Kee (n 50), para 44.09. On this discussion, see also Rostila (n 6), 14.

absence of the fault requirement in the CISG's remedial system cannot be perceived as an argument against the allocation of preventive objectives to the damages remedy and the allowance of the disgorgement of profits in certain cases.

On a final note, the existing literature has argued that Art. 84(2) of the CISG may be applied *per analogiam* in order to support the disgorgement claims.[80] Art. 81(2) stipulates that in case of avoidance of contract, both parties are required to restitute what they have obtained from the other, and Art. 84 regulates how this restitution will take place. If the object of the restitution is money, then the seller must pay interest. If the object of the restitution is the delivered goods, then the buyer must return these goods. In the latter scenario, if the buyer has profited from the goods that they are obliged to return, then these profits must also be restituted. According to some authors, the obligation to account for all the benefits derived from these goods may be considered an analogical basis for allowing the disgorgement of profits.[81] However, we do not share this view. The *ratio legis* of Art. 84 and the remedy of disgorgement of profits diverge. The disgorgement of profits is related to the profits made in relation to the breach, whereas a link between the breach and the profits is not necessary according to Art. 84(2), which provides for the return of the profits (e.g., the legal and natural fruits) with the goods. The position of the buyer — or more clearly, whether the avoidance was caused by the breach committed by the buyer or the seller — also has no bearing on the application of Art. 84(2).[82]

[80] See, e.g., Hartmann (n 72), 191 ff; Eicher (n 14), 33 ff.

[81] Hartmann (n 72), 191 ff; Eicher (n 14), 33 ff. Art. 84(2) stipulates that "(2) The buyer must account to the seller for all benefits which he has derived from the goods or part of them: (a) if he must make restitution of the goods or part of them; or (b) if it is impossible for him to make restitution of all or part of the goods or to make restitution of all or part of the goods substantially in the condition in which he received them, but he has nevertheless declared the contract avoided or required the seller to deliver substitute goods."

[82] Christiana Fountoulakis, 'Artikel 84', in Peter Schlechtriem, Ingeborg Schwenzer and Ulrich Schröter (eds), *Kommentar zum UN-Kaufrecht* (7th edn, CH Beck 2019), para 22.