The Future of Agreed Sums Payable upon Breach of an Obligation

Pascal Hachem[*]

A. Introduction

Even amongst those clauses frequently found in commercial contracts in general and sales contracts in particular, agreed sums enjoy exceptional popularity. Now, when I say 'agreed sum', of course I do not talk about the purchase price but about clauses that in traditional terminology are called penalty or liquidated damages clauses.

Typically, such clauses are included where there is special interest in timely delivery of the goods or payment of the purchase price, adherence to a confidentiality or non-competition agreement. Furthermore, the applicable law may not acknowledge certain detriments as 'losses' and may therefore deny compensation for the breach of an obligation leading to such a detriment. This may, for instance, be the situation where chances are lost, reputation is damaged or legal costs are not compensated for. Similarly, from a comparative perspective the recovery of non-pecuniary loss is anything but certain. Finally, the complexity of the contract may bring about serious problems in proving loss. In these cases, agreed sums reduce legal costs for producing evidence and the risk of losing litigation or arbitral proceedings due to the required standard of proof not being met.

These classic scenarios allow us to identify three essential functions of agreed sums, namely securing performance, compensation and liquidation of detriments incurred. Naturally, these functions overlap and the dividing line is not easily drawn.[1]

B. Comparative Analysis

It appears almost trite to point out the long history of agreed sums but it seems worth noting that these were a prolific legal instrument already under Roman law and their use in contracts highly recommended. This is true for the area of sales

* Dr. iur. (University of Basel, Switzerland), ACIArb, Senior Researcher in the Global Sales Law Project at the Chair of Private Law held by Prof. Dr. Ingeborg Schwenzer, LL.M. and Lecturer of Comparative Private Law and International Trade Law at the University of Basel, Switzerland.

1 *See* for details P. Hachem, *Agreed Sums Payable upon Breach of an Obligation – Rethinking Penalty and Liquidated Damages Clauses*, The Hague, 2011, pp. 43-50.

contracts in particular, but also for arbitration agreements.[2] But as Roman law even today enjoys already a huge – and I think disturbing – amount of attention and admiration, it is not necessary for me to elaborate on it further. Instead I shall focus on the future of agreed sums payable upon breach of an obligation.

The future of the law, I firmly believe, will not take place at the domestic level but at the international level in the unification and harmonisation of laws. When compared to its centuries long history at the domestic level, the law of agreed sums is still in its infancy. The starting point for the observations to be made in this regard is the traditional difference between Common Law legal systems and Civil Law legal systems in approaching agreed sums.

I. Common Law

Building on developments originating in the 14th century Common Law legal systems do not accept agreed sums that they classify as penalties.[3] This means in traditional understanding that where an agreed sum does not merely and genuinely pre-estimate the loss likely to occur upon breach, but where it is designed to deter the debtor from breach of contract, that clause will not be upheld. In other words, where a clause functions as a mere means to secure performance and is not designed to compensate or liquidate detriments, it is inadmissible.

Nevertheless, the traditional Common Law approach is increasingly challenged. For example, the well known American Court of Appeal Judge Richard Posner speaks of an 'anomaly'[4] with 'mysterious'[5] underlying ratio that remains 'one of the abiding mysteries of Common Law'[6] and is an 'anachronism especially in cases in which commercial enterprises are on both sides of the contract'.[7] The increasing strengthening of the principle of *pacta sunt servanda* adds to the impression that the traditional Common Law position on agreed sums will not be the future at the international level. Finally, the principles underlying the law of damages no longer focus exclusively on economic considerations but increasingly on the protection of performance.[8]

2 *See* J. Münch, *in* T. Rauscher, P. Wax & J. Wenzel (Eds.), *Münchener Kommentar zur Zivilprozessordnung mit Gerichtsverfassungsgesetz und Nebengesetzen*, 3rd edn, Munich, 2008, Vor para. 1025 ZPO, para. 97. Unilateral penalties were not sufficient for the validity of the arbitration agreement, rather each party had to promise a penalty, *see* R. Zimmermann, *The Law of Obligations – Roman Foundations of the Civilian Tradition*, Cape Town/Wetton/Johannesburg, 1990, p. 526. *See also* A. Redfern *et al.*, *Law and Practice of International Commercial Arbitration*, 5th edn, London, 2009, para. 1.04.

3 *See* for details Hachem, *supra* note 1, pp. 34-38.

4 *See XCO International, Inc v Pacific Scientific Company*, 369 F.3d 998 (U.S. Ct App 7th Cir 2004), at 1001: 'Courts don't review the other provisions of contracts for reasonableness; why this one?'.

5 *Ibid.*

6 *Ibid.*

7 *Ibid.*, at 1002. Already at p. 1001 Judge Posner had pointed out that 'ironically, it is the larger firm, PacSci, that is crying penalty clause.'

8 For details *see* Hachem, *supra* note 1, pp. 83-115.

II. Civil Law, Mixed and Nordic Jurisdictions, International Instruments

On the other hand, building on Roman law heritage, Civil Law legal systems traditionally uphold all types of agreed sums independent of whether they are classified as penalty or liquidated damages.[9] In other words, the function of the respective agreed sum is not relevant for the validity of the clause.

The Civil Law approach has also been adopted by the Mixed Jurisdictions[10] as well as by the Scandinavian legal systems. The same holds true for the UNIDROIT Principles of International Commercial Contracts in 1994 and 2004,[11] the Principles of European Contract Law in 1999[12] and the Draft Common Frame of Reference prepared by the Study Group on a European Civil Code in 2009.[13]

This liberal approach to agreed sums naturally is not unrestricted. All of the legal systems – including the international instruments – following this approach have established mechanisms to protect the debtor. Some of them, especially in Eastern Europe and Central Asia start out by establishing specific writing requirements for agreed sums.[14] A few legal systems, especially in the Ibero-American

9 *See* for Argentina Art. 652 Civil Code; Armenia Art. 369 Civil Code; Austria para. 1336(1) Civil Code; Belarus Art. 311 Civil Code; Belgium Art. 1226 Civil Code; Bolivia Art. 532 Civil Code; Brazil Art. 408 Civil Code; Bulgaria Section 92 Obligations and Contracts Act; Chile Art. 1535 Civil Code; China Art. 114 Contract Law; Colombia Art. 1592 Civil Code; Costa Rica Art. 708 Civil Code; Croatia Art. 350 Civil Obligations Act; Czech Republic para. 544 Civil Code; Ecuador Art. 1578 Civil Code; Egypt Art. 223 Civil Code; El Salvador Art. 1406 Civil Code; Georgia Art. 417 Civil Code; France Art. 1226 Civil Code; Germany para. 339 Civil Code; Greece Art. 405 Civil Code; Estonia para. 158 Law of Obligations Act; France Art. 1226 Civil Code; Italy Art. 1382 Civil Code; Iraq Art. 170 Civil Code; Iran Art. 230 Civil Code; Japan Art. 420 Civil Code; Jordan Art. 364 Civil Code; Republic of Korea Art. 398 Civil Code; Latvia Art. 1716 Civil Code; Lebanon Art. 266 Code of Obligations and Contracts; Lithuania Art. 6.71 Civil Code; Luxembourg Art. 1226 Civil Code; Macau Art. 799 Civil Code; Mexico Art. 1841 Civil Code; Moldova Art. 624 Civil Code; Mongolia Art. 232 Civil Code; the Netherlands Art. 6.91 Civil Code; Nicaragua Art. 1985 Civil Code; Panama Art. 1039 Civil Code; Paraguay Art. 454 Civil Code; Peru Art. 1341 Civil Code; Poland Art. 481(1) Civil Code; Portugal Art. 812 Civil Code; Romania Art. 1066 Civil Code; Russia Art. 330 Civil Code; Slovakia para. 544 Civil Code; South Korea Art. 398 Civil Code; Spain Art. 1152 Civil Code; Switzerland Art. 160 Code of Obligations; Syria Art. 224 Civil Code; Taiwan Art. 250 Civil Code; Uruguay Art. 1363 Civil Code; Uzbekistan Art. 325 Civil Code; Venezuela Art. 1257 Civil Code; Vietnam Art. 422 Civil Code; Yemen Art. 348 Civil Code. In Cambodia the 2008 draft for a Civil Code contains a provision on 'liquidated damages etc.' in Art. 403.

10 *See* for the Israel Art. 15 Contracts (Remedies for Breach of Contract) Law (the draft of the Civil Code no longer uses the term 'liquidated damages' but in Arts. 568 and 569 only speaks of 'agreed upon compensation'); Philippines Art. 1229 Civil Code; South Africa Arts. 1 and 3 Conventional Penalties Act (1962).

11 *See* the respective Art. 7.4.13 Principles of International Commercial Contracts (PICC) 1994 and 2004.

12 *See* Art. 9:509 Principles of European Contract Law (PECL).

13 Art. III. – 3:712 Draft Common Frame of Reference (DCFR).

14 *See* for Armenia Art. 370; Belarus Art. 312(1) Civil Code; Georgia Art. 418(2); Lithuania Art. 6.72 Civil Code; Moldova Art. 625(1) Civil Code; Mongolia Art. 232.3 Civil Code; Russia Art. 330 Civil Code; Slovakia para. 544(2) Civil Code. Whether the new Civil Code of the Czech Republic will uphold this requirement – currently contained in para. 544(2) Civil Code – could not be confirmed at the time of writing.

region, stipulate upper limits for agreed sums in that a sum must not exceed the value of the principal obligation.[15]

Far more prominent, however, is the mechanism employed by almost[16] all of the legal systems upholding clauses independent of their type – which is the reduction of excessive sums.[17]

III. UNCITRAL Rules

These traditional differences between legal systems have often been considered to present insurmountable difficulties for the unification of this area of the law.[18] At least this is the reason typically cited for the fact that the CISG does not contain an express provision dealing with agreed sums although the incorporation of such a clause was advocated at the Vienna Conference. However, I may take the liberty of drawing your attention to the fact that these difficulties seem to have mysteriously disappeared three years after the CISG was finalised. In 1983 UNCITRAL was able to publish the Uniform Rules on Contract Clauses for an Agreed Sum Due upon Failure of Performance.[19] The fact that these were not

15 *See* for Bolivia Art. 534 Civil Code; Brazil Art. 412 Civil Code; Mexico Art. 1843 Civil Code; Portugal Art. 811(3) Civil Code.

16 Some Civil Law legal systems do not establish express reduction mechanisms. This is *e.g.* the case in the Czech Republic, Costa Rica, Latvia and Slovakia. In Japan Art. 420(1), sentence 2 Civil Code expressly states that the court may not increase or decrease the amount of liquidated damages. Art. 420(3) Civil Code states that any penalty is considered liquidated damages.

17 *See* for Argentina Art. 656 Civil Code; Armenia Art. 372 Civil Code; Austria para. 1336(2) Civil Code; Belarus Art. 314 Civil Code; Brazil Art. 413 Civil Code; Bulgaria Section 92 Obligations and Contracts Act; Chile Art. 1539 Civil Code; China Art. 114 Contract Law; Colombia Art. 1601 Civil Code; Croatia Art. 354 Civil Obligations Act; Ecuador Art. 1587 Civil Code; Egypt Art. 224(2) Civil Code; El Salvador Art. 1415 Civil Code; France Arts. 1231 and 1152 Civil Code; Georgia Art. 420 Civil Code; Germany para. 343 Civil Code; Greece Art. 409 Civil Code; Estonia para. 162 Law of Obligations Act; France Art. 1152 Civil Code; Italy Art. 1384 Civil Code; Iraq Art. 171(2) Civil Code; Iran Art. 230 Civil Code; Jordan Art. 364(2) Civil Code; Republic of Korea Art. 398(2) Civil Code; Lebanon Art. 266(2) Code of Obligations and Contracts; Lithuania Art. 6.73(2) Civil Code; Luxembourg Arts. 1231 and 1152 Civil Code; Macau Art. 801 Civil Code; Mexico Arts. 1844 and 1845 Civil Code; Moldova Art. 630(1) Civil Code; Mongolia Art. 232(8) Civil Code; the Netherlands Art. 6.94 Civil Code; Panama Art. 1041 Civil Code; Paraguay Art. 459 Civil Code; Peru Art. 1346 Civil Code; Poland Art. 484(2) Civil Code; Portugal Art. 812 Civil Code; Romania Art. 1070 Civil Code; Russia Art. 333 Civil Code; South Korea Art. 398(2) Civil Code; Spain Art. 1154 Civil Code; Switzerland Art. 163 Code of Obligations; Syria Art. 225(2) Civil Code; Taiwan Art. 252 Civil Code; Uzbekistan Art. 326 Civil Code; Venezuela Art. 1260 Civil Code; Yemen Art. 354 Civil Code. An unusual rule can be found in Art. 403(3) of the 2008 draft for a Cambodian Civil Code which first holds that the agreed amount of damages must not be modified but adds that this may be done where the damage sustained is grossly higher or lower than the amount fixed.

18 On a very narrow scale Belgium, Luxembourg and the Netherlands in 1973 drafted the *Convention Benelux Relative à la Clause Pénale* which entered into force in 1978. On a broader scale – though often overlooked in this context – the so called *Gandolfi Initiative* in 2001 published the European Code of Contract (reproduced in which in its Art. 170 contains a provision dealing with agreed sums).

19 Full text is available at <www.uncitral.org/pdf/english/texts/sales/contract/vol14-p272-273-e.pdf>.

established as a Convention but as a recommendation to domestic legislators may explain a fair portion of why seemingly no greater difficulties were encountered in the drafting process.

I should add that these rules not only overcame traditional domestic distinctions already about thirty years ago, but for their main part contain solutions that are still convincing and display a high degree of clarity. It is to be regretted that this work appears to not have been fully appreciated in the drafting of the UNIDROIT Principles of International Commercial Contracts, the Principles of European Contract Law and the Draft Common Frame of Reference. All of them contain only a fragment of the law of agreed sums and are in this respect quite disappointing seeing that UNCITRAL had provided them with at least arguable suggestions of how this area of the law could have been developed at the international level, which were neither confirmed nor rejected. This surprising ignorance has led the development of the law of agreed sums at the international level to stagnate.

C. Issues Relevant in the Future

In light of the traditional differences in approaches at the domestic level and the deficiencies in the developments at the international level, a number of important questions are still open and must be solved on the basis of comparative research. At least, it is clear that at the international level the function assumed by an agreed sum does not have an impact on the validity of the clause but that the obligor is to be protected by reducing unreasonable sums. Additionally, as all uniform projects follow a strict-liability approach to damages it is evident that fault on the part of the obligor is not of relevance for the agreed sum.

From a general conceptual point of view the questions that will need to be answered in the future include first of all the exact ways in which the reduction mechanism is to be applied, whether an exemption from the liability for damages also applies to an agreed sum and most importantly the relationship of an agreed sum to the default remedies for breach of contract. In the area of sales law in particular the treatment of agreed sums in CISG contracts requires further attention.[20] As stated earlier the Convention does not explicitly address agreed sums. What is clear, however, is that Article 6 CISG allows for the incorporation of an agreed sum into the contract and that the CISG governs the formation of agreed sums.

Tempting as it is to embark on all these issues and present the solutions I have suggested elsewhere,[21] I shall only briefly comment on the application of the pro-

20 *See* for details and possible solutions Hachem, *supra* note 1, Chapter VI.; P. Hachem, 'Fixed Sums in CISG Contracts', 13 *Vindobona Journal of International Commercial Law and Arbitration* 2009, p. 217 *et seq*.

21 *See* Hachem, *supra* note 1, Chapter IV. E., F. and Chapter VI.

tection of the obligor by reducing excessive sums and the relationship of the agreed sums to the remedy of damages.

I. The Application of the Reduction Mechanism

a. General

The purpose of the reduction of agreed sums is to provide a flexible mechanism which on the one hand ensures legal certainty as regards the general existence of the clause and on the other hand gives due regard to the necessary protection of the debtor.[22] The general rule is that the judge or arbitrator is enabled to modify an agreed sum it finds unacceptable in the particular case. Due to their nature as a protective mechanism operating in favour of the obligor, the respective provisions enabling courts and arbitral tribunals to reduce the sum in question are generally held to be mandatory at the domestic[23] as well as at the international level[24] – this means they cannot be abrogated or modified to the detriment of the debtor by contractual agreement.

b. Application Upon Request or Ex Officio

The nature of the reduction mechanism as a protective measure raises the question, whether the obligor must demand its application or whether courts and

22 For Switzerland *see* Swiss Federal Supreme Court (BGer), 30 October 2006, BGE 133 III 43 at 52; G. H. Treitel, 'Remedies for Breach of Contract', *in* M. Siebeck & M. Nijhoff (Eds.), *International Encyclopedia of Comparative Law*, Vol. VII, Chapter 16, Tübingen/Leiden/Boston, 2001, p. 103 holds this flexibility to be an advantage over the traditional Common Law rule on agreed sums.

23 In France this is expressed by the plain wording of Art. 1152(2) sentence 2 Civil Code: '*Toute stipulation contraire sera réputée non écrite.*' An essentially identical wording is to be found in Algeria Art. 184(3) Civil Code; Bahrain Art. 226(3) Civil Code; Egypt Art. 224(3) Civil Code; Estonia para. 162(2) Law of Obligations Act; Iraq Art. 170(2) sentence 2 Civil Code; Jordan Art. 364(2) Civil Code; Kuwait Art. 303(3) Civil Code; Libya Art. 227(3) Civil Code; Morocco Art. 264 sentence 3 Code of Obligations; the Netherlands Art. 6.94(3) Civil Code; Qatar Art. 266(3); Syria Art. 225(3) Civil Code; United Arab Emirates Art. 390(2) Civil Code; Yemen Art. 354. This position seems to be general consent among legal systems, even if lacking express wording to that effect, *see* for Austria R. Reischauer, *in* P. Rummel (Ed.), *Kommentar zum Allgemeinen Bürgerlichen Gesetzbuch in zwei Bänden*, 3rd edn, Vienna, 2007, para. 1336 ABGB, para. 12; H. Danzl, *in* H. Koziol, P. Bydlinski & R. Bollenberger (Eds.), *ABGB – Allgemeines Bürgerliches Gesetzbuch – Kommentar*, 2nd edn, Vienna, 2007, para. 1336 ABGB, para. 10; Dittrich & Tades, *Das Allgemeine Bürgerliche Gesetzbuch*, 21st edn, Vienna, 2005, para. 1336 ABGB, para. 13; German Federal Supreme Court (BGH), 13 February 1952, *Neue juristische Wochenschrift* 1952, p. 623; BGH, 22 May 1968, *Neue juristische Wochenschrift* 1968, p. 1625; P. Gottwald, *in* K. Rebmann, F.J. Säcker & R. Rixecker (Eds.), *Münchener Kommentar zum Bürgerlichen Gesetzbuch, Vol. 3 – Schuldrecht – Besonderer Teil I paras. 433–610*, 5th edn, Munich, 2008, para. 343 BGB, para. 2; A. Stadler, *in* O. Jauernig, *Bürgerliches Gesetzbuch*, 12th edn, Munich, 2007, para. 343 BGB, para. 1; Italy L. Mari, in L. Antoniolli & A. Veneziano, *Principles of European Contract Law and Italian Law – A Commentary*, The Hague, 2005, p. 474; Switzerland G. Couchepin, *La Clause Pénale – Etude générale de l'institution et de quelques applications pratiques en droit de la construction*, Zurich/Basel/Geneva, 2008, para. 785.

24 *See* Art. 9 UNCITRAL Rules; Art. 4(2) *Convention Benelux;* Art. 7.4.13(2) PICC; Art. 9:509(2) PECL; Art. III.-3:712(2) DCFR. An exception in this regard is Art. 170 European Code of Contract which does not expressly indicate that the reduction mechanism is mandatory.

arbitral tribunals must consider reduction *ex officio*. At the international level the wording used by the UNCITRAL Rules as well as the uniform projects is not conclusive. However, the *Convention Benelux* in Article 4(1) requires the debtor to request reduction of the agreed sum in dispute.

At the domestic level Some legal systems either expressly require the debtor to request reduction of the agreed sum,[25] or courts and scholarly writings establish this requirement.[26] Similarly, in Common Law jurisdictions the obligor is required to raise the penalty defence. However, in the majority of legal systems the wording of the respective provisions appears to turn directly to the court. Typically, it is stated that 'the court may reduce' or that the sum 'may be reduced by the court'.[27] This suggests that in these legal systems the reduction mechanism applies *ex officio*, although the wording of these provisions is admittedly not entirely conclusive.[28] In France Article 1152(2) sentence 1 CC expressly provides for an *ex officio* application of the reduction mechanism.[29] Similarly, in Russia Article 333 CC states that the court 'shall have the right to reduce' the agreed sum,[30] however, at least a part of Russian arbitration practice expects the debtor to request reduction.[31]

25 *See* for China Art. 114 Contract Law; Estonia para. 162(1) Law of Obligations Act; Germany para. 343(1) sentence 1 Civil Code; Jordan Art. 364(2) Civil Code; the Netherlands Art. 6.94(1) Civil Code; Peru Art. 1346 Civil Code. Probably also Iraq Art. 170(2) sentence 1 Civil Code. For Chinese arbitration practice, *see* CIETAC, 20 September 2006, CISG-online 1473, available at <www.cisg-online.ch>.

26 *See* for Austria most recently Austrian Federal Supreme Court (OGH), 13 May 2009, 7Ob230/08m, note III.4; OGH, 29 April 2009, 7Ob281/08m, note 2.1.; Reischauer, *supra* note 23, para. 1336 ABGB, para. 18; Danzl, *supra* note 23, para. 1336 ABGB, para. 10; Switzerland F.R. Ehrat, *in* H. Honsell, N.P. Vogt & W. Wiegand, *Baseler Kommentar, Obligationenrecht I – Art 1 – 529 OR*, 4th edn, Basel, 2007, Art. 163 OR, para. 11; Couchepin, *supra* note 23, para. 925.

27 *See* for Algeria Art. 184(2) Civil Code; Bahrain Art. 226(2) Civil Code; Brazil Art. 413 Civil Code; Egypt Art. 224(2) Civil Code; El Salvador Art. 1410 Civil Code; Kuwait Art. 303(2) Civil Code; Libya Art. 227(2) Civil Code; Lithuania Art. 6.73(1) sentence 2 Civil Code; Luxemburg Art. 1231 Civil Code; Mexico Art. 1844 Civil Code; Panama Art. 1041 Civil Code; Paraguay Art. 459 Civil Code; Peru Art. 1346 Civil Code; Portugal Art. 812(2) Civil Code; Qatar Art. 266(2); Québec para. 1623(2) Civil Code; Romania Art. 1070 Civil Code; South Korea Art. 398(2) Civil Code; Spain Art. 1154 Civil Code; Syria Art. 225(2) Civil Code; Uruguay Art. 1370 Civil Code; Uzbekistan Art. 326 Civil Code; Venezuela Art. 1260 Civil Code.

28 In Italy case law is divided on whether the wording of Art. 1384 Civil Code – 'can be equitably reduced by the court' – requires the debtor to make a request for reduction, *see* for an account of the different decisions rendered Mari, *supra* note 23, p. 475 who discern a tendency in recent times towards an *ex officio* application of the reduction mechanism.

29 «*[L]e juge peut, meme d'office, modérer ou augmenter la peine* [...]».

30 The same rule is to be found in Belarus Art. 314(1) Civil Code. Almost identical is Armenia Art. 372 Civil Code.

31 *See* Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry, 20 April 2004, CISG-online 1209. Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry, 10 January 1998, CISG Pace the agreed sum was reduced. The facts do, however, not indicate whether the debtor had requested it. An *ex officio* reduction also in arbitration proceedings is advocated by C. Osakwe, 'Modern Russian Law of Contracts. A Functional Analysis', 24 *Loy. L.A. Int'l & Comp. L. Rev.* 2002, p. 185.

The practical differences in this regard, however, must not be overestimated. In those legal systems requiring the debtor to request reduction of the agreed sum this requirement is interpreted quite liberally.[32] It has been held that the debtor makes a sufficient request where it merely denies the obligation to pay the agreed sum,[33] or where it indicates that it is unwilling to pay the agreed sum due to its amount[34]. Nevertheless, in my opinion the obligor should be required to apply for the reduction of the agreed sum. Agreed sums seek to reduce time and costs in dispute resolution. Courts and tribunals should not enter into possibly lengthy requirements unless asked to do so by the obligor.

c. Standard

Reducing an agreed sum is a severe interference with the general principles of freedom of contract and *pacta sunt servanda*. In developing criteria for the excessiveness of an agreed sum all of these legal systems seem to agree that a restrictive approach is to be followed and a high threshold for excessiveness to be established. At the international level the uniform projects allow for reduction only where the sum is 'grossly excessive'.[35] The UNCITRAL Rules require that the sum be 'substantially disproportionate'.[36]

The approach taken at the international level finds its basis in a broad consensus at the domestic level where numerous legal systems operate with the formula that an agreed sum must not be reduced or modified, unless it is excessive.[37] Others reiterate that the parties are free to determine the amount of the agreed sum.[38] Numerous legal systems signify that a high threshold is to be met by requiring agreed sums to be 'manifestly disproportionate'[39] or 'grossly excessive'.[40] Some legal systems, only speak of 'excessive'[41] or 'unreasonable'.[42] How-

32 *See* for Austria Danzl, *supra* note 23, para. 1336 ABGB, para. 10; Germany Gottwald, *supra* note 23, para. 343 BGB, para. 12; Stadler, *supra* note 23, para. 343 BGB, para. 4; Switzerland Ehrat, *supra* note 26, Art. 163 OR, para. 11.

33 *See* for Austria OGH, 13 May 2009, 7Ob230/08m; OGH, 30 November 2006, 2Ob253/06d.

34 *See* for Germany BGH, 22 May 1968, *Neue juristische Wochenschrift* 1968, p. 1625.

35 *See* Art. 7.4.13(2) PICC; Art. 9:509(2) PECL; Art. III.-3:712(2) DCFR.

36 *See* Art. 9 UNCITRAL Rules. *See also* Art. 170(4) European Commercial Cases (ECC) ('clearly excessive'); Art. 4 Convention Benelux ('*manifestment*').

37 *See* for Louisiana Art. 2012 Civil Code; Art. 8 UNCITRAL Rules.

38 *See* for Switzerland Art. 163(1) Code of Obligations.

39 *See* for Belarus Art. 314(1) Civil Code ('obviously'); Colombia Art. 1601 Civil Code and Ecuador Art. 1587 Civil Code both rely on the principles of *laesio enormis*; France Art. 1152(2) sentence 1 Civil Code; Italy Art. 1384; Lithuania Art. 6.73(2) sentence 2 Civil Code; Paraguay Art. 459 Civil Code; Peru Art. 1346 Civil Code; Poland Art. 484(2) Civil Code; Russia Art. 333(1) Civil Code ('obviously'); Uzbekistan Art. 326 Civil Code.

40 Algeria Art. 184(2) Civil Code; Bahrain(2) Art. 226 Civil Code; Cambodia Art. 403(3) Draft Civil Code; Egypt Art. 224(2) Civil Code; Libya Art. 227(2) Civil Code; Kuwait Art. 303(2) Civil Code; Qatar Art. 266(2); Syria Art. 225(2) Civil Code; Yemen Art. 354(1) Civil Code.

41 *See* for Austria para. 1336(2) Civil Code; Germany para. 343 sentence 1 Civil Code; Morocco Art. 264 CO; South Africa Art. 3 Conventional Penalties Act (1962); Switzerland Art. 163(3) Code of Obligations.

42 Estonia para. 162(1) Law of Obligations Act; Georgia Art. 420 Civil Code; Israel Section 15(b) Contracts (Remedies for Breach of Contract) Law; the Netherlands Art. 6.94(2) Civil Code.

ever, in this case courts and scholarly writings may have clarified that a restrictive approach is to be taken.[43] Occasionally, the sum needs to be 'oppressive' to trigger the reduction mechanism.[44] Legal systems using none of the formulas mentioned are a rare exception.[45]

A typical case in which domestic legal systems provide for the reduction of an agreed sum is that of partial performance.[46] Apart from the specific case of partial performance most legal systems do not expressly establish further criteria for the excessiveness of an agreed sum but rather refer to all relevant circumstances of the case.[47] This approach is also followed at the international level by Article 8 UNCITRAL Rules and the uniform projects.[48] Among these circumstances it is the actual loss incurred by the creditor which is considered to be decisive.[49] While from a conceptual perspective this notion is fairly easy to grasp, its practical application presents significant difficulties. In particular it must not be forgotten that one of the functions of agreed sums is to make questions of proof of loss irrelevant. Hence, the reduction mechanism must not be applied in a way so as to invite obligors to always dispute the reasonableness of the sum and thus to have issues of proof resurfacing. Rather, it must be kept in mind that it is on the obligor to prove the excessiveness of the sum and thus it should also be on the obligor to prove that the actual loss of the obligee was negligible or in fact no actual loss occurred. This allocation of the risk for the ability to prove the excessiveness of the sum constitutes the necessary deterrent to dilatory tactics such as standardised objections to the reasonableness of the agreed sum.

43 *See* for Germany BGH, 1 June 1983, *Neue juristische Wochenschrift* 1984, p. 919 at 921; M. Nodoushani, *Vertragsstrafe und vereinbarter Schadensersatz – Eine vergleichende Untersuchung des amerikanischen und deutschen Rechts*, Baden-Baden 2004, p. 151; Switzerland BGer, 22 June 1988, BGE 114 II 264.

44 *See* for Iraq Art. 170(2) sentence 1 Civil Code.

45 *See* for Iran Art. 230 Civil Code.

46 Algeria Art. 184(2) Civil Code; Bahrain Art. 226(2) Civil Code; Brazil Art. 413 Civil Code; Bulgaria Section 92(2) Obligations and Contracts Act; Costa Rica Art. 713 Civil Code; Egypt Art. 224(2) Civil Code; El Salvador Art. 1410 Civil Code; Estonia para. 162(1) Law of Obligations Act; France Art. 1231 Civil Code; Italy Art. 1384 Civil Code; Iraq Art. 170(2) sentence 1 Civil Code; Kuwait Art. 303(2) Civil Code; Lebanon Art. 266(2) sentence 3 Code of Obligations; Libya Art. 227(2) Civil Code; Lithuania Art. 6.73(2) sentence 2 Civil Code; Louisiana Art. 2011 Civil Code; Luxemburg Art. 1231 Civil Code; Mexico Art. 1844 Civil Code; Panama Art. 1041 Civil Code; Paraguay Art. 459 Civil Code; Peru Art. 1346 Civil Code; Poland Art. 484(2) Civil Code; Portugal Art. 812(2) Civil Code; Québec para. 1623(2) Civil Code; Romania Art. 1070 Civil Code; Spain Art. 1154 Civil Code; Syria Art. 225(2) Civil Code; Uruguay Art. 1370 Civil Code; Uzbekistan Art. 326 Civil Code; Venezuela Art. 1260 Civil Code; Art. 170(4) ECC.

47 *See* for Austria Reischauer, *supra* note 23, para. 1336 ABGB, para. 14; Germany Grüneberg, *in* Palandt, *Bürgerliches Gesetzbuch*, 68th edn, Munich, 2009, para. 343 BGB, para. 6; Switzerland BGer, 22 June 1988, BGE 114 II 264, at 265.

48 *See* Art. 7.4.13(2) PICC; Art. 9:509(2) PECL; Art. 170(4) ECC.

49 *See* for Austria Reischauer, *supra* note 23, para. 1336 ABGB, para. 14; France Cour de Cassation, Civ 3, 3 June 2009, No 08-13414; Cour de Cassation, 26 May 2009, No 08-17829; Art. 7.4.13(2) PICC; Art. 9:509(2) PECL.

II. Relationship of Agreed Sums to the Remedy of Damages

It is conceivable that an agreed sum does not fully cover the loss incurred by the aggrieved party. This raises the question whether the obligee is also entitled to the remaining loss or whether it is limited to the amount fixed in the agreed sum. Unfortunately, at the international level the uniform projects are silent on this issue. However, Article 2(1) *Convention Benelux* and Article 170(1) European Code of Contract expressly limit the recovery of losses to the sum fixed in the contract.

At the domestic level legal systems react differently to such situations. Under the *caveat* that the parties have not made any stipulations in the contract two main position can be distinguished. The first position taken by a number of legal systems is that the creditor cannot recover losses beyond the amount fixed in the contract.[50] However, these domestic systems have developed certain exceptions to this general rule. Some of these legal systems allow for the recovery of additional losses only where the obligor has acted intentionally or fraudulently.[51] Finally, another group of legal systems resorts to the courts by granting them the power to increase the agreed sum.[52] The discretion given to courts varies. Some systems appear to give broad discretion to the court, as the right to adjust the amount of the agreed sum is not qualified by the wording of the respective provisions.[53] In other legal systems, the agreed sum must be disproportionately low – '*dérisoire*',[54] '*infimo*'[55] – to the actual loss so as to trigger the right of the court to interfere with the agreement.

50 *See* for Algeria Art. 185 Civil Code; Argentina Art. 655 Civil Code; Bahrain Art. 227 Civil Code; Belarus Art. 313(2) Civil Code; Brazil Art. 416 sentence 2 Civil Code; Costa Rica Art. 426 Commercial Code; Egypt Art. 225 Civil Code; England *Diestal v. Stevenson* [1906] 2 K.B. 345; Italy Art. 1382 Civil Code; Iraq Art. 171 Civil Code; Kuwait Art. 304 Civil Code; Libya Art. 228 Civil Code; New Zealand J.F. Burrows, J.N. Finn & S. Todd, *Law of Contract in New Zealand*, 3rd edn, Wellington, 2007, para. 21.2.6(a); Paraguay Art. 454(2) Civil Code; Portugal Art. 811(2) Civil Code; Syria Art. 226 Civil Code; USA E.A. Farnsworth, *Farnsworth on Contracts*, Vol. 3, 3rd edn, New York, 2004, p. 304 *et seq.*; Yemen Art. 355 Civil Code.

51 *See* for Algeria Art. 185 Civil Code; Bahrain Art. 227 Civil Code; Costa Rica Art. 427 Commercial Code; Egypt Art. 225 Civil Code; France I. Steltmann, *Die Vertragsstrafe in einem Europäischen Privatrecht*, Berlin 2000, p. 174 *et seq.* with an overview of the discussion; Iraq Art. 171 Civil Code; Kuwait Art. 304 Civil Code; Libya Art. 228 Civil Code; Qatar Art. 267; Syria Art. 226 Civil Code; Yemen Art. 355 Civil Code.

52 *See* for Argentina A.A. Alterini, *Contratos Civiles – Comerciales – de Consumo – Teoría General*, Buenos Aires, 2005, p. 602; China Art. 114(2) Contract Law; France Art. 1152(2) sentence 1 Civil Code; Iran Art. 230 Civil Code; Jordan Art. 364(2) Civil Code; Morocco Art. 264 Code of Obligations and Contracts; the Netherlands Art. 6.92(2) Civil Code; United Arab Emirates Art. 390(2) Civil Code.

53 China Art. 114(2) Contract Law; Iran Art. 230 Civil Code; Jordan Art. 364(2) Civil Code; Morocco Art. 264 Code of Obligations and Contracts; the Netherlands Art. 6.92(2) Civil Code; United Arab Emirates Art. 390(2) Civil Code.

54 France Art. 1152(2) sentence 1 Civil Code.

55 Argentina Alterini, *supra* note 52, p. 602.

The second position taken by domestic legal systems is to generally grant the creditor a damage claim for additional losses.[56] Absent any agreement to the contrary, the agreed sum will be set off against the claim for damages brought by the creditor.[57] The claim for additional losses generally follows the standard pattern for contract damages claims based on breach of contract. An exception is for example made in Switzerland, where contrary to general claims for damages the creditor of an agreed sum has to prove fault on the part of the debtor, if it claims additional losses.[58]

In light of these domestic differences it is difficult to predict what the future position at the international level will be. As stated, the uniform projects are silent. The UNCITRAL Rules attempt to strike a balance between both approaches. Article 7 sentence 1 states that no damages may be claimed to the extent the loss is covered by the agreed sum. This means that where the agreed sum falls short of the actual loss, the difference may be claimed. However, this rule is restricted by Article 7 sentence 2 to situations where the loss 'substantially exceeds the agreed sum'. From a conceptual perspective this approach certainly amounts to a reasonable compromise, it is less fortunate from a practical point of view. My personal view is that primary emphasis needs to be placed on the interpretation of the agreed sum to determine its scope and relationship to the remedy of damages. As far as interpretation does not lead to a result I favour the rule that by default damages are generally available but to set off against the agreed sum.

D. Conclusion

The field of agreed sums payable upon breach of an obligation remains a particularly fertile one for comparative lawyers[59] despite the great attention it has received for centuries. In this short roundtrip I have tried to familiarise you with some of the current issues at the international level and the remaining differences at the domestic level and to give an outlook on what might be the future of agreed sums. Finally, I would like to thank Prof. Dr. Ingeborg Schwenzer, LL.M. and Mr. Jean Alain Penda Matipe for inviting me to this conference.

56 *See* for Austria para. 1336(3) sentence 1 Civil Code; Bulgaria Section 92 Obligations and Contracts Act; Estonia para. 161(2) Law of Obligations Act; Georgia Art. 419(2) Civil Code; Germany para. 340(2) sentence 2 Civil Code; Lithuania Art. 6.73(1) sentence 3 Civil Code *e contrario*; Moldova Art. 625(2) sentence 1 Civil Code; Switzerland Art. 161 Code of Obligations; I. Schwenzer, *Schweizerisches Obligationenrecht Allgemeiner Teil*, 5th edn, Bern 2009, para. 71.12.

57 Germany paras. 340(2) sentence 1, 341(2) Civil Code; Lithuania Art. 6.73(1) sentence 3 Civil Code; Moldova Art. 625(2) sentence 1 Civil Code; Switzerland Ehrat, *supra* note 26, Art. 161 OR, para. 5.

58 *See* Art. 161(2) Code of Obliagations. For criticism towards this provision as being foreign to the system of the Swiss Code of Obligations Ehrat, *supra* note 26, Art. 161 OR, para. 6.

59 *See* L. Miller, 'Penalty Clauses in England and France: A Comparative Study', 53 *Int'l Comp. L. Q.* 2004, p. 79: 'rewarding area for comparative research'.