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TEXT OF DRAFT UNIFORM RULES ON LIQUIDATED DAMAGES AND PENALTY CLAUSES, TOGETHER WITH A COMMENTARY THEREON

Report of the Secretary-General

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INTRODUCTION

1. At its eleventh session, the Commission included in its new programme of work the subject of liquidated damages and penalty clauses as part of the study of international contract practices. 1/ At its twelfth session, the Commission considered a report of the Secretary-General entitled "Liquidated damages and penalty clauses", 2/ and requested its Working Group on International Contract Practices to consider the feasibility of formulating uniform rules on liquidated damages and penalty clauses applicable to a wide range of international trade contracts. 3/ The Working Group held two sessions, 4/ and at its second session adopted draft uniform rules on liquidated damages and penalty clauses. 5/

2. At its fourteenth session, the Commission considered these draft rules, and inter alia requested the Secretary-General to incorporate in the draft uniform rules such supplementary provisions as might be required if the rules were to take the form of a convention or a model law, and to prepare a commentary on the uniform rules. 6/ The present document has been prepared in response to this request. The draft uniform rules incorporating the supplementary provisions are hereinafter referred to as "the Rules".

3. Two previous attempts have been made at a regional level at unification in this field. 7/ An attempt made within the Council of Europe culminated in the

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1/ Report of the United Nations Commission on International Trade Law on the work of its eleventh session (1979), Official Records of the General Assembly, Thirty-third Session, Supplement No. 17 (A/33/17), para. 67 (c)(i) b (Yearbook of the United Nations Commission on International Trade Law, Volume IX: 1978 (United Nations publication, Sales No. E.80.V.8) Part One, II, A, para. 67 (c)(i) b).

2/ A/CN.9/161 (Yearbook of the United Nations Commission on International Trade Law, Volume X: 1979 (United Nations publication, Sales No. E.81.V.2) Part Two, I, C).

3/ Report of the United Nations Commission on International Trade Law on the work of its twelfth session (1979), Official Records of the General Assembly, Thirty-fourth Session, Supplement No. 17 (A/34/17), para. 31 (Yearbook of the United Nations Commission on International Trade Law, Volume X: 1979 (United Nations publication, Sales No. E.81.V.2) Part One, II, A, para. 31).

4/ The report of the Working Group on the work of its first session is contained in A/CN.9/177, and on the work of its second session in A/CN.9/197. At its second session, the Working Group had before it a report of the Secretary-General entitled "Liquidated damages and penalty clauses (II)", A/CN.9/WG.2/WP.33 and Add.1.

5/ A/CN.9/197, Annex.

6/ Report of the United Nations Commission on International Trade Law on the work of its fourteenth session (1981), Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17 (A/36/17), para. 44.

7/ The General Conditions of Delivery of Goods between Organizations of the Member Countries of the Council for Mutual Economic Assistance, 1968/1975 as amended in 1979, also contain several provisions regulating liquidated damages and penalty clauses.

formulation of a set of principles set forth in an appendix to resolution (78) 3 on penal clauses in civil law adopted by the Committee of Ministers on 20 January 1978. The resolution (hereinafter referred to as the "Council of Europe resolution") recommends to member Governments that they take the principles into consideration when preparing new legislation on this subject, and consider the extent to which the principles can be applied, subject to any necessary modifications, to other clauses which have the same aim or effect as penal clauses. 8/ An attempt made within the Benelux Economic Union culminated in the adoption at the Hague on 26 November 1973 of the Benelux Convention relating to the Penalty Clause (hereinafter referred to as the "Benelux Convention"). Under article 1, the Contracting States agree that they will bring their national legislation on penalty clauses into conformity with certain common provisions set forth in an annex to the Convention, at the latest by the date of entry into force of the Convention. 9/ While these attempts are directed to unifying national law, the scope of application of the uniform provisions is not restricted to domestic transactions. Accordingly, relevant provisions formulated in these two previous attempts are referred to where appropriate in the commentary set forth below.

4. Liquidated damages and penalty clauses are very widely used in international trade transactions. However, there are major differences in the way different legal systems resolve certain issues arising under such clauses. As a result, there may be considerable uncertainty as to the rights of the parties under a clause until the applicable law is determined. 10/ The Rules are intended to remedy this situation by unification at a global level.

5. The formulation of the Rules reflect the impact of several factors. An attempt was made, to the extent possible, to give effect to international trade practice. 11/ An examination of such practice disclosed that, while the clauses to some extent followed a standard pattern and were used for a limited number of purposes, there was a considerable variety in their formulation. To accomodate this feature, the Rules to a large extent give autonomy to the parties. Parties are free to vary all the provisions except those defining the scope of application of the Rules, and that defining the power of a court or arbitral tribunal to reduce the agreed sum. International trade practice was also referred to in determining what should appropriately be the rights of the parties under the Rules.

6. In the course of formulating the Rules, various national laws were also examined, and an attempt was made to retain in the Rules solutions common to the different laws, and to embody therein compromise solutions which satisfy the various policies in the laws.

8/ The resolution, the principles, and an explanatory memorandum have been published as a booklet by the Council of Europe (Strasbourg, 1978).

9/ The Convention, with its annex, and a commentary, have been published as a booklet by the Benelux Economic Union. The Convention has not yet entered into force.

10/ For a full treatment of this issue, see A/CN.9/161, sections IV and V.

11/ A/CN.9/WG.2/WP.33 contains the results of an investigation of international trade practice.

7. Part I of this document sets forth the Rules, i.e. the texts of the draft Convention and the draft Model Law. The Rules combine the draft provisions adopted by the Working Group with supplementary provisions prepared by the Secretariat. In preparing the supplementary provisions, in accordance with the directions of the Commission, the Secretariat took into account the relevant provisions of instruments which have emerged from the work of the Commission. 12/ Footnotes indicate which provisions were adopted by the Working Group and which were prepared by the Secretariat.

8. The full text of a convention must include a set of final provisions. Some of these would be provisions necessary in any convention (e.g. articles providing for methods by which States may become parties, entry into force articles, articles providing for methods by which States cease to be parties, depositary article). Others would relate more closely to the substance of a convention. Examples of issues to be regulated by such provisions would be: the relationship between the draft Convention and earlier and later Conventions which also regulate liquidated damages and penalty clauses, and the possibility of not applying the draft Convention when two or more States have closely related rules on liquidated damages and penalty clauses. A set of final provisions has not been prepared at this stage in accordance with the past practice of the Commission.

9. Where a State adopts the draft Model Law, provisions additional to those set forth below may be necessary to ensure that the adopted law is workable within the legal system of that State. The legislature of the State adopting the law would be the appropriate body to decide on what provisions are necessary.

10. The texts of the draft Convention and the draft Model Law differ only in Article A, paragraph (1). Accordingly, in Part II a separate commentary is given on this paragraph in respect of each instrument and a single commentary is given in respect of the other provisions.

12/ Report of the United Nations Commission on International Trade Law on the work of its fourteenth session (1981), Official Records of the General Assembly, Thirty-sixth Session, Supplement No. 17 (A/36/17), para. 43.

PART I: THE RULES

DRAFT CONVENTION

Article A, paragraph (1)

(1) This Convention applies to contracts in which the parties have agreed /in writing/ that, upon a total or partial failure of performance by a party (the obligor), another party (the obligee) is entitled to recover, or to forfeit an agreed sum of money 13/ when, at the time of the conclusion of the contract, the parties have their places of business in different Contracting States. 14/

DRAFT MODEL LAW

Article A, paragraph (1)

(1) This law applies to contracts in which the parties have agreed /in writing/ that, upon a total or partial failure of performance by a party (the obligor), another party (the obligee) is entitled to recover, or to forfeit an agreed sum of money: 15/

(a) when, at the time of the conclusion of the contract, the parties have their places of business in different States, and

(b) when the rules of private international law lead to the application of the law of (the State adopting the Model Law). 16/

13/ Working Group draft (draft rule 1, A/CN.9/197, Annex).

14/ Secretariat supplementary provision. This criterion has been adopted in the Convention on the Limitation Period in the International Sale of Goods (hereinafter referred to as the "Limitation Convention") article 2(a), and in the United Nations Convention on Contracts for the International Sale of Goods (hereinafter referred to as the "Sales Convention") article 1(1).

15/ Working Group draft (draft rule 1, A/CN.9/197, Annex).

16/ Secretariat supplementary provision. The criterion at (a) has been adopted in the Limitation Convention, article 2(a), and in the Sales Convention, article 1(1). The criterion at (b) has been adopted in the Sales Convention, article 1(b).

DRAFT CONVENTION AND DRAFT MODEL LAW

Article A, paragraphs (2) and (3) [17]

(2) The fact that the parties have their places of business in different States is to be disregarded whenever this fact does not appear either from the contract or from any dealings between, or from information disclosed by, the parties at any time before or at the conclusion of the contract.

(3) Neither the nationality of the parties nor the civil or commercial character of the parties or of the contract is to be taken into consideration in determining the application of this (Convention) (law).

Article B [18]

For the purposes of this (Convention) (law):

(1) If a party has more than one place of business, the place of business is that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract.

(2) If a party does not have a place of business, reference is to be made to his habitual residence.

Article C [19]

This (Convention) (law) does not apply to contracts concerning goods, other property or services which are to be supplied for the personal, family or household purposes of a party, unless the other party, at any time before or at the

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17/ Secretariat supplementary provisions. Paragraph (2) is identical with the Limitation Convention, article 2(b), and the Sales Convention, article 1(2). Paragraph (3) is identical with the Limitation Convention, article 2(e), and the Sales Convention, article 1(3).

18/ Secretariat supplementary provision. It is identical with the Sales Convention, article 10, and in substance identical with the Limitation Convention, article 2(c) and (d).

19/ Secretariat supplementary provision. It is to some extent derived from the Limitation Convention, article 4(a), and the Sales Convention, article 2(a).

conclusion of the contract, neither knew nor ought to have known that the contract was concluded for such a purpose.

Article D [20/]

Unless the parties have agreed otherwise, the obligee is not entitled to recover or to forfeit the agreed sum if the obligor is not liable for the failure of performance.

Article E [21/]

(1) Where the agreed sum is to be recoverable or forfeited on delay in performance of the obligation, the obligee is entitled to both performance of the obligation and the agreed sum.

(2) Where the agreed sum is to be recoverable or forfeited on non-performance, or defective performance other than delay, the obligee is entitled either to performance, or to recover or forfeit the agreed sum, unless the agreed sum cannot reasonably be regarded as a substitute for performance.

(3) The rules set forth above shall not prejudice any contrary agreement made by the parties.

Article F [22/]

Unless the parties have agreed otherwise, if a failure of performance in respect of which the parties have agreed that a sum of money is to be recoverable or forfeited occurs, the obligee is entitled, in respect of the failure, to recover or forfeit the sum, and is entitled to damages to the extent of the loss not covered by the agreed sum, but only if he can prove that his loss grossly exceeds the agreed sum.

20/ Working Group draft (draft rule 2, A/CN.9/197, Annex).

21/ Working Group draft (draft rule 3, A/CN.9/197, Annex).

22/ Working Group draft (draft rule 5, A/CN.9/197, Annex).

Article G [23/]

(1) The agreed sum shall not be reduced by a court or arbitral tribunal.

(2) However, the agreed sum may be reduced if it is shown to be grossly disproportionate in relation to the loss that has been suffered by the obligee, and if the agreed sum cannot reasonably be regarded as a genuine pre-estimate by the parties of the loss likely to be suffered by the obligee.

23/ Working Group draft (draft rule 6, A/CN.9/197, Annex).

PART II: COMMENTARY

DRAFT CONVENTION AND DRAFT MODEL LAW

Article A

PRIOR UNIFORM LAW

Limitation Convention, article 2 and article 3, paragraph 1;

Sales Convention, article 1(1) and (3);

Council of Europe resolution, appendix, article 1;

Benelux Convention, annex, article 1.

COMMENTARY, DRAFT CONVENTION, Article A, paragraph (1)

11. This paragraph determines the scope of application of the Convention, and deals with the following issues:

(a) the international character of a contract to which the Convention applies;

(b) the link between a Contracting State and a contract which attracts the application of the Convention; and

(c) the nature of contractual clauses regulated by the Convention.

The international character of a contract

12. The Convention only applies to international trade contracts. A contract is regarded as international if, at the time of the conclusion of the contract, the parties have their places of business in different States. In contrast with other possible criteria (e.g. that the acts constituting the offer and acceptance have been effected in the territories of different States) the criterion adopted, taken together with the rules in article B, is convenient to apply and provides certainty in the application of the Convention.

The application of the Convention

13. Some connexion must exist between an international contract and the Convention sufficient to justify the application of the latter.

14. Under this article, the necessary connexion is that each party has his place of business in a State which has adhered to the Convention. When this connexion exists, the Convention must be applied by the forum of a Contracting State regardless of its rules of private international law.

Nature of the contractual clauses regulated

15. The clauses regulated are those commonly known as liquidated damages or penalty clauses. 24/ They are normally formulated as follows: upon a failure

24/ For a full description of the nature of these clauses, see A/CN.9/161, Sections I and II.

to perform an obligation (hereinafter referred to as "the main obligation") by one party, the obligor, the other party, the obligee, is entitled to recover or to forfeit an agreed sum of money.

(a) Failure of performance

16. In international trade such clauses are always linked to a main obligation arising out of a contract, and accordingly the application of the Convention is restricted to contracts. As the agreed sum may become due on various kinds of failure of performance (e.g. delay, non-delivery, defective workmanship) the article is given a comprehensive scope covering both total and partial failure of performance. 25/

(b) The agreed sum

17. In the practice of international trade, the obligation imposed on the non-performing party (the obligor) is always the payment of a sum of money. In most cases parties agree not on a fixed sum but on a formula for determining the sum payable by the obligor (e.g. $X payable for each day of delay, or $Y payable for each stipulated unit of output not attained), and the article is intended to cover such an agreement.

18. The article applies irrespective of whether the function of the agreed sum is to provide compensation payable by the obligor for the loss caused by his failure to perform, or is to coerce the obligor to perform, or is to serve as a limitation of the obligor's liability. 26/ In many cases, however, the agreed sum serves both as compensation and as a coercion to perform. Accordingly, the article has been formulated to cover clauses with this dual purpose. 27/

(c) Recovery or forfeiture

19. Under a liquidated damages or penalty clause, the agreed sum may be recoverable by the obligee directly from the obligor. However, it is often provided in international trade contracts that the sum is to be recovered from a bank under a bond for proper performance opened by the bank of the obligor in favour of the obligee 28/, and the article is drafted to cover such cases.

20. The entitlement to forfeiture envisaged in the article might arise in the following cases:

(i) it is agreed between the parties that a sum of money paid by the obligor to the obligee is to be retained (forfeited) by the obligee in the event of failure of performance by the obligor, but returned in the event of proper performance;

(ii) it is agreed between the parties that a sum of money due from the obligee to the obligor is to be withheld (forfeited) by the obligee in the event of failure of performance by the obligor, but paid in the event of proper performance.

25/ A/CN.9/WG.2/WP.33, para. 14.

26/ A/CN.9/161, para. 4.

27/ A/CN.9/WG.2/WP.33, para. 12.

28/ A/CN.9/WG.2/WP.33, para. 17.

(d) Types of clauses not covered

21. The formulation of the article excludes certain types of clauses from its scope. A clause under which the obligor has the right not to perform (e.g. to withdraw from the contract subject to paying the agreed sum), is excluded. 29/ Such a clause is not regarded as a liquidated damages or penalty clause in most national laws. Furthermore, a limitation of liability clause which fixes a maximum amount payable if liability is proved, but not a minimum 30/, is excluded as no agreed sum of money is payable.

22. Whether certain other types of clauses fall within the scope of the article may depend on the wording of the clause in question. A contract may provide for the payment of a sum in instalments, and a clause may be added that, upon a single default, all outstanding instalments are immediately payable. 31/ Such an acceleration clause falls outside the article, as the contract only provides for a single main obligation. If however, upon the single default, a sum additional to the outstanding instalments becomes payable, the clause may fall within the article. Again, a clause may be formulated as providing alternative obligations, e.g. fixing the price of goods sold at $10,000 payable on 1 January, but giving an alternative of paying on 1 October the sum of $15,000. 32/ If this is a true alternative obligation, the clause falls outside the article, as the $15,000 is not payable on a failure of performance. However, if the clause is construed to impose a main obligation to pay $10,000 on 1 Janaury, and an obligation to pay $5,000 on failure of that performance, it falls within the article.

23. The words "in writing" have been provisionally included because under some legal systems certain international trade contracts are only valid if they are in writing.

COMMENTARY, DRAFT MODEL LAW, Article A, paragraph (1)

The international character of a contract, and the nature of the contractual clauses regulated

24. As regards these matters, the scope of application of Article A is the same as that of article A of the draft Convention.

The application of the law

25. Under paragraph (1)(b) of this article, the forum of a State which adopts the Model Law must apply the law when its rules of private international law lead to the application of its law. Since after its adoption the Model Law becomes national law, it is appropriate to make its application depend on the choice of law rules regulating the application of national law.

29/ A/CN.9/161, para. 9; A/CN.9/WG.2/WP.33, para. 19, illustration.

30/ A/CN.9/161, para. 12.

31/ A/CN.9/161, para. 10; A/CN.9/WG.2/WP.33, para. 15, illustration.

32/ A/CN.9/161, para. 8.

COMMENTARY, Article A, paragraphs (2) and (3)

Paragraph (2)

Awareness of situation

26. Under paragraph (2), the Rules do not apply if "the fact that the parties have their places of business in different States ... does not appear either from the contract or from any dealings between,or from information disclosed by, the parties at any time before or at the conclusion of the contract". One example of such a situation is where the parties appeared to have their places of business in the same State but one of the parties was acting as the agent for an undisclosed foreign principal. In such a situation paragraph (2) provides that the contract, which appears to be between parties whose places of business are in the same State, is not governed by the Rules.

Paragraph (3)

Nationality of the parties, civil or commercial character of the transaction

27. The question whether the Rules are applicable to a contract is determined primarily by whether the relevant "places of business" of the parties are in different Contracting States. The relevant "place of business" of a party is determined by application of article B without reference to his nationality, place of incorporation, or place of head office. This paragraph reinforces that article by making it clear that the nationality of the parties is not to be taken into consideration.

28. In some legal systems the law relating to contracts is different depending on whether the parties or the contract are characterized as civil or commercial. In other legal systems this distinction is not known. In order to ensure that the provisions of the Rules are not interpreted to apply only to contracts characterized as "commercial" or between parties characterized as "commercial" under the law of a Contracting State or a State which has adopted the Model Law, this paragraph provides that the civil or commercial character of the parties or the contract is not to be taken into consideration.

29. It should be noted, however, that article C excludes from the sphere of application of the Rules certain contracts which are likely to be characterized as "civil" contracts by a legal system which recognizes the distinction between civil and commercial contracts.

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DRAFT CONVENTION AND DRAFT MODEL LAW

Article B

PRIOR UNIFORM LAW

Limitation Convention, article 2(c) and (d);

Sales Convention, article 10.

Paragraph (1)

Place of business

30. Paragraph (1) lays down the criterion for determining the relevant place of business: it is the place of business "which has the closest relationship to the contract and its performance". The phrase "the contract and its performance" refers to the transaction as a whole, including factors relating to the offer and the acceptance as well as the performance of the contract. The location of the head office or principal place of business is irrelevant for the purposes of this article unless that office or place of business becomes so involved in the transaction concerned as to be the place of business "which has the closest relationship to the contract and its performance".

31. In determining the place of business which has the "closest relationship", paragraph (1) states that regard is to be given to "the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract". Therefore, when the paragraph refers to the performance of the contract, it is referring to the performance that the parties contemplated when they were entering into the contract. If it were contemplated that a party would administer the contract at his place of business in State A, a determination that his "place of business" under this article was in State A would not be altered by his subsequent decision to transfer his place of business to State B.

32. Factors that may not be known to one of the parties at the time of entering into the contract would include supervision over the making of the contract by a head office located in another State, or the foreign origin or final destination of the goods. When these factors are not known to or contemplated by both parties at the time of entering into the contract, they are not to be taken into consideration.

Paragraph (2)

Habitual residence

33. Paragraph (2) deals with the case where one of the parties does not have a place of business. Most international contracts are entered into by businessmen who have recognized places of business. Occasionally, however, a person who does not have an established "place of business" may enter into a contract that is intended for trade purposes. The present provision provides that in this situation reference is to be made to his habitual residence.

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DRAFT CONVENTION AND DRAFT MODEL LAW

Article C

PRIOR UNIFORM LAW

Limitation Convention, article 4;

Sales Convention, article 2;

Council of Europe resolution, appendix, article 8.

COMMENTARY

34. The Rules are intended to apply only to international trade transactions as it is in this field that uniform rules are needed. The article expresses this limitation.

35. This limitation also serves another purpose. Many national legal systems have laws which regulate liquidated damages and penalty clauses in specific types of contracts with a view to protecting the weaker party to such contracts. Such laws may be applicable only to domestic contracts, and in that event no conflict would arise with the Rules. Even where their scope is not so limited, they are often restricted to consumer contracts (i.e. transactions for personal, family or household purposes). By excluding such contracts from the scope of the Rules, possible conflict with such laws is reduced. Furthermore, if the Rules were to take the form of a Model Law, any potential conflicts between the Model Law and national laws could be expressly resolved by the legislature of the State adopting the Model Law at the time of such adoption.

36. The exclusion of application of the Rules is, however, qualified in certain cases. The parties should know by the time of the conclusion of the contract whether their rights and obligations are those under the Rules or those under the applicable national law. However, the circumstances attending a contract may in some cases be such that a party has no reason to know that the contract is a consumer contract to which the Rules do not apply. In such cases the Rules apply.

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DRAFT CONVENTION AND DRAFT MODEL LAW

Article D

PRIOR UNIFORM LAW

Council of Europe resolution, appendix, article 4;

Benelux Convention, annex, article 2, paragraph 3.

COMMENTARY

37. Under this article, the liability of the obligor for the agreed sum is dependent on his liability for failure to perform the main obligation. It follows from the article that loss caused by the failure of performance of the obligor falls on the obligee "if the obligor is not liable for the failure of performance". Since the main purpose of the agreed sum is to provide a remedy for breach of contract, no sum is payable if there is no liability for failure of performance. Whether there is no liability, e.g. because the obligor has the defence of force majeure, or absence of fault, is determined under the applicable law.

38. The opening phrase of the article gives the parties the faculty of agreeing that the loss caused by the failure to perform the main obligation by the obligor lies on him even when he is not liable for such failure. Such an agreement may be justified by the circumstances attending the contract. However, where the defence of the obligor for failure to perform the main obligation is that the contract is void, the agreement may be ineffective because the liquidated damages or penalty clause is also void as forming part of the contract.

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DRAFT CONVENTION AND DRAFT MODEL LAW

Article E

PRIOR UNIFORM LAW

Council of Europe resolution, appendix, articles 2 and 3;

Benelux Convention, annex, article 2, paragraph 1.

COMMENTARY

39. This article regulates the relationship of two potential rights of the obligee - performance of the main obligation, and recovery of the agreed sum. 33/ In relating the two rights, the adoption of the principle that in all circumstances the obligee could only recover the agreed sum would result in his under-compensation in some instances. However, the adoption of the principle that in all circumstances the obligee could recover the agreed sum, and could also enforce the main obligation, would result in his over-compensation in some instances. Accordingly, paragraphs (1) and (2) of this article deal separately with the two cases encountered in practice, and attempt to provide results in accord with international trade practice and which are fair to both parties.

40. An agreed sum payable on delay in performance (paragraph (1)) will usually be quantified by the parties to compensate the obligee for the loss likely to be suffered by him during the delay occurring until performance takes place, and not to compensate him for non-performance. Accordingly, the obligee should be entitled to claim performance of the main obligation and also to recover the agreed sum. 34/ The position would be the same even if the delay continued for such a long period as to justify the anticipation that the obligor will not perform. 35/ In such a case, if performance by the obligor is not enforced by the legal system, the obligee will be awarded by the court a remedy additional to the agreed sum in order to compensate for the non-performance. Whether there has been delay in a particular case will be decided under the applicable national law.

41. Paragraph (2) covers all cases other than those where the agreed sum is payable on delay. 36/ In cases covered by this paragraph, the agreed sum is normally quantified so as fully to compensate the obligee for the failure to perform. In such cases, recovery of the agreed sum would be a monetary substitute for performance of the main obligation by the obligor. Accordingly, the obligee should not be entitled both to claim performance of the main obligation and to recover the agreed sum. On the other hand, it also follows that, where the

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33/ A/CN.9/161, Section V, A; A/CN.9/WG.2/WP.33, Part I, Section C.

34/ A/CN.9/WG.2/WP.33, paras. 30-32.

35/ Parties sometimes insert specific terms on the obligee's rights when the delay is of long duration: A/CN.9/WG.2/WP.33, para. 32.

36/ A/CN.9/WG.2/WP.33, paras. 33-39.

agreed sum cannot reasonably be regarded as a substitute for performance, the reason noted above for refusing to give the obligee both remedies does not exist.

42. Paragraph (3) gives the parties the faculty to vary the principles contained in paragraphs (1) and (2) (e.g. to vary the principle in paragraph (2) by providing that the obligee is in all circumstances entitled to claim both performance of the main obligation and recovery of the agreed sum).

Relationship to articles F and G

43. It must also be noted that the rights of the parties under this article may, depending on the circumstances of the case, be affected by the succeeding articles F and G. For example, in a case falling under paragraph (1) of this article, if the loss suffered by the delay grossly exceeds the agreed sum, the obligee is entitled under article F to damages to the extent of the loss not covered by the agreed sum. As another example, where the obligee chooses to recover the agreed sum under paragraph (2) of this article, the sum may be reduced by the application of article G, paragraph (2).

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DRAFT CONVENTION AND DRAFT MODEL LAW

Article F

PRIOR UNIFORM LAW

Council of Europe resolution, appendix, article 5;

Benelux Convention, annex, article 2, paragraph 2.

COMMENTARY

44. This provision regulates the relationship of two potential rights of the obligee - recovery of damages for failure to perform the main obligation, and recovery of the agreed sum. 37/ Two advantages in agreeing on the sum payable for failure of performance are avoidance of the expense and uncertainty accompanying an action for the recovery of damages, and the fixing of the limits of the obligor's liability. 38/ These advantages would be maximized by restricting the obligee to the recovery of the agreed sum. However, such a restriction would cause hardship to the obligee if his actual loss exceeds the agreed sum. The provision adopted compromises between these competing considerations by providing that the obligee is restricted to recovery of the agreed sum, except when his loss grossly exceeds that sum. Accordingly, when the obligee claims the agreed sum under article E, his rights may be supplemented by the right to damages given by this article.

45. The opening words of the article give the parties the faculty of varying the principle contained therein. Thus, where parties wish the agreed sum to be the absolute limit of the obligor's liability, they may so provide. 39/

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37/ A/CN.9/161, Section V, B; A/CN.9/WG.2/WP.33, Part I, Section D.

38/ A/CN.9/161, para. 4.

39/ A limitation clause which does not fix an agreed sum but only provides a monetary limit of liability is outside the scope of these provisions. See also para. 21 above.

DRAFT CONVENTION AND DRAFT MODEL LAW

Article G

PRIOR UNIFORM LAW

Council of Europe resolution, appendix, article 7;

Benelux Convention, annex, article 4.

COMMENTARY

46. Paragraph (1) of this article states that the agreed sum cannot be reduced. This principle is justified by the need for certainty in international trade transactions.

47. Paragraph (2) recognizes, however, that in very exceptional circumstances reduction of the agreed sum may be justified. Firstly, the agreed sum must grossly exceed the loss suffered by the obligee. Recovery of the agreed sum in such circumstances would unjustly enrich the obligee, and unfairly penalize the obligor. Secondly, the agreed sum should be such that it cannot reasonably be regarded as a genuine pre-estimate by the parties of the potential loss of the obligee. This limitation is justified by the view that agreements aiming solely at compensation for loss caused by failure to perform deserve to be encouraged.

48. As the purpose of this article is to permit a court or arbitral tribunal to vary the agreement of the parties, the article itself cannot be varied by the parties.

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