Comments:

85. The above formulations are based on variants submitted to the Working Group.[73] Variant 1 provides that the specified sum shall not be reduced, variant 2 provides that it may be reduced in certain circumstances, and variant 3 provides that it may be void in certain circumstances. Further work must depend on a decision as to which approach is to be adopted.

[73] A/CN.9/177, paras. 37-39 (Yearbook . . . 1980, part two, II).

2. Report of the Secretary-General: analysis of expert opinions, and of replies to the Secretariat questionnaire on liquidated damages and penalty clauses (A/CN.9/WG.2/WP.33/Add.1)*

CONTENTS

Analysis of expert opinions, and of replies to the Secretariat questionnaire

Introduction

1. In order to obtain views on commercial practice in regard to liquidated damages and penalty clauses, and in particular as to their experience in difficulties encountered in the negotiation, drafting and enforcement of such clauses, the Secretariat solicited the opinions of selected legal experts. The Secretariat also requested the International Chamber of Commerce (ICC) to circulate a questionnaire on the subject to its national committees.[1]

2. Replies to the questionnaire were received from Belgium, France, Finland, Germany, Federal Republic of, India, Israel, Italy, Japan, Norway, Republic of Korea, Sweden and Turkey. The questions contained in the questionnaire are set forth below, and under each question is set forth an analysis of the replies received to that question. A few opinions were received from legal experts, and it appeared convenient to record these opinions in the present document. The opinions are contained *in footnotes* under each question in the questionnaire to which the opinion expressed was relevant.

Analysis of opinions and replies

Question 1:

3. *Are provisions inserted in international contracts for the payment of liquidated damages or penalties for total or partial non-performance of contracts*

(a) *often?*

(b) *occasionally?*

(c) *never?*

4. The majority of respondents noted that such provisions were inserted often in international contracts, while some noted that they were inserted occasionally. Some respondents observed that the likelihood of the insertion of such provisions depended on the type of contract in question, such provisions being normally inserted in contracts for the supply of goods, for failure to observe the stipulated delivery time, and in contracts for the supply and erection of plant and machinery.[2]

Question 2:

5. *Have you encountered difficulties in agreeing upon the insertion of such provisions in international contracts? Please give details.*

6. The majority of respondents noted that, while there was often agreement on the need for such provisions, difficulties were encountered in agreeing on their contents (especially on the amount of the sum payable,

* 9 March 1981. Incorporates A/CN.9/WG.2/WP.33/Add.1/Corr.1 (English only).

[1] The Secretariat is most grateful to the International Chamber of Commerce for its co-operation, and to the ICC secretariat for its assistance.

[2] See also the replies to question 4 below.

and the ceiling on liability). A few respondents indicated that difficulties in reaching agreement did not arise when the agreed sum had only a compensatory function, but arose when the sum was intended to go beyond compensation and provide a sanction for non-performance. It was noted that difficulties were sometimes encountered in reaching agreement as to what remedies buyers might be entitled to in addition to claiming the agreed sum.[3]

Question 3:

7. *If the answer to question 1 is either* (a) *or* (b), *in what kinds of international contracts are such provisions inserted?*

8. It was noted that such provisions were inserted in a large variety of contracts. The following types were specially mentioned: supply of goods, manufacture and installation of plant and machinery, construction contracts, joint ventures, and supply of long-term services. As regards loans, it was noted that the penalty would consist of an enhanced rate of interest.[4]

Question 4:

9. *For what types of non-performance (e.g. delay in performance, failure to meet contract standards) are such provisions usually inserted, and what are the special advantages of such provisions for those types of non-performance?*

10. All respondents noted that such provisions are usually inserted for delay in performance.[5] Many respondents also indicated that they were sometimes inserted for failure to meet specified contract standards, usually in contracts for the supply of goods, including plant and machinery.

Question 5:

11. *Have you encountered any difficulties in the application or enforcement of such provisions in international contracts? Please give details. In particular, have liquidated damages or penalties*

(a) *been declared void?*

(b) *been reduced by Courts or arbitral tribunals?*

12. Most respondents noted that they had not encountered any difficulties, and that in their experience liquidated damages and penalty clauses had not been declared void, nor the agreed amounts reduced. A few respondents indicated that such clauses were rarely declared void, except when the agreed amount was grossly excessive. The agreed amounts were sometimes reduced when the judge or arbitrator had the power of reduction. It was also observed that parties sometimes amicably settled out of court disputes as to payment of liquidated damages and penalties.[6]

Question 6:

13. *Would the drawing up of a uniform law applicable to international contracts and reducing the difficulties which arise in the use of such provisions be worthwhile?*

14. Respondents were evenly divided on this issue. Those who observed that the drawing up of a uniform law would be worthwhile adduced the following reasons in support of their views: a uniform law would reduce the difficulties caused by the differences in national laws on liquidated damages and penalties; such a law would reduce negotiations on issues covered by it, and in any event provide a guideline as to issues to be covered; and a uniform law would provide better remedies to the party entitled to liquidated damages or a penalty.

15. Those who observed that the drawing up of a uniform law would not be worthwhile adduced the following reasons in support of their view: States were hesitant to accept uniform laws in the field of contract, and in particular States which had national laws to check abuses of liquidated damages and penalties would be

[3] (*a*) One expert noted that difficulties might arise in agreeing on the following matters: the law which should govern the contract and the liquidated damages or penalty clause; the measure of liquidated damages where such damages are stipulated for delay in delivery of plant or equipment (e.g. whether it should be a proportion of the value of the total unit, or of the item delayed, or the items not operable because of the delay); and the additional remedies which the buyer should have, where liquidated damages are provided for partial non-performance (e.g. output inferior to that specified) and there is total non-performance (the unit cannot be used at all).

(*b*) Another expert noted that difficulties might arise in ensuring that the proposed clause was enforceable under the agreed applicable law. The following solutions had been used to overcome possible difficulties in this regard (i) contracts in the alternative (i.e. a contract that specifies differing obligations for alternative qualities, quantities or timings of performance) (ii) discounts for early payment or premiums for early performance (iii) acceleration clauses and (iv) provision of the right to cancel the contract before it would otherwise be terminated, conditioned on a cancellation payment. One of the above solutions may be more appropriate to a particular contract, or more acceptable to a particular party.

[4] One expert noted that the type of contract in question was one of several factors which were considered as a whole when deciding on whether to insert such provisions. Other factors were: the importance of the proposed undertaking (e.g. the timing of completion might have developmental or political implications); difficulties of proving loss in respect of particular types of breach; the likely treatment of such provisions by the applicable law; and the attitude to such clauses of the forum chosen to settle disputes.

[5] One expert noted that it was not always possible to agree on a quantification of the loss which might be caused by delayed performance (e.g. quantification of lost profits caused by the failure to deliver a unit on time, the loss caused by the adverse "spread" effect to other economic activities resulting from the absence of the unit). At the same time, it was noted that even where quantifiable, the costs of delay (e.g. in a large scale industrial development project) might be so great that no contractor would agree to a liquidated damages clause covering such costs.

[6] (*a*) One expert noted that a technique used to enhance the validity of such provisions was, as a first step, to try to reach agreement on the applicable law and the forum for the settlement of disputes. Thereafter, the clause would be drafted so as to maximize the likelihood of its validity being upheld under the selected law and by the selected forum. It was noted, however, that there may be difficulty in agreeing on the law and the forum, and that there may also be limits to the extent to which parties could make a choice of law or forum.

(*b*) Another expert noted that difficulties often arose when the original plan in a construction contract was modified, but corresponding adjustments were not made to the liquidated damages and penalty clauses. Difficulties also arose where parties provided an overall ceiling for aggregate liquidated damages, but failed to state clearly what the remedies would be if performance was totally defective.

reluctant to exclude international commercial contracts from their sphere of application; the difficulties in this area were of a practical nature and varied with each contract, and could not be resolved by a uniform law; and the text of a uniform law would be of a vague and general character, and therefore of doubtful value.

Question 7:

16. *Are there any approaches, other than the drafting of a uniform law, which might reduce the difficulties currently encountered by parties in the use of liquidated damages and penalty clauses (e.g. the drawing up of guidelines to assist parties wishing to use a liquidated damages or penalty clause)?*

17. Two other possible approaches were noted. Firstly, the drawing up of standard contracts or general conditions, which would contain terms resolving the difficulties currently encountered. Secondly, the drawing up of guidelines, with an analysis of the problems encountered, and possible solutions to such problems.

18. Most of the respondents opposed to the drafting of a uniform law saw some merit in one or the other of the above approaches, and a few of the respondents supporting the drafting of a uniform law saw merit in the above approaches as alternatives to a uniform law.[7]

[7] One expert noted that the drafting of standard or model clauses was not desirable because immunity of a liquidated damages or penalty clause from attack on grounds of public policy, or other grounds, depended primarily on the clause being reasonable in relation to the circumstances of the particular contract in which it was contained.

Question 8:

19. *Are there any other observations you wish to make?*

20. Most respondents made no other observations. Those who replied to this question made the following observations on negotiating liquidated damages and penalty clauses:

(1) A ceiling should always be placed on the amount payable. This ceiling should generally be 5% to 8% of the amount of the contract;

(2) In lump-sum contracts, which are very frequent in the industrial construction sector, liquidated damages or penalties should only be inserted for failure to observe the final date of delivery. They should not be inserted for non-compliance with the successive stages of manufacture, transport, and erection;

(3) The contract should not contain provision for the deduction of liquidated damages or penalties from sums due to the supplier;

(4) Clauses providing liquidated damages or penalties for delay were often combined with clauses providing a bonus for early performance.

C. Report of the Secretary-General: clauses protecting parties against the effects of currency fluctuations (A/CN.9/201)*

1. The Commission, at its eleventh session, decided that, as part of the general study of international contract practices, consideration should be given to clauses in international trade contracts by which parties seek to protect themselves against the effects of currency fluctuations.[1] At that session it requested the Secretary-General to make a preparatory study of the question.

2. The Commission, at its twelfth session, had before it a report of the Secretary-General entitled "Clauses protecting parties against the effects of currency fluctuations".[2] The report described the commercial reasons for clauses designed to protect creditors against changes of the value of a currency in relation to other currencies and for clauses by which creditors seek to maintain the purchasing value of the monetary obligation under the contract. The report examined the various kinds of clauses designed to accomplish these two results and considered the legal and policy framework in which such clauses operate in a selected number of countries.

3. The Commission, at its twelfth session, recognized that the subject was of current interest because of the floating of the major trade currencies.[3] There was wide agreement that the development of clauses of the type described in the report would benefit international trade. However, doubts were expressed in the Commission whether such clauses were effective as a safeguard against currency fluctuations or world-wide inflation. The view was also expressed that it was doubtful whether it was possible for the Commission to regulate on a world-wide basis the content of clauses that sought to eliminate most or all of the monetary risks involved in long-term contracts.

4. As a result, the Commission requested the Secretariat to carry out further studies in respect of clauses protecting parties against the effects of currency fluctua-

* 2 April 1981. Referred to in Report, para. 48 (part one, A, above).

[1] *Official Records of the General Assembly, Thirty-third Session, Supplement No. 17* (A/33/17), para. 67 (Yearbook . . . 1978, part one, II, A).

[2] A/CN.9/164 (Yearbook . . . 1979, part two, I, D).

[3] *Official Records of the General Assembly, Thirty-fourth Session, Supplement No. 17* (A/34/17), paras. 32 to 40 (Yearbook . . . 1979, part one, II, A).