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DRAFT UNIFORM RULES ON
LIQUIDATED DAMAGES AND PENALTY CLAUSES

Analysis of the responses of Governments and
international organizations

Note by the Secretary-General

Addendum

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INTRODUCTION

1. Subsequent to the issuance of the analysis of responses of Governments and international organizations (A/CN.9/219), responses were received from the Governments of the Federal Republic of Germany (the FRG), Hungary, the Netherlands and Norway. These responses are analysed below.

PART I. APPROPRIATE FORM FOR THE UNIFORM RULES

A. Convention

2. The Netherlands considers a convention to be the most appropriate form for the uniform rules, as this form would be the most effective for unification. The FRG is of the view, however, that a convention is not an appropriate form. Many States, including the FRG, have national legislation which creates a fair balance between the rights of obligors and obligees under liquidated damages and penalty clauses, taking into account the circumstances prevailing in the particular States (e.g. the need for consumer protection). It would be very difficult for States to displace this national legislation by the uniform rules, and accordingly the FRG is doubtful if a convention would be ratified by a sufficiently large number of States.

B. Model Law

3. Hungary considers a model law to be the most appropriate form for the uniform rules. A model law is best suited to the nature of the uniform rules, and it can be incorporated in the national legislation in harmony with such legislation. The FRG is of the view, however, that if this form were adopted, the uniform rules would be embodied in the national legislation only very incompletely and with substantial alterations, and no effective unification would result.

C. UNCITRAL Rules (general conditions)

4. The FRG and Norway consider general conditions to be the most appropriate form. The FRG notes that in this form the uniform rules would help the parties in drafting their contracts by giving uniform criteria according to which, in the case of total or partial failure to perform the contract, the relation of claims for performance on the one hand and claims for penalties or damages on the other can be adjusted. Norway notes that the form of general conditions will make it possible to simplify the text, in particular regarding its scope of application. This form will also facilitate a clearer text for article F (because the rule therein can be linked to the intention of the parties) and for article G (because questions of modification based on the validity of the contract can be left to the applicable law).

PART II. COMMENTS ON SPECIFIC ARTICLES

A. Draft Convention and draft Model Law, article A, paragraph (1)

5. The Netherlands proposes the deletion of the term "agreed" appearing before the phrase "sum of money" as it is not necessary that the parties specify an exact sum in a liquidated damages or penalty clause. It is sufficient that it should be possible to determine the sum on the basis of the agreement.

6. Norway proposes clarification that the uniform rules do not apply to any guarantee by a third party (e.g. bank or other credit institution).

B. Draft Convention and draft Model Law, article E, paragraph (2)

7. The Netherlands and Norway propose the modification of this paragraph to clarify that when the last clause of this paragraph 1/ applies, the effect is not to impose a restriction on the obligee's choice between recovery of performance, or recovery or forfeiture of the agreed sum, but to remove the restriction on concurrent recovery of performance and recovery or forfeiture of the agreed sum. To secure this clarification, Norway suggests the following re-drafting:

"(2) Where the agreed sum is to be recoverable or forfeited on non-performance, or defective performance other than delay, the obligee is entitled to recover or forfeit the agreed sum. However, he is not so entitled where performance has been effected, unless the agreed sum cannot reasonably be regarded as a substitute for performance." 2/

C. Draft Convention and draft Model Law, article F

8. The Netherlands notes that it is unnecessary for this article to state that the obligee is entitled, in respect of a failure of performance, to recover the agreed sum. The article should only state that, in the circumstances specified therein, 3/ the obligee is entitled to damages to the extent of the loss not covered by the agreed sum.

9. Norway notes that liquidated damages or penalty clauses may be formulated for different purposes:

- (a) as a clause exclusively providing a penalty, independent of damages; or
- (b) as a clause providing for liquidated damages, limiting the damages to a maximum amount; or
- (c) as a clause providing minimum damages, but not preventing the recovery of excess damages.

1/ "... unless the agreed sum cannot reasonably be regarded as a substitute for performance."

2/ New wording underlined.

3/ "... but only if he can prove that his loss grossly exceeds the agreed sum."

10. Norway notes that the article as presently drafted attempts to provide a single rule in respect of clauses with these different purposes, and that this leads to unsatisfactory results. Norway proposes that the rule to be applied under the article should be made to depend on the intention of the parties in formulating the clause. The fact that the need for additional damages may differ according to whether the breach of contract consists of delay, non-performance or defective performance should also be taken into account.

11. Norway accordingly makes the following suggestions:

- (a) that the last sentence of the article 4/ be deleted; or
- (b) that the article should be re-drafted as follows -

"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 for loss not intended to be covered by the agreed sum (e.g. where the sum is not to be regarded only as a penalty independent of any loss or as liquidated maximum damages)." 5/

The following sentence may also be added if considered necessary:

"However, where the agreed sum must be regarded as part of the damages, the obligee may claim damages to the extent of the loss not actually covered by the sum." 6/

D. Draft Convention and draft Model Law, article G

12. The FRG notes that, if the form of general conditions is adopted for the uniform rules, the present drafting of this article may be inappropriate. The national legislation of many States, including that of the FRG, contains mandatory provisions providing for review by the courts of liquidated damages and penalty clauses in certain cases. Such legislation would, to some degree at least, conflict with the provisions of article G. Accordingly, the FRG suggests that it should be expressly provided, either in article G or elsewhere in the uniform rules, that when such mandatory provisions are inconsistent with the uniform rules, the former is to prevail.

13. Norway notes that the difficulties encountered in article G will be reduced if the uniform rules are given the form of general conditions, which will be subject to mandatory law e.g. rules on validity or on unconscionable contracts. Norway proposes that, if this form is to be chosen, paragraph (1) of this article should be re-drafted as follows:

"(1) The agreed sum shall not be reduced by a court or arbitral tribunal, unless to the extent that the agreement may be modified according to the rules on validity of contracts or on unconscionable contracts under the law applicable" 7/

4/ "... but only if he can prove that his loss greatly exceeds the agreed sum."

5/ New wording underlined.

6/ Idem.

7/ Idem.

14. The Netherlands proposes that the uniform rules should state that parties cannot by agreement vary the provisions of this article. This might be done in a new paragraph added to this article, or in a new article specifying which articles the parties can vary (articles D to F) and which they cannot (articles A to C and G). If a new article is formulated, the provisions in articles D to F enabling the parties to modify those articles could be deleted.

15. The Netherlands notes that the provisions in this article defining the conditions under which an agreed sum can be reduced may be inappropriate for cases where the function of the agreed sum is not to compensate the obligee for loss he might suffer by the obligor's non-performance, but to coerce the obligor to perform. For instance, where the agreed sum was stipulated to coerce the obligor to perform an obligation, non-performance of which would not result in appreciable financial loss to the obligee, the obligor may be able to obtain a reduction, which in the circumstances would be inappropriate.

16. The Netherlands suggests that, before an agreed sum can be reduced under paragraph (2) of this article, both conditions specified in the paragraph 8/ must be satisfied, and that the paragraph should clearly state this requirement. The FRG and Norway, however, are of the view that paragraph (2) should be modified to enable reduction of the agreed sum if only one of the conditions is satisfied. The FRG notes that to require both conditions to be satisfied excessively restricts the scope of application of the article to a few cases which in practice rarely occur. Norway suggests the following re-drafting of the paragraph:

"(2) However, the agreed sum may be reduced if it is shown to be unreasonably disproportionate in relation to the loss suffered by the obligee, or if the agreed sum cannot reasonably be regarded to reflect a genuine pre-estimate by the parties of the loss likely to be suffered by the obligee." 9/

8/ "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."

9/ New wording underlined.