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‘MEXICAN REVOLUTION’ IN CISG
JURISPRUDENCE AND CASE-LAW:
ATTORNEYS’ FEES AS (NON)RECOVERABLE
LOSS FOR BREACH OF CONTRACT*

Abstract

This article examines whether attorneys’ fees incurred in litigation constitute a loss within the meaning of Article 74 of the CISG. The methodology used to answer this question includes: interpretation of the Convention with due regard to its international character and the need to promote uniformity in its application; comparative survey with regard to legal classification of recovery of attorneys’ fees as a procedural or substantive issue; analysis of relevant international instruments, including ALI/ UNIDROIT Principles of Transnational Civil Procedure and numerous rules of arbitral institutions, and examination of existing case law where the CISG was applied. The author concludes that attorneys’ fees incurred in litigation are not a ‘loss suffered as a consequence of breach of contract,’ but rather a specific kind of procedural expenditure subject to different rules of reimbursement.

Key words: *CISG, damages, loss, attorneys’ fees, litigation, substance-procedure distinction, autonomous and uniform interpretation of the Convention.*

Dr. Christa Jessel-Holst has affected many young scholars from Serbia and the region in their work on comparative and international private law. Not only that she has enabled them access to important resources for their academic research but her expertise and warm personality were a strong impetus and inspiration for the establishment or extension of cooperation between scholars from the countries of former Yugoslavia. This cooperation resulted in a highly constructive exchange of ideas on some of the most important issues of harmonization of domestic private law with contemporary legal developments on the global and European level. It is therefore my privilege and great pleasure to contribute to this *Liber Amicorum*, to honor Christa Jessel-Holst’s past achievements and to show my sincere appreciation for our long and fruitful friendship and collaboration in this manner.

* I wish to thank Prof. Harry Flechtner from the University of Pittsburgh School of Law for the long-term exchange of thoughts and ideas on this topic which I found to be extremely valuable in finalizing this paper. I would also like to thank a colleague of mine, Marko Jovanovic, who took the time to review, comment and edit this paper. Any errors of fact or law are, of course, mine.

This contribution will address one of the most debated issues arising out of the application of the 1980 UN Convention on Contracts for International Sale of Goods (hereinafter referred to as the CISG or the Convention),¹ which despite the 30th anniversary of this act still represents an insurmountable obstacle to unified interpretation and application of the Article 74 of the CISG – the issue of recovery of attorneys’ fees. It has been the source of many controversies and conflicting opinions amongst legal scholars, courts and arbitral tribunals. The anniversary of the CISG, which coincides with the anniversary of Christa Jessel-Holst’s work at the Max Planck Institute in Hamburg, seemed as an appropriate occasion to elaborate on this issue herein. Furthermore, given that this paper stems from research that I have conducted in Hamburg for my doctoral dissertation under her guidance, it seemed more than proper to share the results of my work in this publication.

I. INTRODUCTION

Emiliano Zapata is celebrated throughout Mexico as a true hero of revolution against the dictatorship of Porfirio Diaz at the beginning of the 20th century. He fought for social reform, including agrarian reform and restoration of land to the citizens of Mexico under the slogan ‘Tierra y Libertad’ (land and liberty). Although the newly established government had not shared his goals and had even arranged for his murder, the name of Emiliano Zapata lives on and his commitment to social justice is remembered by all Mexicans.²

One century later, the name of Emiliano Zapata has reappeared to mark the beginning of perhaps another revolution, but this time in the field of the law of contracts – more precisely, in the area of the law of damages for breach of international sales contracts. Namely, in a 2001 case *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co* (hereinafter referred to as the *Zapata case*), before the US Federal District Court for Northern District of Illinois, Eastern Division, the plaintiff-seller sued the defendant-buyer for breach of contract (failure to pay the price) and sought recovery of losses suffered as a consequence of such breach.³ Given that the parties had their respective places of businesses in different Contracting States to the CISG, i.e. Mexico and the United States, the court applied the Convention and ruled in favor of the plaintiff. At the first glance, this outcome does not seem surprising. However, it is important to note that not only did the Court decide that the seller had the right to claim damages but it also found that the damages request is grounded in part in which the seller claimed compensation for his litigation expenses including attorneys’ fees representing *a consequence of buyer’s breach* in the seller’s view.

1 The CISG has now been ratified by 76 countries, thus representing the global code for international sales contracts. See <http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html> (last visited on July 16, 2010).

2 See <<http://www.mexonline.com/emilianozapata.htm>>; <<http://www.answers.com/topic/emiliano-zapata>>; <http://en.wikipedia.org/wiki/Emiliano_Zapata> (last visited on June 11, 2010).

3 *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co., Inc., etc.*, 2001 U.S. Dist. LEXIS 15191 and 2001 WL 1000927 (N.D. Ill.), available at: <<http://cisgw3.law.pace.edu/cases/010828u1.html>>.

In majority of jurisdictions, the rules on recovery of costs of civil proceedings, including legal costs of the parties (such as attorneys' fees), are contained in the codes on civil procedure.⁴ Also, in a vast majority of jurisdictions there is a rule which requires the 'losing' party to reimburse the 'winning' party for its legal costs incurred in the proceedings⁵ ('loser pays', 'costs follow the event', 'fee shifting' or 'English rule'⁶). Consequently, not only is the issue of legal costs rarely (if ever) included in the damages claim and awarded on that basis, but the legal nature of such loss is often specified in national legal doctrines as loss distinct from the loss that arises out of a breach of contract.⁷ Hence, the decision of the US court to grant

4 See J. Gotanda, 'Damages in Private International Law,' 326 *Recueil des cours* 73 (Hague Academy of International Law, Martinus Nijhoff Publishers 2007) at pp. 269–289 (containing a survey of national laws on the awarding of costs and fees in Europe, North America, Latin America, Oceania, Asia and the Middle East); R. Jackson (Royal Courts of Justice, London), *Review of Civil Litigation Costs: Preliminary Report*, Vol. 1 and Vol. 2, May 2009 (containing a survey of national laws on the awarding of costs and fees in England, Wales, Scotland, Germany, France, the Netherlands, Australia, New Zealand, the USA, Canada and the Eastern Caribbean), available at: <http://www.judiciary.gov.uk/about_judiciary/cost-review/jan2010/vol1-low.pdf>; S. Cromie, *International Commercial Litigation* (London, Butterworths 1990) at pp. 229–254. For practitioners and academic reports on costs of litigation in 33 jurisdictions, prepared for the purposes of the International Conference on Litigation Costs and Funding organized by the Centre for Socio-Legal Studies and the Institute of European and Comparative Law of the University of Oxford in July 2009, see: <<http://www.csls.ox.ac.uk/COSTOFLITIGATIONDOCUMENTSANDREPORTS.php>>.

5 Ibid.

6 As an underlying rationale of the 'loser pays' rule the following policies have been quoted: 1. punishing the losing party, 2. indemnifying the winning party and 3. deterring frivolous and bad faith litigation (J. Gotanda, 'Awarding Costs and Attorneys' Fees in International Commercial Arbitrations,' 21 *Michigan Journal of International Law* 1 (1999) at p. 5). It has also been said that this rule assist the parties to finance their litigation, is a factor in the settlement process and helps minimize the potential for damages awards to be eroded by the costs of litigation (Australian Law Reform Commission Report No. 75, *Costs shifting – who pays for litigation*, August 1995, p. 49). The 'loser pays' rule is controversial in certain types of litigation but is generally considered appropriate in commercial litigation and is typically stipulated in commercial contracts (comment P–25A to the 2006 ALI/UNIDROIT Principles of Transnational Civil Procedure, *Uniform Law Review* 2004–4, 758 at p. 802, available at: <<http://www.unidroit.org/english/principles/civilprocedure/ali-unidroitprinciples-e.pdf>>). For a critical overview of different rationales of a 'fee shifting' rule, see: T. Rowe, 'The Legal Theory of Attorney Fee Shifting: A Critical Overview,' 1982 *Duke Law Journal* 651 (1982) pp. 651–680.

7 In Serbian legal doctrine, for example, the obligation to reimburse attorneys' fees to a successful litigant is said to arise out of the law itself (*obligatio ex lege*) and should not be confused with the request for damages (B. Poznić, *Komentar Zakona o parničnom postupku prema tekstu Zakona iz 1976. godine sa docnijim izmenama i dopunama* [Commentary of the 1976 Law on Civil Procedure with amendments] (Službeni glasnik, Beograd 2009), at p. 320; B. Poznić and V. Rakić-Vodinelić, *Građansko procesno pravo* [Law of Civil Procedure] (Beograd, Savremena administracija 2010) at p. 435; A. Jakšić, *Građansko procesno pravo* [Law of Civil Procedure] (Beograd, Službeni glasnik 2009) at pp. 512–513). In Croatia, duty to compensate the winning litigant for its costs incurred during the proceedings is an autonomous obligation regulated by procedural rules and independent from the substantive relationship which is the subject matter of the proceedings (S. Triva and M. Dika, *Građansko parnično procesno pravo* [Law of Civil Procedure] (Zagreb, Narodne novine 2004) p. 462). In Japanese legal doctrine, it has been stated: 'The cost of litigation [including attorneys' fees] is not directly related to the actual right claimed and should instead be considered as the cost for dispute resolutions related to such right.' (T. Ninomiya, 'Funding, Costs and Proportionality in Civil

the seller's claim in this respect in the *Zapata case* represented a revolution of a sort in the field of contract law and, more specifically, in the field of interpretation of Article 74 of the CISG. Furthermore, unlike the majority of countries which follow the 'loser pays' principle, the US courts generally do not require the losing party to reimburse the winning party for its legal expenses ('American rule'⁸). Consequently, it is safe to say that the *Zapata* decision marked the beginning of a 'revolution' in the field of litigation before US courts.

Despite the fact that this decision was later reversed on appeal by the U.S. Federal Court of Appeals for the 7th Circuit⁹ and that the said 'revolution' was at least in the

Justice Systems in Japan,' at p. 17, available at: <<http://www.csls.ox.ac.uk/COSTOFLITIGATIONDOCUMENTSANDREPORTS.php>>). In Danish legal doctrine, the rationale for the 'loser pays' principle is explained as follows: 'The decisive condition for having to pay costs is the fact that the case is lost. In other words, this is an area where there is liability without culpability.' (A. Ørgaard, Report, available at: <<http://www.csls.ox.ac.uk/COSTOFLITIGATIONDOCUMENTSANDREPORTS.php>>). In the Netherlands, '[o]riginally [the] principle of liability for procedural costs was founded on the notion that the losing party had committed tort. Shortly after this rule of law was implemented, however, the general opinion on this notion changed. Equity and justice, rather than tort, should be at the root of the rule that the losing party has to bear the procedural costs.' (see Comparative Project on Litigation Costs and Funding Systems: the Netherlands, at p. 1, available at: <<http://www.csls.ox.ac.uk/COSTOFLITIGATIONDOCUMENTSANDREPORTS.php>>). In the US, under the usual approach of U.S. courts, damages provisions of the Uniform Commercial Code are not construed so as to authorize recovery of a successful litigant's attorney's fees absent a specific reference to such recovery in the express language of the statute (H. Flechtner, 'Recovering Attorneys' Fees as Damages under the UN Sales Convention: A Case Study on the New International Commercial Practice and the Role of Case Law in CISG Jurisprudence, with Comments on *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co.*' 22 *Northwestern Journal of International Law & Business* 121 (2002) at p. 138).

- 8 Award of attorneys' fees is the rule prevailing in most legal systems, although, for example, not in China, Japan and the United States (however, even in these countries there are exceptions justifying for reimbursement of attorneys' fees). See J. Gotanda, loc. cit. n. 6, at pp. 12–13. The rationale behind this regulation in the US is said to be that: '[O]ne should not be penalized for merely defending or prosecuting a lawsuit and [...] the poor might be unjustly discouraged from instituting actions to vindicate their rights if the penalty for losing included the fees of their opponents' counsel.' See judgment of the US Supreme Court in *Arcambel v. Wiesman*, (3 U.S. 306 (1796)).
- 9 *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co.*, 313 F.3d 385 (7th Cir. 2002), available at: <<http://cisgw3.law.pace.edu/cases/021119u1.html>>. What followed after this decision is that the U.S. Court of Appeals denied a rehearing *en banc* on 9 January 2003 (2003 U.S. App. LEXIS 375). A petition for *writ of certiorari* was filed to the Supreme Court of the United States in 2003 and an *amicus curiae* brief was submitted by the International Association of Contract and Commercial Managers and the Institute of International Commercial Law of the Pace University School of Law, given that they found this proceedings to be of the outmost significance not only for proper resolution of the conflict over the meaning of Art. 74, but also more generally for clarifying the interpretative rules that courts must follow in applying the CISG. In the end the U.S. Supreme Court requested the U.S. Solicitor General to express a view of the United States in this case (Supreme Court Reporter 123, 2599.). The Solicitor General expressed his view that the Petition ought to be rejected and it was eventually denied by the Supreme Court on 1 December 2003 by the U.S. Supreme Court (124 S.Ct. 803). See Case History, available at: <<http://cisgw3.law.pace.edu/cases/021119u1.html>>. The view expressed in the *Zapata* case on appeal was later followed in two other cases: see judgment of U.S. Federal District Court, Northern District of Illinois, Eastern Division in *Ajax Tool Works, Inc. v. Can-Eng Manufacturing Ltd.* (2003 U.S. Dist. LEXIS 1306) of 29 January 2003, available at: <<http://cisgw3.law.pace.edu/cases/030129u1.html>>.

US thus brought to an end, the *Zapata case* continues to attract considerable interest and give rise to debates amongst legal scholars worldwide. The significance of this topic is not only academic but practical as well, given that the amount of legal costs in an international commercial setting can be rather high,¹⁰ sometimes even exceeding the amount in dispute.¹¹ Consequently, the early assessment of (non)recoverability of such costs may discourage the aggrieved party from taking legal recourse against the breaching party unless a satisfactory costs allocation is agreed on by the parties in advance. As stated by Eric Schwartz: 'When an international commercial dispute arises, the cost of resolving it may be as important to the parties as the merits of the claims themselves.'¹² The possibility of recovering attorneys' fees as damages is particularly important in countries where legal costs are not recoverable under the pertinent procedural rules, but it is also important in 'loser pays' countries since such a possibility would require change of their long established practice of awarding legal costs under the procedural codes and rules (and not as part of the damages claim).¹³

>; judgment of U.S. District Court, Western District of Pennsylvania in *Norfolk Southern Railway Company v. Power Source Supply, Inc.* (2008 U.S. Dist. LEXIS 56942) of 25 July 2008, available at: <<http://cisgw3.law.pace.edu/cases/080725u1.html>>.

- 10 In the *Zapata case* itself the amount of attorneys' fees claimed by the successful litigant amounted to more than half of the main claim for purchase price (US \$550,000). Similarly, in one ICC case, the prevailing respondent was awarded UK £500,000 for legal costs (final award No. 4975 (ICC 1988), reprinted in 14 *Y.B. Com. Arb.* 122, pp. 136–137 (1989)). In ICSID cases legal costs may amount to several millions of US dollars. E.g. in *Plama Consortium Limited v. Bulgaria* (ICSID Case No. ARB/03/24, award of 27 August 2008) the prevailing party was awarded US \$7 million for legal costs (half of the amount it claimed), available at: <<http://ita.law.uvic.ca/documents/PlamaBulgariaAward.pdf>>; in *Southern Pacific Properties Ltd. v. Egypt* (ICSID Case No. ARB/84/3, award of 20 May 1992, reprinted in 19 *Y.B. Com. Arb.* 51, at pp. 82–83 (1994)), the prevailing party was awarded \$5 million for costs and attorneys' fees.
- 11 J. Gotanda, loc. cit. n. 6, at pp. 2–3; B. Hanotiau, 'The parties' costs of arbitration' in Yves Derains, Richard Kreindler, eds., *Evaluation of Damages in International Arbitration* (Paris, Dossiers of the ICC Institute of World Business Law (ICC Publication No. 668) 2006) at p. 213. For an overview of the amount of attorneys' fees incurred in litigation before national courts see World Bank 'Doing Business Report' for 2009, available at: <<http://www.doingbusiness.org/ExploreTopics/EnforcingContracts/>>. According to this Report, the costs of legal representation in litigation in Serbia, amounted to 9,43% of the value of the claim, in average. In the US they amounted to 8%, in Germany to 8,78%, in France to 10,7%, and in UK to 19,6%; but in some countries they exceeded the value of the claim (in Democratic Republic of Congo, Indonesia, Malawi, Sierra Leone and Timor-Leste).
- 12 E. Schwartz, 'The ICC Arbitral Process, Part IV: The Costs of ICC Arbitration', 4 *ICC International Court of Arbitration Bulletin* 8 (1993) pp. 8–23.
- 13 This would impact not only the legal basis under which the recovery of these expenses is being granted but also the conditions for their reimbursement (subject to the foreseeability limitation of Art. 74 CISG and mitigation principle of Art. 77 CISG) and the method of their calculation, since the CISG would then preempt the otherwise applicable domestic law. In some jurisdictions, including Serbia, the amount of recoverable legal fees is calculated on the basis of tariffs and schedules of attorneys' fees published by the Bar Association (or other institution) and dependent of, inter alia, the type of dispute, amount involved, nationality of the client, type and number of services rendered etc. For different limitations on awards of attorneys' fees in European countries see J. Gotanda, *Supplemental Damages in Private International Law*, (The Hague, Kluwer Law International 1998) at pp. 152–153, 157–158.

This paper will attempt to summarize the diverse opinions regarding this issue and suggest perhaps a different view on this matter. The first part of the paper provides a short overview of Article 74 of the CISG and the meaning of the word 'loss' used in that Article. The second part of the paper contains a presentation and criticism of the views against recovery of attorneys' fees under the CISG, whilst the third part will summarize the opinions of those scholars who justify recovery of attorneys' fees as damages for breach of contract. In fourth part of the paper the author concludes with her own understanding of this subject.

II. RIGHT TO CLAIM DAMAGES UNDER THE CISG AND CALCULATION OF DAMAGES

Articles 45 and 61 of the CISG constitute legal bases for the award of damages to the aggrieved party under the Convention. Article 74 of the CISG, on the other hand, constitutes a general rule for the calculation of damages.¹⁴ It states:

'Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.'

Hence, in order for damages to be recoverable under Article 74 of the CISG, the following three elements have to exist: (1) breach of contract, (2) loss suffered as a consequence of the breach and (3) foreseeability of such loss at the time of conclusion of the contract by the party in breach. The amount of damages so calculated may be reduced under the principle of mitigation of loss laid down in Article 77 of the CISG, or the debtor may be exempted from paying damages in entirety under Articles 79 and 80 of the CISG.

The CISG does not specify what types of losses are recoverable, except for clarifying that besides the 'actual loss' (lat. *damnum emergens*) 'loss of profit' (lat. *lucrum cessans*) is also recoverable.¹⁵ This is reasonable, given the great variety of breaches of contract that may give rise to a claim for damages, and given the wide diversity of losses that may be suffered as a consequence of such breaches.¹⁶

14 Arts. 75 and 76 CISG provide for special methods for calculation of damages in cases where the contract was avoided. However, even in the case of avoidance, an aggrieved party is free to opt for calculation of damages under Art. 74 CISG.

15 The specific reference to loss of profit was deemed necessary because in some legal systems the concept of 'loss' as such does not include loss of profit. See Secretariat Commentary on Article 70 of the 1978 Draft, para 3, available at: <<http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-74.html>>.

16 To name a few: travel expenses of the aggrieved party in relation to conclusion and/or performance of the contract; fees for issuing and modifying the letter of credit; costs for acquiring a bank loan for the advance payment of the price; inspection costs and costs of repair of the non-conforming goods; costs incurred while mitigating the loss; costs for lending the machines needed for the buyer's production facilities (due to seller's delay in delivery of such machines); freight and transshipment freight; fees for loading and unloading; storage costs; import costs; VAT; administrative penalties and other expenses incurred as a result of a breach of contract.

Consequently, it would be impossible to list all types of losses. Not surprisingly, the lack of enumeration of the concrete types of recoverable losses in the CISG is in line with major contract laws worldwide. Consequently, given that the Article 74 is based on the principle of full compensation,¹⁷ it may be concluded that all kinds of losses, suffered by the party and caused by the breach, are recoverable *in principle* under the CISG.¹⁸ This conclusion is subject to an exception based on Article 5 of the CISG which specifies that the Convention does not apply to the liability of the seller for death or personal injury caused by the goods to any person. Consequently, losses suffered as a consequence of death or personal injury caused by the goods to any person are not recoverable under the CISG.¹⁹

Moving back to the issue of attorneys' fees as a recoverable loss, it is clear that the CISG does not expressly exclude this type of loss from the category of losses that may be considered recoverable under Article 74. Although there is no suggestion in the drafting history of the Convention or in the cases where the CISG was applied that 'loss' was intended to include attorneys' fees, there is no suggestion to the

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- 17 V. Knapp 'Article 74' in C. M. Bianca and M. J. Bonell, eds., *Commentary on the International Sales Law - the 1980 Vienna Sales Convention* (Milan, Giuffrè 1987) at p. 543; J. Honnold, *Uniform Law for International Sales* (The Hague, Kluwer Law International 1999) at p. 445; I. Schwenzer 'Article 74' in I. Schwenzer, ed., *Schlechtriem & Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG)* (New York, Oxford University Press 2010) at p. 1000; CISG-AC Opinion No. 6, *Calculation of Damages under CISG Article 74*, para. 1, available at: <<http://www.cisg.law.pace.edu/cisg/CISG-AC-op6.html>>. Also see award No. SCH-4366 of 15 June 1994, available at: <<http://cisgw3.law.pace.edu/cases/940615a3.html#cd>>; judgments of Austrian Supreme Court of 6 February 1996, available at: <www.cisg.law.pace.edu/cases/960206a3.html> and 14 January 2002 available at: <<http://cisgw3.law.pace.edu/cases/020114a3.html#uab>>; judgment of the US Federal Court of Appeals for the 2nd circuit in the case *Delchi Carrier, S.p.A. v. Rotorex Corp.* of 6 December 1995, available at: <<http://cisgw3.law.pace.edu/cases/951206u1.html>>, etc.
- 18 See P. Huber 'Damages', in P. Huber, A. Mullis, *The CISG - A new textbook for students and practitioners* (Munich, Sellier 2007) at pp. 268-269.
- 19 As for the recovery of non-pecuniary losses, the CISG does not expressly call for their recovery, unlike Art. 7.4.2(2) of the UNIDROIT Principles of International Commercial Contracts and Art. 9:501(2)(a) of the Principles of European Contract Law. However, the fact that certain types of losses stemming from the liability referred to in Art. 5 CISG are not recoverable under the CISG does not necessarily mean that all kinds of non-pecuniary losses are not recoverable under the CISG, such as the loss of good will, i.e. loss to business reputation. Against recovery of non-pecuniary loss see P. Schlechtriem, 'Non-Material Damages - Recovery under the CISG', 19 *Pace International Law Review* (Spring 2007/1) at p. 90 et seq; J. Gotanda, 'Awarding Damages under the United Nations Convention on the International Sale of Goods: A Matter of Interpretation', 37 *Georgetown Journal of International Law* 95 (Fall 2005) at pp. 129-130; CISG-AC Opinion No. 6, op. cit. n. 17, comment 7.1; award of the Tribunal of International Commercial Arbitration at the Russian Federation Chamber of Commerce and Industry of 3 March 1995, available at: <<http://cisgw3.law.pace.edu/cases/950303r2.html>>. For recovery of non-pecuniary loss in exceptional circumstances, such as if the contract has an express non-material purpose and the loss is a typical consequence of the breach of contract or in the instances of loss to business reputation see: H. Stoll, G. Gruber 'Article 74' in P. Schlechtriem and I. Schwenzer, eds., *Commentary on the UN Convention on the International Sale of Goods (CISG)*, (New York, Oxford University Press 2005) at p. 753; I. Schwenzer and P. Hachem, 'The Scope of the CISG Provisions on Damages' in D. Saidov and R. Cunningham, eds., *Contract Damages: Domestic and International perspectives* (Oxford, Hart Publishing 2008) at pp. 91-96; D. Saidov, *Methods of Limiting Damages under the Vienna Convention on Contracts for the International Sale of Goods*, § 5 (December 2001), available at <<http://cisgw3.law.pace.edu/cisg/biblio/saidov.html>>.

contrary either. As a matter of fact, certain pre-litigation/pre-arbitration legal costs have often been reimbursed by the courts (tribunals) to the aggrieved party,²⁰ or have been deemed recoverable in principle.²¹ However, the recovery of attorneys' fees incurred in the litigation/arbitration was said to be of a different character thus calling for a different treatment.²² As previously mentioned, this paper aims to explore whether such standpoint is justified.

III. RECOVERY OF ATTORNEYS' FEES IS NOT COVERED BY THE CISG – IS IT REALLY THAT OBVIOUS?

There are several authors who argue that the issue of recovery of attorneys' fees is not regulated by the CISG and that, consequently, this issue needs to be solved in conformity with the law applicable by virtue of the rules of private international law. The justification of such a position, though, is diverse. There are authors who find this issue being a matter of procedural law and consequently not governed by the CISG (1.), those who are basing their argument on the drafter's intent (i.e. lack of an intent to have this issue covered by the CISG) (2.), those who find recovery of attorneys' fees under the CISG against the principle of equality of the parties to the sales contract (3.) and those who find the CISG principles not well-suited to deal with the calculation of attorneys' fees as recoverable loss (4.). Also, many authors justify their position by combining two or more of these reasons. As for the case-law, it seems that the majority of the awards and judgments where the CISG was applied is in line with this standpoint given that the recovery of attorneys' fees was almost always required and awarded on the basis of procedural law of a forum (5.).

1. Recovery of attorneys' fees is a matter of procedural law – 'Don't mix apples and oranges'

Given that the issue of recovery of costs of the proceedings, including attorneys' fees, is almost always regulated by the provisions of the codes on civil procedure (or arbitration rules), some authors and judges (arbitrators) consider this issue as a

20 See Judgement of LG Potsdam of 7 April 2009, available at: <<http://cisgw3.law.pace.edu/cases/090407g1.html>>; judgment of Kantonsgericht Zug of 27 November 2008, available at: <<http://cisgw3.law.pace.edu/cases/081127s1.html>>; award of Foreign Trade Court of Arbitration attached to the Serbian Chamber of Commerce No. T-09/07 of 21 January 2008, available at: <<http://cisgw3.law.pace.edu/cases/080123sb.html>>; judgment of LG Coburg of 12 December 2006, available at: <<http://cisgw3.law.pace.edu/cases/061212g1.html>>; judgment of OLG Köln of 3 April 2006, available at: <<http://cisgw3.law.pace.edu/cases/060403g1.html>>; judgment of AG Viechtach of 11 April 2002, available at: <<http://cisgw3.law.pace.edu/cases/020411g1.html>>; judgment of OLG Düsseldorf of 22 July 2004, available at: <<http://cisgw3.law.pace.edu/cases/040722g1.html>>; judgment of Handelsgericht des Kantons Aargau of 19 December 1997, available at: <<http://cisgw3.law.pace.edu/cases/971219s1.html>>; judgment of OLG Düsseldorf of 11 July 1996, available at: <<http://cisgw3.law.pace.edu/cases/960711g1.html#ua>>; judgment of LG Krefeld of 28 April 1993, available at: <<http://cisgw3.law.pace.edu/cases/930428g1.html>>. See also H. Stoll, G. Gruber, op. cit. n. 19, at p. 757; P. Huber, op. cit. n. 18 at p. 279. But see I. Schwenzer, P. Hachem, op. cit. n. 19 at pp. 104–105; D. Saidov, *The Law of Damages in International Sales, The CISG and other International Instruments* (Oxford, Hart Publishing 2008) at p. 52.

21 *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co.*, op. cit. n. 9.

22 See part III *infra*.

matter of procedural law and, as such, as an issue not governed by the Convention.²³ As Justice Posner expressly stated:

*'The Convention is about contracts, not about procedure. The principles for determining when a losing party must reimburse the winner for the latter's expense of litigation are usually not a part of a substantive body of law, such as contract law, but a part of procedural law. For example, the "American rule," that the winner must bear his own litigation expenses, and the "English rule" (followed in most other countries as well), that he is entitled to reimbursement, are rules of general applicability. They are not field-specific. There are, however, numerous exceptions to the principle that provisions regarding attorneys' fees are part of general procedure law. For example, federal antidiscrimination, antitrust, copyright, pension, and securities laws all contain field-specific provisions modifying the American rule (as do many other field-specific statutes). An international convention on contract law could do the same. But not only is the question of attorneys' fees not "expressly settled" in the Convention, it is not even mentioned. And there are no 'principles' that can be drawn out of the provisions of the Convention for determining whether "loss" includes attorneys' fees; so by the terms of the Convention itself the matter must be left to domestic law (i.e., the law picked out by "the rules of private international law," which means the rules governing choice of law in international legal disputes).'*²⁴

Although Justice Posner is right in saying that the CISG is about contracts and not procedure, his rationale of this decision is subject to criticism. Namely, if the decision on recovery of attorneys' fees is to be made on distinction between substance and procedure viewed through the lenses of the domestic law, then the interpretation of the Convention in light of its international character, and consequently its uniform application, as mandated by Article 7 of the CISG, would be severely jeopardized. This is because the distinction between substance and procedure varies in different jurisdictions.²⁵ For example, some legal systems find the issue of interest being an issue of procedural law, whereas others find it to be an issue of substantive law.²⁶ The same differences have been noted with respect to limitation period.²⁷ Consequently, if one is to interpret the issues arising out of

23 J. Lookofsky, 'Case Note: *Zapata Hermanos v. Hearthside Baking*,' 6 *Vindobona Journal of International Commercial Law and Arbitration* 27 (2002) at pp. 27–29; H. Flechtner, op. cit. n. 7 at pp. 153–155; H. Flechtner and J. Lookofsky, 'Viva Zapata! American Procedure and CISG Substance in a U.S. Circuit Court of Appeal,' 7 *Vindobona Journal of International Commercial Law and Arbitration* 93 (2003) at pp. 94–95; J. Lookofsky and H. Flechtner, 'Zapata Retold: Attorneys' Fees Are (Still) Not Governed by the CISG,' 26 *Journal of Law and Commerce* 1 (2006–2007) at p. 3; H. Stoll and G. Gruber, op. cit. n. 19 at p. 757; P. Huber, op. cit. n. 18 at p. 278.

24 *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co.*, op. cit. n. 9.

25 C. Orlandi, 'Procedural Law Issues and Law Conventions,' 5 *Uniform Law Review* 23 (2000) at p. 23.

26 J. Gotanda, 'Awarding Interest in International Arbitration,' 90 *American Journal of International Law* 40 (1996) at p. 40.

27 While civil law jurisdictions usually treat limitation period as an issue of substantive law governed by the *lex causae*, common law jurisdictions, on the other hand, traditionally deem limitation period as an institute of procedural law, governed by the law of the forum. See American Bar Association Section of International Law and Practice Reports to the House of Delegates - Convention on the Limitation Period in the International Sale of Goods, 24 *International Lawyer* 583 (1990) at p. 584; K. Boele Woelki, 'The Limitation of Actions in International Sale of Goods,' 4 *Uniform Law Review* (1999–3) at pp. 621–650, available at: <<http://igitur-archive.library.uu.nl/law/2010-0408->

the international sales contract from the perspective of his/her own domestic laws, the efforts on harmonizing the law of international sales would be in vain and the doors for application of domestic rules and standards in this sphere would be again wide open. As Peter Schlechtriem correctly noted when commenting on the Zapata decision on appeal:

*'If national courts simply qualify the recoverability of litigation costs and lawyers' fees as a procedural matter to be decided under their own lex fori, thereby circumventing Article 74 and the analysis of whether such costs are a risk to be borne by any party having to litigate in the US, there will soon be more enclaves of domestic law, which for the deciding judge may seem to be self-evident and which conform to his or her convictions, formed by historic rules and precedents, but which will not be followed in other jurisdictions and, thereby, will cause an erosion of the uniformity achieved.'*²⁸

On the same lines, Warren Khoo noted that the label given by domestic law is not conclusive as to whether a particular matter falls within the Convention.²⁹

Consequently, although Justice Posner has, in my view, reached the correct conclusion by not awarding the attorneys' fees on the basis of Article 74 of the CISG, the rationale of such a decision is incorrect since it undermines the need for autonomous interpretation of the Convention and its international character.

2. Recovery of attorneys' fees was not envisioned by the drafters of the CISG – The tale of the 'hallowed American Rule'

The second group of authors bases their arguments on the drafters' intent or, more precisely, on the lack thereof.

*'[T]he matter of lawyer's fees never arose during the drafting and negotiation of the treaty. This strongly suggests that those involved in the drafting did not expect or intend that CISG would change such a significant aspect of the litigation process. While some "unexpected" effects on national law may result from ratification of an international treaty, it is surely going too far to suggest that such a fundamental change to civil procedure could have happened by omission.'*³⁰

Furthermore, Justice Posner notes:

200254/1999Boele Woelki LIMITATION.pdf>; G.Biehler, *Procedures in International Law* (Berlin, Springer 2008) at pp. 14–15.

28 P. Schlechtriem 'Introduction' in P. Schlechtriem and I. Schwenzer, eds., *Commentary on the UN Convention on the International Sale of Goods (CISG)* (New York, Oxford University Press 2005) at p. 7.

29 'The substance rather than the label or characterization of competing rule of domestic law determines whether it is displaced by the Convention. In determining such questions, the tribunal, it is submitted, should be guided by the provisions of Article 7, and give the Convention the widest possible application consistent with its aim as a unifier of legal rules governing the relationship between parties to an international sale.' See W. Khoo 'Article 4' in C. M. Bianca and M. J. Bonell, *Commentary on the International Sales Law – the 1980 Vienna Sales Convention* (Milan, Giuffrè 1987) at p. 48.

30 A. Mullis, 'Twenty-Five Years On - The United Kingdom, Damages and the Vienna Sales Convention,' 71 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 35 (January 2007) at p. 44. Cf. P. Schlechtriem, 'Legal Costs as Damages in the Application of UN Sales Law,' 26 *Journal of Law and Commerce* 71 (2006/2007) at pp. 77–78.

*'And how likely is it that the United States would have signed the Convention had it thought that in doing so it was abandoning the hallowed American rule? To the vast majority of the signatories of the Convention, being nations in which loser pays is the rule anyway, the question whether "loss" includes attorneys' fees would have held little interest; there is no reason to suppose they thought about the question at all.'*³¹

Although the drafting history of the CISG does not support the presumption put forward by these authors that the recovery of legal costs was consciously disregarded by the drafters of the CISG, it is important to note that accepting such interpretation without allowing for any exceptions would prevent the CISG to respond to new challenges brought by the modern age.³² What is true, though, is that this issue was not discussed in the drafting process as it does not appear in the *travaux préparatoires*.³³

While it is impossible to assess what was in the minds of the drafters in the absence of any indication thereof in the *travaux préparatoires*, there is no evidence that the United States as the architect of the 'American Rule' was not willing to abandon it when it comes to international disputes. Namely, the joint effort of the American Law Institute and UNIDROIT to unify the rules of transnational civil procedure, especially with respect to commercial disputes, has resulted in the adoption of the provision that follows the 'loser pays' approach.³⁴ Such a route has already been taken by the leading American arbitral institutions³⁵ and some state laws on arbitration.³⁶ Hence, the argument that the US might be unwilling to deviate from the 'American rule' when it comes to transnational litigation does not stand and CISG cases are always cases of transnational commercial character. After all, the

31 *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co.* case, op. cit. n. 9. See also: H. Flechtner and J. Lookofsky, op. cit. n. 23 at p. 97.

32 The application of the CISG and its interpretation by legal doctrine with respect to another issue, evidently not envisioned or discussed by the CISG drafting team and at the Diplomatic Conference when its text was finalized – an issue of exchange of e-mail communications as means of contract conclusion, clearly proves that the fact that the issue was not raised by the drafters does not prevent classifying such issue under relevant CISG provisions and finding it covered by the Convention. Consequently, despite e-mails not being mentioned in the Convention and not being discussed during the drafting process, it is widely accepted that the definition of 'writing' from Art. 13 CISG includes e-mails. See CISG-AC Opinion No. 1, Electronic Communications under CISG, 15 August 2003, Rapporteur: Professor Christina Ramberg, Gothenburg, Sweden, available at: <<http://www.cisg.law.pace.edu/cisg/CISG-AC-op1.html#art13>>.

33 See J. Honnold, *Documentary History of the Uniform Law for International Sales – the studies, deliberation and decisions that led to the 1980 United Nations Convention with introductions and explanations* (Deventer, Kluwer Law and Taxation Publishers 1989).

34 Art. 25 of 2006 ALI/UNIDROIT Principles of Transnational Civil Procedure, loc. cit. n. 6.

35 All major arbitral institutions in the US allow for recovery of costs of arbitration including the reasonable costs for legal representation of a successful party. See Art. 31 of the International Arbitration Rules of International Centre for Dispute Resolution of the American Arbitration Association; Art. 37 of the Arbitration Rules of Chicago International Dispute Resolution Association (CIDRA); Art. 34.1. of the Rules of JAMS International Arbitration Rules.

36 See California Civil Procedure Code §1297.318 (West 1988); Hawaii Revised Statutes §658D-7(d) (6) (Michie 1996); Florida Statutes Annotated §684.19(4) (West 1996); Texas Civil Practice & Remedies Code Annotated §172.254(i) (West 1997).

‘American rule’ does not form part of US public policy and US courts have generally enforced foreign arbitral awards of costs and attorneys’ fees despite adhering to the American rule in domestic cases.³⁷

Furthermore, by ratifying the CISG the US has already accepted to depart from two important aspects of its legal system – the ‘parol evidence rule’ and ‘the statute of frauds’, just like the Islamic countries have accepted general entitlement of the parties to interest on the sums due, although such a provision is otherwise not enforceable under Sharia law.³⁸ After all, it is not only speculative but also irrelevant whether the United States would have signed the Convention for the qualification of the recovery of attorneys’ fees as a matter governed by the CISG or not.³⁹ However, it might be true that in the minds of the drafters the issue of recovery of attorneys’ fees was at all times considered as a procedural issue not worthy of discussion at that forum, since it is indeed recognized as such in all jurisdictions around the world. Nevertheless, the fact that the issue of recovery of attorneys’ fees as damages was not discussed by the drafters of the Convention, should not in itself preclude such recovery under the Convention.

3. Recovery of attorneys’ fees runs against the principle of party equality – What if the defendant won?

The third group of authors, gathered in the CISG Advisory Council,⁴⁰ agrees on the point that the answer to this question cannot be made on the basis of the substance-procedure distinction.⁴¹ They find reliance upon such a distinction in this context outdated and unproductive. Instead, they propose that it should be determined whether the payment of litigation expenses was deliberately excluded from the Convention and, if not, whether the issue may be resolved ‘in conformity with the general principles on which [the Convention] is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law,’ as required by Article 7(2) of the CISG. They conclude that the issue is not expressly excluded from the Convention and that, consequently, it should be resolved by application of general principles of the CISG. They also

37 J. Gotanda, *op. cit.* n. 6 at p. 32.

38 See J. Gotanda, ‘Awarding Interest in International Arbitration,’ 90 *American Journal of International Law* 40 (1996) at pp. 47–50; T. S. Twibell, ‘Implementation of the United Nations Convention on Contracts for the International Sale of Goods (CISG) under Shari’a Law: Will Article 78 of the CISG Be Enforced When the Forum Is an Islamic State?,’ 9 *International Legal Perspectives* 25 (1997) at pp. 25–92; D. Klein, ‘The Islamic and Jewish Laws of Usury: A Bridge to Commercial Growth and Peace in the Middle East,’ 23 *Denver Journal of Law & Policy* 535 (1995) at pp. 535 et seq.

39 R. Koch, ‘The CISG as the Law Applicable to Arbitration Agreements?,’ in C. Andersen and U. Schroeter, eds., *Sharing International Commercial Law across National Boundaries, festschrift for Albert H Kritzer on the Occasion of his Eightieth Birthday* (London, Wildy, Simmonds & Hill Publishing 2008) at pp. 277–278.

40 For the work of the CISG Advisory Council see M. Đorđević, ‘Pravo međunarodne trgovine, Rad Savetodavnog veća za primenu Konvencije UN o ugovorima o međunarodnoj prodaji robe od 1980. godine’ [International Trade Law: The Work of CISG Advisory Council], 9–12 *Pravo i privreda* (2008) pp. 137–145.

41 CISG-AC Opinion No. 6, *op. cit.* n. 17, comment 5.2.

acknowledge that application of the principle of full compensation might lead to recovery of such expenses. Yet, they find such an outcome contrary to another general principle of the Convention, namely, the principle of party equality (equality between buyers and sellers as expressed in Articles 45 and 61⁴²). In their words:

*'If legal expenses were awarded as damages under Article 74, an anomaly would result where only a successful claimant would be able to recover litigation expenses. The ability to recover damages under Article 74 is grounded on a breach of contract; thus, a successful respondent will not be able to recover its legal expenses if the claimant has not committed a breach of contract. Therefore, the purpose of awarding attorneys' fees and costs, to make a prevailing party whole for costs incurred in litigation, will not be realized in those cases where the respondent prevails. Remedies are the core of contract law, and to interpret Article 74 to create unequal recovery of damages between buyers and sellers is contrary to the design of the Convention. However, Article 74 does not preclude a court or arbitral tribunal from awarding a party its attorneys' fees and costs when the contract provides for their payment or when authorized by applicable rules.'*⁴³

However, even if the Advisory Council was right in making a recourse to the general principles in order to resolve this issue, this does not mean that they are also right in finding the existence of a conflict between the principle of full compensation and the principle of party equality if the successful claimant's claim for recovery of attorneys' fees is granted. It is perhaps too far fetched to claim that Articles 45 and 61 provide for an absolutely equivalent system of remedies to both buyers and sellers. This is, of course, not possible given the different modalities of parties' obligations.⁴⁴ Whilst it is true that both parties have the right to exercise avoidance and claim damages, some of the buyer's remedies are specifically tailored in order to address a non-conforming performance by the seller. Consequently, the seller does not have a comparable remedy to the buyer's right to claim price reduction, for example.⁴⁵ Still, this does not mean that the parties are not given equal treatment under the Convention when it comes to their right to claim damages, even if the attorneys' fees are considered a 'loss for breach of contract'. Accordingly, if a successful plaintiff in CISG litigation would be entitled to recover attorneys' fees as damages for breach of contract this would not put the successful defendant

42 Arts. 45 and 61 CISG provide similar system of remedies to buyer and seller, respectively, in case of a failure of the other party to perform its obligations.

43 CISG-AC Opinion No. 6, op. cit. n. 17, comment 5.4. Cf. H. Flechtner, op. cit. n. 7, at p. 151; T. Keily, 'How Does the Cookie Crumble? Legal Costs under a Uniform Interpretation of the United Nations Convention on Contracts for the International Sale of Goods,' *Nordic Journal of Commercial Law of the University of Turku*, Issue 2003 #1, § 6.2(b), available at: <http://www.njcl.fi/1_2003/commentary2.pdf>; J. Vanto, 'Attorneys' fees as damages in international commercial litigation,' 15 *Pace International Law Review* 203 (Spring 2003) at p. 221.

44 The seller has an obligation to deliver the goods, hand over any documents relating to them and transfer the property in goods, while the buyer has an obligation to pay the price and to take delivery of the goods (Arts. 30 and 53 CISG).

45 See Secretariat Commentary on Article 57 of the 1978 Draft, para. 2, available at: <<http://www.cisg.law.pace.edu/cisg/text/secomm/secomm-61.html>>. For an overview of variant rights and obligations of the seller and the buyer under the CISG see K. W. Diener, 'Recovering Attorneys' Fees under CISG: An Interpretation of Article 74,' *Nordic Journal of Commercial Law*, issue 2008 #1, Appendix A, available at: <http://www.njcl.utu.fi/1_2008/article3.pdf>.

in an unequal position since both parties would have the right to claim damages amounting to attorneys' fees incurred in litigation *provided that there is a breach of contract*. But, if there is no breach, the issue of recovery of attorneys' fees (thus not being a loss suffered as a consequence of breach as required by Article 74) remains an issue regulated under the otherwise applicable law. Consequently, the resulting inequality in the treatment of the parties in such a case should not be construed as inequality in the sense of the CISG, but rather as the inequality induced by virtue of procedural rules of the forum, provided that the case is being resolved before the court of the 'American rule' country.⁴⁶ The differential treatment of the successful litigants that the domestic rules might provide for is not a matter that should be reconciled by the CISG in such an instance but by harmonizing attempts in the field of procedural law. The recovery of attorneys' fees under the CISG would be consistent – whenever they are incurred as a consequence of breach of contract before or during litigation/arbitration, its recovery would be granted. Finally, the CISG drafters were aware that an absolute equality amongst the parties cannot be achieved at all times on such a global level.⁴⁷

In conclusion, agreeing with the argument of party equality as opposed to full compensation advocated by these authors brings us to a paradoxical result – inequality of the parties. Namely, by leaving this issue to be dealt with under the domestic procedural rules the Advisory Council is actually approving *de facto* unequal standing of litigants in different jurisdictions (e.g. a successful defendant in a US court would not be able to recover its expenses, whilst a successful defendant in Serbia would be reimbursed for its expenses including legal fees paid).

4. The CISG principles are not well-suited to deal with calculation of attorneys' fees as recoverable loss – Don't trust the judge!

Some authors have questioned the applicability of the CISG to this issue on the basis of lack of certainty in calculation of attorneys' fees if their recovery is deemed to be covered by the CISG.⁴⁸ According to these authors, while certainty in the countries that follow the 'American rule' is secured by non-recoverability of these expenses, and in 'loser pays' countries by firm domestic rules on their calculation, in the case of the CISG being applied to this issue they see the danger for uniform application of the Convention. Namely, they claim that: '*Use of such vague principles*

46 The CISG would preempt the domestic procedural law only where there is a breach of contract and consequently a loss including legal costs would be reimbursed to the 'winning' party. In case that there is no breach of contract, the rules of domestic procedural law allowing or not allowing for recovery of litigation expenses (including attorney's fees) to the successful litigant would remain unchanged, i.e. in a 'loser pays' country the successful litigant would be reimbursed for its legal expenses, whereas in 'American rule' country the successful litigant would not be entitled to such reimbursement.

47 For example, Art. 28 CISG makes the availability of the remedy of specific performance contingent on the existence of such a remedy under the *lex fori*.

48 A. Mullis, op. cit. n 30 at pp. 44–45; T. Keily, op. cit. n. 43 at § 6.2 (c), § 6.3; H. Flechtner, op. cit n. 7 at p. 152; J. Gotanda, op. cit n. 19 at pp. 131–133.

[full compensation, foreseeability, mitigation] in an area such as lawyers' fees would be a recipe for difference rather than harmony.⁴⁹

However, while it is true that the attorneys' fees are calculated on different bases in different countries, this argument alone is not persuasive enough to prevent recovery of attorneys' fees under the CISG. Similarly, the fact that there are different approaches to calculation of lost profit in different jurisdictions⁵⁰ does not prevent its recovery under the CISG.

5. Case-law – Almost uniform in its ignorance

It is true that the analysis of the majority of cases where the CISG was applied clearly shows that the recovery of attorneys' fees was almost exclusively claimed under the applicable procedural rules and that such requests, where granted, were granted under such rules.⁵¹ Although such practice clearly shows uniformity of the approach to this issue it does not necessarily mean that this uniformity reflects the international character of the Convention. It is fair to say that in all these cases both the parties' counsels and the judges (arbitrators) were influenced by the preconceived ideas under their own domestic laws; and where those laws allow for a 'loser pays' system they saw no need to look for a different legal basis for making a request or an award on that issue. However, it might also be true that such an overwhelming similarity in approaches to this question in both 'American rule' and 'loser pays' jurisdictions actually reflects the international consensus on the legal nature of recovery of attorneys' fees.

IV. RECOVERY OF ATTORNEYS' FEES IS COVERED BY THE CISG – IS THE PLAIN MEANING PLAIN ENOUGH?

As previously mentioned, the discussion over the issue whether attorneys' fees constitute a recoverable loss under the CISG or not arose after the first instance decision in the *Zapata case*.⁵² In this case, the court of first instance awarded litigation expenses, including attorneys' fees, as part of damages and avoided application of the 'American rule' by finding that this rule did not apply when there was a law that provided otherwise. The Court held that the CISG, and in particular its Article 74, was such a law. Consequently, given that the defendant could foresee that there might be litigation and legal expenses if it failed to pay sums admittedly due, the court granted the plaintiff's request on the point of damages. The result, the Court stressed, is consistent with the almost universal rule that a successful party may recover its legal expenses and, therefore, supported CISG policies of promoting

49 A. Mullis, op. cit. n. 30 at p. 45.

50 J. Gotanda, 'Recovering Lost Profits in International Disputes,' 36 *Georgetown Journal of International Law* 61 (Fall 2004) pp. 61-112.

51 There are more than 2,500 cases from 45 jurisdictions available at the Pace University database on CISG (<www.cisg.law.pace.edu>). Yet, less than 10 (0,4%) invoke CISG as the applicable law for the issue of recovery of attorneys' fees.

52 *Zapata Hermanos Sucesores, S.A. v. Hearthside Baking Co, etc.*, op. cit n. 3.

uniformity and certainty. Namely, the court invoked the analysis in another case decided by a US court where the CISG was applied⁵³ and stated that the rationale of this judgment although written about a different provision of the Convention, applies with equal force to mandate universality rather than a purely home-town rule as to the awardability of attorneys' fees under the Convention.⁵⁴

The group of authors advocating for recovery of attorneys' fees under the Article 74 of the CISG are basing their arguments on the plain wording of Article 74 and principles of full compensation, foreseeability, mitigation and reasonableness.⁵⁵ Allowing different domestic rules on recovery of legal costs would, in their view, undermine not only the uniform interpretation of the Convention, but the core principle of full compensation itself since the aggrieved party would not be adequately compensated for its loss i.e. would not be made whole. Felemegas cites numerous judgments and awards in support of his position that the principle of full compensation confirms this view.⁵⁶ However, while these decisions support the existence of the principle of full compensation as the general principle of the CISG, they do not, at the same time, confirm Felemegas' assumption that attorneys' fees are covered by the CISG. Quite the contrary, the recovery of attorneys' fees in these cases was granted on the basis of *lex fori*. The number of decisions where recovery of attorneys' fees was granted on the basis of the CISG is much smaller and not necessarily persuasive.⁵⁷ Consequently, although the Appellate Court in the *Zapata case* failed to consider

53 Judgment of Federal Appellate Court for 11th Circuit of 29 June 1998, *MCC-Marble Ceramic Ctr., Inc. v. Ceramica Nuova D'Agostino, S.F .A.*, 144 F.3d 1384, 1391 (11th Cir.1998), available at: <<http://cisgw3.law.pace.edu/cases/980629u1.html>>.

54 The court stated: '*One of the primary factors motivating the negotiation and adoption of the CISG was to provide parties to international contracts for the sale of goods with some degree of certainty as to the principles of law that would govern potential disputes and remove the previous doubt regarding which party's legal system might otherwise apply. [...] Courts applying the CISG cannot, therefore, upset the parties' reliance on the Convention by substituting familiar principles of domestic law when the Convention requires a different result. We may only achieve the directives of good faith and uniformity in contracts under the CISG by interpreting and applying the plain language of article 8(3) as written and obeying its directive to consider this type of [legal issue].*'

55 J. Felemegas, 'An Interpretation of Article 74 CISG by the U.S. Circuit Court of Appeals', 15 *Pace International Law Review* 91 (2003) at pp. 91-147, available at: <<http://www.cisg.law.pace.edu/cisg/biblio/felemegas4.html>>; B. Zeller, *Damages under the Convention on Contracts for the International Sale of Goods* (New York, Oceana Publications Inc. 2005) at pp. 143-166; K. W. Diener, op. cit. n. 45.

56 J. Felemegas, op. cit. n. 55, fn. 7.

57 See Judgment of Rechtbank van Koophandel Hasselt of 25 February 2004, available at: <<http://cisgw3.law.pace.edu/cases/040225b2.html>>; judgment of the Court of Appeal in Turku of 12 April 2002, available at: <<http://cisgw3.law.pace.edu/cases/020412f5.html>>; China International Economic & Trade Arbitration Commission award of 11 February 2000, available at: <<http://cisgw3.law.pace.edu/cases/000211c1.html#attorneys>>; China International Economic & Trade Arbitration Commission award of 12 February 1999, available at: <<http://cisgw3.law.pace.edu/cases/990212c2.html>>; judgment of AG Berlin-Tiergarten of 13 March 1997, available at <<http://cisgw3.law.pace.edu/cases/970313g1.html>>; award of Schiedsgericht der Handelskammer Hamburg of 21 March 1996, available at: <<http://cisgw3.law.pace.edu/cases/960321g1.html>>; China International Economic & Trade Arbitration Commission award of 14 May 1996, available at: <<http://cisgw3.law.pace.edu/cases/960514c1.html>>; judgment of AG Augsburg of 29 January 1996, available at:<<http://cisgw3.law.pace.edu/cases/960129g1.html>>, ICC award No. 7585/1992,

international jurisprudence in respect of this issue, it would be too much of a stretch to claim that had it done so it would reach a different conclusion.

Felemegas further suggests that under the 'breach of duty of loyalty' the alleged anomalies in equal treatment of the parties would be eliminated.⁵⁸ Such an approach is being criticized by other authors as a 'result-oriented jurisprudential stretch'⁵⁹ that should not be taken seriously.

Zeller, on the other hand, also advocates for the recovery of attorneys' fees under the CISG general principle of full compensation and the 'asset test' which confirms the view that attorneys' fees constitute loss under the meaning of Article 74.⁶⁰ In addition, Zeller suggests, while recognizing the anomaly mentioned by Posner and the Advisory Council that the successful defendant would be able to recover its legal expenses under the otherwise applicable procedural law, since recovery of successful defendant's expenses (where there is no breach of contract on part of the plaintiff) is not covered by the CISG. According to Zeller: '*If there is an anomaly, and it is not denied that there will be one, it is not for judges to usurp the power of the drafters of the legislation. [...]T]he CISG like any other legal document is not a perfect tool and hence some problems or imbalances must be expected.*'⁶¹

However, while Zeller is right in qualifying the attorneys' fees as a financial loss, he fails to take into account both the requirement of Article 74 of the CISG that such a loss should be *a consequence of breach of contract* and the very nature of the recovery of attorneys' fees. Under my view, this is where both Felemegas' and Zeller's propositions are flawed, as will be elaborated in detail below.

V. (NOT) A REVOLUTIONARY SOLUTION

Although the application of the general principles of the CISG, as invoked in legal doctrine, does not prevent recovery of attorneys' fees as damages since it does not jeopardize the principle of equality of the parties, it is my view that this issue is not governed by the Convention and that, consequently, there is no need for exploring the general principles of the CISG in supporting such a stance.

It goes without saying that legal costs incurred in pursuing a contract claim before court (arbitration) constitute financial loss. However, although they are in causal link with the breach of contract (provided that there is a breach of contract), they are more closely connected with the proceedings themselves. Consequently, they are uniformly not regarded as 'loss suffered as a consequence of breach of contract' in either countries that follow the 'loser pays' rule (where their recovery is regulated by

available at: < <http://cisgw3.law.pace.edu/cases/927585i1.html>>. For criticism of some of these decisions see H. Flechtner, op. cit. n. 7 at pp. 127–134.

58 J. Felemegas, op. cit. n. 55 at § 5 (d).

59 H. Flechtner, op. cit. n. 7 at p. 152.

60 '*To put a party into a position – it would have been financially – is simply asking the question, has the balance sheet changed? If the asset base is diminished as a consequence of the breach, then those items diminishing the asset base must be understood to fall under the principle of full compensation pursuant to Article 74.*' See B. Zeller, op. cit. n. 55 at pp. 151–155.

61 B. Zeller, op. cit. n. 55 at pp. 155, 164.

procedural laws) or in the countries that adhere to the ‘American rule’ (where their recovery is not allowed as a rule).⁶² This is not surprising given that the recovery of attorneys’ fees incurred in litigation indeed differs from recovery of such fees before litigation. The difference results from the nature of litigation itself, since its initiation (filing a claim in the court and delivering the claim to the defendant) transforms the two-party relationship i.e. sales contract (buyer-seller) into a three party relationship i.e. litigation (plaintiff-court/arbitration tribunal-defendant).⁶³ Hence, the legal basis for the recovery of attorneys’ fees incurred in litigation is in the litigation itself and not in the breach of sales contract which was the reason for initiating the proceedings.⁶⁴ Consequently, it is fair to say that both parties have suffered financially *as a result of litigation*,⁶⁵ and not necessarily as a result of breach – since these expenses are incurred even if the court found that there was no breach of contract, so they can exist independently from the breach.⁶⁶ Furthermore, the amount of the incurred expenses will depend not only on the behavior of the breaching party but also on the extent of the court’s orders and instructions. This makes the causal link between the breach and this type of loss interrupted. Consequently, in my view, once the litigation is instituted the incurred attorneys’ fees become a loss that is too distinct from the usual loss suffered as a consequence of breach of contract thus not allowing for its recovery under Article 74 of the CISG.⁶⁷

It is important to emphasize that this view is confirmed by comparative research and systematic analysis of different legal systems and not based exclusively on domestic law. Namely, to the best of my knowledge, there is not a single jurisdiction

62 ‘Universally, the allowability of costs and their allocation is regarded as a matter of procedural law.’ See J. G. Wetter, C. Priem, ‘Costs and Their Allocation in International Commercial Arbitrations,’ 2 *American Review of International Arbitration* 249 (1991) p. 329.

63 Such an understanding of litigation, as a three-party relationship, is said to represent the prevailing view in contemporary academic writing on civil procedure. See B. Poznić and V. Rakić-Vodinelić, op. cit. n. 7, at pp. 31–33; A. Jakšić, op. cit. n. 7 at pp. 16–18.

64 See supra note 7.

65 See J. Vanto, op. cit. n. 43 at p. 214.

66 Some rules in the ‘loser pays’ countries further show how recovery of legal costs in the civil proceedings is treated differently than the ‘usual’ request for damages. For example, claim for reimbursement of the costs of the civil proceedings can only be made until the closure of the main hearing and cannot be invoked in different legal proceedings (Art. 159(3) of the Law on Civil Procedure [*Zakon o parničnom postupku*] in Serbia, published in the Official Gazette of the Republic of Serbia No. 125/2004). On the contrary, the fact that a plaintiff omitted to claim one part of the damages does not preclude him from requesting such damages in other proceedings. Furthermore, unlike the damages claim, a claim for reimbursement of the costs of the proceedings is limited to the ‘actual loss’ and does not include loss of profit suffered as a consequence of litigating (B. Poznić and V. Rakić-Vodinelić, op. cit. n. 7, at pp. 31–33). Finally, in many jurisdictions calculation of legal costs is usually being made pursuant to a fixed fee schedule that may result in an award amounting to less than the actual fee incurred (the fee agreed upon with the attorney) (see comment P25-A to Art. 25 of 2006 ALI/UNIDROIT Principles of Transnational Civil Procedure, loc. cit. n. 6). This runs contrary to the principle of full compensation, which, as the landmark principle of the law of contract damages, aims at making the aggrieved party whole.

67 It could also be argued that irrespective of the ‘American rule’ or ‘loser pays’ background of a party, the party could not foresee that attorneys’ fees incurred in litigation could constitute a ‘loss’ recoverable under Art. 74 CISG.

that treats attorneys' fees incurred in litigation as a 'loss for breach of contract'.⁶⁸ Although it is true that the substance-procedure distinction in the field of uniform law is erroneous if it leads to the qualification of a relevant legal issue under the applicable domestic law, there should be no obstacles in invoking such distinction when based on a comparative survey and supported by the international uniform classification of this matter.⁶⁹

Not only do domestic legal systems regulate this issue in the procedural codes, but some international acts also accept the same classification. Namely, ALI/UNIDROIT Principles of Transnational Civil Procedure (Article 25),⁷⁰ as well as the rules of many international arbitral institutions⁷¹ (including the ones from 'American

68 For the sake of clarity, in (at least) one judgment of the Belgium Supreme Court of 2 September 2004 (which was made before adoption of the 'loser pay' rules into the Belgian legal system) it has been stated that: *'the fees of an attorney or technical expert which have been paid by the victim of a contractual non-compliance can be part of the damage to be compensated, as far as they are a necessary effect of the non-compliance'*. However, this judgment should be carefully examined within the wider context in which it was made. Namely, until recently recovery of lawyers' fees was not allowed under Belgian law: it was neither provided by the procedural rules nor allowed on the basis of liability law (either because of their legal nature - not being considered a component of damages or based on the doctrine of breach of causality). However, such practice was abolished in 2002 as a consequence of implementation of the Directive 2000/35/EC of the European Parliament and the Council of 29 June 2000 on combating late payment in commercial transactions (*Official Journal of the European Communities*, L 200/35 of 8 August 2000) in Belgian legal system which allowed recovery of attorneys' fees to creditors falling within the scope of the Late Payment Act. The alleged inequality created by this Act i.e. discrimination between litigants falling within or outside the scope of the Act, was confirmed as unconstitutional by the judgment of the Belgian Constitutional Court (judgment n° 16/2007 of 17 January 2007). According to the Court *'the discrimination was not situated in the Late Payment Act, but in the lack of a general solution [with regards to recovery of attorneys' fees] which must be provided by the legislator in line with the articles 10 and 11 of the Constitution'*. This, in turn, forced the Belgian legislator to introduce general rules with regard to the recovery of attorneys' fees (the Act of 21 April 2007 extended the definition of the 'expenses of judicial procedure' so to include attorneys' fees). As a result, recovery of attorneys' fees in Belgium is nowadays covered by procedural rules and not by the substantive law (see V. Sagaert and I. Samoy, 'Questionnaire on Funding, Costs and Proportionality in Civil Justice Systems: Belgium,' at pp. 14-17, available at: <<http://www.csls.ox.ac.uk/COSTOFLITIGATIONDOCUMENTSANDREPORTS.php>>). For an overview of the academic understanding of the recovery of attorneys' fees in Serbia, Croatia, Japan, Denmark, the Netherlands and the US, see *supra* note 7.

69 For example, the issue of capacity of the parties is not deemed governed by the Convention since it is traditionally separated from sales law. See M.J. Bonell, 'Article 7' in C. M. Bianca and M. J. Bonell, eds., *Commentary on the International Sales Law - the 1980 Vienna Sales Convention* (Milan, Giuffrè 1987) at p. 76.

70 It is important to note that UNIDROIT, which was involved in drafting of the ALI/UNIDROIT Principles of Transnational Civil Procedure, has been the drafter of yet another important text on unification of laws - UNIDROIT Principles on International Commercial Contracts. By comparing the texts of these two documents it is easy to conclude that the issue of recovery of legal costs was regulated by the principles *on procedure*, and *not* by the principles on substantive law.

71 UNCITRAL Arbitration Rules Art. 40; London Court of International Arbitration Rules Art. 28(4); ICC Arbitration Rules Art. 31; DIS Arbitration Rules, Art. 35; Swiss Rules of International Arbitration Art. 38; Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce Art. 44; Rules of Arbitration and Conciliation of the International Arbitral Centre of the Federal Economic Chamber of Vienna, Art. 19; Rules of the International Commercial

Rule' jurisdictions⁷²) and international courts,⁷³ treat the recovery of attorneys' fees incurred in litigation/arbitration as a matter of procedural law and not substantive law, thus governed by the procedural codes or rules. Moreover, the overwhelming majority of CISG cases, including the famous Italian decisions of Vigevano and Rimini court,⁷⁴ provides for recovery of these expenses on the basis of applicable procedural rules.⁷⁵ Consequently, treating the recovery of attorneys' fees incurred in litigation as a 'loss suffered as a consequence of breach of contract' would go against the global consensus on their legal nature and their real cause.⁷⁶

Again, as Justice Posner correctly noted, CISG is about contracts and not procedure. This is confirmed by interpretation of the relevant provisions on the scope of application of the Convention. Namely, Article 4 of the CISG by limiting its scope of application to the narrow notions of 'formation of contract of sale' and 'the rights and obligations of [the parties] arising from such a contract', has clearly limited the Convention's applicability to issues of substantive character, unless specifically provided otherwise.⁷⁷ This view is further confirmed by the legislative history of the Convention.⁷⁸ After all, the Preamble to the CISG itself states that the object and

Arbitration Court at the Chamber of Commerce and Industry of the Russian Federation §14 and its Schedule of Arbitration Fees and Costs §6; CIETAC Arbitration Rules Art. 46(2); Rules of Foreign Trade Court of Arbitration attached to Serbian Chamber of Commerce, Art. 51, and many others.

72 See *supra* note 35.

73 For example, both the European Court of Justice and the Court of First Instance regulate this issue in the rules of procedure. See Rules of Procedure of the Court of Justice of the European Communities, Arts. 69–75 (OJ L 176 of 4 June 1991, last amended on 15 January 2008); Rules of Procedure for the Court of First Instance, Arts. 87–93 (OJ L 136 of 30 May 1991, last amended on 18 December 2006).

74 These decisions surely cannot be criticized for 'homeward trend' in interpretation of the CISG since they have quoted 40 and 37 foreign cases respectively in the reasoning of the judgment, and still have not awarded the attorneys' fees on the basis of CISG but rather on the basis of the *lex fori*. See judgment of Tribunale di Vigevano of 12 July 2000, available at: <<http://cisgw3.law.pace.edu/cases/000712i3.html>>; judgment of Tribunale di Rimini of 26 November 2002, available at: <<http://cisgw3.law.pace.edu/cases/021126i3.html>>.

75 Such a trend *sub silentio* supports the view that this issue should not be dealt with under the CISG despite the lack of express language (H. Flechtner, *op. cit.* n. 7, at p. 153).

76 It may sound odd that the attorneys' fees incurred in litigation are the only type of irrecoverable financial loss under the CISG apart from those losses limited by virtue of Article 5 of the CISG. However, such a stance would be incorrect since by the same token an equal understanding should apply to any cost incurred during litigation/arbitration, such as the cost of expert witnesses, cost of travel associated with litigation, translation costs etc. For example, while the costs for hiring an expert to inspect the goods before litigation undoubtedly represent recoverable loss under the CISG if the goods were found to be non-conforming, the costs for expert opinion on the non-conformity during the proceedings should not be recovered on the basis of the CISG but rather on the basis of *lex fori*.

77 E.g. contract *may be proved* by witnesses (Art. 11 CISG) or breaching party *must prove* that the grounds for his excuse for non-performance are fulfilled (Art. 79(1) CISG) [emph. added].

78 For example, when discussing on the issue of burden of proof the national delegations agreed that it was not the intention to deal in the Convention with any questions concerning the burden of proof. Furthermore, the consensus was that such questions must be left to the court as matters of procedural law (W. Khoo, 'Article 2' in C.M. Bianca and M.J. Bonell, *Commentary on the*

purpose of the CISG is the 'adoption of uniform rules which govern *contracts* for the international sale of goods' and not the *procedures* of their court enforcement.⁷⁹ Consequently, the quest for the proper meaning and scope of the phrase 'any loss suffered as a consequence of breach of contract' referred to in Article 74 and its autonomous yet uniform understanding as mandated by Article 7(1) of the CISG clearly shows that recovery of attorneys' fees should not be governed by the CISG since it is one of the issues excluded from the Convention.

Finally, at the risk of oversimplifying this matter I cannot help but cite a maxim that reflects the guiding idea in the analysis of this problem: '*If it looks like a duck, swims like a duck, and quacks like a duck, then it probably is a duck.*'⁸⁰ In other words, if it (i.e. recovery of attorneys' fees) is governed by the procedural codes, requested and awarded under procedural rules, and caused by initiation of the proceedings, then it probably is a procedural expenditure (and not the loss suffered as a consequence of breach of contract) that should be excluded from the (substantive) realm of the CISG.

In conclusion, given that the issue of recovery of attorneys' fees incurred in litigation is not a matter governed but not expressly settled in the Convention there is no need to apply the general principles of the CISG to this matter and no need for discussion whether their application allows or does not allow for recovery of attorneys' fees.⁸¹ Instead, this issue should be left to the applicable procedural rules.⁸² Although this will not bring the harmony in international trade relations, it is not for the arbitrators and judges '*to usurp the power of the drafters of the legislation*' and impose uniform rules to states that never adhered to such an outcome. Although I agree that unification of the procedural rules is a key factor in the effective uniform application of international bodies of rules as it contributes to the removal of legal barriers in international trade and promotes the development of international trade, I am also fully convinced that the CISG was not intended to be the tool for achieving such a goal. As Alastair Mullis correctly noted:

International Sales Law – the 1980 Vienna Sales Convention (Milan, Giuffrè 1987) at p. 39; J. Lookofsky and H. Flechtner, op. cit. n. 23, at pp. 6–7; C. Orlandi, op. cit. n. 25, at pp. 25, 27–28).

- 79 I. Schwenzer, P. Hachem, B. Zeller, J. Lookofsky and many others also concur that procedural questions are not addressed by the CISG. See I. Schwenzer and P. Hachem, 'The CISG – Success and Pitfalls,' 57 *American Journal of Comparative Law* 457 (Spring 2009) p. 471; B. Zeller, op. cit. n. 55, at p. 80; J. Lookofsky, *Consequential Damages in the Comparative Context: From Breach of Promise to Monetary Remedy in the American, Scandinavian and International Law of Contracts and Sales* (Jurist – og Økonomforbundets Forlag 1989) at p. 283, fn. 158. This view was also emphasized by the Swiss Federal Supreme Court: '[T]he Convention itself does not regulate procedural matters [...]' (judgment of 11 July 2000, available at: <<http://cisgw3.law.pace.edu/cases/000711s1.html>>).
- 80 The origin of this phrase is attributed to the famous American poet James Whitcomb Riley (1849–1916). See <http://en.wikipedia.org/wiki/Duck_test>.
- 81 In accord: H. Flechtner and J. Lookofsky, op. cit. n. 23, at p. 102; J. Lookofsky, 'Walking the Article 7(2) Tightrope Between CISG and Domestic Law,' 25 *Journal of Law and Commerce* 87 (2005–2006) at pp. 98–99.
- 82 However, even if one is to find that a recourse to the general principles is needed, the evidence submitted in this paper that justify recoverability of attorneys' fees under the *lex fori* should be deemed to constitute a general principle on which the CISG is based and consequently, recovery of attorneys' fees should nevertheless be avoided under the CISG.

*'Even as an advocate of the harmonisation of international commercial law, I can see nothing to be gained, and indeed much to be lost, by treating lawyers' fees as recoverable damages under Art. 74. If one wants a good example of a matter that should not be shoe-horned into the Convention, this is surely it.'*⁸³

In the end, it is important to emphasize that all countries, including the ones that follow the 'American rule,' allow for recovery of attorneys' fees incurred in litigation/arbitration if agreed so by the parties.⁸⁴ Consequently, parties should be advised to specifically provide for such a provision if a possibility of litigating before a court that follows the 'American rule' is anticipated. Or, in the alternative, they should use the choice of forum clauses that call for jurisdictions where these costs are recoverable, or agree to arbitration under the rules that provide for recovery of such expenses. This will relieve both the parties and the courts of uncertainties in this regard.⁸⁵

83 A. Mullis, *op. cit.* n. 30, at p. 45.

84 See *F.D. Rich Co. v. United States f/u/o Industrial Lumber Co.*, 417 U.S. 116, 126 (1974); *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 257 (1975).

85 For a model clause on allocation of costs and fees in arbitration see: J. Gotanda, *op. cit.* n. 6, at pp. 26–27.