CHAPITRE 8 : DAMAGES – INDEMNITY

DAMAGES – INDEMNITY

Main concerns

The present study is a clear illustration of the obstacles in terms of translation which are encountered in the search for a common terminology. Certain terms have specific connotations in certain legal systems, more so than others. In such cases, it will be preferable to adopt terms which are as close as possible to the various notions studied below, whilst remaining aware of the context of legal culture in which these expressions or words are intended to be used.

1. **The French expression « *dommages et intérêts* »** (« damage*s* ») may be retained, although the following observations should be taken into account.

In certain legal systems, such as the French legal system, the expressions « *dommages et intérêts* » and « *dommages-intérêts* » are usually employed as synonyms. Moreover, the juxtaposition of the two terms, « *dommages* » on the one hand and « *intérêts* » on the other, would appear to be generally considered as pleonastic, even though the use of the expression is widely accepted. If the expression « *dommages et intérêts* » is maintained in French, the English translation which is closest is probably the single term « damage*s* », sometimes considered as synonymous with the expression « loss compensation ». The English terminology thus highlights the compensatory role of damages. It will therefore be necessary to distinguish damages which do not have this function by qualifying them with the addition of a suitable adjunct (« exemplary damages », « nominal damages », « restitutionary damages » and « disgorgement damages »).

The expression « *dommages et intérêts* » can be defined as the sum of money owed to the obligee to make good the loss or damage arising out of the failure to perform, or out of the faulty or late performance by the obligor of an obligation. Damages almost always cover, in the various legal texts which were examined, lost profits and loss suffered.

It emerges from the various sources which were studied that this expression implies a number of different functions: compensation for loss or damage, equivalent performance or a sanction. It would therefore be useful in terms of clarity to specify whether the damages are compensatory, equivalent performance damages or punitive damages.

Regarding compensatory damages in particular, the scope of the compensation granted should be determined in a precise and uniform way: should it include both the positive benefit, that is to say the advantage obtained by the obligee from the performance of the contract, and the negative benefit, that is to say the advantage derived from the fact that the obligee did not enter into a contract with a defaulting obligor?

2. The various sources which were studied seem to identify *«dommages et intérêts moratoires* » (damages for late performance) as a separate category, governed by a different legal regime. In such a case, in order to ensure a uniform terminology, the expression « *intérêts moratoires* » (interest for late performance) could be used, thus marking more clearly the different nature of this concept.

3. **The term « *indemnité* »** (indemnity) is also included in the terms which form the subject matter of this study.

In comparative law, this term would appear to be used essentially for convenience, without any specific legal regime being attached to its use.

A study of the Acquis reveals that this term is equivocal because it is used with two different meanings.

On the one hand, it refers to the sum of money payable under a contract in the event of non-performance, and which is payable, in certain cases, whether or not any loss or damage is

incurred. In this first situation, it would be useful to clarify the terminology in relation to contractual provisions which relate to the payment of an indemnity. The question arises, based also on comparative law observations, as to whether the terminology used should vary depending on the function of such clauses: the word « penal clause » or « penalty clause » could be used when the clause has a punitive function and the word « liquidated damages clause » could be used for the clauses which aim to compensate the loss suffered by the payment of a predetermined sum.

On the other hand, the term applies, more narrowly, to certain mandatory protection regimes, which concern for example commercial agents and travelers. The terminology could, in relation to these two categories, be further clarified, on the basis that in certain situations, the indemnity does not have the function of compensating a loss suffered, but rather of ensuring that a financial balance is maintained between the parties when such balance is threatened by the termination of the contract. The first category is a compensatory indemnity whilst the second is akin to a client indemnity.

Acquis Communautaire and Acquis International

The study of Acquis Communautaire and Acquis International brings to light the variety of terms used to refer to the sum of money which is granted to compensate for a breach of contract. The sum of money which is granted is referred to by a number of names: « *dommages et intérêts* », « *dommages-intérêts* » (damages), « *indemnité* » (indemnity or liquidated damages), « *dédommagement* » (compensation) or even « *dommages* » (damages), sometimes qualified by adjectives which make the terms more precise, such as for example punitive damages or damages for late performance (« *dommages et intérêts moratoires* »).

From a terminological point of view, the two most widespread families of terms would appear to be « damages » (**I**) and « indemnity » (**II**).

I. « DAMAGES »: AN EXPRESSION WITH A VARIETY OF MEANINGS

The diversity of functions performed by damages is not specific to the field of contract. For example, article 10.101 of the *Principles of European Tort Law* drafted in November 2006 define damages as a money payment « to compensate the victim […] Damages also serve the aim of preventing harm ».

A number of functions are attributed to damages in contract. Damages can compensate for a loss suffered; they can act as a deterrent, each party being strongly encouraged not to cause loss or damage to the other; finally they can be punitive when be a sanction for the defaulting obligor without any link with the loss suffered.

In almost all the texts studied, three categories of damages can be identified. The first category, damages for late payment, is defined positively with a separate and specific regime, which is almost uniform in the different texts analysed (**A**). Conversely, the second category, that of punitive damages, is largely rejected in contract (**B**). The third category is concerned with compensatory damages, which despite their natural function which is to compensate, have given rise to the most hesitations (**C**).

A. Damages for late payment

Damages for late payment are dealt with specifically in the texts which were examined. Generally speaking, their legal regime requires them to be evaluated as a fixed amount and payable automatically in the event that a delay occurs, without the obligee being required to show any loss arising out of the delay. It is therefore the moratory function which

predominates in that it is the delay itself, without any further legal proceedings, which gives rise to a fixed sum compensation, independently from any loss being shown or invoked (**1**). However, the Directive of 29 June 2000 on combating late payment in commercial transactions[1] attributes to damages for late payment a double function which is more ambiguous, since it is both compensatory and deterrent (**2**).

1. The exclusively moratory function of damages/interest for late payment

In the debate on the content of the *lex mercatoria* such as could be applied in the field of international arbitration, it is generally considered that there is no transnational rule on interest for late payment[2]. However, such interest is the subject of provisions in a number of texts, both international and European.

Interest for late payment is dealt with in article 78 of the Vienna Convention of 11 April 1980 on the international sale of goods (CISG): any sum in arrears produces interest. The text is drafted in a very general way, in order to cover the money debts resulting from a contract of sale: price paid by the buyer or which must be restituted by the seller in the event of rescission, down payments, payment of balance, excess payment, expenses paid by one party on account of the other[3]. This interest has no compensatory function. Article 78 itself provides that the interest is without prejudice to the damages which the obligee can claim under article 74; the obligee is not required to show any loss arising out of the delay in performance and academics unanimously agree that the obligor cannot avoid the payment of such interest by showing that the performance was impossible[4].

Damages for late performance are also dealt with specifically in the UNIDROIT Principles on international commercial contracts (2004 version), the *Principles of European Contract Law* (PECL) and the European Code of Contracts drafted by the Academy of European Private Lawyers in Pavia (« PAVIA project »).

Article 7.4.9 of the UNIDROIT Principles provides for specific rules which apply to damages for late payment (« interest for failure to pay money »). In the event of a delay in payment, the obligee is entitled to damages amounting to a lump sum equal to the interest upon that sum from the time when payment is due to the time of payment. The payment of these liquidated damages is independent from any loss and is due even in cases of *force majeure*: as highlighted by the commentary, this sum is not, in this last case, intended to compensate for a loss but to compensate for the enrichment of the obligor.

PECL distinguish ordinary damages and damages for late performance, which are dealt with in article 9:508. Damages for late performance are treated very specifically in this provision and can be completed by damages to compensate for additional loss, such as the future earnings lost by the obligee who could have entered into a contract with a third party should the payment have been made on time. Article 9:508 thus establishes the specificity of the damages for late performance, as underlined by the commentaries. The fact that these damages for late performance should be liquidated is affirmed, as is the fact that they are automatic: they arise out of a delay in payment, without on the one hand the obligee having to show the existence of a loss and on the other hand without the obligor being entitled to invoke any defence.

Article 169 of the PAVIA Project contains specific provisions relating to the « compensation » for monetary obligations which apply unless otherwise agreed by the parties. The English translation of this provision is also ambiguous: it refers to

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[1] Directive 2000/35/EC, *OJ* L 200 of 8 August 2000.

[2] Y. DERAINS, « Intérêts moratoires, dommages-intérêts compensatoires et dommages punitifs devant l'arbitre international » : *Etudes Bellet*, Litec 1991, p. 101; H. SCHONLE, « Intérêts moratoires, intérêts compensatoires et dommages-intérêts de retard en arbitrage international »: *Études Lalive*, Helbing et Lichtenhahn 1993, p. 649.

[3] A hesitation remains: does interest accrue on damages themselves? This question is linked to another difficult point which is not dealt with by the CISG: the starting point for interest on late payment (see V. HEUZE, *op. cit.*, n° 462 and 463, pp. 416 - 419).

[4] V. HEUZE, *op. cit*., n° 462, p. 416.

« compensation » by the payment of « interest ». A first reading of the text might give the impression that the damages referred to have a compensatory function. However, the provisions are in fact close to the UNIDROIT Principles and to PECL in the sense that they place the accent on the moratory character of the interest granted. The sums which are payable bear interest without the obligee having to prove the existence of a loss and without the obligor being able to invoke any cause in defence. The interest rate, in the absence of any specific clause, is fixed by reference to the rates published by the European Central Bank. The sum payable can be adjusted in accordance with the methods indicated in the text. All sums payable by virtue of this text bear interest themselves and can be adjusted.

2. The deterrent and compensatory function of interest for late performance in the directive on combating late payments

Interest on late payments has become an issue in terms of the creation of the Internal Market, because of the delays in payment which occur in respect of commercial transactions within the European Union. The objective of this directive is to establish obligations to pay interest on late payments which are a deterrent, both in terms of principle and procedure[5]. Recital 16 clearly sets out the ambitions of the directive: to make interest on late payments a sanction for the breach of contract which discourages debtors[6]. The legislator notes in this recital that delays in payment are financially attractive for debtors in most Member States because of the low rates of interest on late payments and the slow procedures for redress.

Article 3 of the directive provides that Member States should enable the creditor to claim interest for late payments. The delay runs either from the date for payment set out in the contract, or if there is no such date, automatically 30 days following the date of receipt by the debtor of an invoice or equivalent request for payment (or after the date of receipt of goods or services in certain cases). Article 3.3 provides that any agreement not in line with the terms of the directive is either not enforceable or gives rise to a claim for damages if it is grossly unfair to the creditor. The applicable interest rate is, unless otherwise provided, the sum of the interest rate applied by the European Central Bank to its most recent main refinancing operation carried out before the first calendar day of the half-year in question, plus at least seven percentage points.

Article 3.c specifies that the creditor « shall be entitled to interest for late payment to the extent that he has fulfilled his obligations and he has not received the amount due on time, unless the debtor is not responsible for the delay ». This wording seems less strong than the texts mentioned above: the creditor receives a sum in compensation for the loss suffered in the case of a delay, but the debtor may, it seems, avoid the payment of such compensation by showing that he is not responsible for the delay. This compensatory aspect is reinforced by the fact that the creditor must be given the right, by virtue of article 3.e, to « claim reasonable compensation from the debtor for all relevant recovery costs incurred through the latter's late payment ». These costs should be proportional to the debt and Member States can in fact fix maximum amounts for different levels of debt.

The diversity of functions attributed to the same term is even more striking in the study of the other damages.

B. Punitive damages

Punitive damages are excluded by most texts. They are impliedly excluded in the texts which are based on the principle of total compensation for loss suffered such as the CISG, the

[5] See in particular the Regulation n° 805/2004 of the European Parliament and Council dated 21 April 2004 creating a European Enforcement Order for uncontested claims, *OJ* L 143 of 30 April 2004 and Regulation n° 1896/2006 of the European Parliament and Council dated 12 December 2006 creating a European order for payment procedure, *OJ* L 399 of 30 December 2006.

[6] See in support of this point, *L'acquis communautaire – les sanctions de l'exécution du contrat* – under the direction of C. AUBERT de VINCELLES et J. ROCHFELD, Economica 2006, esp., p. 32, n° 35.

UNIDROIT Principles or PECL: the compensation should cover the whole loss, but only the loss. As stated by Mr. HEUZE in relation to article 74 of the CISG, « The principle applied by the CISG is that of total compensation for these heads of damages, which excludes not only liquidated damages or the capping of damages, the reduction of damages on the basis of equitable principles, but also an increase in damages by way of sanction. It is for this reason in particular that the defaulting party cannot be held liable to pay punitive damages »[7]. The PAVIA Project in its article 166 paragraph 1 which defines the function of the damages also impliedly excludes punitive damages (« Apart from the subsequent mitigating provisions, reparation must specifically aim to eliminate the harmful consequences of non-performance, defective performance, delay […] »).

International arbitration raises the question as to whether transnational principles are emerging. Although the majority of academics take the view that there is a trend towards the creation of transnational rules regarding interest for late payment, as seen above, certain arbitrators have already held that the liability to pay punitive damages was not sufficiently widespread in comparative law for it to be accorded the status of a general principle[8]. However, an arbitral tribunal could, in an international case, hold one party liable to pay punitive damages without necessarily infringing, at the enforcement stage, the international *ordre public* (public policy) of the country in which enforcement is sought. Certain authors are even in favour of this type of judgment which allows a better compensation for loss in certain cases, in particular when it is possible to show the existence of a lucrative fault[9].

Consequently, punitive damages may not be limited, as their name would suggest, to a pure function of punishment for the defaulting party. To some extent, they may amount to a deterrent, or even a means of additional compensation for loss when the loss is difficult to quantify.

The issue of punitive damages was in fact considered by the Commission with regard to competition law, in addition to contractual matters in the strict sense. In the Green paper on damages actions for breach of the EC antitrust rules, of 19 December 2005[10], the Commission states, with regard to questions relating to damages, and mainly with regard to fixing the amount of such damages, that the courts could be given the possibility, whether automatic or conditional, to double the damages in the case of horizontal cartel agreements. The European Court of Justice (ECJ), in a decision of 13 July 2006[11], takes the view in this respect that punitive damages awarded in the context of domestic claims could also be awarded in actions founded on Community rules and that these damages should compensate the loss suffered overall, which includes the actual loss, the loss of profits and the payment of interest.

C. Compensatory damages

The main function of damages is compensatory: the damages should compensate all of the damage suffered and therefore place the victim in the position in which he would have been had he not suffered the damage, by reasoning retrospectively. This function is sometimes

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[7] « Le principe retenu par la CVIM est celui de la réparation intégrale de ces chefs de préjudice, ce qui exclut aussi bien leur forfaitisation ou leur plafonnement que la réduction de leur indemnisation pour des raisons d'équité ou, au contraire, leur majoration à titre de sanction. C'est ainsi en particulier que la partie en défaut ne saurait être condamnée au paiement de dommages–intérêts punitifs. » *Op. cit.,* n°448, p. 401.

[8] ICC judgment n° 5030/1992, *JDI* 1993.1004; ICC judgment n° 10114/2000, *Bull. ICC* 2201, n° 2, p. 105. In support, see also Ph. FOUCHARD, E. GAILLARD, B. GOLDMAN, *Traité de l'arbitrage commercial international*, Litec 1996, n° 1493, p. 845 and G. ROBIN, « Les dommages et intérêts punitifs dans les contrats internationaux », *RDAI* n° 3/2004, p. 247.

[9] In support of this point, Ph. FOUCHARD, E. GAILLARD, B. GOLDMAN, *op. cit.*, n°579 (regarding the American Supreme Court decision of 6 March 1995, *Mastruobuono v. Shearson Lehman Hutton, Inc., Rev. Arb.* 1995.295, note L. NIDDAM; G. ROBIN, *op.cit.* p. 264 and 265; J. ORTSCHEIDT *La réparation du dommage dans l'arbitrage commercial international,* Dalloz 2001.

[10] COM (2005) 672 final – see also M. CHAGNY, « La notion de dommages et intérêts punitifs et ses répercussions sur le droit de la concurrence », *JCP G* 2006, I. 149.

[11] Aff. C- 295/04 to C-298/04.

completed, more or less clearly, with other functions, depending on the objectives pursued. Damages also aim to provide the creditor with an equivalent performance and to incite the parties to perform the contract correctly.

The functions of damages, other than a punitive function, are often complex, and usually combined. A hard core remains, however: the compensation for the loss in its entirety (**1**). The PAVIA Project is particular in that it has abandoned this widely accepted principle (**2**).

1. Total compensation for the loss

In the above mentioned Green paper, the Commission questions the Member States in order to define whether damages are based exclusively on the notion of compensation or on the recovery of an illegal gain. This question echoes a judgment of 20 September 2001[12]. In this case, a lease of a public house, which contained an exclusive purchasing clause for beer (beer tie) was entered into between an English brewery and a tenant also established in England. The tenant, in an action brought against him for non-payment of two deliveries of beer, argued that the claim was invalid on the basis that the contract was contrary to European competition law and brought a counterclaim for damages. The ECJ was asked to decide whether a party to such a contract could claim damages from the other party to the contract in compensation for the loss suffered as a result of the performance of the contract. The ECJ reasserted that the question was governed by the law of Member States (point 31) but that national provisions which bar such a claim on the sole ground that the claimant is party to the contract were contrary to Community law. The ECJ adds, however, that the national jurisdiction may take into account the respective positions of the two parties: if one party is in a marked weaker position compared to the other, the national court may award damages to the extent that such party was not able to negotiate the clauses in the contract and avoid or limit its loss.

The diversity of the functions of damages also appears in other texts.

Damages are covered by section 2 of Chapter V of the CISG, which relates to « provisions common to the obligations of the seller and of the buyer ». Damages arise out of a breach of contract; they are the compensation for any breach of the contract of sale, whether by the seller or the buyer, whatever the nature or seriousness of the breach. Damages are therefore the means of fully compensating the creditor for his loss arising out of the non-performance when other remedies do not achieve a full compensation for the loss suffered. The damages therefore are in addition to the other remedies. If the debtor can show a valid defence, however, the creditor can no longer claim damages (article 79§5). Conversely, a creditor may sometimes claim damages in certain cases when other remedies are not available to him (article 83 gives the right to the buyer to claim damages in the case where he cannot require substitute goods or where he has lost the right to declare the contract avoided), or even when he may not rely on the breach itself (article 44 gives the right to the buyer to claim damages for the loss suffered when he has lost the right to rely on certain breaches of the seller but he has a reasonable excuse for his failure to give notice regarding the lack of conformity of the goods or their being subject to third party rights within a reasonable time). Under the terms of article 74, damages consist of a sum equal to the loss, including loss of profit; such damages may not exceed the loss which the party in breach foresaw or ought to have. Moreover, article 77 specifies that the party relying on the breach must take such measures to mitigate the loss, including loss of profit. If he fails to take such measures, the party in breach may claim a reduction in the damages in the amount by which the loss should have been mitigated. Specific rules for the calculation of damages are provided in the event that damages are claimed following the contract being avoided (art. 75 and 76). In such a case, the damages are intended to compensate for the loss arising out of the replacement of the goods: they are therefore calculated in principle by reference to the difference between the contract price and the price in the substitute transaction.

[12] Aff. C- 453/99, *Courage Ltd/Bernard Créhan*.

Section 4 of Chapter 7 relating to non-performance in the UNIDROIT Principles deals with damages. Article 7.4.1 sets out that any non-performance gives the aggrieved party a right to damages either exclusively or in conjunction with any other remedies. As indicated in the commentary under this provision, the cause of the non-performance is irrelevant; where the non-performance is excused, as for example in the case of *force majeure*, this could prevent the aggrieved party from receiving damages. Article 7.4.2 states that the creditor is entitled to full compensation for the harm sustained, which includes « both any loss which it suffered and any gain of which it was deprived, taking into account any gain to the aggrieved party resulting from its avoidance of cost or harm». The commentary below this provision points out that the non-performance should be a source neither of gain nor of loss for the aggrieved party. Account should be taken of the gain arising out of the non-performance (costs or losses avoided) and of the loss sustained as well as of the gain of which the aggrieved party was deprived as a result of the non-performance. The commentary highlights that generally, the gain will be uncertain and will frequently take the form of a loss of a chance (see in this respect the provisions of article 7.4.3). As in the CISG, the conduct of the aggrieved party will be taken into account, since such party is under an obligation to mitigate the damage (art. 7.4.7 and 7.4.8).

In the event of termination, article 7.4.5, in the same way as the CISG, states that the aggrieved party may recover the difference between the contract price and the price for the replacement transaction, so long as this is entered into within a reasonable time and in a reasonable manner. If no replacement contract is entered into, article 7.4.6 provides that the aggrieved party may recover the difference between the contract price and the price current at the time the contract is terminated. In both these cases, the aggrieved party may claim damages for additional loss. The damages in these cases enable the aggrieved party to obtain compensation for the loss sustained and provide an equivalent to performance.

The question of the nature of damages referred to in article 9:501 of PECL is not answered any more clearly: do damages fulfill a compensatory function for the wrongful behaviour of one of the parties to the contract or do they reflect an equivalent performance of the contract? Article 9:501 would seem to tend towards the second interpretation, especially if it is read in conjunction with article 9:502: under the terms of this provision, the aggrieved party should be placed in the position it would have found himself in had the contract been duly performed. The damages cover «the loss which the aggrieved party has suffered and the gain of which it has been deprived » and are consequently intended to provide the aggrieved party with an equivalent performance. The aggrieved party will however be entitled to recover the reasonable costs incurred to mitigate the loss. Should the aggrieved party enter into a substitute transaction within a reasonable time and in a reasonable manner, it will be entitled to recover the difference between the original contract price and the price of the substitute transaction, as well as damages for any further loss, so long as these are recoverable (art. 9:506); the difference between the current price for the performance contracted for and the original contract price may be awarded as damages as well as damages for any further loss so far as these are recoverable (art. 9:507).

2. The principle of full compensation for the loss is abandoned by the PAVIA Project

Article 163 of the PAVIA Project provides that damages are recoverable for the loss sustained and the profits lost which the aggrieved party (« creditor » in accordance with the official translation) could reasonably have expected. The loss of the chance of a gain will be taken into account if it can be deemed with reasonable certainty that such gain would occur. The PAVIA Project provides that the conduct of the creditor will be taken into account and that such creditor is under a duty to mitigate the loss.

This text however shows some original features.

Article 166 mixes, in an ambiguous fashion, the function of damages in relation to compensation and in relation to performance by equivalence. Indeed, it provides that « if possible, reparation shall take the form of specific performance or specific redress

supplemented, if necessary, by a monetary indemnity ». « If the entire or partial restoring to the former state is not possible or is too onerous for the debtor, considering the interest of the creditor, and in any case if the creditor so demands, suitable monetary compensation shall be paid ». The PAVIA Project is wider than the UNIDROIT Principles and PECL: the damages, under the terms of article 166, must provide the creditor with satisfaction of his interest (positive) in that the contract be punctually and exactly performed, also taking into account the expenses and costs incurred by him and which would have been covered by performance if the prejudice comes from non-performance, delayed or defective performance and the satisfaction of his interest (negative) in that the contract had not been made or the precontractual negotiation had not taken place, in the other cases, and particularly when damage comes from the non-existence, nullity, annulment, ineffectiveness, rescission, non-conclusion of the contract and in similar cases ».

The PAVIA Project finally sets itself apart from the UNIDROIT Principles and PECL in that is not attached to the principle of full compensation for the loss. Indeed, article 198 provides that the judge may, depending on the conduct, the interest and the financial conditions of the creditor, limit the amount of damages if full compensation should prove disproportionate and should create for the debtor (party in breach) obviously unbearable consequences, having regard to its economic situation, and if the non-performance delayed or defective performance is not due to such debtor's bad faith ».

II. THE AMBIVALENCE OF THE TERM « INDEMNITY »

The term « indemnity » is used in two different contexts: on the one hand, it refers to contractual clauses used by the parties to define the conditions for compensation (**A**) and on the other hand, it refers to the mandatory protective regime provided by certain international and Community legislation (**B**).

A. An indemnity provided by a contractual provision

This type of indemnity is very frequent in international contracts. These clauses have a double function, both compensatory and coercitive (**1**). This complexity is reflected in the terminology which is very hesitant (**2**).

1. The functional ambiguity of contractual indemnity clauses.

The generic definition of these clauses is imprecise because of the great variety of clauses which can be agreed[13]. These clauses appear both in general conditions and in individual contracts. They are present in a great variety of contracts. They come into play in the event of delay, but also in the case of partial or total failure to perform certain obligations which are generally referred to as obligations to achieve a given result. They can be paid in a number of ways: direct payment, foregoing a sum due, or calling upon a bank guarantee. Their enforcement can be in addition to the performance of the obligation in question or to supplemental damages.

There is however a hard core on which all the texts which were analysed agreed: such a provision consists in the payment of a monetary sum in the event of late performance or wholly or partly defective performance, of a contractual obligation.

Such a clause is intended, on the one hand, to compensate for the loss suffered as a result of the non-performance by fixing in advance the amount of the indemnity payable in the case of a breach or a delay in performance, and on the other hand, because of its amount, to incite the

[13] See the detailed examples of clauses provided by M. FONTAINE et F. de LY, *Droit des contrats internationaux, Analyse et rédaction de clauses*, edition: Bruylant et FEC 2003, p. 333 - 366.

parties to duly perform their respective obligations, with the defaulting party being « punished » by having to pay a lump sum which is not linked to the damage caused[14].

From a terminological perspective, it should be noted that a number of authors have put forward distinct names for these clauses, based either on the compensatory or on the coercitive function. In French, although such a clause will generally be referred to as a « *clause pénale* » (penalty clause), certain authors have suggested making a clearer distinction between the « *clause pénale* » with the meaning of a private punishment and the damages clause or lump sum indemnity clause which places the emphasis on the compensatory function[15]. In other languages, these functions are clearly distinguished: for example, in English, a distinction is made between the penalty clause and the liquidated damages clause. The International Chamber of Commerce has prepared guidelines (*Guide to penalty and liquidated damages clauses* - 1990) in which it recommends that it should be specified whether the clause has a deterrent element.

The terminological issues are crucial because from the wording used stem the difficulties encountered in relation to the legal regime which governs such clauses. Firstly, the terminology should enable such clauses to be distinguished from similar clauses, such as clauses providing compensation for revocation for example. Secondly, an effort with regard to the wording is fundamental in establishing the legal regime which governs such clauses; in this respect, crucial questions arise as to the validity of such clauses, the power of the judge to revise the amounts stipulated or the possibility of cumulating other sanctions with the payment of the sum provided.

Despite the issues at stake, the texts which were analysed in the context of Acquis reveal many hesitations.

2. Terminological hesitation: from penalty clause to damages clause

A first hesitation arises out of the purpose of the clause. Most texts provide that the purpose of such clauses is to stipulate a sum of money. Two texts however widen the possibilities. Both the BENELUX Convention of 26 November 1973 relating to penal clauses (not ratified) and the PAVIA Project specify that the clause may prescribe a performance other than the payment of sums of money.

A second uncertainty arises out of the duality of functions mentioned above. The texts sometimes attempt to distinguish two types of clauses depending on the function fulfilled, but at the same time providing a uniform legal regime.

The abovementioned BENELUX Convention clearly puts forward a single expression: the penalty clause. Under the terms of article 1, a penalty clause is « any clause which provides that the debtor, if he fails to fulfill his obligation, must pay a sum of money or perform some other service by way of penalty or indemnity ». This unitary logic calls for a legal regime which is also unified: the penalty clause only applies in the event of a failure to perform attributable to the debtor, excludes the performance of the obligation to which it is attached and may be reduced by the judge « if manifestly required by equity ».

The UNCITRAL Uniform Rules of 1983 on Contract Clauses for an Agreed Sum due upon Failure of Performance effect the same terminological junction. Article 1 provides that the rules will apply « to international contracts in which the parties have agreed that, upon a failure of performance by one party (the obligor), the other party (the obligee) is entitled to an agreed sum by the obligor, whether as a penalty or as compensation. The UNCITRAL rules only complete the intention of the parties. Subject, therefore, to any clause which is different or clause to the contrary, the clause can only apply if the debtor is liable for the failure to perform. The rules distinguish, always in the absence of any provision to the contrary,

[14] In support of this point, see M. FONTAINE et F. de LY, *op. cit.*, esp. p. 370; U. DRAETTA et R. LAKE, *Contrats internationaux – pathologies et remèdes*, edition: Bruylant et FEC 1996, p. 114 and 115.

[15] In support of this point, see D. MAZEAUD, *La notion de clause pénale,* LGDJ 1992; A. PINTO-MONTEIRO, « La clause pénale en Europe », *Études offertes à J. GHESTIN, le contrat au début du XXI*e *siècle*, LGDJ 2001, p. 719.

between a failure to perform resulting from a delay and the other failures to perform: in the first case, the obligee is entitled to both performance of the obligation and the agreed sum, whilst in the second case, the payment of the sum in theory excludes the performance of the obligation unless the sum agreed cannot reasonably be regarded as sufficient compensation for that failure. If the loss « substantially » exceeds the agreed sum, the obligee may, unless otherwise provided, claim damages to the extent of the loss not covered by the agreed sum. Finally, the clause cannot be reduced by a court or an arbitrator unless it is substantially disproportionate in relation to the loss that has been suffered.

The UNIDROIT Principles and PECL acknowledge the validity of contractual clauses which provide that a sum will be payable in the event of non-performance by a party who fails to comply with its obligations.

Article 7.4.13 of the UNIDROIT Principles deals with clauses which provide for an agreed payment for non-performance («*indemnité* » in the French version). The specified sum (« *indemnité* ») is the term used to refer to the sum which is to be paid to the aggrieved party « irrespective of its actual harm ». The specified sum may be reduced to a reasonable amount where it is grossly excessive in relation to the harm resulting from the non-performance and to the other circumstances. Article 9:509 of PECL contains similar provisions.

The commentaries in relation to both texts indicate that the clauses covered by the provisions include both clauses which have a compensatory function and those which operate as a deterrent against non-performance (penalty clauses proper). In the first case, the clauses evaluate the damages in a prospective way and facilitate the task of the aggrieved party in proving the damage. In the second case, the clauses generally fix a high amount which strongly encourages obligor to perform. The commentaries on article 7.4.13 of the UNIDROIT principles specify that the clause can theoretically only apply in the event of a non-performance for which the non-performing party is liable.

Article 170 of the PAVIA Project makes use of a variety of terms which may at first sight lead to some confusion. This provision refers to the terms « penal clause », « penalty » and « compensation » in the same text. However, it would appear that the text only deals with clauses which have as their function the compensation of loss suffered by reason of the non-performance or a delay in performance or one of its obligations by the obligor. The obligee who relies on such a provision is not required to prove the existence or the extent of the loss. The judge may in accordance with equitable principles reduce the amount of the penalty if the latter is manifestly excessive. The text specifies, finally, that in contracts entered into with consumers, « penalty clauses against the consumer contained in the general conditions of the contract are of no effect in all cases ».

Article 3 of the Council Directive 93/13/EEC of 5 April 1993 on unfair clauses in consumer contracts[16] defines what constitutes an unfair clause and refers to an annex which contains an indicative list of clauses which may, on the basis of the criteria set out, be held to be unfair. Article 1.e of this annex refers to clauses which have the object of effect of « requiring any consumer who fails to fulfill his obligation to pay a disproportionately high sum in compensation ». This provision is neutral in French, in that it uses the term « *indemnité* » which could cover provisions which serve a compensatory purpose as well as a coercitive one; the English version is more precise and appears to place the emphasis on the compensatory function.

In the field of consumer rights, the same term « *indemnité* » is used in another sense. The purpose is no longer to exclude potentially unfair clauses, but to provide, in favour of the consumer, an indemnity in the context of a number of mandatory provisions.

B. An indemnity provided by a mandatory legal regime

The consumer is protected by a number of Community or international texts, in particular in the field of transport (**1**). The commercial agent also benefits from the payment of an

[16] *OJ* L 95 of 21 April 1993.

indemnity when the contract is terminated, under the terms of mandatory provisions which exist for the protection of the agent by establishing or re-establishing a financial balance between the parties upon the termination of the contract (**2**).

1. The traveller's right to compensation

In the field of transport, the traveller is protected, on the one hand by mandatory provisions which guarantee a minimum level of indemnification, and on the other hand, by the introduction of an original right to compensation in the directive on package travel, package holidays and package tours. In the various texts which were studied, either the term « *indemnité* » (indemnity) is either expressly used, or it is implied by expressions such as « the right to indemnification » or « the right to compensation ».

With regard to carriage by air, the traveller benefits from a particular protection. Although the interests of the carriers are taken into account, the present day trend, whether at international or Community level, is to guarantee a mandatory minimum level of indemnification.

The Montreal Convention for the Unification of Certain Rules for International Carriage by Air (28 May 1999), due to replace the Warsaw Convention in relation to international carriage by air, recognizes in its preamble the importance of ensuring the protection of the interests of consumers in international carriage by air and « the need for equitable compensation based on the principle of restitution ». The Convention thus fixes limits for compensation according to the different types of damage. Articles 25 and 26 provide that the contract of carriage may not fix limits on liability which are lower that those laid down in the Convention, any such limits being null and void.

The 1997 Council Regulation on air carrier liability in the event of accidents, clearly states in recital 7 that it is appropriate to remove all monetary limits of liability no matter their origin. Article 3 of this regulation provides that the liability of a Community air carrier for damages sustained in the event of death, wounding or any other bodily injury by a passenger shall not be subject to any financial limit, be it defined by law, convention or contract.

An original right to compensation was introduced by the directive on package travel, package holidays and package tours.

Under the terms of article 4§6 of the directive, the consumer is entitled to compensation. This right is granted when he has exercised his right to withdraw following an alteration by the organizer of essential terms of the contract (article 4§5) or when the organizer cancels the package before the agreed date for departure for whatever cause other than the fault of the consumer. In either of these situations, article 4§6 provides that the consumer is entitled either to a substitute package or equivalent or higher quality (or of lower quality with a refund in the price difference) or to be repaid as soon as possible all sums paid by him under the contract. In either case, the consumer is entitled «if appropriate, to be compensated for non-performance of the contract ». The text of the directive is not very clear on this point. Although the compensation is linked to the non-performance of the contract, it would appear that the right to compensation is not limited to the case of non-performance only: the wording of the directive seems to allow the consumer to claim compensation even though he has accepted to be provided with an equivalent package[17]. The conditions of exercise of this right are left for the Member States to decide. However, the directive specifies that no compensation can be claimed when the cancellation is on the grounds that the number of persons enrolled for the package is less than the minimum number required or when the cancellation is for *force majeure*.

[17] More affirmative concerning the link between the compensation and the non-performance, see E. POILLOT, *Droit européen de la consommation et uniformisation du droit des contrats*, LGDJ 2006, n° 436, p. 199. More ambiguous, see C. AUBERT de VINCELLES et J. ROCHFELD (under the direction of), *L'acquis communautaire – les sanctions de l'inexécution du contrat, op. cit*., n°68, p. 29.

2. The commercial agent's right to compensation

The commercial agent is protected in the event of the contract being terminated by the payment of an indemnity[18].

The OHADA Uniform Act relating to general commercial law provides, under the terms of article 197, that « where relations between the principal and the commercial agent come to an abrupt end, the commercial agent shall be entitled to a compensatory allowance, without prejudice to possible damages ». Any clause which derogates from this principle and from the conditions for its application to the detriment of the commercial agent is deemed unwritten. The compensatory allowance is not due in the event of termination of the contract on the agent's initiative, unless such termination is justified by circumstances attributable to the principal or is due to circumstances beyond the agent's control as a result of which the continuation of his activity can no longer be reasonably demanded. The agent will not be entitled to claim such allowance if he caused the termination of the contract by serious misconduct. Article 199 of the Uniform Act imposes methods of calculation for the allowance for the first three years of the contract.

An indemnity for the commercial agent is also provided for under European law by Council Directive 86/653/EEC of 18 December 1986 on the coordination of the laws of the Member States relating to self-employed commercial agents[19]. Article 17 provides that Member States shall take the measures necessary to ensure that the commercial agent is, after termination of the agency contract, indemnified or compensated for damage, for whatever reason other than the cases set out in article 18 (where the principal has terminated the agency contract because of default attributable to the commercial agent, where the commercial agent has terminated the agency contract, unless such termination is justified by circumstances attributable to the principal or on grounds of age, infirmity or illness of the commercial agent in consequence of which he cannot reasonably be required to continue his activities). The indemnity is due if the agent has developed the principal's network and the directive provides that the amount of the indemnity must be equitable. The indemnity does not prevent the agent from claiming damages. This accentuates the difference in nature between the indemnity which rewards the commercial efforts of the agent which have benefited the principal, and damages, which compensate for the loss which may have been sustained as the result of the termination. The right to the indemnity is even acknowledged in the event of a termination due to the death of the agent (art. 18.4). Article 19 of the directive provides that the parties may not derogate from the provisions of articles 17 and 18 to the detriment of the agent. The ECJ in the *Ingmar* case[20] took the view that articles 17 and 18 protected the agent and more generally, through this profession, the freedom of establishment and the operation of undistorted competition (point 24). The rights which are guaranteed to the agent after the termination of the contract must therefore be applied where he carries on this activity in a Member States, in this case in the United Kingdom, although the principal is established in a non-Member State (California) and that the contract was expressly governed by the law of such country.

Comparative law

Although they are close from a terminological point of view, there should be no confusion between the terms « damage » and « damages », the latter representing the monetary

[18] On the analysis of the indemnity claimed by an exclusive distributor in the context of art. 5.1 of the Brussels Convention of 27 Sept. 1968 on the choice of jurisdiction in contractual matters, see ECJ case 14/76, *A. De Bloos c SPRL c. Société en commandite par actions Bouyer*, 6 Oct. 1976, *Rec*. 1497. The case invites the national courts to ascertain whether, under the law applicable to the contract, an independent contractual obligation or an obligation replacing the unperformed contractual obligation is involved (point. 17).

[19] *OJ* L 382 of 31 Dec. 1986.

[20] ECJ 9 November 2000, case C-381/98, *Ingmar GB Ltd c. Eaton Leonard Technologies Inc*, *Rev. crit*. 2001.107, note L. IDOT. *Contra* the French solution, Cass. Com. 28 Nov. 2000, *D. aff*. 2001.305, note E. CHEVRIER.

evaluation of the loss suffered; and referred to indiscriminately in francophone countries as « *dommages et intérêts* » or « *dommages-intérêts* » and « *Wertersatz* » in German. These damages, no matter the country, have as their primary function the reparation also referred to as compensation. Moreover, many legal systems are reluctant, specifically in contractual matters, to award punitive damages, for two main reasons: firstly, it is considered that the function of damages is not to punish but to indemnify; secondly, from an economic perspective, it is accepted that the award of such damages would be contrary to the principle of predictability of the loss. However, through the operation of contractual derogations and, very exceptionally, through the intervention of the court, it appears that damages can take on a punitive function in the wider sense. These exceptions are becoming more generalised; it seems that increasingly, the authors are attracted to the idea of combatting breaches of contract which are motivated by profit, and which could be sanctioned by awarding to the obligee the profits arising for the obligor out of his breach of contract. This would make it possible to fight effectively against opportunistic behaviour, to render the market a more moral place, to make the cost of the obligor's behaviour more predictable. It would also fit well with the generalization of the duty to mitigate one's damage which is taking place at the moment.

Therefore, although the primary function of damages is clearly to compensate for the loss suffered, damages may have other functions. The question therefore arises as to the addition of a qualifying epithet to the expression « damages »: compensatory damages, damages for late payment, punitive or exemplary damages. The expression « damages » becomes polysemic (**I**). Following directly from this point, the question of the evaluation of the amount of damages awarded, although central, is treated with a varying amount of attention by the different countries. Certain legal systems merely refer in an indirect way to loss of gain and actual loss suffered, others operate a distinction between the positive interest and the negative interest, the responses are inadequate in some countries and more elaborate in others. It would appear, however, that the traditional distinction, inherited from JHERING and defended by FULLER, between positive and negative interest – which distinguishes between the fact of putting the obligee in the situation in which he would have found himself had the contract been duly performed, and the fact of putting him in the situation in which he would have found himself had the contract never been concluded – could, if it were generalized, help better ascertain which interest should be protected and in which circumstances. Such an approach would lead to a better predictability with regard to the risks arising out of the conclusion of the contract.

Moreover, the term « indemnity » is notable in that although its use is disparate, even anarchical, it seems to appear in certain recurrent situations. The notion – insofar as it can be considered a notion - was never the subject-matter of a systematization, and yet it tends to reflect, on the one hand, the wider category of the sums paid independently from any idea of compensation, and on the other hand, the sum paid to make up for an unjust enrichment. It is perceived more in terms of what it is not, i.e. a sum intended to compensate for a loss, than in terms of what it is. An indemnity therefore remains an uncertain term, both in its meaning and in its legal treatment (**II**).

I. « DAMAGES »: AN EXPRESSION WITH A VARIETY OF MEANING

For the purposes of the present study in its French version, the well-established expression « *dommages et intérêts* » was adopted.

It does however give rise, from a terminological point of view, to two difficulties which should be mentioned in these preliminary remarks.

Firstly, two French expressions coexist: « *dommages-intérêts* » and « *dommages et intérêts* ». This difference is not clearly apparent in the French Civil Code which uses, prima facie, one or the other expression as if they were interchangeable. In this way, article 1149 of

the Code civil provides, in the event of a failure to perform a contractual obligation, that « *les dommages et intérêts dus au créancier sont, en général, de la perte qu'il a faite et du gain dont il a été privé, sauf les exceptions et modifications ci-après* » (the damages payable to the obligee are, in general, in respect of the loss he suffered and the gain of which he was deprived, except as provided below). The articles which follow, and in particular article 1152, refer to « *dommages-intérêts* »[21] . The present day legislator as well as the courts have also tended to confuse the two expressions by treating them as synonymous. However, certain academics have argued, in particular with regard to contract, that the expressions each have a distinct meaning[22]: the « *dommages et intérêts* » consist of two separate elements – the loss suffered (« *damnum emergens* ») and the lost profits (« *lucrum cessans* ») – and have as their primordial function the compensation of the loss suffered, whilst the « *dommages-intérêts* » are « *une somme déterminée en bloc* » (a lump sum) [23] the main objective of which is to punish the perpetrator of a fault.

Secondly, difficulties arise with regard to the translation of these terms. For example, in English, there is no such distinction between « *dommages et intérêts* » and « *dommages-intérêts* ». The sole term « damages » is used, synonymous with the expression « loss compensation » which clearly reflects the compensatory function of the sum awarded. Damages may however be qualified as soon as other functions come into play[24].

Thus the expression « *dommages et intérêts* » (hereinafter referred to as « damages »), although traditionally considered as the indemnity awarded for the compensation of the loss suffered, appears to be given new functions and even sometimes a specific legal regime. It will be interesting to examine these damages in the different functions which they fulfill. The study will therefore deal with compensatory damages (**A**), damages for late payment (**B**) and punitive damages (**C**). In addition, penal clauses and liquidated damages clauses, which cause real terminological difficulties, will be considered separately (**D**).

A. Compensatory damages

The traditional and primary function of damages generally appears as being the compensation for loss suffered. However, although a vast majority of legal systems share this view, it remains that the notion of compensation is not univocal (**1**) and that it has been at the root of certain difficulties in the understanding of other mechanisms, in particular that of equivalent performance (**2**).

1. Various approaches to the notion of compensation

Rudolph von JHERING, in 1860, made a distinction between « positive interest » and « negative interest »[25]. The positive interest, according to the author, refers to « everything which [the obligee] would have had if the contract had been valid »[26]. Conversely, the negative interest[27] is defined by JHERING as « the interest in the non-conclusion of the contract. (…) it is intended more widely to compensate for the damage arising out of the

[21] See, in support of this position, the topical example of art. 1153 of the Civil Code which uses in the two first paragraphs both expressions in succession « *dans les obligations qui se bornent au paiement d'une certaine somme, les dommages-intérêts résultant du retard dans l'exécution ne consistent jamais que dans la condamnation aux intérêts au taux légal, sauf les règles particulières au commerce et au cautionnement. Ces dommages et intérêts sont dus sans que le créancier soit tenu de justifier d'aucune perte* ».

[22] See, for example, O. SAEDI, « Dommages-intérêts ou dommages et intérêts : celle-ci ou celle là ; ou bien les deux ? », *LPA* 7 June 2005, n° 112, p. 6.

[23] O. SAEDI, *op. cit*.

[24] J. EDELMAN, « The meaning of damages: Common Law and Equity », *in: The Law of Obligations, connections and boundaries*, A. ROBERTSON (ed.), UCL Press 2004, p. 31.

[25] V. R. von JHERING, « De la culpa in contrahendo ou des dommages-intérêts dans les conventions nulles ou restées imparfaites (1860) », in: *Œuvres choisies*, t. II, translation O. DE MEULENAERE, Paris, Mrescq, 1893, p.1, esp., p.15.

[26] R. von JHERING, *op. cit*., p. 16.

[27] Y.-M. LAITHIER, *op. cit.,* n°118, p. 173.

reliance placed in vain by the obligee upon a contract which never proceeded, either because the contract was cancelled, or because the obligor defaulted ».

However, if the distinction has been widely accepted in various legal systems (**a**), it appears that other systems, which had not devised a systematic procedure for evaluating the loss, do not recognize the notion of negative interest (**b**).

a) The distinction made between « positive interest » and « negative interest »

The distinction between positive and negative interest would appear today to have been adopted by a number of legal systems. Indeed, although the wording differs and the differences have been refined, the distinction between positive interest and negative interest appears to be the cornerstone of the evaluation of damages[28]. This is what seems to emerge from common law systems, with the distinction between « expectation » and « reliance interest » (**i**), from German law, with the distinction between « *status quo ante* » and « *status ad quem* » (**ii**) and from Swiss law (**iii**).

i. The distinction between « expectation interest » and « reliance interest » at common law.

The notions of « positive interest » and « negative interest » are today frequently invoked in common law systems[29] in order to determine the function of damages and *a fortiori* their amount[30]. Academics and judges, both in America and England,[31] retranscribe these notions through the concepts of « expectation interest » and « reliance interest »[32]. Article 344 of the (Second) Restatement of Contracts provides as follows: « [j]udicial remedies under the rules stated in this Restatement serve to protect one or more of the following interests of a promisee: (a) his " expectation interest ", which is his interest in having the benefit of his bargain by being put in as good position as he would have been in had the contract been performed, (b) his " reliance interest ", which is his interest in being reimbursed for loss caused by reliance on the contract by being put in as good a position as he would have been in had the contract not been made, or (c) his " restitution interest ", which is his interest in having restored to him any benefit that he has conferred on the party »[33].

With regard to the meaning to be given to the expression « positive interest », translated by FULLER as the expression « expectation interest », this should be understood as the act of « providing to the obligee the benefit which the performance of the obligation should have afforded him ». It corresponds exactly to the expression, more familiar to French jurists, of « *exécution par équivalent* » (equivalent performance). Strictly speaking, the equivalent performance refers to the damages calculated by reference to the benefit to the obligee derived from the performance of the obligation, as opposed to the damages calculated by reference to the benefit derived from the non-conclusion of the contract »[34]. Therefore, the mere value of the service of goods which would have been provided to the obligee is not enough to constitute the positive interest. To this head of damages must be added the value of

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[28] This is the case under Italian law. See C.M. BIANCA*, Il contratto*, 2nd ed., Milano 2000, p. 175.

[29] See in particular J. BEATSON, *Anson's Law of Contract*, 28th ed., OUP 2002, p. 589 and following; E. McKENDRICK, *Contract Law*, Palgrave Macmillan Law Masters, 7th ed., Palgrave Macmillan 2007, n°20.1, p. 402; from the same author, *Contract Law. Text, Cases, and Materials*, 2nd ed., OUP 2005, p. 1005; G.H. TREITEL, *An Outline of the Law of Contract*, 6th ed., OUP 2004, p. 369; H. COLLINS, *The Law of Contract*, 4th ed., LexisNexis 2003, p. 405.

[30] Y.-M. LAITHIER, *Etude comparative des sanctions de l'inexécution*, Préf. H. Muir-Watt, LGDJ 2004, n°106, p.157.

[31] See for example, E. McKENDRICK, *Contract Law*, Palgrave Macmillan Law Masters, 7th ed., Palgrave Macmillan, 2007, n°20.1, p. 402.

[32] The articles establishing the principles on this subject are those of FULLER and PERDUE in 1936. See L.L. FULLER, W. R. PERDUE, « The Reliance Interest in Contract Damages:1 » [1936] 46 *Yale LJ* 52 and by the same authors, « The Reliance Interest in Contract Damages: 2 » [1936] 46 *Yale LJ* 373.

[33] See *infra* for the particularities of restitution interest.

[34] Y.-M. LAITHIER, *op. cit.,* n°112, p. 165; *adde.* Ph. REMY, « Observations sur le cumul de la résolution et des dommages et intérêts en cas d'inexécution du contrat », *in* : *La sanction du droit, Mélanges offerts à Pierre Couvrat*, PUF 2001, p. 121, esp. p.122 - 124.

« the expected usefulness of the contract »[35]. Therefore, the notion of positive interest covers both that of lost profits and loss sustained, as recognized by French law. The lost gain is « the increase in the value of his assets of which the obligee is deprived as the result of the failure to perform the contract »[36] whilst the loss sustained is characterized by the fact that « the assets of the obligee, after the event, have diminished in value »[37]. However, it should be specified here that the positive interest does not consist of all the losses arising out of the failure to perform. It only covers « the decrease in value of the assets which would not have occurred had the contract been duly performed. Correlatively, those expenses which would have been incurred by the aggrieved obligee under the terms of the contract cannot be recovered under this head of damages »[38]. The loss sustained may, it would appear, be divided into two sub-categories: the decrease in the value of the assets, on the one hand, and the increase in costs, on the other.

The diminution in value represents the fact the goods are missing, or wholly or partly destroyed, or the service provided is of an insufficient quality. Under this heading, the obligee will be entitled to claim damages calculated by reference to the monetary value or book value of the goods, referred to by common lawyers as difference in value, diminution in value or loss in value[39]. To this should be added (…) the cases of damage or depreciation caused by the delivered goods to other assets of the obligee, [as well as] any mental distress suffered by the obligee as a result of the failure to perform the contract.

The increase in costs can be defined as « the increase in the costs made necessary by the failure to perform an obligation. [In practice], it consists of all the expenses incurred by the obligee to limit, reduce or eliminate the damage »[40], whether costs of preservation, compensation, handling, carriage of the goods or even security. To these heads of damages should be added « the costs of correspondence, or recovery, expert fee, legal fees and more generally « transaction costs », when these are incurred with a view to reducing the damage». Moreover, the obligee should be entitled to recover the expenses necessary for a substitute performance so long as these are reasonable. In the same way, the obligee may recover expenses necessary to repair the goods.

Conversely, the negative interest[41] is defined by JHERING as « the benefit derived from the contract not being entered into. (…) It refers more widely to compensation for the damage arising out of the reliance placed to no avail by the obligee on a contract which is not pursued, either because the contract is cancelled, or because the obligor has defaulted»[42]. This negative interest, as it was named by JHERING, was translated by FULLER, as reliance interest. « The damages awarded under the head of reliance interest are particular in that they compensate the obligee for the damage sustained by acting in reliance on a promise, or if the expression is preferred, in reliance on a contract that was not performed, so that the obligee is placed in the situation in which he would have been had the contract not been entered into with a defaulting obligor »[43].

This negative interest therefore necessarily includes the expenses inherent in the conclusion of the contract (transport costs, stamp duty, registration fees …) and in the performance of the contract (purchase of goods, transport and moving costs, advertising costs, insurance costs…). It also includes the costs incurred after the failure to perform the contract, that is to say those intended to limit the damage. More controversial, but possible in theory, is the question of compensation for lost opportunity: the loss of a chance to enter into a contract with a third party, which contract may have been duly performed[44].

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[35] Y.-M. LAITHIER, *op. cit.,* n°113, p. 166.
[36] Y.-M. LAITHIER, o*p. cit.,* n°117, p. 172.
[37] J. CARBONNIER, *Droit civil, t.4, Les obligations*, 22nd ed., PUF 2000, n°206.
[38] Y.-M. LAITHIER, *op. cit*., n°114, p. 167.
[39] Y.-M. LAITHIER, *op. cit.,* n°115, p. 167 ; E.A. FARNSWORTH, *op. cit.*, p. 764.
[40] *Ibid.* n°116, p. 170.
[41] Y.-M. LAITHIER, *op. cit.,* n°118, p. 173.
[42] Y.-M. LAITHIER, *op. cit.,* n°119, p. 174.
[43] Y.-M. LAITHIER, *ibid*.
[44] On the question as a whole, see Y.-M.LAITHIER, *op. cit*., n°124.

ii. The protection of the « *status ad quem* » under German law

The distinction between restoring the *status quo ante* and the *status ad quem* is fundamental in the assessment of recoverable damages and for the calculation of the sum awarded.

From a terminological point of view, German codified law does not expressly refer to these two categories, but the distinction is almost unanimously accepted by academics. However, the terms used vary somewhat: instead of « *status ad quem* », the expression used is « *Äquivalenzinteresse* » (equivalent interest – equivalence between the performance and the consideration), or « *Erfüllungsinteresse* » (the interest which the obligee has in the performance of the obligation) or « *positives interesse* » (positive interest), as for « *status quo* », the expression used is « *Integritätsinteresse* » (integrity interest) or« *negatives Interesse* » (negative interest), the latter sometimes referred to as « *Vertrauensschaden* » (reliance damage), in a slightly different context. In fact, the dichotomy between positive and negative interest has been most important and very useful with regard to German contract law, in particular concerning precontractual liability (*culpa in contrahendo* [§§ 311, para. 2, and 241, para. 2 of the BGB]), the liability of the *falsus procurator* (representative acting without a mandate, § 179 BGB) and in the event of a cancellation for lack of consent (§ 122 BGB). In all these cases, the distinction between positive interest and negative interest allows two different situations to be identified: either the obligee is entitled to be placed in the position he would have found himself had the contract been duly performed, and therefore to recover his lost gain (positive interest) - or he is entitled to be placed in the position he would be in, had he not relied on the existence of the contract, and therefore to recover only the costs engaged in view of the conclusion and performance of the contract, and possibly the lost opportunity to enter into another favourable contract which he could have concluded had he not placed his reliance upon the valid conclusion of the contract[45].

German law marks the distinction between the protection of the *status quo* and of the *status ad quem*, to the extent that it provides for specific consequences, in particular with regard to the protection of the *status ad quem.* Indeed, in this case, the BGB distinguishes between two sub-categories of damage, with each one being subject to specific conditions: the damage « in lieu of performance » (« *Schadensersatz statt der Leistung* ») and the damage «for belated performance» (« *Schadensersatz wegen Verzögerung der Leistung* »).

Regarding the damage « in lieu of performance », § 280, para. 3 of the BGB, specifies that damages are only recoverable in certain additional conditions set out in §§ 281, 282 and 283 of the BGB are met. If § 282 BGB, which is not of any practical interest, is ignored, the « additional conditions » of restitution amount to a requirement, in principle, that the obligee should impose a further delay for performance[46].

As for the very notion of damage « in lieu of performance », academics take the unanimous view that the recoverable damages consist of two elements: everything that provides the performance itself, the value of the goods or service to be provided, or the price which the obligee was obliged to pay elsewhere to obtain such goods or services (« *Substanzausfallschaden* » – damage in relation to loss of the substance); and any economic loss caused by the fact that the obligee did not have the benefit of the performance at the time

[45] In fact, German law, together with Swiss law (see *infra.*) and American law (see *supra*.), was among the first to transpose the distinction made by JHERING. See in particular F. RANIERI, « Les sanctions de l'inexécution du contrat en droit allemand », in : *Les sanctions de l'inexécution des obligations contractuelles. Etudes de droit comparé*, M. FONTAINE, G. VINEY (sous la direction de), Bruylant, LGDJ 2001, n°50, p. 828.

[46] The practical effect of this requirement is the granting of a « second chance » which the obligee must give to the obligor in the event of non-performance or of defective performance, before he can claim damages « in lieu of performance ». This second chance has an obvious economic objective: it favours the real performance (in kind) of the contract as opposed to the replacement of the obligation in question by a right to damages. §§ 281, para. 2, and 283 of the BGB contain several exceptions to this second chance principle: when the performance is impossible (§ 283), when the obligor with due consideration and definitively refuses such performance, and after considering the respective interests of the parties, it appears that the immediate transition to damages is justified (§ 281, para. 2), the obligee is not required to impose a delay before claiming damages « in lieu of performance ».

when the obligor was under an obligation to provide it (normally, at the expiry of the specified delay), therefore, the lost gain in relation to the exploitation or resale of the goods or services (« *Ertragsausfallschaden* » – damage in relation to the loss of exploitation/use).[47] In this last sub-category, it is the intention of the obligee regarding what he wanted to do with the goods or services which determines the extent of the recoverable damages.

There are cases in which the damages recoverable in the case of damage « in lieu of performance » are not sufficient to satisfy the obligee. That is the case in particular in certain contracts, where neither the goods or services provided nor the use which was intended for them have a monetary value. A typical example, taken from German caselaw, is the case of a political party renting premises for a meeting, premises which the landlord finally refuses to provide. Obviously, the political party is not obliged to pay the rent; but it claims the costs incurred in vain for advertising and organising the meeting. With regard to contracts for profit, the courts had applied a « presumption of profitability» (« *Rentabilitätsvermutung* ») which consisted in treating the costs incurred in vain as a loss made by the business, by assuming that they would have been amortized by the use of the subject matter of the contract had the contract been performed. But for non-profit making contracts, this presumption was automatically disproved since an amortization in the economic sense was excluded.

It is to remedy this deficiency in contractual liability that the German legislator introduced, in 2002, § 284 of the BGB, which offers the obligee a choice between claiming damages for damage « in lieu of performance » and a claiming the reimbursement of costs incurred in vain, but without allowing a combination of the two. Moreover, this right is subject to the same conditions as the right to claim damages for damage « in lieu of performance ».

From a terminological perspective, it is a right to « *Aufwendungsersatz* », a term which is also used with regard to negotiorum gestio (the manager is entitled to the restitution of the costs incurred – « *Aufwendungsersatz* », § 670 BGB), with regard to a few cases of unjust enrichment (« *Aufwendungskondiktion* », § 812, para. 1, 1st sentence, BGB) and other cases, the main difference being, in relation to the notion of damages, that the restitution of expenses only includes costs voluntarily incurred, whilst the damages include both voluntary and involuntary expenses.

Damages for « late performance » (« *Schadensersatz wegen Verzögerung der Leistung* ») are only recoverable under § 280, para. 2 of the BGB under certain additional conditions set out by § 286 of the BGB. These « additional conditions » amount to a requirement, in principle, that the obligee should make a formal demand to the obligor[48].

The damage « for late performance » covers elements of the obligee's economic interest with regard to the performance required and which do not replace such performance. It is also referred to as « damage in addition to performance ». The question to be asked is the following: would the award to damages remove the obligee's interest in the performance of the contract? If the response is positive, then the damage is « in lieu of performance », if not, it is a damage « in addition to performance » and therefore a damage « for late performance ».

Typically, there are two categories of damage « for late performance »[49]: The *temporary* loss of enjoyment of the goods or services to be provided (unlike the *permanent* loss of

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[47] V. H. C.GRIGOLEIT, Th. RIEHM, « Die Kategorien des Schadensersatzes im Leistungsstörungsrecht », *AcP* 203 (2003), *S.* 727-762.

[48] § 286, para. 1 of the BGB requires a « *Mahnung* » (formal request) by the obligee, and damages « for delayed performance » can only be awarded on that condition. In principle, it is therefore not only the non-performance at the expiry of the delay for performance which is sufficient for the award of damages « for late performance », but the formal request must take place after such expiry.
The formal request is not necessary when the date of performance is specified in the contract; or at least if it can be determined by a particular event set out in the contract (for example 2 weeks after the delivery of the goods or services); when the obligor with due consideration and definitively refuses such performance, and after considering the respective interests of the parties, it appears that the immediate transition to damages is justified (§ 286, al. 2). In addition, following the transposition of directive 2000/35/EC into domestic law, the formal request is no longer necessary after 30 days from the receipt of an invoice. The formal request should not be confused with the requirement for delay: In particular, it is not necessarily followed by a delay for performance. The mere request is sufficient. It therefore imposes less pressure than the requirement for a delay.

[49] For more details, see H.C. GRIGOLEIT, Th. RIEHM, *art. précit*., p. 747 - 751.

enjoyment in the event of a failure to perform, which is included in the damage « in lieu of performance »), and the costs incurred for the recovery of the debt (lawyers' costs, court fees, …). The loss of enjoyment of the goods or services can also include the payment of interest to a bank (for example if the account is overdrawn) which would not have been payable had the obligor performed his obligation. Moreover, the first category of damage « for late performance » can even include lost gains which the obligee would have made by speculating on the stock exchange with the monies owed (on the condition he can prove exactly what he would have done).[50]

iii. Swiss law and the distinction between « positive interest » and « negative interest »

As it is the case for German law, the Swiss legislation does not use the distinction established by JHERING but this is however central in legal theory[51]. Either the damages are intended to place the obligee « in the financial situation in which he would have found himself had the contract been performed »[52] (positive interest), or they are intended to place the obligee « in the financial situation in which he would have found himself had the contract never been entered into »[53] (negative interest).

In the first case (positive interest), the damages are intended to compensate for the loss sustained (« costs incurred unnecessarily with a view to performing the contract [but not entering into it], expenses incurred to supplement the performance, or debts contracted towards third parties because the obligee was unable to fulfill his own obligations ») and the lost profits (« loss of productivity with regard to a productive asset or loss of benefit on the sale of an asset (in other words, the difference between the price fixed by the contract and the price which the buyer could normally have obtained from a sale, whether or not he would actually have sold the asset) »[54]). In other words, the claim for damages for a failure to perform appears to be especially useful to the obligee « when the performance is in relation to a productive asset or to an asset intended to be sold at a benefit, or to an asset which has increased in value since the contract was entered into »[55].

In the second case (negative interest), damages may not only be intended to compensate the obligee for the benefit which he would have derived from the non-conclusion of the contract, but also to cover the damage arising out of the trust placed in the obligor until the termination[56] (« *Vertrauensinteresse* » or reliance interest). These damages are general paid following the termination of the contract and consist of the loss sustained («costs resulting from the conclusion of the contract, or expenses incurred unnecessarily with a view to the performance, or compensation owed to third parties on the basis that the obligee was not able to fulfill his own obligations, without taking into account the decrease in value of the asset which is the subject-matter of the contract »[57]) and of the lost profits (« loss of income resulting from not entering into other contracts which could have been profitable, but not the lost gain in relation to the case in question»[58]).

Such an approach has not been adopted by all the legal systems, and in particular, has not been adopted under French law, which in principle, only takes into account the positive interest.

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[50] BGH, 17 Feb. 2002, NJW 2002, 2553.

[51] See generally, P. ENGEL, *Traité des obligations en droit suisse*, 2e ed., Staempfli Editions, 1997, n°211; L. THEVENOZ, « Le contrat inexécuté en droit suisse », *in* : *Il contratto inadempiuto. Realtà e tradizione del diritto contrattuale europeo*, L. VACCA (dir.), Turin, G. Giapichelli, 1999, p. 173, esp. p. 196.

[52] P. WESSNER, « Les sanctions de l'inexécution des contrats : questions choisies. Exposé du droit suisse et regard comparatif sur les droits belge et français », in*: Les sanctions de l'inexécution des obligations contractuelles. Études de droit comparé*, M. FONTAINE, G. VINEY (under the direction of), Bruylant, LGDJ 2001, n°50, p. 908.

[53] *Ibid.* n°57, p. 910.

[54] *Ibid.* n°51, p. 908.

[55] *Ibid.* n°52, p. 908.

[56] *Ibid.* n°58, p. 911.

[57] *Ibid.*

[58] *Ibid.*

b) The deficiencies in certain legal systems regarding the evaluation of damages

Certain legal systems, including the French legal system, traditionally only recognize the principle of total compensation for loss, consisting of lost profits and loss sustained, such as to place the obligee in the situation in which he would have found himself had the contract been duly performed (**i**). It is therefore, going back to the distinction made by JHERING, the positive interest which is considered, and never (or almost never) the negative interest. Such an approach, however, leads to contradictory results, as illustrated by the issue of concurrent claims for termination for non-performance and for payment of damages (**ii**).

i. The principle of total reparation through the compensation for loss sustained and lost profits

The French approach[59] to the determination of the amount of damages to be awarded and to the damage which gives rise to compensation is perceived by anglo-saxon academics as being at a very early stage of development compared to the theory of damages which has developed under common law systems.[60]. Academic attempts to transpose the system inherited from JHERING have failed[61]. French academics generally tend to rely on the indications found in article 1149 of the Civil Code, which provides: « Damages due to a creditor are, as a rule, for the loss which he has suffered and the profit which he has been deprived of, subject to the exceptions and modifications below »[62].

As noted by P. JOURDAIN: « although our courts do not distinguish between what is often referred to in other countries as positive damages and negative damages, they do not hesitate to award to a victim the compensation necessary to place such victim in the position in which he would have found himself had the contract been duly performed (positive interest) and do not limit themselves to placing the victim in the position in which he would have found

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[59] See P. JOURDAIN, « Les dommages-intérêts alloués par le juge. Rapport français », in: *Les sanctions de l'inexécution des obligations contractuelles. Etudes de droit comparé*, M. FONTAINE, G. VINEY (under the direction of), Bruylant, LGDJ 2001, p. 263 ; *adde*. G. VINEY, P. JOURDAIN, *Les effets de la responsabilité*, Traité de droit civil, 2nd ed., LGDJ 2001, n°57, p. 111.

[60] In support of this view, J. BELL, S. BOYRON, S. WHITTAKER, *Principles of French Law*, OUP 1998, p. 349; B. NICHOLAS, *The French Law of Contract*, 2nd ed., Oxford Clarendon Press 1992, p. 226; G.H. TREITEL, *Remedies for Breach of Contract. A comparative account*, Oxford Clarendon Press 1988, n°89; these references are cited by Y.-M. LAITHIER, *op. cit.,* n°107. The author agrees, in fact, with the observation by these English academics: « *Que la théorie des dommages-intérêts soit plus avancée en common law qu'en France ne fait aucun doute si l'on rappelle que l'analyse théorique de l'article 1149 du Code civil se résume à peu près à ceci : le créancier victime de l'inexécution doit obtenir la « réparation intégrale » du préjudice (perte subie et gain manqué) puisque le contrat a force obligatoire (article 1134 du Code civil) et l'évaluation, variable au gré des circonstances de chaque espèce, relève en grande partie de l'appréciation souveraine des juges du fond* » (There is no doubt that the theory of damages is more advanced under common law systems than it is in France, if one recalls that the theoretical analysis of article 1149 of the Civil Code can be summarized as follows: the obligee, victim of non-performance, must obtain « total compensation » for the loss (loss sustained and lost profits) because the contract is binding (article 1134 of the Civil Code) and the estimation, which varies depending on the circumstances of each case, is for a large part at the discretion of the judges.) (*ibid*.). See also the observations of Ph. STOFFEL-MUNCK on the question of damages following an unlawful unilateral termination: « Le contrôle a posteriori de la résiliation unilatérale », *Droit et patrimoine*, May 2004, n°126, p. 77.

[61] It would appear that a number of academics have focussed on the negative interest. See R. SALEILLES, *Essai d'une théorie générale de l'obligation d'après le projet de Code civil allemand*, Paris, F. Pichon, 1890, n°153, p. 158 ; E. GAUDEMET, *Théorie générale des obligations*, published by H. DESBOIS, J. GAUDEMET, Paris, Sirey, [1937], 1965, p. 196.; C. GUELFUCCI-THIBIERGE, *Nullité, restitutions et responsabilité*, Préf. J. Ghestin, LGDJ 1992, n°109. These references are cited by Y.-M. LAITHIER, *op. cit*., n°108, p. 160, note 429.

[62] There is little organisation in France concerning the rules relating to the determination of the damage, this results largely from the specific powers held by the judge. See in particular G. VINEY, P. JOURDAIN, *Les effets de la responsabilité*, *op. cit.,* n°61, p. 125.

himself had the contract not been entered into (negative interest) »[63]. G. VINEY[64] recently pointed out that although French law does not recognize the notion of negative interest, it may not oppose so much resistance to its introduction. A recent decision, dealing albeit with tortious liability[65], may, according to the author, open the door to future solutions, in particular in the cases of cancellation of the contract or termination for non-performance, when these mechanisms are combined with claims for damages[66]. The issue is that of deciding whether it is appropriate to compensate for the loss of the chance to enter into the contract. The Court refused such compensation on the basis that « a fault committed in exercising the right to terminate precontractual negotiations unilaterally did not cause the damage consisting of the loss of the chance to gain profits which the obligee hoped would arise from the conclusion of the contract »[67]. However, it did not exclude the possible compensation for the loss of the chance to enter into an equivalent contract with a third party[68].

Under the law of Quebec, the terms of article 1621 of the Civil Code result in a total compensation approach, based on compensation for the loss sustained and lost profits. This refers to the positive interest as defined above, that is to say that the damages awarded are intended to place « the obligee in the position in which he would have found himself had the contract been duly executed »[69].

Belgian law adopts a similar position and the principle of total compensation is often deduced from article 1149 of the Civil Code. The principle is classically constituted by the same two elements as under French law: the *damnum emergens* and the *lucrum cessans*, the loss sustained and the lost profits. These two elements are interpreted in the same way as under French law and each cover the same situations. Under the head of *damnum emergens*, there will be compensation for « the expenses incurred by the obligee, which have been incurred in vain or become unnecessary because of the defective performance or non-performance »[70]. The judges award, in this spirit, compensation for « storage costs, costs for the rental of means of transport … »[71]. Under the head of *lucrum cessans,* Belgian tribunals have, for example, compensated an auditor (*commissaire-réviseur*) who had been improperly dismissed, by awarding damages amounting to the fees which he would have received had his mandate run its full term.[72]. In the same way, judges have awarded compensation equal to « the benefit expected by the seller on the resale of the product, benefits expected from rental[73] (…) ».

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[63] P. JOURDAIN, « *si notre jurisprudence ne distingue pas entre ce que l'on nomme souvent à l'étranger les dommages-intérêts positifs et les dommages-intérêts négatifs, elle n'hésite cependant pas à allouer à la victime les indemnités nécessaires pour la replacer dans la situation qui aurait été la sienne si le contrat avait été correctement exécuté (intérêt positif) et ne se contente donc pas de la remettre dans l'état où elle se serait trouvé si le contrat n'avait pas été conclu (intérêt négatif)* »(Although our caselaw does not distinguish between what is referred to abroad as positive and negative damages, it does not hesitate in awarding to the victim the damages which are necessary for him to be placed in the position in which he would have found himself had the contract been duly performed (positive interest) and is not content merely to place him in the state in which he would have found himself had the contract not been entered into (negative interest).) « Les dommages-intérêts alloués par le juge. Rapport français », *op. cit.,* n°10, p. 273 and 274.

[64] G. VINEY, « L'appréciation du préjudice », *LPA* 19 May 2005, n°99, p. 89.

[65] Cass. com, 26 Nov. 2003, *Bull. civ.* IV, n°186, p.206; *RTD civ.* 2004. 80, obs. J. MESTRE and B. FAGES; *JCP G* 2004, I. 163, n°18 obs. G. VINEY; *RDC* 2004, p. 257 obs. D. MAZEAUD; *adde.* O. DESHAYES, « Le dommage précontractuel », *RTD com.* 2004. 187.

[66] G. VINEY, *op. cit.,* p. 95.

[67] Cass. civ. 3e, 28 juin 2006, *Bull. civ.* III, n°164, p. 136, *JCP G* 2006, II. 10130, note O. DESHAYES; *adde.* J. GHESTIN, « Les dommages réparables à la suite de la rupture abusive des pourparlers », *JCP G*2007, I. 157.

[68] *Adde*. J. GHESTIN, *op. cit*., esp. n°21.

[69] J.-L. BAUDOUIN, P.-G. JOBIN, *Les obligations*, 5th edition, Les éditions Yvon Blais 1998, n°814.

[70] I. DURANT, N. VERHEYDEN-JEANMART, *op. cit.,* n°6, p. 311 and 312.

[71] I. DURANT, N. VERHEYDEN-JEANMART, *op. cit.*,n°6, p. 311 and 312.

[72] Liège, 23 Nov. 1989, *R.P.S.*, 1990, p. 178, n°6545, cited by I. DURANT, N. VERHEYDEN-JEANMART, n°6, p. 312.

[73] Bruxelles (4th ch.), 2 June 1992, *J.LM.B.*, 1994, p. 354 (somm.).

The award of damages here is intended, as is the case under French law but also along the same principles as under German and Swiss law, but also under common law systems, to compensate for what JHERING referred to as positive interest. It aims to « place the obligee in the position in which he would have found himself had the obligor fulfilled his obligation »[74]. However, the sum awarded is not exclusively based on the value of the goods which were not delivered or services which were not performed, it even moves away from that value. For example, under French or Belgian law, damages will be awarded to compensate for all the losses arising out of the non-performance of the contract.

ii. The issue of concurrent claims for termination and damages in the event of non-performance

Under French law[75], the deficiencies in the theoretical bases regarding the nature and functions of damages become apparent in the classic example of the caselaw on damages following termination for non-performance. Indeed, as noted by Philippe REMY[76], this solution, established by article 1184 of the Civil Code, is based on a paradox: « what justification can be found for the obligee being entitled to claim both the retroactive cancellation of the contract and at the same time damages on the basis of its non-performance? »[77]. The comment appears particularly relevant, particularly in view of the fact that Swiss law clearly distinguishes positive and negative interests, depending on whether the damages are awarded on the basis of non-performance or of retroactive cancellation of a contract[78]. It would therefore seem that establishing a systematic distinction between positive and negative interests would bring back some coherence and reduce the ever increasing cost of the principle of total compensation.

The evalution of damages is not the only difficulty which arises with regard to the notion of damages. According to certain academics, the function of damages brings them closer to an equivalent performance.

2. Damages and their function of equivalent performance

Under both Belgian[79] and French[80] laws, the very notion of contractual responsibility is the subject of academic debate, which also affects the function of damages. Indeed, for a large number of academics, if a contracting party does not fulfill his obligation, « the other party, having failed to obtain satisfaction after his formal demand, may request a substitute performance. (…) What is customarily referred to as « *réparation* » (compensation), without too much consideration, is in fact a method of performing the contract, probably different

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[74] Cass. (1re ch.), 28 Sept. 1995, *Pas.*, 1995, I, p. 860.

[75] Ph. REMY, « Observations sur le cumul de la résolution et des dommages-intérêts en cas d'inexécution du contrat » in: *La sanction du droit, Mélanges offerts à Pierre Couvrat*, PUF 2001, p. 121 ; P. ANCEL, « La responsabilité contractuelle », *in : Les concepts contractuels français à l'heure des Principes du droit européen des contrats*, P. REMY-CORLAY, D. FENOUILLET (under the direction of), Dalloz 2003, p. 243.

[76] Ph. REMY, « Observations sur le cumul de la résolution et des dommages-intérêts en cas d'inexécution du contrat », *ibid.*

[77] P. ANCEL, *op. cit.,* n°10, p. 249.

[78] V. *supra*.

[79] V. I. DURANT, N. VERHEYDEN-JEANMART (under the direction of), « Les dommages et intérêts accordés au titre de la réparation d'un dommage contractuel », in: *Les sanctions de l'inexécution des obligations contractuelles. Études de droit comparé*, M. FONTAINE, G. VINEY (under the direction of), Bruylant, LGDJ 2001, n°4, p. 310; M. COIPEL, *Éléments de théorie générale des contrats*, Diegem, Story-Scientia 1999, n°170, p. 124.

[80] Ph. REMY, « La responsabilité contractuelle : histoire d'un faux concept », *RTD civ.* 1997. 323; by the same author, « Critique du système français de responsabilité civile », *Droit et cultures* 1996/31, 31 ; D. TALLON, « L'inexécution du contrat : pour une autre présentation », *RTD civ*. 1994. 223; by the same author « Pourquoi parler de faute contractuelle ? », in: *Droit civil, procédure, linguistique juridique, Écrits en hommage à Gérard Cornu*, PUF, 1994, p. 429; C. OPHELE, « Le droit à dommages-intérêts du créancier en cas d'inexécution contractuelle due à la démence du débiteur », *RGDA* 1997, p. 453; Ph. Le TOURNEAU, L. CADIET, *Droit de la responsabilité et des contrats*, Dalloz Action 2000/2001, n°801, p. 196; *adde.* M. FAURE ABBAD, *Le fait générateur de la responsabilité contractuelle*, Préf. Ph. Rémy, LGDJ 2003.

from what had originally been provided (by equivalent) and often deferred, but a method of performance nonetheless, or method of payment (…) »[81]. From this approach, it can be deduced that the proof of damage is indifferent to the payment of damages. Certain Belgian authors are in fact reluctant to use the term « *réparation* » (compensation) to refer to the obligation to indemnify imposed on the defaulting obligor. Conversely, the debate does not appear to have affected the law of Quebec, at least in terms of legislation. Indeed, the structure of the Civil Code of Quebec tends to highlight the historical parallel existing between the two types of liability.

These considerations should be read in the light of common law principles and more precisely of what is referred to as nominal damages[82]. The latter of defined as follows by the House of Lords:

« A technical phrase which means that you have negatived anything like real damage, but that you are affirming by your nominal damages that there is an infraction of a legal right which, though it gives you no right to any real damages at all, yet gives you the right to the verdict or judgment because your legal right has been infringed *»*[83].

These nominal damages are awarded as soon as a failure to perform, attributable to the obligor, is established. However, because the basis for calculation is the actual loss, in cases where the failure to perform does not cause any loss, the judge will hold the obligor liable to pay nominal damages, which traditionally amount to two pounds under English law and one dollar under American law. The value of the agreement entered into by the parties therefore appears to be null or almost null. Damages thus appear, in common law systems, as being the compensation for « a right which has been infringed »[84], so that although theoretically the proof of damage is not necessary to the award of damages, the amount of such damages will be in proportion with the loss suffered, which even under common law principles goes beyond the simple value of the performance required under the contract and includes various types of non-monetary loss[85].

Under positive law, therefore, in order for an obligor to be liable in contract, there is a requirement for a loss, causation, and a failure to perform attributable to the obligor. Moreover, it is the principle of total compensation which will apply and not only the indemnification for the performance which could reasonably be expected[86].

B. Damages for late performance[87]

Under French, Belgian and Quebec laws, the expression « *dommages et intérêts moratoires* » (damages for late performance) is used to describe the sum due to the obligee by reason of the delay in the performance of his obligation by the obligor. More specifically, the expression « *intérêts moratoires* » (interest for late payment)[88] refers to a type of « *dommages et intérêts moratoires* ». They come into play in relation to a delay in the performance of a monetary obligation and are calculated in a particular way: by applying an interest rate – legal or contractual – to the sum which is due. Damages for late payment and interest for late payment therefore fulfill the same function, that of « compensating the obligee for the loss

[81] Ph. LE TOURNEAU, L. CADIET, *op. cit*., n°806.
[82] On this issue, see in particular Y.-M. LAITHIER, *op. cit.,* n°83, p. 117; FARNSWORTH, *op. cit.,* p. 757.
[83] *Owners of the Steamship 'Mediana' v. Owners, Master and Crew of the Lightship 'Comet'* [1900] *AC* 113, spec. p.116.
[84] *Ibid.*
[85] See *supra*.
[86] It is interesting in this respect to note that in the French Proposals for Reform, it is the classical approach to contractual liability which was adopted.
[87] « Moratory » (and « *moratoire* ») comes from the latin « *mora* » which means « delay ».
[88] See on this issue the recent thesis of F. GREAU, *Recherche sur les intérêts moratoires*, Préf. F. Chabas, Defrénois 2006, n°7 and 8, p. 10 and 11; J. FLOUR, J.-L. AUBERT, Y. FLOUR, E. SAVAUX, *Droit civil. Les obligations. 3. Le rapport d'obligation*, 4th ed., Sirey 2006, n°144, p.103.

caused by the obligor's delay »[89]; the difference between them relates both to the type and to the category. Interest for late payment is a type of damages, which is specific in that it does not apply « to all obligations which can be translated into monetary terms, but only to obligations which are *from the outset* expressed in monetary terms, or more precisely, to those which are not the monetary equivalent of a performance in kind (…) »[90]. They are also specific in that they are due independently from evidence any damage caused by the delay, so that under the terms of article 1153 paragraph 2 of the Belgian and French civil codes, the obligee is « not required to show evidence of any loss »[91].

It should be mentioned that the mere use of the term « interest » is enough to introduce some doubt as to the compensatory nature of the sum awarded. Indeed, the word is used both to refer to the remuneration paid to the lender of a sum of money for providing such money, and to refer to the compensation for a delay[92]. This is why the term « interest » should be qualified: In cases where they are intended to be the remuneration for a service, the interest could be referred to as « *rémunératoire* » (which remunerate) [93] in preference to other more problematic qualifiers, such as « compensatory » or « contractual »[94]. And when they are intended as a compensation for late payment, they should be qualified as « *moratoires* » (moratory).

However, it has been noted by authors from both Quebec and France, that the distinction between « *dommages et intérêts compensatoires* » (compensatory damages) and « *dommages et intérêts moratoires* » (damages for late performance) was somewhat awkward in that these two types of indemnity have the objective of compensating for the loss sustained by the obligee[95]. However, although they share the same function, damages for late payment are governed by a specific legal regime, which may justify setting them apart from a terminological point of view, with simplification in mind.

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[89] F. GREAU, *op. cit.*; *adde*. For example on the compensatory function of interest for late payment: G. VINEY, P. JOURDAIN, *Les effets de la responsabilité, op. cit.,* n°334, p. 599.

[90] F. GREAU, *op. cit.,* n°15, p. 19. Along the same lines, under Belgian law: I. DURANT, N. VERHEYDEN-JEANMART (under the direction of), « Les dommages et intérêts accordés au titre de la réparation d'un dommage contractuel », in: *Les sanctions de l'inexécution des obligations contractuelles. Études de droit comparé*, M. FONTAINE, G. VINEY (under the direction of), Bruylant, LGDJ 2001, n°34, p. 334. The authors note the terms of a previous decision of the Cour de Cassation, which had specified that: « *parmi les dettes dont le paiement s'effectue en monnaie ayant cours légal, une distinction est à observer entre celles qui ont pour objet une somme numérique invariablement fixée en vertu de la loi ou par la volonté des parties, et celles dont l'objet diffèrent dans le principe, consiste en une prestation, qui ne sera évaluée en monnaie que le cas échéant et ultérieurement* » (among the debts the payment of which must be paid in legal currency, a distinction should be made between those which concern a sum invariably fixed in accordance with the law or the will of the parties, and those which concern, and this is different in principle, a service which will only be evaluated in monetary times if required and at a later stage) (Cass. (1re ch.), 26 février 1931, *Pas.*, 1931, I, p. 94).

[91] Art. 1617 of the Civil Code of Quebec provides in its paragraph 2 *in fine*: « The creditor is entitled to the damages from the date of default without having to prove that he has sustained any injury».
F. TERRE, Ph. SIMLER, Y. LEQUETTE, *Droit civil, Les obligations*, 9th ed., Dalloz 2005, n°570, p.558 ; n°1090, p. 1047.

[92] In this last meaning, DOMAT defined the « interest » as being exclusively « *le dédommagement, et le désintéressement dont un débiteur d'une somme d'argent peut être tenu envers son créancier, pour le dommage qu'il peut lui causer, faute de payer la somme qu'il doit* » (the compensation, and making good of a debt which the debtor owing a sum of money can be held liable for as regards the creditor, for the damage caused by the failure to pay the sum owed). J. DOMAT, *Les lois civiles dans leur ordre naturel. Le droit public et legum delectus*, t. 1, new ed., Paris, 1777, p.259, cited by F. GREAU, *op. cit.,* n°6, p. 8.

[93] In support of this point, F. GREAU, *op. cit.,* n°6, p. 10; Ch. BIQUET-MATHIEU, *Le sort des intérêts dans le droit du crédit. Actualité ou désuétude du Code civil ?*, Coll. Scientifique de la Faculté de Droit de Liège, Préf. I. MOREAU-MARGREVE, 1998, n°3; V. DAVID, *Les intérêts de sommes d'argent*, Préf. Ph. Rémy, LGDJ 2005, n°28.

[94] For criticism of these qualifying adjectives, see under French law, F. GREAU, *op. cit.* n°6, p. 9; under Belgian law, I. DURANT, N. VERHEYDEN-JEANMART (under the direction of), « Les dommages et intérêts accordés au titre de la réparation d'un dommage contractuel », in: *Les sanctions de l'inexécution des obligations contractuelles. Études de droit comparé*, M. FONTAINE, G. VINEY (under the direction of), Bruylant, LGDJ 2001, n°31, p. 329.

[95] F. GREAU, *op. cit.*; J.-L. BAUDOUIN, P. DESLAURIERS, *op. cit.,* n°1321, p. 872.

Under German law, interest for late payment (« *Verzugszinsen* », § 288 BGB), is not included from a terminological point of view in the categories of damage provided under § 280 of the BGB. This can be explained by the fact that it is considered as a minimal lump sum loss (« *objektiver Mindestschaden* ») which is not linked to the concrete loss of the obligee, but only to a delay in payment. In fact, the obligor is not entitled to claim that the actual loss of the obligee is less than the legal interest rate. Technically, the interest does not represent a compensation for a concrete and precise loss, but a lump sum consisting of legal interest, calculated at a rate set by the law (7,70% at the moment) which is awarded because the delay amounts for the obligee to an involuntary loan. The « loss for late performance » (« *Verzugsschaden* ») may be claimed in addition to interest for late payment, but only with regard to the second head of damage (costs incurred); with regard to the loss of enjoyment, the obligee may choose between interest for late payment (lump sum) or evidence of concrete loss.

Under Italian law[96], damages for late performance, « *danni-interessi moratori* »[97], are similar. From a terminological point of view, it should be noted that it is the only case in which the expression « *danni-interessi* » (« *dommages-intérêts* » in French, damages in English) can be rightly used: they do in fact represent interest (*interessi*) which fulfill the function of compensation for damage (*danni*). With regard to the legal regime which is applicable, the amount of the compensation is the value of the legal interest accruing on cash sums and must be paid even if the obligee has suffered no loss: it is due merely on the basis of the delay. The obligee may, however, show evidence of a loss which is greater than this compensation and he may then be entitled to an additional compensation, except in the event that the evaluation of interest for late payment was provided for in the contract (art. 1224, 2nd para. of the Civil Code). A frequent form of additional loss is monetary devaluation, which before the delay is borne by the obligee, but becomes the liability of the obligor once he is late in payment.

Mention should be made, in addition, of the decree N° 231 of 9 October 2002 implementing Directive 2000/35/EC on combating late payment in commercial transactions: in accordance with this text, in the event of a delay in payment, the obligee is automatically entitled to the reimbursement of interest starting on the day following the end of the period for payment fixed in the contract (art. 3), except where the obligor can demonstrate that he is not responsible for the delay[98].

In the event of termination for non-performance, the evaluation of damages follows the rules set out by the articles 1223 and following of the Civil Code. The majority of academics take the view that in the case of termination for non-performance, the damages take on a deterrent function and the obligation to compensate becomes a tool of persuasion regarding the due compliance by the obligor with his obligations[99]. The point which gives rise to most debate concerns the scope of the compensation, that is to say whether it should only cover positive or negative interest, or both. The majority view amongst academics is that the termination of the contract should only entitle the aggrieved party to claim for compensation regarding positive interest[100].

English law has not, in the past, imposed an obligation, either by statute or at common law, to pay interest in the event of non-payment or late payment[101]. However, the Late Payment of

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[96] V. A. MARI, in: *Principles of European Contract Law and Italian Law. A Commentary*, L. ANTONIOLLI, A. VENEZIANO (eds.), Kluwer Law International 2005, p. 465.

[97] A. TRABUCCHI, *Istituzioni di diritto civile*, 41° edizione, Padova 2004, p. 689.

[98] M. FARNETI, « La disciplina dei ritardi di pagamento nelle transazioni commerciali (d.lg. 9 ottobre 2002, n. 231) », in*: Le Nuove leggi civili commentate*, 2004, p. 652; R. CONTI, Il d. lgs. n. 231/2002 di trasposizione della direttiva sui ritardati pagamenti nelle transazioni commerciali, in Corr.giur., 2003 fasc. 1, p. 99; G. DI MARZIO, « Ritardi di pagamento nelle transazioni commerciali », in I Contr., 2002 fasc. 6, p. 628.

[99] P. CENDON, I contratti in generale, XII, in: *Il diritto privato nella giurisprudenza*, Torino, 2000, p. 205.

[100] P. CENDON, I contratti in generale, XII, in: *Il diritto privato nella giurisprudenza*, Torino, 2000, p. 206.

[101] This is the solution as results from the decision *President of India v. Lips Maritime Corporation* [1988] *AC* 395; Generally, see E. McKENDRICK, *Contract Law. Text, Cases and Materials*, Second edition, OUP 2005, p. 434; O. MORETEAU, *Droit anglais des affaires*, 1st ed., Dalloz 2000, n°703, p. 407. *Adde. Principes du droit*

Commercial Debts (Interest) Act 1998 provides for an implied term to pay interest for the late payment of a debt created by a contract for the supply of goods or services where the purchaser and the supplier are each acting in the course of a business. The parties may agree on the method of payment and calculation of interest so long as the obligation to pay interest is not excluded. Outside the scope of application of the act, the parties are free to agree upon the payment of interest for late payment. Moreover, the High Court [102] and County Courts[103] have been given the power to award interest[104].

C. Punitive damages

Although the traditional function of damages is compensatory, it would appear that they are frequently required to fulfill another supplementary function: that of punishing a reprehensible behaviour, independently from the loss sustained. In this case, the French expression « *dommages et intérêts punitifs* » will generally be used. However, a review of French and Quebec wording used in such circumstances reveals some diversity: the expressions « *dommages-intérêts punitifs* », « *dommages et intérêts punitifs* », « *dommages punitifs* », « *dommages exemplaires* », « *dommages-intérêts exemplaires* » or « *dommages et intérêts exemplaires* » are used indifferently[105]. Similarly, in common law systems, reference is made indifferently to the notions of « punitive damages » and « exemplary damages ».

It is because the principles of civil liability are not there to punish a particularly odious behaviour that the notion of punitive damages gives rise, intrinsically, to controversy. It should be added to this starting point that in contract especially, the fact of awarding punitive damages contravenes the idea of predictability and economic efficiency (**1**). The same issues arise in relation to the analysis of the notion of restitutionary damages, paid in the absence of any loss and based on the profit arising out of the breach of contract (**2**).

1. Punitive damages, a controversial notion in contract

If continental legal systems, in particular Italian, German[106] and French[107] laws, who are attached to the traditional compensatory function of damages, have not traditionally accepted

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européen du contrat, SLC, 2003, Notes below art. 9:508, p. 417. The solution developed in the *President of India* decision is strongly criticized in England and goes against the proposals made by the Law Commission in its report, *Law of contract: Report on interest* n°88, (Cmnd 7229), 1978 which put forward in particular « instating legal interest for contractual obligations to may monetary sums » (*Principes du droit européen du contrat*, *ibid*.).

[102] *Administration of Justice Act* 1982, s. 15 and annex 1 amending the *Supreme Court Act* 1981, s. 35A.

[103] *County Courts* 1984, s. 69.

[104] See also the recent report of the English Law Commission*: Pre-Judgment Interest on Debts and Damages*, n°287, 2004. Under Scottish law, see the recent report of the Law Commission*: Report on Interest on Debt and Damages*, n°203, 2006.

[105] P. PRATTE, *op. cit.,* p. 495 and following; J.-L. BAUDOUIN, P. DESLAURIERS, *La responsabilité civile*, 6th ed., Les éditions Yvon Blais 2003, n°338.

[106] B. MARKESINIS, H. UNBERATH, A. JOHNSTON, *The German Law of Contract. A Comparative Treatise*, 2nd ed., entirely revised and updated, Hart Publishing, 2006, p. 443.

[107] See however the works of: A. JAULT, *La notion de peine privée*, Préf. F. Chabas, LGDJ 2005; S. CARVAL, *La responsabilité civile dans sa fonction de peine privée*, Préf. G. Viney, LGDJ 1995; G. VINEY, P. JOURDAIN*, Les effets de la responsabilité*, Traité de droit civil, LGDJ, 2nd ed., 2001, n°4; M. BEHAR-TOUCHAIS, « L'amende civile est-elle un substitut satisfaisant à l'absence de dommages et intérêts punitifs », *LPA* 20 Nov. 2002, n°232, p. 36. In addition, the French Proposals for Reform, in art. 1371 « *ouvre prudemment la voie à l'octroi de dommages-intérêts punitifs. [Il] soumet le prononcé de cette sanction à la preuve d'une " faute délibérée, notamment d'une faute lucrative ", c'est-à-dire d'une faute dont les conséquences profitables pour son auteur ne seraient pas neutralisées par une simple réparation des dommages causés. Il exige également une motivation spéciale et impose au juge de distinguer les dommages-intérêts punitifs des dommages-intérêts compensatoires. Enfin, il interdit leur prise en charge par l'assurance, ce qui est indispensable pour donner à cette condamnation la portée punitive qui constitue sa raison d'être* » (cautiously opens the door to the award of punitive damages. It subjects such an order to evidence of a « deliberate fault, in particular of a lucrative fault », that is to say a fault, the profitable consequences of which would not be neutralised by a mere award compensating for the damage suffered. It also requires special grounds and requires

that damages be given a punitive function, punitive or exemplary damages have found a more favourable terrain in common law systems[108].

However, the acceptance of this function is controversial in contract, particularly under English law.

Indeed, under English law, unlike American law[109], punitive or exemplary damages are not accepted per se in contract[110], although they can be awarded in tort[111]. Although in current speech as well as from a scientific point of view, there is no difference between punitive and exemplary damages, preferences have been stated in favour of one or the other expression, the main argument being that the use of the word « punitive » does not carry the idea of dissuasion, whilst this is obvious in the term « exemplary »[112]. However, this argument was expressly rejected by the Law Commission which proposed that the use of the term « punitive » be preferred to the use of the term « exemplary »[113].

As is the case under Quebec law (see below), English law attributes a double function to punitive damages: both a punishment – for a reprehensible behaviour – and a deterrent – both with regard to the author of the reprehensible behaviour and to anybody who might want to imitate him. Moreover, it was considered that the award of punitive damages could also bring satisfaction to the victim, who might in this way be discouraged from taking the law into his own hands[114].

The law of Quebec[115] is also one of the most advanced legal systems with regard to punitive damages. In addition to the traditional roles of prevention and deterrence, they also have the role of « " civil " and personal reprobation of the perpetrator of the fault »[116] as well as being an incitement: « the award of this type of damages (or rather the prospect of being entitled to such damages) might actually incite the victim to bring a claim against the perpetrator of the fault and to seek redress before the courts. Indeed, the award of punitive damages compensates, even if only in part, the costs of an action which are not recoverable and therefore improves the balance (which is sometimes unfavourable) between the costs and the

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that the judge should distinguish punitive damages from compensatory damages. Finally, it forbids such damages to be covered by insurance, which is indispensable in order for such a sanction to carry the punitive function which is its raison d'être). (P. CATALA (under the direction of), *Avant-projet de réforme du droit des obligations et de la prescription*, La Documentation française, 2006, p. 168).

[108] On the reasons for which common law forms a better terrain for the adoption of the principle of punitive damages, see C. JAUFFRET-SPINOSI, « Les dommages-intérêts punitifs dans les systèmes de droit étrangers », *LPA* 20 Nov. 2002, n°232, p.8.

[109] H. COLLINS, *The Law of Contract*, 4th ed., LexisNexis 2003, p. 423; Y.-M. LAITHIER, *op. cit.,* n°330; *adde.* C. JAUFFRET-SPINOSI, *op. cit.*

[110] G.H. TREITEL, *An Outline of the Law of Contract*, 6th ed., OUP 2004, p. 373; E. McKENDRICK, *Contract Law*, Palgrave Macmillan Law Masters, 7th ed., Palgrave Macmillan, p. 402; from the same author, *Contract Law, Text, Cases, and Materials*, OUP 2005, p. 1122; J. BEATSON, *Anson's Law of Contract*, 28th ed., OUP 2002, p. 592; H. COLLINS, *The Law of Contract*, 4th ed., LexisNexis 2003, p. 422; Y.-M. LAITHIER, *op. cit.*, n°329, 409; *adde*. P. BENJAMIN, « Penalties, Liquidated Damages and Penal Clauses in Commercial Contracts: A Comparative Study of English and Continental Law » [1960] 9 *ICLQ* 600.

[111] It should however be specified that in the United States, the obligee does not have the right to claim punitive damages in, but there are a few examples which arise on the limits of contractual and tortious liability: FARNSWORTH, *op. cit.*, p. 761; LINZER, « Rough justice: A Theory of Restitution and Reliance, Contracts and Torts », [2001] *Wis.L.Rev.*, 695.

[112] Such was, for example, the approach adopted by the Ontario Law Reform Commission, *Report on Exemplary Damages*, Ontario, 1991: « *the use of the term "exemplary", as opposed to the term "punitive", suggests a deterrence, rather than a punitive purpose* » (OLRC, *op. cit.*, note 8, p. 35); « *exemplary damages for the purpose of punishment [...] should be referred to as "punitive damages" [...] in preference to the term "exemplary damages", to emphasize the punitive rationale* » (OLRC, *op. cit*., p.38)

[113] *Law commission*, *op. cit.*, n°1.39, p. 104.

[114] *Law commission*, *op. cit.*, n°1.85, p. 53.

[115] P.-G. JOBIN, « Les dommages punitifs en droit québécois », in: *Études de droit de la consommation, Liber Amicorum Jean Calais-Auloy*, Dalloz 2004, p. 537; P. PRATTE, « Le rôle des dommages punitifs en droit québécois », (1999) 59 *R. du B*. 445; S. BEAULAC, « Les dommages-intérêts punitifs depuis l'affaire Whiten et les leçons à en tirer pour le droit civil québécois », (2002) 36 *R.J.T.* 637.

[116] P.-G. JOBIN, *op. cit*., p. 539.

benefit of bringing a claim; this is particularly true when the loss suffered only entitles the victim to claim a minimal amount in compensation (or the reimbursement of the price) »[117].

The Charter for human rights and freedoms[118], adopted in 1975, « contains one of the most important provisions on punitive damages in Quebec law, in particular because of its quasi-constitutional status and of the fundamental rights and freedoms which it protects »[119].

Article 1621 of the Quebec Civil Code provides that: « Where the awarding of punitive damages is provided for by law, the amount of such damages may not exceed what is sufficient to fulfill their preventive purpose (paragraph 1). Punitive damages are assessed in the light of all the appropriate circumstances, in particular the gravity of the debtor's fault, his patrimonial situation, the extent of the reparation for which he is already liable to the creditor and, where such is the case, the fact that the payment of the damages is wholly or partly assumed by a third person (paragraph 2) ». The position of this provision seems to indicate that the award of punitive damages is not limited to tortious liability. In fact, the distinction of the source of the infringement giving rise to such damages – whether contractual or tortious – appears as indifferent on the basis that the award of punitive damages by the judge depends on the existence of specific law expressly allowing such award[120]. Indeed, article 49 paragraph 2 provides« [that in the] event of an illegal and intentional infringement, the court may impose on the infringing party the payment of punitive damages ». On that basis, « within the limits set by the code and by a series of specific laws which allow such an award, certain contractual infringements give rise to the right to a compensation under this head »[121].

Canadian common law has also adopted a similar position. Indeed, although strongly influenced by the *Addis v. Gramophone Co Ltd*[122] case which excluded the award of punitive damages in the event of a breach of contract, Canadian judges have gradually accepted the possibility of awarding punitive damages in the case of contractual breaches « so long as there exists « a cause of action which is distinct from the contractual relationship », « a wrongdoing giving rise to a right of action »[123] ». But the courts have recently allowed that « although an independent fault giving rise to a claim is required, such fault may arise out of the infringement of a separate contractual provision or of another obligation, such as a fiduciary obligation »[124].

2. The controversial acceptance of restitutionary damages[125]

Is it conceivable that a party who breaches his contractual obligations should be required by a judgment to restitute the amount of profits arising out of such breach to the aggrieved party, in the absence of any loss?

This question has not been resolved in the same way in the different legal systems.

Under French law, the main body of caselaw subjects the award of damages to the existence of a loss, on the basis of article 1149 of the Civil Code. This position could change, so that the

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[117] *Ibid.*

[118] *L.R.Q.*, ch. C-12.

[119] P.-G. JOBIN, *op. cit*., p. 547.

[120] The first law which provided for such an award was a 1929 law, which concerned the protection of trees, L.Q. 1929, c. 71, which became the « la loi sur la protection des arbres », *L.R.Q.*, ch. P.-37. Note should also be made of « la Loi sur la protection du consommateur », *L.R.Q.*, ch. P-40.1, art. 272.

[121] J.-L. BAUDOUIN, P. DESLAURIERS, *op. cit.,* n°1332, p. 876 and 877. Various decisions can illustrate the principle *Barrou c. Micro-boutique éducative inc.*, [1999] *R.J.Q.* 2659 (C.S.); *Modern Tire Sales Ltd. c. Kumbo Tire Canada inc.*, *J.E.* 2000-1701 (C.S.); *adde*, references cited by J.-L. BAUDOUIN, P. DESLAURIERS, *ibid*, note 18.

[122] [1909] *AC* 488.

[123] *Vorvis c. Insurance Corporation of British Columbia* [1989] 1 *R.C.S.* 1085.

[124] *Whitten c. Pilot Insurance Co*, 2002, *CSC* 18, para. 82. In this case, the « contractual provision » was an obligation to act in good faith.

[125] Y.-M.LAITHIER, *op. cit.,* n°437, p. 524; J. EDELMAN, « The Meaning of 'Damages': Common Law and Equity », in: *The Law of Obligations : Connections and Boundaries*, A. ROBERTSON (ed.), UCL Press 2004, p. 31; E. McKENDRICK, *Contract Law*, *op. cit*., n°20.4, p. 410.

award to restitutionary damages could become acceptable[126]. In one case, which for the moment remains isolated, it was held that the lessee of premises should compensate the lessor for the failure to perform some works without such compensation being subject to the performance of the works or to the proof of any loss[127]. Moreover, article L. 442-6-III of the Commercial Code, brought into force by law n°2001-420 on new economic regulations, provides for a new civil fine limited to a maximum of 2 million Euros, to sanction professionals who engage in anti-competitive practices and therefore deter them from committing lucrative faults.

Under English law, until very recently, damages were considered as being necessarily and exclusively compensatory: as under French law, the award of damages was subject to the existence of a loss[128]. But a succession of cases decided since 2001 show that English law is hesitant[129]: under certain conditions, it would appear that the party who is victim of a breach of contract may be entitled to claim restitutionary damages, that is to say, part of the profits made by the author of the breach and arising therefrom. Aside from the common law concept of restitutionary damages, the terminology gives rise to observations. Indeed, the case which is covered by this expression is sometimes criticized as a « misnomer »[130] or « unhappy »[131]: the use of the term « damages », it is argued, is not applicable to a process which is specific to the law of restitution[132]. However, other authors take the view that the expression « restitutionary damages »[133] is perfectly suited to reflect the mechanism of restitution which occurs. Moreover, the use of such an expression, in lieu of the variety of words used to express the same idea of restitution following a wrongful act (« action for money had and received », « account of profits » and « restitutionary damages »), has the advantage of simplifying the terminology and reducing the historical separation between equity and common law, restitution being an equitable remedy and damages a common law one[134]. Finally, the expression « restitutionary damages » is frequently used instead of « disgorgement damages »; it should be mentioned that the two expressions refer in principle to two distinct situations. Restitutionary damages are intended to prevent the defendant from benefiting from the profits arising out of his behaviour, independently from any loss suffered by the claimant. Disgorgement damages are intended to re-establish a balance in a situation where there has been an unjustified transfer of assets from the obligee to the obligor[135].

These « punitive restitutions »[136] mainly concern the obligor and the profits which he gained from the non-performance for which he is responsible. The central idea is not to compensate the victim but to sanction the obligor for his behaviour and dissuade any other person who might be tempted to proceed in the same way. Restitutionary damages are therefore fulfilling a punitive function. However, this sanction, which is so particular to common law systems[137],

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[126] B. FAUVARQUE-COSSON, obsv. on the English decisions, *RDC* 2005, n° 2, p. 54.
[127] Civ. 3ème, 30 Jan. 2002, *D*. 2003, somm., p. 458, obsv. D. MAZEAUD.
[128] *Wrotham Park Estate Co Ltd. v. Darkside Homes Ltd* [1974] 1 *WLR* 798.
[129] *Esso Petroleum Co. Ltd. v. Niad Ltd.* [2001] *All ER* (D) 324; *Experience Hendrik LLC v. PPX Enterprises Inc.* [2003] *EWCA.* Civ. 323, [2003] *All ER* (D) 328; *Lane v. O'Brien Homes* [2004] *EWHC* 303 (*QB*).
[130] *Co-operative Insurance Society Ltd v. Argyll Stores (Holdings) Ltd* [1996] Ch 286, espec. p. 306, *per* Millet LJ.
[131] *Attorney-General v. Blake* [2001] 1 *AC* 268, *per* Lord Nicholls of Birkenhead.
[132] At common law, restitution means both compensation for a decrease in assets arising out of an increase is another person's assets, but also the restitution of unjust profits. This term therefore has a much wider meaning than in most continental legal systems.
[133] The expression « gain-based damages » has even been put forward. V. E. McKENDRICK, *Contract Law*, *op. cit.*, p. 1118.
[134] In support of this point, the Law Commission, *op. cit*., p. 51, n°1.82 *Adde*, on the historical error made at common law on the compensatory nature of the term « damages »: J. EDELMAN, *ibid*.
[135] In support of this point, A. PHANG, P.-W. LEE, « Rationalising Restitutionary Damages in Contract Law – An Elusive or Illusory Quest? », [2001] 17 *Journal of Contract Law* 240 ; *Contra* J. EDELMAN, « Restitutionary Damages and Disgorgement Damages for Breach of Contract » [2000] *RLR* 129; *adde.* « The Meaning of 'Damages': Common Law and Equity », *ibid.*
[136] The translation is borrowed from Y.-M. LAITHIER, *op. cit.,* n°438.
[137] It should, however, be noted that under French law, and although the solutions adopted are very discrete, a seemingly similar approach is taken in the event of contractual non-performance. « *Le cas le plus fréquent est la*

raises the question of determining in which cases it should come into play. R.L. BIRMINGHAM notes that the courts, when they determine the amount of damages to be awarded to the obligee in the event of a breach of a contractual obligation, aim to compensate the loss suffered by the victim and not to incite the obligor to perform his obligation. On that basis, he takes the view that so-called lucrative breaches of contract should be encouraged. Indeed, the author considers that « by deriving a profit from the violation after having compensated the obligee, the obligor takes a step towards a distribution of resources which is economically optimal and socially desirable. The author thus approves of the existing sanctions for non-performance and warns academics against the introduction of penalties or moral considerations, which create, he argues, a rigidity which is harmful to the efficient operation of the market. (…) The performance of contractual obligations is no longer an objective per se. It is not fair by nature. The sanctions should therefore be there to steer the obligor, in his choice between performance or non-performance, towards adopting the behaviour which will have the most beneficial effects, socially and economically. *In other terms, contractual liability must be sufficiently heavy to prevent a violation which will reduce the assets of the obligee, but sufficiently limited to prevent an inefficient performance of the contract*[138]*,* so that the goods or services which are the subject matter of the contractual obligation always end up in the hands of the party who can give them most value, for an optimal cost »[139]. It would therefore be contrary to the theory of efficient breach to introduce punitive damages or punitive restitution, which by nature are intended to make the payment of damages less attractive than the performance of the obligation. Damages and performance would no longer be treated equally. This is, in fact, one of the reasons which was invoked in the United Kingdom against the introduction of punitive damages in contract law[140]: « (…) the doctrine of efficient breach dictates that contracting parties should have available the option of breaking the contract and paying compensatory damages, if they are able to find a more remunerative use for the subject matter of the promise. To award exemplary damages would tend to discourage efficient breach ».

However, « if an efficient breach supposes a lucrative breach, a creation of wealth which is an indicator of a better distribution of resources, however, a lucrative breach is not necessarily efficient »[141]. Restitutionary damages will only be due in the event of an inefficient lucrative breach. The lucrative breach will be seen as inefficient where the obligor who profited from the deliberate breach of his obligations did so at the expense of the obligee, therefore, unfairly. « The profit of the obligor therefore arises, at least in part, from the loss of the obligee following the breach »[142]. The amount of the restitution will therefore be calculated on the basis of the enrichment that the obligor will have derived from his non-performance, the latter being the upper limit[143].

D. Penalty clauses and liquidated damages clauses

The penalty clause (or penal clause) exemplifies the difficulty in distinguishing the compensatory function of damages from their punitive function. Although widely accepted in a number of legal systems, it raises certain difficulties. Indeed, before the clause is applied, its

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condamnation du débiteur d'une obligation de non-concurrence à verser des dommages-intérêts, évalués en tenant compte du chiffre d'affaires qu'il a réalisé grâce à sa violation » (The most frequent case is when the obligor under a non-compete obligation is ordered to pay damages, determined by reference to the turnover which he achieved though his breach). (Y.-M. LAITHIER, *op. cit.,* n°448, p. 535 and 536). *Adde*. G. VINEY, P. JOURDAIN, *Les effets de la responsabilité*, *op. cit*., n°91.

[138] Our emphasis.

[139] Y.-M. LAITHIER, *op. cit.,* n°407, p. 486.

[140] *The Law Commission, Item 2 of the Sixth Programme of Law Reform: Damages*, « Aggravated, Exemplary and Restitutionary Damages, 199, § 1.71, 1.72, p. 118.

[141] Y.-M.LAITHIER, *op. cit*., n°455. *Adde* concerning the inefficiency of a number of lucrative faults, see Y.-M.LAITHIER, *op. cit.,* n°416.

[142] Y.-M.LAITHIER, *op. cit.,* n°457.

[143]Y.-M. LAITHIER, *op. cit.,* n°458.

function is mainly that of a deterrent: the indemnity is generally fixed independently from the loss which may be sustained. When the clause applies, the function of punishment seems to prevail. From this ambivalence results a terminological difficulty. Should the use of a generic term such as « indemnity » be preferred? Should this type of clause be seen as a category of punitive damages or compensatory damages? Should the use of specific terminology not be envisaged, such as « penalty » or « private fine »?

The way in which a penalty clause is understood varies depending on the role which it takes on: compensatory or repressive[144]. Indeed, the penalty clause can either be considered as a compensatory provision exclusively, so that « any clause which does not have as its aim or purpose to fix the compensation for the loss sustained by the obligee is void »[145]; or the penalty clause can be understood in its repressive function, as a private fine[146]. There is, finally, a middle approach, also called dualist: the nature of the penalty clause is hybrid, compensatory for the party which corresponds to the actual value of the damage, and deterrent, even repressive, for the rest.

Belgian, Italian, English and American law see the penalty clause as clearly having a compensatory function. Anglo-american law operates a distinction between damages which are calculated by contract (liquidated damages) and penalty clauses[147]. Indeed, a liquidated damages clause is a « (…) clause [which] represents a genuine pre-estimate of the loss which is likely to be occasioned by the breach »[148]. It is valid in principle, whether the amount of the loss actually caused by the non-performance of the obligor is lower or higher than the amount provided under the contract. Conversely, if the parties did not intend, in drafting the clause, to evaluate in all good faith the potential loss which could result from a breach of contract, but simply to punish the obligor for his breach – or deter him from failing to perform his contract – then the clause in question will be qualified as a penalty clause. This type of clause is rejected by common law systems[149]. The distinction between liquidated damages, assessed in good faith, the amount of which is higher than the amount of the actual loss suffered and a penalty clause, which fixes an amount necessarily and much higher than the amount of the loss is complicated in practice. The qualification of such a clause is a matter of interpretation of the contract and of the clause in question. The courts have determined a few rules, in particular in the case of *Dunlop Pneumatic Tyre Company Ltd v. New Garage & Motor Co Ltd*[150], in which Lord DUNEDIN declared that a clause would qualify as a penalty clause:

- « if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach ».
- « if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid ».
- « There is a presumption (but no more) that it is a penalty when « a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage ».
- « it is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties ».

The principle remains, however, that a clause which fixes in advance the amount of damages due in the event of non-performance of the contract is a liquidated damages clause. However, exceptionally, when for example the amount fixed is extravagant so that it seems

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[144] It has been demonstrated that certain countries tend to give precedence to the repressive function over the compensatory function, without denying the existence of the latter, whilst other countries only considered the penalty clause as a purely private penalty, independent from any idea of compensation for the loss suffered.
[145] D. MAZEAUD, *La notion de clause pénale*, Préf. F. Chabas, LGDJ 1992, n°520.
[146] The distinction is suggested by D. MAZEAUD, *op. cit.,* n°517.
[147] J. D. CALAMARI, J.M. PERILLO, *Contracts*, 3rd ed., *op. cit.*, §14-31.
[148] E. McKENDRICK, *Contract Law*, *op. cit.,* n°21.5, p. 438.
[149] In the United States, see UCC 2-718 and §356 Rest.2nd. See the important legal precedent *Banta v. Stamford Motor Co.*, 92 A. 665, 667 (Conn. 1914).
[150] [1915] *AC* 79, esp. p. 87, *per* Lord DUNEDIN.

almost impossible that the parties have attempted in good faith to estimate the amount of the loss, this clause will be requalified as a penalty clause and will not be enforced by the judge, who will estimate and award as compensation the actual value of the loss suffered.

Belgian law[151] takes a similar approach. Indeed, ever since the 1970's, the Belgian Cour de Cassation has adopted a purely compensatory conception of the penalty clause. « On the basis of articles 1229 and 1152 of the Civil Code, the Belgian Cour de Cassation held, in two decisions,[152], that, in order to qualify as a (valid) penalty clause, the sum determined by the parties to the contract should have as its sole purpose the compensation of the damage. In other words, the penalty clause either is compensatory or cannot exist, or more exactly is totally void as contrary to the provisions of article 6 of the Civil Code. The idea of a private fine could not be more clearly or more firmly excluded! »[153]. This approach was recently confirmed by the entry into force of the law of 23 November 1998, which clearly chooses the compensatory approach with regard to the penalty clause, defined as the clause under the terms of which « a person undertakes to pay, in the event of a failure to perform the contract, a lump sum compensation for the damage which may arise as a result of the said contract »[154].

The nature of the penalty clause is discussed under French law[155]. Although it is traditionally characterized by two aspects which are the pre-estimate of damages and the deterrent effect on the obligor[156], academics are divided regarding its true nature. Some authors can only accept its compensatory function, others its repressive function, and others see it as having a dual nature, both compensatory and repressive[157]. It seems to emerge from contemporary studies, however, that the penalty clause should be understood as a « private fine »[158]: it fulfills a dissuasive (or deterrent) function, depending on the angle, a punitive function (in that it does not depend upon the occurence or the measure of the loss sustained by the obligee, but rather on the non-performance[159]) and a compensatory function insofar as it allows compensation for the loss, when it exists, to be taken into account on a case by case basis.

Under German law, the penalty clause (« *Vertragsstrafe* » – contractual penalty) is governed by §§ 339 of the BGB. It is generally seen as a preventive tool which should incite the obligor to perform his obligations. In this sense, it has a deterrent function. Nevertheless, when it applies in the event of non-performance (as opposed to defective or delayed performance), it is treated by law as the minimum amount of damages which may be awarded (« in lieu of performance »)[160]: on the one hand, the obligee may require its application without having to show evidence of any loss, on the other hand, when the obligee is able to show a loss which is of a greater amount than the penalty fixed at the outset, the penalty will be deducted from that

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[151] R.-O. DALCQ, « Les clauses pénales et les clauses abusives. Rapport belge », in: *Les sanctions de l'inexécution des obligations contractuelles. Études de droit comparé*, M. FONTAINE, G. VINEY (under the direction of), Bruylant, LGDJ 2001, p. 435.

[152] Cass., 17 Apr. 1970, *Pas.*, 1970, I, 7111; *RCJB*, 1972, p. 454, note I. MOREAU-MARGREVE ; Cass. 24 Nov. 1972, *Pas*. 1973, I, 297; *RCJB*, 1973, p. 303, note I. MOREAU-MARGREVE.

[153] D. MAZEAUD, *op. cit.,* n°520, p. 300. In support of this position, R.-O. DALCQ, *op. cit*., n°4, p. 437. This author specifies that the contested case was subsequently confirmed, see esp. n°4, p. 437, note 8.

[154] For an analysis of this law, see R.-O. DALCQ, *op. cit.,* n°7.

[155] Generally, see D. MAZEAUD, *op. cit.*; Ph. DELEBECQUE, D. MAZEAUD, « Les clauses de responsabilité : clauses de non responsabilité, clauses limitatives de réparation, clauses pénales », in: *Les sanctions de l'inexécution des obligations contractuelles. Études de droit comparé*, M. FONTAINE, G. VINEY (under the direction of), Bruylant, LGDJ 2001, p. 361; G. VINEY, P. JOURDAIN, *Les effets de la responsabilité*, Traité de droit civil, LGDJ 2001, n°229, p. 441; A. JAULT, *La notion de peine privée*, Préf. F. Chabas, LGDJ 2005, n°211, p. 130.

[156] G. VINEY, P. JOURDAIN, *Les effets de la responsabilité*, *op. cit*., n°229, p. 443.

[157] For a summary of academic proposals, see D. MAZEAUD, *op. cit*., n°529.

[158] In support of this point, D. MAZEAUD, *op. cit.,* n°555; A. JAULT, *op. cit.,* n°211.

[159] See recently Cass. civ. 3ème., 20 Dec. 2006, *Bull. civ.* III, n°256: « (…) *alors que la clause pénale, sanction du manquement d'une partie à ses obligations, s'applique du seul fait de cette inexécution, la Cour d'appel a violé les textes (...)* »(whereas the penalty clause, which sanctions a breach by one party of his obligations, applies on the sole basis of this breach, the Court of Appeal contravened the texts (….))

[160] § 340, para. 2 BGB.

amount[161]. Despite the European law developments which treat the penalty clause in the same way as liquidated damages, German law continues to operate a distinction between the two. For instance, the special regime set out in §§ 339 and following of the BGB as well as the power given to the judge to reduce the amount provided in § 343 of the BGB only apply to penalty clauses in the narrow sense of the term. Furthermore, §309 of the BGB – a general provision prohibiting certain general commercial terms (pre-drafted clauses, introduced by one party without individual negotiation and intended for frequent use) – makes a distinction between clauses which provide for liquidated damages (§309 n°5 requires that the sum payable as liquidated damages should correspond to the average foreseeable damage, and that the obligor must be entitled to adduce evidence of a lesser damage) and penalty clauses (§ 309 n° 6 prohibits any penalty clause applying to cases of non-acceptance or late acceptance of the service/goods, of delay in payment or for termination of the contract). Regarding contracts entered into between two professionals, only the first provision (liquidated damages) applies and in a less stringent way (the proof of lesser damage is not required to be *expressly* permitted). The distinction between the two types of clause, which are very close, is operated by the interpretation of the disputed clause. When the lump sum amount is obviously higher than the average foreseeable damage, the clause is a penalty clause (notwithstanding its title), because the parties have obviously not sought to anticipate the damage. In other cases, the question is whether the parties wished to facilitate the estimation of the loss rather than impose a sanction.

Under Italian law, the parties are also able to determine in advance, by contract, the amount of the loss to be compensated[162]. The existence of a contractual relationship allows the parties to provide, either by a contractual clause or by an addendum to the contract, the amount which will be payable by a party if it defaults. The « *clausola penale* », penalty clause (art. 1382 c.c.), which fixes the amount intended for compensation, is the main type of clause enabling the determination of the amount of the loss. If the penalty clause is obviously excessive or if the main obligation has been performed in part, the judge may reduce the sum equitably (art. 1384 c.c.), even without a party requesting it. The Italian Supreme Court justified this form of judicial control of the content of the contract by the general principle of substantial justice between the contracting parties[163], and referred to what it considers to be the fundamental function of the penalty clause, the expression of contractual freedom[164].

II. THE INDEMNITY, A TERM WITH AN UNCERTAIN USE AND AN UNCERTAIN LEGAL REGIME

Since numerous national legal systems use the term « indemnity » as a term of convenience, it is not surprising to discover that it occurs in the most varied of situations. Because the notion has not been defined, even in the broadest of terms, it often appears difficult to understand what distinguishes it from, in particular, damages or remuneration. However, it is striking that the term « indemnity » is used systematically, whether this is correct or not, in certain contexts, even for a certain purpose.

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[161] This provision is mandatory: BGH, 27 Nov. 1974, BGHZ 63, 256.

[162] U. BRECCIA, L. BRUSCUGLIA, F.D. BUSNELLI, F. GIARDINA, A. GIUSTI, M.L. LOI, E. NAVARRETTA, M. PALADINI, D. POLETTI, M. ZANA, *Diritto privato*, Parte II, Torino 2003, p. 480

[163] The Cour de Cassation recently held in favour of this position: Cass., Sez. II, 28 nov. 2006, n. 21066. C. MEDICI, *Controllo sulla clausola penale « manifestamente eccessiva » ed equilibrio degli scm,bi contrattuali*, *Danno e resp.*, 2006, p. 416; U. PERFETTI, *Riducibilità d'ufficio ed interesse oggettivo dell'ordinamento : un rapporto da chiarire*, *Nuova giur. civ.comm*., 2006, p. 187; G. SCHIAVONE, *Funzione della clausola penale e potere di riduzione da parte del giudice*, *Resp.civ. e prev.*, 2006, p. 61.

[164] A. GALLARATI, « La clausola penale tra funzione deterrente e risarcitoria », *Giur.it*, 2003, p. 450; L. BOZZI, « La clausola penale tra risarcimento e sanzione : lineamenti funzionali e limiti dell'autonomia privata », *Eur .dir.priv*., 2005, p. 1087.

References are made in French, Belgian and Swiss law to the « *indemnité d'éviction* » (indemnity for an eviction), the « *indemnité de non-concurrence* » (non-competition indemnity) , the « *indemnité de clientèle* » (indemnity for loss of clients), the « *indemnité de congés payés* » (holiday pay), the « *indemnité légale de licenciement* » (termination or redundancy payment), the « *indemnités journalières* » (sick pay), the «*indemnités d'occupation* » (payment for the occupation of premises after termination of the lease), the « *indemnités d'immobilisation* » (non refundable deposit on the purchase of property) …

It seems to emerge from the study of certain legal systems that the term « indemnity » is a generic term: it covers all of the monetary payments made to a person, whether it be the compensation of a loss suffered or a sum intended to reimburse the costs arising or the conclusion or the performance of a contract in order to avoid the unjust enrichment of one party. This is the case under Italian law, where the legislation mentions « *indennità* » ou « *indennizzo* » in a number of cases. These terms do not refer to a constant and uniform notion[165], but it is possible to make out the existence of general conditions which enable the notion to apply[166]. From this point of view, under Italian law, the indemnity is the instrument which is used to guarantee compensation in the event of a loss, without the subjective element of fault being taken into consideration. This is the case in relation to expenses incurred in good faith during the period of formation of the contract, in the event that the offer is then revoked (art. 1328 c.c.) or damage caused by a person acting out of necessity (art. 2045 c.c.), or in the case of the indemnity sometimes provided in a labour relationship. An indemnity is also provided under article 2582 of the Civil Code in favour of the purchasers of the rights to reproduce a work, when the author has withdrawn such work from the market[167].

The term « *indemnità* » is sometimes used as a synonym of « *risarcimento* » (compensation): it is only recently that a technical meaning was given to the term « *indemnità* »[168] (even if this meaning is not yet well defined). Instead of referring to « *risarcimento* », the Code uses the notion of « *indemnità* » for which the damage is considered from an economic point of view, to refer to cases of forced property transfer, for which the legislator wishes to compensate (art. 834, 43, 924, 925, 1032, 1038, 1047, 1053 c.c.)[169].

Finally, a convergence appears to be emerging out of French[170], German and English law, regarding the use of the term « indemnity», in that it appears to represent the monetary compensation for loss without cause, independently from the compensation for any damage caused.

Such an approach is adopted, it would seem, by German law. The notion of indemnity (« *Entschädigung* ») is often used as a general notion covering both the damages in the narrow sense of the term and other mechanisms of restitution.

What is specific about indemnities, which do not double up as damages, seems to be that the amount of the indemnity is not strictly linked to an actual loss (understood as the difference between the position in which the victim finds himself today and the state he would have found himself in had the wrongful act not occurred, see § 249, para. 1 BGB). The amount is determined more liberally: sometimes it only amounts to the value of lost goods – and not the lost profits associated with those goods. In any event, the indemnity is not intended to compensate a victim in totality, nor even to compensate him intrinsically.

English law does not conceptualize the notion of indemnity either. It is not used very frequently and the notion should not be confused with that of damages[171]. The notion of

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[165] S. CICCARELLO, *V° « indennità* », *Enc. Dir*., XI, p. 99

[166] See, in support of this point, under Italian law, S. Ciccarello, *op. cit.*, p. 105.

[167] F. MASTROPAOLO, *V° « Danno III»*, *Enc.giur.*, p. 14

[168] S. CICCARELLO, *op. cit*, p. 105.

[169] F. MASTROPAOLO, *op. cit*, p. 14. The idemnity is also found in relation to expropriations on the grounds of public interest. On the nature of the terms *indennità* / *indennizzo* with regard to expropriation, see D. Bonamore, "Equivalenza semantica ed equipollenza giuridica di "indennità, indennizzo, risarcimento" quale corrispettivo nelle espropriazioni per fini pubblici", *Giust.civ*., 1998, I, p. 3243.

[170] C. LE GALLOU, *La notion d'indemnité en droit français*, LGDJ 2007, préf. A Sériaux, n° 755, p. 680.

[171] J. BEATSON, *Anson's Law of Contract*, 28th ed., OUP 2002, p. 251.

indemnity is mostly found in the context of the consequences of misrepresentation, as an element of rescission, when this has a retroactive effect and when the misrepresentation is innocent. This indemnity is intended to place the misrepresentee in the position he held before the contract was entered into: it is a case of returning to the *status quo ante* rather than to the *status ad quem*.

The indemnity only covers the sums expended for the direct performance of the contract[172]. It was in the case of *Newbigging v. Adam*[173] that the two opposing theories regarding the determination of the amount of the indemnity, rather than its principle, were discussed. Indeed, in FRY LJ's view, the misrepresentee « is entitled to an indemnity in respect of all obligations entered into under the contract when those obligations are within the necessary or reasonable expectation of both of the contracting parties at the time they made the contract »[174]. However it was argued that such an approach did not differ from that taken for the determination of damages. On that basis, a more rigourous and precise test was required, such as that put forward by BOWEN LJ, who took the view that the misrepresentee « is not to be replaced in exactly the same position in all respects, otherwise he would be entitled to recover damages, but he is to be replaced in his position so far as regards the rights and obligations which have been created by the contract into which he has been induced to enter »[175].

The case of *Whittington v. Seale-Hayne*[176] illustrates the application of the theory defended by BOWEN LJ regarding the determination of the amount of an indemnity. The case involved breeders of poultry who had entered into a lease. They were the victims of an innocent misrepresentation made by the defendant who had represented that the premises were in a thoroughly sanitary. This was not in fact the case. Because the water supply was poisoned, one of the breeders fell ill and the poultry died. The breeders claimed to rescind the lease, and also claimed an indemnity covering the value of stock lost, the loss of profit on sales, the loss of breading season, the medical expenses of the manager, taxes, rent, and expenses incurred for the erection of outbuildings … They were also required by the urban district council to replace the drains, and these amounts were included in the amount of the indemnity claimed. The Court allowed the claim for rescission. However, in determining the amount of the indemnity, it only included the losses directly linked to the performance of the lease or necessarily arising out of the occupation of the premises. It followed the theory developed by BOWEN LJ in *Newbigging v. Adam* which only allows compensation for the « expenses created by the contract. On that basis, the Court only allowed for the reimbursement of the rent, taxes and for the repair of the drains. The other expenses were not recoverable because this would have amounted to awarding damages, in the sense that these expenses did not arise directly out of the breeding of poultry on the leased premises[177].

The legal basis for this solution relies on restitution in order to avoid any case of unjust enrichment. It is therefore not surprising that this indemnity is in fact almost identical to a personal restitutionary claim[178].

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[172] G.H. TREITEL, *An Outline of the Law of Contract*, 6th ed., OUP 2004, p. 162.
[173] [1886] 34 *Ch. D.* 582.
[174] *Newbigging v. Adam* [1886] 34 *Ch. D.* 582., esp. p. 596.
[175] *Newbigging v. Adam* [1886] 34 *Ch. D.* 582., esp. p. 593.
[176] [1900] 82 *L.T.* 49.
[177] See generally, J. BEATSON, *op. cit*., p. 251.
[178] E. McKENDRICK, *Contract Law, Text, Cases and Materials*, Second edition, OUP 2005, p. 710.