

Price reduction vs Damages: a Battle without a Winner.

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Abstract

Damages is considered the primary remedy in English sales law. This remedy has been adopted in the CISG too. However, price reduction seems to be of higher importance than damages in the latter legal regime, while the SGA has excluded the remedy of price reduction. It remains unanswered whether it is time for English law to introduce price reduction in the SGA so that it can add significantly practical advantage to the current remedies available to a commercial buyer. This article seeks to explore the appropriateness of price reduction in comparison with its leading competitor, i.e. damages. To do this, the article examines the distinctions between damages and price reduction against a novel evaluative framework, which provides an appropriate mechanism for analysis of the relationship of doctrine to commercial utility necessary for the buyer. This framework consists of four norms: certainty, performance interest, efficiency and relational theory of contract. However, it proves difficult to determine which remedy could most effectively address and satisfy the particular needs of a commercial buyer. Damages is likely to provide very similar practical solutions to price reduction once a sales contract is breached. This may constitute the reason why the SGA excluded price reduction in business to business transactions and that no serious attempt has been carried out to include this remedy within this legal regime.

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1- Introduction

This article aims to critically compare the remedy of price reduction under the United Nations Convention on Contracts for the International Sale of Goods, 1980 (hereinafter CISG) with the remedy of damages under the Sale of Goods Act, 1979 (hereinafter SGA). The article seeks to evaluate their differences on the basis of a conceptual framework introduced in this article. The evaluation seeks to find out which remedy is more effectively able to compensate the international commercial buyer of manufactured goods. The reason for choosing these two types of remedies revolves around the fact that both remedies deal with compensating the buyer with money and that their operation might be functionally equivalent. The remedy of price reduction is not prescribed under the SGA, whereas the remedy of damages is the primary remedy under this legal regime.¹ This exclusion will be explored in this article. By contrast, damages under the CISG are not considered the primary remedy. Rather, price reduction seems to be of high importance in these legal regimes. Therefore, there is a need to evaluate which monetary remedy, i.e. price reduction or damages, is more appropriate for the international sales of goods.

First, the law of price reduction under the CISG will be briefly exposed. Also, it will be explored whether the SGA allows the remedy of price reduction. Secondly, the general rules of damages under the SGA will be summarised. Finally, the conceptual framework will be introduced and significant distinctions drawn out between damages and price reduction will be assessed on the basis of this framework.

2- Price Reduction

2.1. Price Reduction under the CISG

¹ S. Rowan, *Remedies for Breach of Contract, A Comparative Analysis of Protection of Performance* (OUP, 2012) 40; G.H. Treitel, *Remedies for Breach of Contract: A Comparative Account* (Clarendon Press, Oxford, 1988) 56; I. Schwenzer, P. Hachem & C. Kee, *Global Sales and Contract Law* (OUP, 2012) 563; C. Szladits, 'The concept of specific performance in civil law' (1955) 4 *The American Journal of Comparative Law* 208, 212.

2.1.1. Right of Price Reduction

CISG Article 50 provides the remedy of price reduction for the buyer. This article applies when the delivered goods do not conform to the contract.² This remedy is applicable ‘whether the non-conformity constitutes a fundamental or a simple breach of contract, whether or not the seller acted negligently, and whether or not the seller was exempted from liability under article 79’.³ Also, price reduction can be exercised by the buyer without performing his duty to mitigate, as CISG Article 50 is not subject to CISG Article 77, ‘which imposes a duty on the buyer to mitigate his losses’.⁴ However, there are some disagreements amongst commentators on the CISG about whether the buyer should be sanctioned for his failure to mitigate losses. Kritzer opines that the buyer’s right to price reduction is not subject to the duty to mitigate under Article 77.⁵ By contrast, Honnold argues that ‘not only does the second sentence of Article 50 incorporate certain concepts of mitigation, but Article 77 should be read to apply to a wide range of remedies’.⁶ It seems that Kritzer’s opinion is correct, as price reduction does not aim to compensate the loss, but is ‘a reformation of the original contract which retains the relative balance of the bargain made by the parties’.⁷ The buyer keeps the non-conforming goods by adjusting the contract price according to the lesser value of the goods.⁸ Therefore, the rules with the aim of limiting the compensation of the loss such as ‘duty to mitigate’ or ‘the test of foreseeability’ should not be applied to this remedy.

However, the remedy of price reduction has limited application: it cannot be used for breaches consisting of late delivery and non-delivery, as the price is reduced on the basis of delivered

² P. Schlechtriem & I. Schwenzer, *Commentary on the UN Convention on the International Sale of Goods (CISG)* (3rd edn, OUP, 2010) 771; see also S. Kroll, L. Mistelis & P.P. Viscasillas, *UN Convention on Contracts for the International Sale of Goods (CISG) Commentary* (Hart Publishing, 2011) 752; 2012 UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods, Article 50, Comment n 3 <<http://cisgw3.law.pace.edu/cisg/text/digest-2012-50.html>>.

³ 2012 UNCITRAL Digest of case law on the United Nations Convention on the International Sale of Goods, Comment n 4 <<http://cisgw3.law.pace.edu/cisg/text/digest-2012-50.html>>.

⁴ E. Sondahl, ‘Understanding the remedy of price reduction – A means to fostering a more uniform application of the United Nations Convention on contracts for the International Sale of Goods’ (2003) 7 *Vindobona Journal of International Commercial Law and Arbitration* 255, 256.

⁵ A.H. Kritzer, *Guide to Practical Applications of the United Nations Convention on Contracts for the International Sale of Goods* (Kluwer, 1989) 377.

⁶ J.O. Honnold, *Uniform Law for International Sales under the 1980 United Nations Convention* (3rd edn, Wolters Kluwer Law and Business, 2009) 420.

⁷ E.E. Bergsten & A.J. Miller, ‘The remedy of reduction of price’ (1979) 27 *American Journal of Comparative Law* 273.

⁸ Schwenzer, Hachem and Kee (n 1) 761.

non-conforming goods being either defective in quality or quantity.⁹ Price reduction only covers ‘both delivery of non-conforming goods and delivery of an *aliud*’ (totally different goods).¹⁰ In addition, this remedy cannot be applied when the seller has remedied any lack of conformity either under Article 37 (cure in case of early delivery) or under Article 48 (cure after date for delivery).¹¹ Also, the application of price reduction might be restricted by the buyer’s duty of notifying the defect to the seller.¹² It has been indicated that ‘certain actions of the buyer can preclude his right to declare price reduction’.¹³ In other words, the buyer needs to initially give timely notice of the non-conformity to the seller, before declaring a price reduction. If he does not perform his notification duty, he might be debarred from his right of price reduction. CISG Articles 40 and 44 acting as ‘safety valves’ help the buyer use price reduction.¹⁴ These two articles protect the buyer if the notice about defective goods is not given within the reasonable time prescribed by CISG Article 39(1). CISG Article 40 provides that if the seller knew or could not have been unaware of the non-conformity of goods, he is not entitled to rely on the provisions concerning the buyer’s examination and notification. CISG Article 44 deals with exempting the buyer from his notification duty, provided that he can raise a reasonable excuse for failure to give the required notice.¹⁵

2.1.2. Nature of Price Reduction

CISG Article 50 provides the buyer with the right to ‘unilaterally alter the terms of the contract’.¹⁶ The buyer does not need to have recourse to the court in order to exercise this right, which gives him very valuable procedural strategic advantages.¹⁷ The buyer can apply this

⁹ Kroll, Mistelis and Viscasillas (n 2) 752; see also *Calzaturificio Piceno di Roberto Catinari & Uvaldo Raccosta v. Vivace Mode GmbH* (1996) Landgericht Düsseldorf, Germany <www.unilex.info/case.cfm?id=246>.

¹⁰ Schlechtriem and Schwenzler (n 2) 771; Kroll, Mistelis and Viscasillas (n 2) 752.

¹¹ Schlechtriem and Schwenzler (n 2) 773.

¹² See CISG. Arts 35(3), 38, 39, 40 and 44. These articles deal with examination and notification duty of the buyer. CISG Arts 40, 44 deal with the circumstances exempting the buyer from giving a timely notice.

¹³ Kroll, Mistelis and Viscasillas (n 2) 752.

¹⁴ C.B. Andersen, ‘Exceptions to the notification rule – are they uniformly interpreted?’ (2005) 9 *Vindobona Journal of International Commercial Law & Arbitration* 20 <www.cisg.law.pace.edu/cisg/biblio/andersen5.html>.

¹⁵ *Ibid.*

¹⁶ Kroll, Mistelis and Viscasillas (n 7) 751.

¹⁷ PA Piliounis PA, ‘The remedies of specific performance, price reduction and additional time (Nachfrist) Under the CISG: Are These Worthwhile Changes or Additions to English Sales Law?’ (2000) 12 *Pace International Law Review* 1; see also Sondahl (n 4) 5; for the sake of avoiding repetition, ‘the court’ refers to a court, expert and arbitral tribunal.

remedy by timely declaration, as this article requires the buyer to declare a reduction of the purchase price.¹⁸ The content of declaration ‘must clearly and unambiguously state that the buyer wishes to reduce the purchase price but need not include the technical term of price reduction’.¹⁹

Moreover, it has been argued that it should be asserted whether price reduction is a claim or a defence.²⁰ The significance of this argument comes to the fore if price reduction is a defence in nature and the parties have waived their defence rights. In this particular scenario, the buyer is barred from asserting a price reduction, even though the necessary requirements are satisfied for pursuing a reduction of price, such as the existence of non-conformity and the giving of timely notice of the non-conformity. The idea of recognising price reduction as a defence has not been widely accepted.²¹ CISG Article 50 specifically explains price reduction as a unilateral action of the buyer. In other words, the buyer can assert this right with no need to wait for the seller to start any legal action.²² Thus price reduction should be considered a claim, and not a defence.

2.1.3. Aim of Price Reduction

CISG Article 50 has originated from *actio quanti minoris* of the Roman law.²³ In terms hereof:

‘If a buyer became aware, after delivery, of certain specified defects which the vendor did not declare and which, had the buyer been aware of

¹⁸ Kroll, Mistelis and Viscasillas (n 2) 758; Schlechtriem and Schwenzer (n 2) 773.

¹⁹ Kroll, Mistelis and Viscasillas (n 2) 756; see also Schlechtriem and Schwenzer (n 2) 772; *Furniture case* (1992) District Court Locarno Campagna Switzerland, <http://cisgw3.law.pace.edu/cases/920427s1.html> accessed 10 July 2013; *Cowhides case* ICC Arbitration Case No. 7331 of 1994, <http://cisgw3.law.pace.edu/cases/947331i1.html>.

²⁰ Sondahl (n 4) 4.

²¹ It has been claimed that ‘in light of Article 383 of the Mexican Commercial Code, the use of *Actio Quanti Minoris* is more practical as a defense to the seller’s legal claim upon buyer’s default on payment, than as a cause of action for the buyer.’ A.M. Tunon, ‘The *Actio Quanti Minoris* and Sales of Goods Between Mexico and the U.S.: An Analysis of the Remedy of Reduction of the Price in the UN Sales Convention, CISG Article 50 and its Civil Law Antecedents’ (1998) www.cisg.law.pace.edu/cisg/biblio/muria.html.

²² Sondahl (n 6) 5; see also C. Liu, ‘Price Reduction for Non-Conformity: Perspectives from the CISG, UNIDROIT Principles, PECL and Case Law’ (2005), www.cisg.law.pace.edu/cisg/biblio/chengwei2.html.

²³ R. Zimmermann, *The Law of Obligations, Roman Foundations of Civilian Tradition* (OUP, 1996) 318; Bergsten and Miller (n 7) 255.

them at the time of sale would have led him to pay a lesser price, he could bring an action for reduction of price or for rescission of contract.’²⁴

The aim of this remedy is to preserve the bargain. The buyer is able to keep the defective goods and reduce the purchase price ‘it otherwise would have paid had it been aware of the hidden defects in the goods’.²⁵ This remedy is not designed to protect a buyer’s expectation, reliance, or restitution interests, such as damages.²⁶ ‘Price reduction is thus neither damages nor partial avoidance of the contract, but rather adjustment of the contract.’²⁷ Price reduction is unique in this regard. This remedy is calculated on the basis of ‘the abstract relationship between the actual value of the goods delivered and the hypothetical value of conforming goods’.²⁸ This type of calculation is called ‘proportionate’.²⁹ The mathematical model for calculating the reduced price is as below:

$$\text{Reduced price} = \frac{\text{value of delivered (non-conforming goods)}}{\text{value of owed (conforming) goods}} \times \text{contract price.}^{30}$$

2.3 Price Reduction under the SGA

It is arguable whether the SGA allows the remedy of price reduction. It has been submitted that ‘common law systems do not recognise the principle of price reduction for defects in goods’.³¹ Likewise, it has been expressed that ‘common law lawyers experienced great difficulty in understanding the nature of the remedy of price reduction and tended to confuse it with the remedy of damages’.³² The reason for unavailability of price reduction might be that ‘the

²⁴ Bergsten and Miller (n 7) 256.

²⁵ Sondahl (n 4) 3.

²⁶ Treitel (n 1) 108; Sondahl (n 4) 3.

²⁷ Schlechtriem and Schwenger (n 2) 771.

²⁸ Ibid.

²⁹ Piliounis (n 17) 15.

³⁰ Kroll and Mistelis and Viscasillas (n 2) 759; see also Schlechtriem and Schwenger (n 2) 774.

³¹ Treitel (n 1) 108; see also A.E. William, ‘Forecasting the Potential Impact of the Vienna Sales Convention on International Sales Law in the United Kingdom’ (2000-2001) *Pace Review of the Convention on Contracts for the International Sale of Goods (CISG)* 9, www.cisg.law.pace.edu/cisg/biblio/williams.html#ivc.

³² C. Liu, ‘Price Reduction for Non-Conformity: Perspectives from the CISG, UNIDROIT Principles, PECL and Case Law’ (2005) <www.cisg.law.pace.edu/cisg/biblio/chengwei2.html>; see also Schlechtriem and Schwenger (n 2) 770; Bergsten and Miller (n 7) 272.

It should be noted that surprisingly the UNIDROIT Principles of International Commercial Contracts refused to adopt the remedy of price reduction. Although there were extensive debates among the Working Group who prepared the Principles, they finally decided to exclude this remedy. No explanation to reflect this exclusion is provided in the Principles. It seems that the strongest reason lies in the nature of price reduction. This remedy is

remedy of damages is more readily available in common law systems than under many civil codes, as most of these codes allow buyers to claim damages only when the seller is at fault for his breach'.³³

However, it has been claimed that 'a general remedy of price reduction can be implied from sections 30 and 53 of the SGA'.³⁴ This opinion does not seem to be correct. SGA s 53 deals merely with the remedy of set-off, which comes into effect when there is a breach of warranty. Set-off is calculated on the basis of loss incurred by the buyer. By contrast, price reduction does not consider the loss and it is calculated according to the abstract relationship between the delivered goods and conforming goods. Bridge has noted this difference: 'in English law, the position is somewhat different, though superficially similar'.³⁵ Nevertheless, SGA s 30 is functionally equivalent to price reduction under CISG Article 50. SGA s 30(1) 'applies a principle very much like that of price reduction to the case of short delivery of goods'.³⁶ SGA s 30(1) provides that 'where the seller delivers to the buyer a quantity of goods less than he contracted to sell, the buyer may reject them, but if the buyer accepts the goods so delivered he must pay for them at the contract rate'. 'The price is reduced simply in proportion to the amount which the shortage bears to the full quantity contracted for.'³⁷ 'The reference to "contract rate" is comparable to the "proportional" calculations made under Article 50 of the CISG'.³⁸ If the parties have stipulated a contract rate for each contract item, that item determines the proportion of value that the goods delivered had to the conforming goods.³⁹ Therefore, when there is a short delivery of goods, SGA s 30 is likely to reach the same result as price reduction under CISG Article 50.

believed to have a character of consumer protectionism, being originally designed to protect buyers from latent deficiencies in goods. Since the UNIDROIT Principles govern commercial contracts, such protections may not be felt to be necessary. For more information see: S Vogenauer and J Kleinheisterkamp, *Commentary on the UNIDROIT Principles of International Commercial Contract (PICC)* (OUP 2009); MJ Bonell, *The UNIDROIT Principles in Practice: Caselaw and Bibliography on the UNIDROIT Principles of International Commercial Contracts* (Brill, Nijhoff 2006).

³³ Kroll, Mistelis and Viscasillas (n 7) 749.

³⁴ Piliounis (n 17) 19.

³⁵ M.G. Bridge, *The International Sale of Goods* (3rd edn, OUP, 2013) 604.

³⁶ Treitel (n 1) 110.

³⁷ *Ibid.* 109.

³⁸ Piliounis (n 17) 19.

³⁹ Piliounis (n 17) 19; See e.g. *Behrend & Co. v. Produce Brokers Co.* [1920] 3 KB 217; *Biggerstaff v. Rowatt's Wharf Ltd* [1896] 2 Ch. 93; *Oxendale v. Wetherell* (1829) 109 ER 143.

3- Damages under the SGA

3.1. Right to Damages

Damages is the standard remedy in English law and ‘the action for damages is always available, as of right, when a contract has been broken’.⁴⁰ Damages must be awarded for any breach of contract that causes loss to the buyer.⁴¹ As this article deals with international commercial sales of goods, the focus will be on remedies for pecuniary losses, because commercial actors normally make contracts in order to make profits and maximise their wealth. In other words, they will seek to achieve a remedy that will put them in a same financial position they would have been in if the expected benefit had flown from the contract, which was breached by other party. Therefore, they are mainly concerned with available remedies that can compensate their pecuniary losses and might ignore the ways for compensating their non-pecuniary losses.

3.2. Aim of Awarding Damages

The aim of an award of damages for breach of contract is to compensate the injured party for his loss incurred as a result of breach.⁴² The basis of an award of damages for breach of contract under English contract law has been expressed in the dictum of Parke B in *Robinson v. Harman*: ‘The rule of the common law is that where a party sustains loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed.’⁴³ Burrows explains that the ‘expectation measure is ... the natural measure of recovery, since it accords directly with the underlying morality of promise keeping’.⁴⁴ The aim is therefore to protect ‘the claimant’s expectation

⁴⁰ Treitel (n 1) 988. This right is reflected in SGA s 51(1). See further H.G. Beale (ed.), *Chitty on Contracts*, vol. 1 (13th edn, Sweet & Maxwell, 2008) 1598.

⁴¹ SGA s 51(1); *Robinson v. Harman* (1848) 154 ER 363; *Lock v. Furze* (1866) 144 ER 722; *Wertheim v. Chicoutimi Pulp Co.* (1911) AC 301; *Johnson v. Agnew* (1979) 123 SJ 217, (1980) AC 367. See also R. Bradgate, *Commercial Law* (3rd edn, Butterworths, 2000) 326.

⁴² *AG v. Blake* [1998] 1 ALL ER 833, 844. Also McGregor has stated: ‘Damages are dominated by the idea of compensation in money; such compensation is the rule. Day after day, in case after case, damages are awarded to claimants to compensate them for loss and damage.’ H. McGregor, *McGregor on Damages* (3rd edn, Sweet & Maxwell, 2012), para. 1-002.

⁴³ (1848) 1 Exch 383, 385; see also *Golden Strait Corp. v. Nippon Yusen Kubishika Kaisha (The Golden Victory)* [2007] 2 AC 353, [2007] UKHL 12; Beale (n 50) 1598.

⁴⁴ A. Burrows, *Remedies for Torts and Breach of Contract* (3rd edn, OUP, 2004) 20; see also see also McGregor (n 52), para. 1-021, 1-022; A. Burrows, ‘Legislative reform of remedies for breach of contract: the English perspective’ (1997) ELR 155; L.L. Fuller & W.R. Perdue, ‘The reliance interest in contract damages’ (1936-

interest'.⁴⁵ The reason for protecting the expectation interest might be the fact that 'the function of exchange is to realise a surplus, the central concept of "loss" following a breach of contract is [the claimant's] failure to obtain the future expected surplus'.⁴⁶ In other words, damages seek to 'achieve the post-performance situation, which is to be contrasted with the attempt in the law of tort to restore the pre-accident situation'.⁴⁷

3.3. General Measure of Damages

The general measure of damages is reflected in SGA s 51(2): 'The measure of damages is the estimated loss directly and naturally resulting, in the ordinary course of events, from the seller's breach of contract.'⁴⁸ This rule applies where there is no available market for the contract goods. For instance in *Air Studios (Lyndhurst) Limited t/a Air Entertainment Group v. Lombard North Central Plc*, the buyer intended to use the goods in a filming business.⁴⁹ The goods were second-hand and finding an available market for them was almost impossible. 'There was no ready availability of an AMS Neve Gemini DFC system either in August 2011 or at all.'⁵⁰ The buyer instead purchased similar goods, which could be used in his business. The court awarded damages 'being the difference between the contract price of GBP 100,000 and the cost of obtaining the nearest equivalent second-hand equipment, together with interest.'⁵¹ Although this provision prescribes the way of quantifying damages, it also deals with one rule that limits damages. This limitation rule is called the 'remoteness test'.⁵² However, where there is an available market for the goods in question the measure of damages is *prima facie* the difference between: (a) the market price of the relevant goods at the time fixed for delivery and at the

1937) 46 YLJ 52, 54; M. Bridge, *The International Sale of Goods* (n 45) 461; D.H. Vernon, 'Expectancy damages for breach of contract: a primer and critique' (1976) 2 Wash Uni LQ 179, 180.

⁴⁵ Fuller and Perdue (n 44) 54.

⁴⁶ D. Harris, D. Campbell & R. Halson, *Remedies in Contract and Tort* (2nd edn, Butterworths LexisNexis, 2002) 74.

⁴⁷ *Ibid.*

⁴⁸ See also *Hadley v. Baxendale* (1854) 156 ER 145; *Transfield Shipping Inc. v. Mercator Shipping Inc.* [2008] UKHL 48; [2009] 1 AC 61; SGA s 51(2).

⁴⁹ [2012] EWHC 3162 (QB); [2013] 1 Lloyd's Rep 63.

⁵⁰ *Ibid.* para. 93.

⁵¹ *Ibid.* para. 108.

⁵² *Hadley v. Baxendale* (1854) 156 ER 145; *Wroth v. Tyler* [1972] 117 SJ 90, [1974] Ch 30; *Transfield Shipping Inc. v. Mercator Shipping Inc.* [2008] UKHL 48; [2009] 1 AC 61; SGA s 51(2); see also Treitel (note 1) 151; Beale (note 50) 1626; A. Komarov, 'The Limitation of Contract Damages in Domestic Legal Systems and International Instruments', in D. Saidov & R. Cunningham (eds), *Contract Damages: Domestic and International Perspectives* (Oxford, Hart Publishing, 2008).

place fixed for delivery' and (b) the contract price.⁵³ This method of calculation is called the 'abstract' method.⁵⁴ This method requires the buyer to take reasonable steps in finding a seller in the available market. The abstract method has been reflected in SGA s 53(1), which assumes that the buyer will go to the market and buy substitute goods with the difference between the contract price and the market price.⁵⁵

But a contrary approach was adopted by the Court of Appeal in *Bence Graphics International Ltd v. Fasson UK Ltd*.⁵⁶ In this case, the buyer contracted to purchase vinyl film on which they printed words and numbers and which they then sold to end users. The film supplied tended to degrade and the decals became illegible, but remarkably few end users actually sued. At first instance the buyer was held entitled to the difference between the value of the goods at the time of delivery and the value they would have had if they had fulfilled the warranty. But the Court of Appeal favoured that the correct measure of damages was the actual loss suffered by the buyer and that damages should not be measured according to the *prima facie* rule. In this case, the seller knew that the buyer would sell on to others after substantially converting the goods into another product, and the court ruled that the parties contemplated that the measure of damages for defects in the goods should be the extent of the buyer's liability to those others resulting from the defect. Therefore, damages were measured on the basis of SGA s 53(2): the estimated loss directly and naturally resulting from the seller's breach of contract. This means that the buyer was entitled to actual loss from those that sued, which was nominal damages of GBP 22,000. The Court of Appeal found it difficult to award damages on the basis of 'difference in value' rule, probably due to the two issues of whether loss was actually suffered and how it could be quantified.⁵⁷ If the buyer is unable to establish the actual loss or does not suffer a loss, he is entitled to nominal damages. However, it is submitted that this case should not be followed for two reasons. First, 'remoteness is not relevant when the claim is simply for the difference in value between what was contracted for and what was delivered'.⁵⁸ Secondly, 'any windfall which the buyer may have obtained was obtained at the expense, or perhaps more accurately by the grace, of such of the users of the decals as made no claims against them'.⁵⁹

⁵³ M. Bridge, 'The market rule of damages assessment', in: D. Saidov & R. Cunnington (eds), *Contract Damages, Domestic and International Perspective* (Hart Publishing, 2008).

⁵⁴ Treitel (n 1) 111.

⁵⁵ M.G. Bridge (ed.), *Benjamin's Sale of Goods* (8th edn, Sweet & Maxwell, 2010), para. 17-004.

⁵⁶ [1997] CLC 373; [1997] 1 All ER 979.

⁵⁷ N. Tamblyn, 'Damages under string contracts for sale of goods' (2009) 1 JBL 1, 10-11; C. Hawes, 'Damages for defective goods' (2005) 121 LQR 389, 390.

⁵⁸ Beale, *Chitty on Contracts* (n 40) 1855.

⁵⁹ G.H. Treitel, 'Damages for breach of warranty of quality' (1997) 113 LQR 194.

Therefore, this case should not be considered as a general approach adopted by English courts and that in the section dealing with the evaluation part, regard will be had to the *prima facie* rule of measuring damages.

3.3.2. The Duty to Mitigate

The buyer should take reasonable steps to mitigate his loss; this is called ‘the duty to mitigate’.⁶⁰ This duty implies that the claimant cannot recover for loss caused by the defendant’s breach of contract where the claimant could have avoided or minimised the loss by taking reasonable steps, such as buying substitute goods in the market.⁶¹ If the buyer declined to do so, he should bear the risk of any increase in the market price. The rules of mitigation are related to the ‘market price’ rules.⁶² The duty to mitigate is the foundation of the normal rule for the measure of damages that requires the innocent party to buy or sell immediately in an available market.⁶³ It has been stated that ‘the market price rule in contracts for the sale of goods represents a major departure from the ordinary rules of contract law relating to mitigation of loss’.⁶⁴ Thus, the concept of ‘available market’ relates exclusively to contracts for the sale of goods and it therefore deserves an in-depth analysis.

3.3.2.1. Market Price Rule Reflecting the Duty to Mitigate

SGA s 51(3) has utilised the market price rule for the measurement of damages. English law has extensively used the concept of ‘market price’ for measuring damages, which is ‘not characteristic of other legal systems’.⁶⁵ The ‘market price’ rule reflects the buyer’s duty to mitigate his loss by ‘buying substitute goods in the open market’.⁶⁶ Goode has adopted a stringent approach by defining an available market ‘as a market to which the buyer has reasonable access and in which he can procure goods of a description and quality comparable

⁶⁰ *Tucker v. Linger* [1882-83] 21 Ch; *Banco de Portugal v. Waterlow & Son Ltd* [1932] AC 452; *Macrae v. Swindells (HG)* [1954] 1 WLR 597; see also Beale, *Chitty on Contracts* (note 50) 1667.

⁶¹ *Roper v. Johnson* [1872-73] LR 8 CP 167; *British Westinghouse Electric v. Underground Electric Railways Company of London* [1912] AC 673, 689; *Pilkington v. Wood* [1953] Ch 770; *Strutt v. Whitnell* [1975] 1 WLR 870; see also Bridge, *Benjamin’s Sale of Goods* (n 55), para. 16-052; McKendrick, *Goode on Commercial Law* (note 50) 398.

⁶² Bridge, *Benjamin’s Sale of Goods* (n 55), para. 16-052.

⁶³ *Ibid.*

⁶⁴ McKendrick, *Goode on Commercial Law* (Penguin Books, London 2010) 398.

⁶⁵ Bridge, *International Sale of Goods* (n 55) 467.

⁶⁶ McKendrick, *Goode on Commercial Law* (n 64) 399.

to those he has contracted to buy and at a price governed primarily by the market forces of supply and demand'.⁶⁷ He provides three criteria constituting the available market that must co-exist. First, the test of fungibility: 'Goods of which any one unit is considered in the locality or trade in question to be the exact equivalent of any other unit of the same grade, sample or description'.⁶⁸ Thus manufactured goods made to the buyer's special order are unlikely to satisfy this test.⁶⁹ However, Goode has stated that the buyer must still mitigate his loss if there is a 'nearest' equivalent to the goods contracted for, even if the nearest equivalent does not constitute the available market.⁷⁰ Secondly, the test of sufficient quantity: 'The equivalent units must be available in sufficient quantities to meet all demands by would-be purchasers.'⁷¹ This is obviously problematic with transactions involving unique goods which have no exact equivalent. Thirdly, the test of fluctuation of price: 'The price must be one which fluctuates with supply and demand.'⁷² The same reasoning for the test of sufficient quantity of manufactured goods applies to this test as well; if goods are unique then it is highly unlikely that the price fluctuates according to supply and demand in the normal sense (i.e. in an abnormal sense, there will be price fluctuations in that there is no price without demand for unique goods, and a demand for such goods will necessitate the creation of a price). However, it has been submitted that if the contract goods are to be manufactured according to the specifications of the contract, there might be 'an available market in which the buyer could buy suitable substitute goods'.⁷³ But, it is likely that there will be no available market for unique manufactured goods, since 'the chance of buying such goods within a reasonable time after the breach is too limited and fortuitous'.⁷⁴

In case-law, an early view was that 'an available market is some place (e.g. an exchange) where the goods in question can be sold'.⁷⁵ Upjohn J in *Thomson (WL) Ltd v. Robinson* has stated that an available market means 'a situation in the particular trade in the particular area is such that

⁶⁷ Ibid. 398.

⁶⁸ Ibid. 415.

⁶⁹ *Lazenby Grages Ltd v. Wright* [1976] 2 ALL ER 770; *M&J Marine Engineering Services Co. Ltd v. Shipshore Ltd* [2009] EWHC 2031 (Comm).

⁷⁰ McKendrick, *Goode on Commercial Law* (n 64) 415.

⁷¹ Ibid.

⁷² Ibid.

⁷³ Bridge, *Benjamin's Sale of Goods* (n 55), para. 17-006.

⁷⁴ Ibid. para. 16-067.

⁷⁵ *Dunkirk Colliery Co. Ltd v. Lever* [1878] 9 Ch D 20, 25.

the particular goods could freely be sold'.⁷⁶ This is considered the prevailing view.⁷⁷ He then states 'an available market in the subsection is not limited to a market such as the Baltic or Stock Exchange, but means that the situation in the trade in the area is such that the goods can freely be sold if a purchaser defaults'.⁷⁸ Another view is that it means 'a situation where the current price for the goods may fluctuate according to supply and demand'.⁷⁹ The case-law is inconsistent in dealing with the notion of available market for manufactured goods. For instance, in a recent case concerning second-hand goods, the court held that:

'New equipment cannot be regarded as being equivalent to "the goods in question", which were second-hand goods and, although the availability of equivalent second-hand goods would have constituted an available market, it would have taken three months to source a similar console, which fell short of constituting an available market within the meaning of s.51(3).'⁸⁰

In this case, the court confirmed that there is an available market for the second-hand goods, although those goods have special characteristics conforming to the contract terms. In another case, the court rejected the available market for the contract goods by stating that an available market 'involves a reasonably available supply of the contract goods and a reasonably available source of demand for such goods, and there was no such market for the goods to be supplied by M&J'.⁸¹ It has been indicated that 'in a predictable way, therefore, subsequent cases, faced with conflicting authority in higher courts, came down in favour of a line being drawn between non-delivery and defective goods cases, with the market rule continuing to apply in the former category'.⁸²

4- Examining the Existing Differences

⁷⁶ [1955] Ch 177, 185.

⁷⁷ Bridge, *International Sale of Goods* (n 35) 434.

⁷⁸ *Ibid*, 187.

⁷⁹ *Charter v. Sullivan* [1957] 2 QB 117, 128.

⁸⁰ *Air Studios (Lyndhurst) Ltd (t/a Air Entertainment Group) v. Lombard North Central Plc*, (2012) EWHC 3162 (QB), para. 92.

⁸¹ *M&J Marine Engineering Services Co. Ltd v. Shipshore Ltd* (2009) EWHC 2031 (Comm), para. 30.

⁸² Bridge, *International Sale of Goods* (n 35) 433.

There are two significant differences between the remedy of damages under the SGA, and the remedy of price reduction under the CISG. These two differences will be critically analysed. The first and most obvious one revolves around their method of calculation. Damages are calculated in accordance with the actual loss incurred by the buyer, while in the case of set-off the price is reduced on the basis of the difference between the market price and the actual value of the goods.⁸³ By contrast, price reduction is not dependent on actual loss being suffered, but merely dependent on the abstract relationship between the actual value of the goods delivered and the hypothetical value of conforming goods.

Another distinction relates to the rules limiting the availability of these remedies. Price reduction is subject to the seller's duty to cure and the buyer's duty to notify the seller of non-conformity and declaration of price reduction.⁸⁴ In other words, if the seller cures his defective performance or the buyer does not timely notify the seller about the deficiency or does not declare a price reduction, the buyer is precluded from exercising price reduction.⁸⁵ However, the rules limiting damages, i.e. the foreseeability test and the duty to mitigate, are not applicable to price reduction.⁸⁶ This is because the buyer's right to price reduction does not depend on his actual loss suffered as a result of the reduction in the value of the goods.

4.1. The Evaluative Framework

The evaluative framework employed in this article draws on the insights of general analyses of remedies for breach of contract in order to develop criteria that are specifically designed in light of the commercial realities and needs of international sales transactions and can be applied to the full range of buyers' remedies made available by the two main governing regimes. This framework consists of four criteria that will be introduced and justified in this part. The first

⁸³ Set-off is abatement in common law principle in which the buyer can exercise the remedy of damages by way of defence against the seller's claim for contract price, either in or out of court. See *Mondel v Steel* [1841] 151 ER 1288; [1841] 8 M & W 858; *Mellowes Archital Ltd v Bell Projects Ltd* (1997) 87 BLR 26; *Bluestorm Ltd v Portvale Holdings Ltd* [2004] EWCA Civ 289, [2004] HLR 49; R Derham, *Derham on the Law of Set-off* (4th edn, OUP 2010) 472. Set-off in the evaluative section will be analysed only if it can add any practical significance to the remedy of damages.

⁸⁴ CISG Arts 39, 37, 48.

⁸⁵ CISG Arts 48, 50.

⁸⁶ *Mondel v. Steel* (1841) 151 ER 1288, (1841) 8 M & W 858; Bridge, *Benjamin's Sale of Goods* (n 55) paras 17-049, 17-051; Piliounis (n 17) 15.

criterion is ‘certainty’. Rules need to be clear in order to avoid costly dispute resolution. Also, in the context of buyer’s remedies, ‘certainty’ implies that a buyer should know where he will stand in the event of a breach.⁸⁷ In other words, the buyer needs to be able to predict what will happen if the seller does not perform his contractual obligation and what options are available to him. The second criterion is ‘performance interest’. ‘A [buyer] enters into a contract because he is interested in getting that which the other party has to offer and because he places a higher value on the other party’s performance than on the cost and trouble he will incur to obtain it.’⁸⁸ This interest is called ‘performance interest’; its importance must be acknowledged, for it has been called ‘the only pure contractual interest’.⁸⁹ This criterion is used to identify to what degree a remedy can satisfy this interest. The third criterion is ‘efficiency’. An efficient remedy can be determined by examining the transaction costs facing the disputants.⁹⁰ In other words, the level of transaction costs affects what remedy would be efficient in the particular circumstances. The fourth criterion consists of the norms of ‘relational theory’. This theory is particularly suitable for assessing buyer’s remedies in international sales of manufactured goods.⁹¹ Where manufactured goods are specific goods, they need to be made to the buyer’s special requirements reflected in the contract terms. This compliance is achieved by regular negotiation and communication between the parties before the ultimate performance of the contract. For this reason the norms of relational theory are utilised to analyse the extent to which these remedies are responsive to on-going relationship of parties in this type of transaction. In this paper, the two dominant relational norms of preservation of relations and substantial fairness will be used for assessing the discrepancies between damages under the SGA and price reduction under the CISG.

⁸⁷ For further explanation on ‘certainty’ see e.g. J. Fitzgerald, ‘CISG, Specific Performance, and the Civil Law of Louisiana and Quebec’ (1996-1997) 16 JLC 291, 292-293.

⁸⁸ D. Friedmann, ‘The Performance Interest in Contract Damages’ (1995) 111 LQR 628, 632.

⁸⁹ Also, as Rowan has put it, ‘the performance interest therefore refers to the interest of the promisee in obtaining the performance to which he is entitled under the contract’. Rowan (n 1) 2.

⁹⁰ T.S. Ulen, ‘The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies’ (1984-1985) 83 MLR 341, 366-367; see also R.H. Coase, ‘The Nature of the Firm’ (1937) 16 *Economica New Series* 386, 395-396; L.A. Kornhauser, ‘An Introduction to the Economic Analysis of Contract Remedies’ (1985-1986) 57 UCLR 683, 708-709.

⁹¹ I.R. Macneil, ‘Values in Contract: Internal and External’ (1983) 78 NULR 340, 344; for further explanations see also D. Campbell, ‘The Relational Constitution of Remedy: Co-operation as the Implicit Second Principle of Remedies for Breach of Contract’ (2004-2005) 11 TLR 455; Y. Adar & M. Gelbard, ‘The role of remedies in the relational theory of contract’ (2011) 7 ERCL 399 (2011); R. Austen-Baker, ‘Comprehensive Contract Theory: a Four Norm Model of Contract Relations’ (2009) 25 JCL 216.

4.2. Certainty

Generally, it seems that the remedy of price reduction can satisfy the certainty interest of the buyer to a larger extent than remedy of damages. The buyer claiming damages should prove that he has reasonably mitigated his loss and also the loss has been reasonably foreseeable for the seller.⁹² These two rules restricting availability of damages and the defence of set-off undermine the certainty interest of the buyer. This uncertainty lies in the vagueness of the concept of ‘reasonableness’ and that the buyer can never predict with certainty what the court might decide about the fulfilment of the duty to mitigate. However, it should be noted that if the buyer does not fulfil this duty, he will not be debarred from the remedy of damages.⁹³ In other words, ‘actual performance of steps in mitigation is not a prerequisite of the claimant’s right to recover’.⁹⁴ The buyer will be only unable to recover damages for any losses which he should have reasonably avoided by taking reasonable steps.⁹⁵ The loss due to the seller’s breach of contract is still compensable.⁹⁶ Also, it is up to the court to decide whether the loss was reasonably foreseeable for the seller, so that it can be recovered by damages.⁹⁷ But, the duty to mitigate and the foreseeability test do not apply to the remedy of price reduction. In other words, the buyer is not required to reasonably mitigate the loss or prove that the loss was foreseeable for the seller. This would make price reduction more freely available than damages and the defence of set-off, and hence might satisfy the certainty interest of the buyer to a larger extent in this regard.⁹⁸

4.3. Performance Interest

Generally, damages seek to put the buyer in the same promised financial position, whereas price reduction simply aims to put the buyer ‘in the position he would have been in had he

⁹² See generally Bridge, *Benjamin’s Sale of Goods* (n 55) paras 16-043, 16-052.

⁹³ *Westwood v. Secretary of State for Employment* [1985] AC 20, 44.

⁹⁴ McKendrick, *Goode on Commercial Law* (n 64) 136.

⁹⁵ Beale, *Chitty on Contracts* (n 40) 1667; Bridge, *Benjamin’s Sale of Goods* (n 55), para. 16-052; Harris, Campbell and Halson (n 46) 110.

⁹⁶ See e.g. *Borealis AB v. Geogas Trading SA* [2010] EWHC 2789 (Comm); [2011] 1 Lloyd’s Rep. 482.

⁹⁷ See generally *Hadley v. Baxendale* (1854) 9 Ex 341; *Wroth v. Tyler* [1972] 117 SJ 90, [1974] Ch 30; Treitel (note 1) 151.

⁹⁸ Kroll, Mistelis and Viscasillas (n 2) 750.

purchased the goods actually delivered rather than the ones promised'.⁹⁹ These different aims have been reflected in different methods of calculation. These different methods of calculation between damages and price reduction determine the degree of satisfaction of the buyer's performance interest. This determination can be done by the amount of money awarded under damages and price reduction. Also, price reduction has an advantage over damages for the injured buyer. If the buyer seeks to succeed in his claim for damages, he has to show that he has actually suffered a loss due to the breach. This might be difficult for the buyer, particularly when he has substantially processed the goods and sold them on to other consumers. For instance, in *Bence Graphics* the buyer was awarded only nominal damages of GBP 22,000, due to the fact that only few sub-buyers complained about the goods, which were actually defective when supplied by the seller.¹⁰⁰ However, if price reduction were available in English sales law, the buyer would have been able to recover a substantial sum. This is because under the price reduction formula, there is no need to show the loss occurred and as such the price is reduced on the basis of the proportional value of non-conforming goods to conforming goods. Price reduction under the CISG can therefore satisfy the performance interest of the buyer to a higher degree than damages under the SGA in this regard.

Price reduction and damages need to be assessed in three different situations in order to identify whether – and also to what extent – they can satisfy the buyer's performance interest. First, when the market price of the contract goods has not changed between the time of contract and the time of delivery 'there would be no difference in the amount that could be claimed as damages versus a price reduction'.¹⁰¹ For instance, if a car is sold to a buyer for GBP 10,000 and at the time of delivery, its motor is deficient so that the car is worth only GBP 8,000. The amount awarded as damages is GBP 2,000: the difference between the market value of conforming goods (GBP 10,000) and the delivered goods. The same amount is reduced under price reduction:

Reduced price: GBP 8,000 =

$$\frac{\pounds 8,000: \text{value of delivered (non-conforming goods)} \times \pounds 10,000: \text{contract price}}{\pounds 10,000: \text{value of owed (conforming) goods}}$$

⁹⁹ H.M. Flechtner, 'More US Decisions on the UN Sales Convention: scope, parol evidence, validity and reduction of price under Article 50' (1995) 14 *Journal of Law and Commerce* 153, 173.

¹⁰⁰ See section 3.3.

¹⁰¹ Piliounis (n 17) 18.

Under damages, the buyer is left with GBP 10,000 in value: a car valued GBP 8,000 plus GBP 2,000 as damages. Under price reduction, the buyer also recovered GBP 2,000, as the car has lost one fifth of the value it should have had at the delivery date (GBP 2,000 over GBP 10,000). The buyer is left with GBP 10,000 in value: GBP 2,000 as the reduced price plus the car valued GBP 8,000. Accordingly, price reduction and damages (also set-off) can equally satisfy the buyer's performance interest.

Secondly, when the parties are faced with a falling market and the contract price has fallen at the time of delivery.¹⁰² In the example given above, the contract price of the car is again GBP 10,000 and its market price has dropped to GBP 8,000 at the delivery date. The value of the defective car is now GBP 6,000. Under damages, the buyer can only recover GBP 2,000: the difference between the market value of conforming goods (GBP 8,000) and the delivered goods (GBP 6,000). Under the defence of set-off the buyer is also allowed to reduce GBP 2,000 from the contract price. However, under price reduction, the buyer is able to recover one quarter (GBP 2,500, as the value of delivered goods over GBP 8,000, as the value of conforming goods) of the contract price, which is GBP 2,500.

$$\frac{\text{£ 8,000 :value of conforming goods} - \text{£ 6,000: value of delivered goods}}{\text{£ 8,000: value of owed (conforming) goods}} = \frac{1}{4}$$

$$\frac{1}{4} \times \text{Contract price: £ 10,000} = \text{£ 2,500.}$$

Or:

$$\text{GBP 7500: Reduced price} = \frac{\text{£ 6,000: value of delivered} \times \text{£10,000: contract price}}{\text{£ 8,000: value of owed (conforming) goods}}$$

$$\text{GBP 10,000} - \text{GBP 7,500} = \text{GBP 2,500}$$

Under damages, the buyer is left with GBP 8,000 in value: a car valued GBP 6,000 plus GBP 2,000 as damages. Under price reduction, the buyer is left with GBP 8,500 in value: a car valued GBP 6,000 plus GBP 2,500 as the reduced price. This shows that price reduction is not only able to satisfy the performance interest of the buyer, it also puts him in a better position financially, if the contract is performed.

¹⁰² Bridge, *The International Sale of Goods* (note 35) 604.

Thirdly, when the parties are faced with a rising market and the contract price has increased at the time of delivery.¹⁰³ In the same example, the contract price of the car is again GBP 10,000 and its market price has increased to GBP 12,000 at the delivery date. The value of the defective car is now GBP 9,000. Under damages and the defence of set-off, the buyer is able to recover GBP 3,000, as the difference between the market value of conforming goods and the delivered goods. Under price reduction, the buyer is permitted to recover only one-fourth (GBP 3,000 over GBP 12,000) of the contract price, which is GBP 2,500.

$$\frac{\text{£ 12,000 : value of conforming goods} - \text{£ 9,000: value of delivered goods}}{\text{£ 12,000: value of owed (conforming) goods}} = \frac{1}{4}$$

$$\frac{1}{4} \times \text{Contract price: GBP 10,000} = \text{GBP 2,500.}$$

Under damages, the buyer's performance interest is effectively satisfied, as the buyer is left with GBP 12,000 in value: the car worth GBP 9,000 plus GBP 3,000, as damages. Under price reduction, the buyer is left with GBP 11,500 in value: the car worth GBP 9,000 plus GBP 2,500, as the reduced price. Price reduction awards GBP 500 less than the amount awarded under damages. Accordingly, the buyer's contractual expectancy is not fully recovered when the market is rising.¹⁰⁴

4.4. Efficiency

Price reduction under the CISG is likely to decrease the post-breach transaction costs more effectively than damages under the SGA. However, one should distinguish between two different scenarios affecting transaction costs. First, when the seller accepts the reduction by the buyer under price reduction. Litigation costs are minimised and the parties are only faced with the post-breach re-negotiation costs. As has been discussed before, price reduction is an adjustment of the contract to the new situation.¹⁰⁵ 'The price is reduced, just as if the subject matter of the contract had from the outset been the non-conforming.'¹⁰⁶ These costs should not be high, as the parties in international sales of manufactured goods have normally done a

¹⁰³ Ibid. 604.

¹⁰⁴ Ibid. 605.

¹⁰⁵ See sections 2.1.2 and 2.1.3.

¹⁰⁶ Schlechtriem and Schwenger (n 2) 771.

substantial amount of negotiation and it would be not be costly for them to alter the contract terms. For instance, in the *Clothes* case decided by a German district court, the representatives of the buyer and seller communicated several times concerning delivery of the goods and method of payment.¹⁰⁷ The buyer could easily demand a price reduction of 20% by fax as part of this communication process. Also, in the *Cobalt Sulphate* case, the parties communicated several times concerning the inspection of the quality and the quantity of manufacturing the cobalt sulphate.¹⁰⁸

By contrast, under damages, it is always up to the court to determine whether the loss was actually incurred. In the case of price reduction, the court only becomes involved if the seller uses legal avenues to challenge the buyer's use of these remedies. Also, in the case of a damages claim, the court must investigate the satisfaction of the remoteness test and the fulfilment of the duty to mitigate. These two rules are likely to increase litigation costs noticeably, as the court is faced with the vague concept of 'reasonableness' employed in these two rules: reasonable foreseeability of the loss and the duty to mitigate the loss reasonably. Price reduction and the defence of set-off do not require such investigations and therefore it is submitted that post-breach renegotiations costs are likely to be lower than the considerable litigation costs involved in damages claims. This shows that price reduction and the defence of set-off are more efficient than remedy of damages if the seller has not yet started legal proceedings.

A second variation occurs when the seller disagrees with the reduction of price and thus starts legal proceedings against the buyer for the purchase price. Even if the seller reacts in this manner, the litigation costs under price reduction would be lower than in the case of a damages claim. It has been claimed that 'price reduction does not require any affirmative action by a court' and that the court does not have to delve into subjective circumstances surrounding each individual case.¹⁰⁹ However, this statement does not seem to be entirely correct. The court needs to understand whether the price reduction was fulfilled properly and the buyer has carefully performed according to the mathematical formula. But the court does not need to explore the doctrines limiting damages. For instance, in the *Bottles* and *GMS Modules* cases

¹⁰⁷ District Court Kassel, Germany (1995), <<http://cisgw3.law.pace.edu/cases/950622g1.html>>.

¹⁰⁸ *Cobalt Sulphate* case, Germany 3 April 1996 Supreme Court, <<http://cisgw3.law.pace.edu/cases/960403g1.html>>.

¹⁰⁹ Sondahl (n 4) 5.

the court did not investigate whether the loss was actually incurred and whether it was foreseeable and also whether the buyer has performed his duty to mitigate.¹¹⁰ In this case, if damages were claimed by the buyer, the court should have examined whether all those requirements were satisfied, which would have considerably increased the court's costs.

Under the defence of set-off, transactions costs will be higher than under price reduction if the seller has started legal proceedings. The court's costs under set-off will be the same as the remedy of damages, as the amount of reduction of price under set-off is determined on the same basis as the remedy of damages. It has been stated that 'where a buyer incurs damages by virtue of the seller's breach of the parties' contract, the buyer's liability for goods sold and delivered is diminished to the extent of his damages'.¹¹¹ Other costs associated with declaring deduction of price to the seller are also added to those litigation costs. For instance, in *Carbontek Trading Co., Ltd v. Phibro Energy, Inc.*, the court investigated whether the deduction intended to compensate for contamination of coal was reasonable.¹¹² This type of investigation is costly for the court, as they need to consider the subjective circumstances of each case. Also, the buyer inspected the goods and informed the seller of contamination by a telex, which might have incurred some costs on the buyer. Therefore, set-off under the SGA is the least efficient remedy compared with damages and price reduction if the seller starts legal proceedings.

4.5. Relational Theory of Contract

4.5.1. Preservation of Relations

It seems that price reduction under the CISG is capable of maintaining the relationship between the parties more effectively than damages. 'Price reduction is primarily concerned with preserving the bargain between the parties and being used as a means of rebalancing the performance required by both sides.'¹¹² Preserving the bargain can be accomplished through 'reformation of the original contract which retains the relative balance of the bargain made by the parties'.¹¹³ The parties renegotiate with each other and adjust the contract to the new

¹¹⁰ Appellate Court Koblenz, Germany (2006), <http://cisgw3.law.pace.edu/cases/061214g1.html>; District Court Zug, Switzerland (2007) <<http://cisgw3.law.pace.edu/cases/070830s1.html>>.

¹¹¹ *LaBarbav Morrell & Co., Wine Emporium* 272AD2d 165 (NY 2000).

¹¹² M. Tunan, 'The *Actio Quanti Minoris* and sales of goods between Mexico and the United States: An analysis of the remedy of the reduction of the price in the United Nations Sales Convention, CISG Article 50 and its Civil law antecedents', <www.cisg.law.pace.edu/cisg/biblio/muria.html>.

¹¹³ Bergsten and Miller (n 7) 273.

situation with no resort to the court, which can strengthen the parties' relationship. The process of exercising the right to price reduction can provide an opportunity for the parties to cooperate with each other and that might lead to preserving the relationship. For instance, in the Swiss *Furniture* case, governed by the CISG, the buyer notified the seller about the non-conformity and declared his intention of reducing the price to the seller.¹¹⁴ The seller sent one of its representatives to inspect the goods. The representative communicated effectively with the buyer and the parties had the chance to get to know each other and to preserve their relationship. Also, in the American *Car amplifiers* case, governed also by the CISG, the seller manufactured amplifiers for the buyer for two years.¹¹⁵ However, one of the deliveries of amplifiers was defective and the buyer sought to reduce the price. The buyer notified the seller about the deficiency and that encouraged the presidents of the seller's company and the buyer's company to cooperate in order to solve the problem.

However, damages might also enable the parties to negotiate and maintain their relationship particularly when the seller has not yet started the legal proceedings claiming for the purchase price. In other words, there is a possibility for the buyer to send a letter to the seller requesting damages with no resort to the court.¹¹⁶ This might trigger a process of communication by which the parties' relationship is likely to be enhanced. The defence of set-off as a mechanism enabling the buyer exercises the right to damages out of court, similar to price reduction, requires the buyer to declare the deduction of the price due to the incurred loss.¹¹⁷ In other words, set-off also facilitates and encourages cooperation of the parties by requiring the buyer to declare the deduction of the price, with no need to resort to the court. In *Mondel v. Steel*, the buyer declared the amount of compensation to which he was entitled.¹¹⁸ This declaration might be viewed as a way for the parties to further cooperate with each other and possibly maintain their contractual relationship. Also, in *Adam Metal Supply, Inc. v. Electrode, Inc.*, the

¹¹⁴*Furniture* case (1992) District Court Locarno Campagna, Switzerland, <<http://cisgw3.law.pace.edu/cases/920427s1.html>>.

¹¹⁵(2012) Federal District Court United States (Illinois) <<http://cisgw3.law.pace.edu/cases/120321u1.html>>; see also *Artificial Turf* (2009) District Court Stuttgart Germany, <<http://cisgw3.law.pace.edu/cases/091029g1.html>>; *Bullet-Proof Vest* (2009) Decision 4505/2009 the Multi-Member Court of First Instance of Athens, Greece, <http://cisgw3.law.pace.edu/cases/094505gr.html>; *Automobile* (2008) Appellate Court Stuttgart, Germany, <http://cisgw3.law.pace.edu/cases/080331g1.html>.

¹¹⁶ H Beale, 'Contracts between businessmen: planning and the use of contractual remedies' (1975) 2 *British Journal of Law and Society* 45, 45.

¹¹⁷ R Derham, *Derham on the Law of Set-off* (4th edn, OUP 2010) 70; see also C Fountoulakis, *Set-off Defences in International Commercial Arbitration* (Hart Publishing, 2011) 110.

¹¹⁸ (1841) 151 ER 1288, 1289; (1841) 8 M& W 858, 860.

manufacturer notified the supplier about the nonconformity of aluminium within the reasonable time after discovery and thereby reduced the purchase price.¹¹⁹ This process of exercising the defence of set-off could provide an opportunity for the parties to cooperate. In other words, the parties could actually reach a compromise settling their dispute without necessarily referring to the court, which might lead to preserving their relationship. Thus, defence of set-off along with damages and price reduction are equally able to maintain contractual relations.

4.5.2. Substantial Fairness

Price reduction under CISG and damages under the SGA are able to equally fulfil substantial fairness. Substantial fairness should not be limited to evaluation of the adequacy of reciprocity in quality-price relations, but it can have wider application to parties' investment in making contractual relations and their expectations of sustaining these relations. The parties in international sales of manufactured goods normally expect to cooperate sufficiently with each other in order to make sure that their contractual expectations are adequately satisfied. Price reduction can reinforce this expectation by requiring the parties to cooperate in order to resolve their legal problems and this cooperation might continue and sustain their relationship. For instance, in the *Car Amplifiers* case, the parties had already been in a contractual relationship for two years and they endeavoured to resolve their legal issue. The buyer communicated with the seller about the deficiency and their representatives re-negotiated the contract terms. Although the legal proceedings settled this dispute, price reduction could actually protect substantial fairness by encouraging the parties to negotiate and cooperate by using their prior knowledge of each other. Also, the defence of set-off implemented by the buyer outside the court might protect substantial fairness to a higher extent than damages. This defence is implemented by the buyer's declaration and helps parties reach a compromise by reducing the purchase price without starting legal proceedings. Similarly, the buyer might communicate with the seller asking for damages. This communication can form the basis of an out-of-court settlement that can effectively improve the parties' relationship and satisfy their expectation of sustaining it. Accordingly, the exercise of set-off, damage and price reduction outside the court might equally fulfil the requirement of substantial fairness.

¹¹⁹ *Adam Metal Supply, Inc. v. Electrodex, Inc.* 386 So2d 1316 (Florida 1980); see also *Shreve Land Co., Inc. v. J & D Financial Corp.*, 421 So 2d 722 (Florida 1982).

5- Conclusion

The upshot of the evaluative analysis of the existing differences between those two remedies reveals that price reduction under the CISG is more in line with the criteria of certainty and efficiency. But damages under the SGA fulfil the performance interest to a higher degree than price reduction. The defence of set-off under the SGA does not make as much difference as the remedy of damages in terms of certainty, performance interest and relational theory.

In terms of certainty, it is difficult to determine which remedy can satisfy this criterion, as there are some doctrines surrounding these remedies which vigorously limit their availability and also undermine their clarity. The injured party seeking damages should show that the loss has been reasonably mitigated as well as being reasonably foreseeable for the party in breach at the time of concluding the contract.¹²⁰ The concept of ‘reasonableness’ in these two requirements would make the remedy of damages uncertain and that the injured party is unlikely to effectively predict his situation after the breach of contract. By contrast, the duty to mitigate and the foreseeability requirement are not applicable to the remedy of price reduction, making this remedy more freely available to the injured buyer and satisfying the buyer’s certainty interest to a larger extent.¹²¹

In terms of performance interest, damages along with the defence of set-off under the SGA can satisfy this interest more effectively than the remedy of price reduction under the CISG. Satisfaction of the performance interest under price reduction and damages varies depending upon the market value of the goods. When the contract price and market price remain the same, damages and price reduction equally give the buyer full contractual expectancy. However, if the market price has fallen, price reduction over-satisfies the buyer’s performance interest. The money reduced under price reduction puts the buyer in a better financial position than he would have been in if the contract was performed. Examining those two different situations shows that although price reduction under the CISG was not designed to satisfy the buyer’s performance interest, it is capable of satisfying this interest. But when the market price has risen, price reduction is unable to satisfy the performance interest, and only damages can fully satisfy this interest.

¹²⁰ See generally Bridge, *Benjamin’s Sale of Goods* (n 55) paras 16-043, 16-052.

¹²¹ Kroll, Mistelis and Viscasillas (n 2) 750.

In terms of efficiency, price reduction under the CISG is more efficient than damages under the SGA. Set-off is equally as efficient as price reduction before the commencement of legal proceedings. But when the seller has turned to the court, set-off is less efficient than damages and price reduction. When the parties do not start legal proceedings, the litigation costs are minimised. The parties need only bear the low post-breach re-negotiation costs, as most probably they will have already negotiated with each other, especially in international sales of manufactured goods, so that their communications' costs are likely to be low. However, it can be submitted that set-off is even more efficient than price reduction, as it does not need reformation of contract terms as such. Even if the seller does not agree with the reduced price and starts legal proceedings, price reduction under the CISG is more efficient than damages. Under damages, the court is required to identify whether the buyer has reasonably mitigated the loss and also to determine whether the loss was reasonably foreseeable for the seller. In this situation, set-off under the SGA is less efficient than damages, as the court's costs relating to damages aggregates with the costs relating to declaring the set-off by the buyer. By contrast, under price reduction, the courts do not need to investigate the satisfaction of the remoteness test and fulfilment of the duty to mitigate. The courts inquire whether the buyer has timely and sufficiently notified the seller of non-conformity and also he has properly reduced the price on the basis of the mathematical formula. These two tasks are likely to be less costly than the litigation costs involving in damages.

In terms of the relational theory of contract, price reduction under the CISG, damages and defence of set-off under the SGA are equally in line with the norms of this theory. Price reduction encourages the parties to cooperate in order to solve their problems without resort to the court. In damages, the buyer can ask the seller pay damages without resort to the court. This can effectively enhance the parties' relationship. In set-off, the buyer is required to declare the deduction of price. This declaration can be seen as an opportunity for continuing the parties' relationship. Also, substantial fairness can be equally satisfied by the remedy of price reduction, defence of set-off and the remedy of damages. This is because the parties are encouraged to negotiate, which might develop their relationship. This can satisfy the parties' expectations in sustaining their relationship effectively.