Comparative analysis of Damages

in the Anglo-American legal system, Germany and Ukraine

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Abstract

Currently almost every county experiences the process of stronger interdependence with other states through international trade. Consequently, lawyers who earlier dealt only with domestic legislation, nowadays face the need to work with international clients. One of the most important issue which appears in drafting of international contracts is the problem of protection of an innocent party through the mechanism of remedies. This paper is focused on the comparison of damages application between two civil law countries (Germany and Ukraine) and the Anglo-American legal system. Here reader will be able to become familiar with the structure of damages regulation in the analyzed countries, the core terminology and the comparative analysis of application of particular types of damages in mentioned above countries.

Introduction

The constantly increasing processes of globalization and economic interdependence of states induce lawyers to be familiar not only with their national legislation, but with the law of other countries as well. This trend is certainly quite positive: despite the additional burden to learn more in order to meet the needs of modern business, lawyers receive the opportunity to expand their professional outlook and spot the legal mechanisms which are unknown in their domestic law.

One of the trickiest, and at the same time extremely important issues, an international business lawyer faces on a daily basis is the application of foreign remedies in a contract. The problem is that they are so different, that the knowledge of national legislation can not only be worthless, but what is much worse, can be misleading. This is why it is extremely important for a professional who deals with foreign clients to be familiar with the principles and particular types of remedies which are used in common and civil law countries.

Because of the limits of the current paper, it would be impossible to cover the whole remedial system in the analyzed countries. This is why, it was narrowed to the issue of damages application. In order to analyses the almost opposite perception of the concept of damages, the list of chosen countries included:

- **Anglo-American legal** system with its strict reliance on damages as the primary remedy;
- **German law** with the emphasis on performance in specie;
- **Ukrainian legislation**, which being close to the German position concerning specific performance, combines the application of damages with a range of economic penalties and administrative sanctions in the area of commercial law.

The paper is aimed to give a deeper understanding of differences in damages application among the analyzed countries, achieved through comparative analysis of their legislations, which will help lawyers who face the need to start their practice in the field of international business law. Moreover,

the comparisons made on particular types of damages can be used to discover the possible ways of improvement of their regulation in the analyzed countries. In fact, it will be explained that on first glance opposite legal systems contain a large part of provisions which, despite the forms of expression and procedures used, are in their nature similar.

In addition, it will help lawyers from both common and civil law based systems to get acquainted with national terminology of the countries under analysis.

The structure of the paper helps the reader at first to learn the core information related to the regulation of damages in Anglo-American, German and Ukrainian legislations. Further, compensatory damages, which are the main type of monetary remedies, are examined in depth. In the last chapter particular types of damages, which go beyond the simple compensation for direct loss are explained and compared.

With the knowledge obtained from this paper, a reader will know all types of damages applied in the analyzed states. Moreover, it will become possible to spot the differences which are not expressly stated in statutory provisions. In addition, this knowledge will be sufficient to make an informed choice of law to govern the future contract. The reader will obtain the understanding of available monetary compensation tools in examined countries and of their regulatory procedure.

Chapter 1 Damages: General Overview

The remedy of damages is the sum of money paid by the party in breach in order to compensate the loss suffered by the innocent party. It is a universal rule applied in every legal system that in *contract law* the *main purpose of damages* is to put the aggrieved party in the position it would have had if the breach had not happened. It is necessary to mention that two conditions should be fulfilled: a party should receive what was stated in the contract, but it should also perform its own obligation in return. [1] Otherwise a party itself will conduct a breach.

The approaches to damages are different in every legal system. That is why, in order to prepare the reader for a more precise comparative analysis of particular types of damages, it is necessary to give a general overview of the main characteristics in relevant countries.

1.1 The Concept of Damages in the Anglo-American Legal System

There is no doubt that the doctrine of damages is the most developed in the Anglo-American legal system. The main approach which traces its history to the courts of law is that a court will consider at the beginning whether it is possible to grant monetary compensation to the aggrieved party and only if such compensation is not available, it will look to so-called equitable remedies to serve justice.

In fact, there are several doctrinal approaches in classification of damages in the Anglo-American legal system. However, the majority of scholars, supported by centuries of court practice, separate the following types of damages:

- **Compensatory damages** (damages, aimed to cover the losses of the innocent party which directly follow from the breach of a contract);

[1] Martin A. Frey *An Introduction to the Law of Contracts,* West Legal Studies is an imprint of Delmar, a division of Thomson Learning, 2000, 3-rd edition, p. 371

- **Consequential damages** (damages aimed to cover the losses which can be foreseen at the moment of contract formation);
- **Nominal damages** (used when there is no actual loss in order to formally acknowledge the breach);
- **Punitive damages** (rarely used by courts to punish the most outrageous breaches);
- **Liquidated damages** (stated in the contract by the parties themselves).

The other classification divides the damages into two groups: **liquidated and unliquidated**.[2] The main particularity in this approach is whether damages were decided by parties before the breach or they were applied by the court afterwards. It should be noted that this classification is quite interesting due to the emphasis on the active position of parties in deciding the sanction which can be applied to them.

Moreover, it is important to identify the ***aim of an action for damages***. An *action for unliquidated damages* includes not only the request to obtain monetary compensation for the breach, but also to determine the issue of liability through courts assessment of the case.[3] In contrast, *actions for liquidated damages* do not usually need court's interference, because damages are already stipulated in the contract. The only issue which should be decided by a court is whether the party in breach is liable or not. Perhaps, the only exception from this rule will be if *liquidated damages are excessively big* in comparison with actual loss suffered by the aggrieved party. We will come back to this issue in the section concerning the liquidated damages.

1.1.1 Damages versus Debt

The separation of the whole range of damages on liquidated and unliquidated becomes particularly interesting when comparison is made between the concepts of *debt and damages in liquidated and unliquidated claims*.[4] Geoffrey in his book alleges that liquidated damages possess the same

[2] Mary Charman, *Contract Law,* Willan Publishing, 2007, fourth edition, p. 244
[3] Samuel Geofrey *Law of Obligations and legal remedies,* Cavendish Publishing Limited, 2001 second edition, p. 125
[4] Ibid. p. 126

features which are peculiar to debt. Both of them are definite monetary sums stated in the contract which should be paid by one of the parties upon the occurrence of a specific event. At the same time he asserts that damages by their nature are the consequence of non-payment of a debt. That is why, despite some similarities mentioned by Geoffrey it is crucial to differentiate the terms of liquidated damages and debt.

In fact, the importance of such differentiation is extremely big. At first, on the doctrinal level, Anglo-American legal science defines *a claim in debt as primary action* for an obligation and *claim for damages as secondary*.[5] The reason for such division is simple: damages are claimed for the violation of primary obligation. One more important reason is that claim for damages is made not to induce the party to perform, as it is with claim in debt, but to obtain a compensation for non-performance.[6]

The *practical consequences* are even more essential. The plaintiff has no obligation to prove anything except the evidence that debt really exists. Claim in debt gives a party the right not to mitigate the loss. There are no rules of remoteness, and penalty rules do not apply either.[7] It gives to a claimant a tremendous freedom in his actions.

Moreover, the formal division of these two concepts can be often seen in real cases. For instance, two different claims can be brought in one case with one matter of dispute.[8] Let us assume that the defendant leased a house for a year and constantly refused to pay. In addition, he organized home parties which caused severe damage to the house. After months of threatening to terminate the contract, the claimant brings an action against him and claims an unpaid rent and damages for diminished value of the house. In this case the first claim will be a claim in debt, and the second one – claim for damages. A court will perceive these two actions differently because of their distinct nature. If the defendant does not deny the existence of the lease contract, then the court will have no

[5] Samuel Geofrey *Law of Obligations and legal remedies,* Cavendish Publishing Limited, 2001 second edition, p. 126
[6] Ibid.
[7] Ibid.
[8] Ibid.

further requirements to the claimant concerning the claim in debt. It will be automatically presumed as valid. However, this will not work for the claim for damages, because the proper assessment by the court and most probably by special expertise will be needed.

An excellent example of the importance of understanding the differences between the debt and damages is the case *White and Carter versus Mc Gregory*[9]. Here the plaintiff agreed to be an advertiser of the defendant's company. Later the defendant breached the contract through cancellation. However, the plaintiff decided to ignore the breach and continued to perform the contract and in the end sued the defendant not only for damages but for contract price as well. Despite the allegations made by the defendant that the claimant was aware about the breach and therefore had no right to claim the contract price, the House of Lords decided the case in favor of the claimant. The rule which can be taken from the case is that after breach of the contract the aggrieved party has two options:

- to acknowledge that breach was made and claim damages;
- to continue the performance under the contract and claim along with damages the contract price;

However, it was stated by the court that *in case of obvious abuse, the claim for contract price can be withdrawn*. It can happen when a party has no interest in performing of the contract and still does it, which brings excessive hardship for the defendant. In such a situation the court will limit the claim only to the damages for breach of the contract with all range of applicable rules: duty to mitigate the loss, remoteness rules etc.

1.1.2 Damages versus Specific Performance

Despite the fundamental principle applied in the Anglo-American legal system that granting of damages is always more preferable than ordering the specific performance, this issue is often particularly tricky for courts to apply.

[9] http://www.legalmax.info/members2/conbook/white_ca.htm Accessed: 17.03.2012

A very good example is the case *Cooperative Insurance Ltd v Argyll Stores Ltd*[10]. Here the defendant owned several supermarkets which stopped being profitable. The decision was taken to close them, which subsequently led to breach of the lease contract. The claimant insisted on the specific performance to be granted by the court instead of damages for breach of the contract. It is notable that the court of appeals ruled in favor of the defendant and only the House of Lords overruled the decision granting damages instead of specific performance. The main reason stated by the court was that specific performance will put the defendant into an unjustly unfavorable position. The company will incur sufficient losses through the operation of unprofitable business while the claimant will receive profit from lease. Moreover, both parties were legal entities with equal bargaining powers. Such institutions should understand the possibility of commercial risk during the conduct of their business.

However, one issue appears to be of relevance in deciding between the ordering of specific performance or choosing damages – the **concept of law as the price**.[11] In his book, dedicated to problems of corporate law, Greenfield raised a particularly important question: nowadays there is a tendency to perceive the law as a kind of price which should be paid by parties in order to conduct their business in the manner they want. He gave an example of the corporation which permanently pays fines for water pollution and nevertheless continues to pour out toxic liquids in a nearby river.

In contract law this principle works exactly the same way. In the case discussed one party decided to breach the contract and pay damages in order to free itself from the undesirable obligation. Definitely, in this exact situation the judgment of the court was absolutely fair. Nevertheless, courts should be aware that the border between justice and perceiving the *law as a mere instrument* in conducting of business is very thin. For example, let us assume the same situation as described above but with a little change – the contract was the lease of an office and the landlord was a private party whose main source of income was the profit from leasing of this office. Such situations are very common in post-Soviet countries, where people have lost their jobs and survive only through

[10] http://www.publications.parliament.uk/pa/ld199798/ldjudgmt/jd970521/coop01.htm Accessed: 17.03.2012
[11] Greenfield Kent, *The Failure of Corporate Law*, University of Chicago Press, 2007, p.75

rent of rooms in their apartments or leasing of other real property. Will the judgment made by the House of Lords still retain its fairness? Probably not, because the bargaining power of parties will be grossly disproportionate and cancellation of a contract even with payment of certain damages will lead to tremendous losses on the side of the innocent party who will be deprived from the only possible source of income.

It should be noted that such a problem is more common in the Anglo-American legal system and not in the continental one. Obviously, the main reason is that in Germany or Ukraine a court will look first at whether the specific performance is possible, and only if it is not will the court grant damages. Most probably, according to Ukrainian legislation, the decision of the court in the case with similar facts to *Cooperative Insurance Ltd versus Argyll Stores Ltd* will be granting specific performance plus damages for breach of the contract.

To conclude, the importance of such remedial instruments as damages in the Anglo-American legal system is hard to overestimate. It has created through centuries of graduate development a sophisticated scheme, where damages of different types are applied in certain situations in order to guarantee the monetary compensations for an aggrieved party. Contrary to the continental approach, courts will not use specific performance or any other equitable remedy as long as dissent satisfaction can be granted through any kind of damages.

1.2 The Peculiarities of Damages in German Legal System

The analysis of the German system of remedies shows that concentration on damages, which can be seen in Anglo-American legal system, is not the only possible way to regulate the legal relations. In contrast, legislators in Germany chose ***opposite approach*** with strict *emphasis on specific performance*. The party usually does not have a choice between these two remedies – *it is required to choose the performance in specie*, and only if it is impossible – refer to other remedies.[12]

[12] Lord Bingham, Dr. Günter Hirsch, *German Law of Contract, Comparative Tretise*, Oxford and Portland, Oregon, 2006 second edition, p. 452

This concept is implemented through the obligatory period of performance which should be given to the party in breach before claiming the damages. The provision which contains this principle is put to BGB in article 281: [13]

Damages in lieu of performance for nonperformance or failure to render performance as owed

(1) To the extent that the obligor does not render performance when it is due or does not render performance as owed, the obligee may, subject to the requirements of section 280 (1), ***demand damages in lieu of performance***, if he has without *result set a reasonable period* for the obligor for performance or cure.

The idea of making it obligatory to require the special period of performance is very important to secure the spirit of German law approach. Definitely, the main reason is to induce the parties as much as possible to perform their obligations under the contract and only in exceptional cases to refer to damages.

In general, the whole system of damages can be divided into three types: [14]

- Damages in lieu of performance;
- Damages for delay;
- Simple damages.

The article in BGB which grants the aggrieved party the right to claim damages and contains the provisions which define the types of this remedy is 280:

Damages for breach of duty

(1) If the obligor breaches a duty arising from the obligation, the *obligee may demand damages* for the damage caused thereby. This does not apply if the obligor is not responsible for the breach of duty.
(2) *Damages for delay* in performance may be demanded by the obligee only subject to the additional requirement of section 286.
(3) *Damages in lieu* of performance may be demanded by the obligee only subject to the additional requirements of sections 281, 282 or 283.

[13] http://www.gesetze-im-internet.de/englisch_bgb/german_civil_code.pdf Access: 12.03.2012
[14] http://www.iuscomp.org/gla/literature/schulte-noelke.htm Access: 12.03.2012

It is notable that the heading of the main article in German legislation includes the term **"breach of duty"** ***(Pflichtverletzung)***. The main reason for such attention is an exceptional importance of this principle which includes delay, impossibility and non-conformity of the performance.[15] An interesting aspect of this concept is that acts of God also lead to a breach of duty,[16] which makes it possible to allege that fault of the party has nothing to do with it. Definitely, force majeure is an excuse for non-performance in German law as it is in every civilized country, but the doctrinal approach still separates the liability which the party can incur from the breach of duty under the contract. That is why, it is reasonable to assert that ***Pflichtverletzung*** *is a mere lack of party's full performance* under the contract.

1.2.1 Fault principle (*Verschuldensprinzip)* in German Contract Law

Article 280 of BGB in the first paragraph states the second major principle of German contract law: a party will be excused from damages if it proves that it is not responsible for the breach of duty. In the German doctrine this principle is known as ***fault principle,*** **or** ***Verschuldensprinzip***. Probably, this concept creates one of the biggest differences between German and Anglo-American approaches: in the latter system damages can be easily granted for any breach of contract regardless the existence of fault.

In fact, the drafters of the reform provisions implemented in 2002 were especially proud of presence of this principle in German law.[17] They claimed it to be the "*ethical superiority*" which guarantees that only a truly guilty party will undertake the rightful liability. However, in defense of other types of systems where such a principle does not exist, it should be said that the structure of the whole remedial system is relevant. The strict reliance on damages in the US will not be effective if only breaches where a party was guilty are applied. In the German system there is a variety of other

[15] Lord Bingham, Dr. Günter Hirsch, *German Law of Contract, Comparative Tretise*, Oxford and Portland, Oregon, 2006 second edition, p.387
[16] Ibid.
[17] Lord Bingham, Dr. Günter Hirsch, *German Law of Contract, Comparative Tretise*, Oxford and Portland, Oregon, 2006 second edition, p.445

means which come first in queue before damages can even be claimed. Moreover, nothing precludes, for instance, English courts from applying the concept of force majeure when it is clear that the party in breach is not liable for the consequence under the contract.

The conclusion is that the fault principle, even if not expressly stated in the legislation, in one form or another is applied practically in every legal system in order to grant justice in courts' decisions. However, in Germany it reached the peak of its development and was named as the major concept in the doctrine of liability in German contract law.

1.2.2 Intention and Negligence in the Concept of Fault

According to the theory of law, *fault includes two aspects:* ***intention and negligence***. Obviously, a party will answer for any intentional breach, but what is more important – even negligent behavior will lead to the same result. One more significant observation is that BGB does not imply fault requirement to other types of remedies, such as termination or price reduction. The article which embodies the fault rule and defines the meaning of negligence under the BGB is 276[18]:

Responsibility of the obligor

(1) The obligor is responsible for intention and negligence, if a higher or lower degree of liability is neither laid down nor to be inferred from the other subject matter of the obligation, including but not limited to the giving of a guarantee or the assumption of a procurement risk. The provisions of sections 827 and 828 apply with the necessary modifications.
(2) A person acts negligently if he fails to exercise reasonable care.
(3) The obligor may not be released in advance from liability for intention.

In order to qualify the breach of contract as **intentional**, it is necessary to establish the fact of *knowledge* by the party in breach of the information related to the contract. However, the mere knowledge of this information can not itself be the evidence of intentional breach. The second important factor should be the *desire to commit the breach* which is expressed in certain actions. That is why, the first defense by the breaching party will be the ***claim of ignorance*** concerning the

[18] http://www.gesetze-im-internet.de/englisch_bgb/german_civil_code.pdf Access: 12.03.2012

relevant facts.[19] If this claim is satisfied, the party will be excused by the court. The second defense will be to claim the existence of ***mistake of law or mistake of fact.***[20] *Mistake of law* will take place if a party was sure that refusal of performance will be justified by statutory provisions. However, a party will take a high risk acting this way, because a court will assess its action from different angels and there is a big probability to find itself liable in the court's decision.

The mistake of fact happens when a party did not evaluate the situation correctly. It can be also combined with partial ignorance concerning the facts related to the contract. A good example will be a situation when one party rents a car which is supposed to be in perfect condition and it appears that there is a leak in it, which makes the usage quite inconvenient. In this case the second party will fail to recover damages for untimely repair because the first party was not notified about the fact of the leak.

1.2.3 Reasonable Care Standard

The paragraph 2 in article 276 of BGB states the important requirement for the rule of negligence – ***reasonable care standard***. Courts usually apply the test in which they compare the level of care applied by the defendant with the level stated in a contract or a statute, or even with standards which are usual to a particular business.[21] Probably, the excuse for the lack of care can be an impediment which was impossible to overcome, such as sudden illness or force major. However, in such a case the defendant should provide evidence that it was impossible to find the substitute for his performance by the third party,[22] because in this case he will breach the rule of mitigation of loss caused by a breach.

[19] Lord Bingham, Dr. Günter Hirsch, *German Law of Contract, Comparative Tretise*, Oxford and Portland, Oregon, 2006 second edition, p. 447
[20] Ibid.
[21] Lord Bingham, Dr. Günter Hirsch, *German Law of Contract, Comparative Tretise*, Oxford and Portland, Oregon, 2006 second edition, p. 448
[22] Ibid.

1.2.4 Exceptions From Fault Principle in German Contract Law

In some situations the application of the fault principle will be unreasonable. Usually such cases include strict liability to the defendant. They can be classified the following way:[23]

- money debts;
- delivery of generic goods;
- inclusion of strict liability term into a contract;
- the occurrence of impediment to performance when the debtor was in default;
- cases with strict vicarious liability.

The comment should be made concerning the impossibility to excuse the party in breach in case *non-delivery of generic goods*. The reason of such approach taken by the legislator is the availability of such goods on the market. It is hard to assume the situation that one party will not be able to buy a certain amount of, for instance, rice or potato. Even if the supplier refuses to provide the generic good, it will still be available from other sources. That is why inability to obtain it would be fully the fault of the party in breach. However, courts should be careful in assessment of particular goods concerning their uniqueness. For example, certain types of wheat are considered to be particularly rare and therefore difficult to get. In such cases there is a chance that the court will not apply the rule of strict liability due to the fact that it was objectively impossible to obtain the stipulated in the contract goods. Still, the party in breach should provide evidence of attempts to mitigate the loss trying to find a substitute. The issues of vicarious liability and liability for money debts will be discussed further.

At the same time it is possible under German law to *lower the level of liability*. It happens in case of:[24]

- terms in a contract which decrease the standards of care;

[23] Ibid.

[24] Lord Bingham, Dr. Günter Hirsch, *German Law of Contract, Comparative Tretise*, Oxford and Portland, Oregon, 2006 second edition, p. 451

- the application of provision in BGB for certain types of contracts (so-called light negligence);
- as the result of improper conduct of creditor himself;

It should be noted that there are certain contracts, such as contract of donation[25] which induce one party to higher level of performance than the second one. That is why, in order not to shift the balance to the benefit of the second party, the legislator granted the first party the lessened or in other words ***light negligence liability***. This rule gives an excuse to the party in the case of minor breaches with obligatory requirement of absent intention to breach.

It is interesting to compare the German approach with *Ukrainian provision* which governs the decrease of liability of the party in breach.[26] Article 219 of the Economic Code of Ukraine states three situations:

- founders of economic entity are not liable for entity's obligations;
- in the case that the acts of another party were the cause of breach;
- if the circumstances of limitation (or even exclusion) of liability are foreseen in a contract.

In all other cases the article imposes the full liability for the obligor. At the first glance it may seem that the main difference between Ukrainian and German approaches is the *exhaustive list* of cases when the liability can be lessened in Ukraine, in contrast with the possibility to apply decreased liability to certain contracts, regulated by BGB. However, common sense induced the Ukrainian courts to apply the German approach and grant the lessened liability to such agreements as a donation contract.

The second difference is the opportunity not just to decrease the liability, but expressly mentioned in the article full *exclusion of liability upon parties' consent* in a contract. The provision that founders of an economic entity are not liable for its obligation, though not mentioned in the relevant article of BGB, is implied on the bases of German corporate law.

[25] http://www.gesetze-im-internet.de/englisch_bgb/german_civil_code.pdf Access: 12.03.2012
[26] Article 219 Economic Code of Ukraine

1.2.5 The Problem of Initial Impediment

One more important provision is given in article 311a II BGB: [27]

Obstacle to performance when contract is entered into

(2) The obligee may, at his option, demand damages in lieu of performance or reimbursement of his expenses in the extent specified in section 284. *This does not apply if the obligor was not aware of the obstacle to performance when entering into the contract and is also not responsible for his lack of awareness*. Section 281 (1) sentences 2 and 3 and (5) apply with the necessary modifications.

A good example of this rule will be the situation when there is a sales contract of a picture, and the picture was destroyed after the contract was formed. Zimeermann in his report rightfully alleges that in this case the seller can become liable for lack of care under the contract. In contrast, if there was no contract yet and the painting was also destroyed – the seller will not be held liable because the initial impediment existed before the moment of contract formation. [28]

To conclude, the approach of the German legislation is specifically oriented on performance in specie. However, the role of damages is also not minor. If the performance is not a fair compensation in case of a breach, then, in compliance with the principle of fault, damages can become the substitute.

1.3 Ukrainian Approach to Damages

The Economic Code of Ukraine places the concept of damages among economic sanctions in the chapter dedicated to liability for economic offences.[29] It is worth mentioning that the Ukrainian legislator avoided the word "damages" and used instead the term **"compensation for losses"**. In fact, this was done on purpose to emphasize the main role of damages in Ukrainian legislation –

[27] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012

[28] Reinhard Zimeermann, *The Harmonisation of European Contract Law Implications for European Private Laws, Business and Legal Practice*, Oxford and Portland, Oregon, 2006, p.77

[29] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012

compensatory. In order to understand the perception of the idea of damages in Ukrainian legislation it is important to discuss the notion of **losses.** They include:[30]

- expenses of the innocent party;
- loss or damage of property;
- lost profit ("profit that would have been received in case of due performance or compliance with good business practices by the other party").[31]

It is necessary to state that in the structure of remedial system of Ukraine damages take important but not the primary place. Still, a court will first observe the possibility to order the *specific performance* or other types of remedies. The developed scheme of *penal sanctions* enables courts to apply fines, forfeit and interest along with *administrative kinds of remedies*, which sufficiently ease their work. The reason is that the granting of damages needs deep assessment of the facts in a case (excluding the situation with liquidated damages), while fine or forfeit are already stated in the legislation or in the contract.

From the point of view of a common lawyer the damages in Ukraine are divided on **compensatory** and **consequential** ones. **Compensatory damages** include direct loss from the breach (expenses of the innocent party and loss or damage of property), while **consequential damages** embrace the lost profit from the deal incurred by the innocent party. However, it is necessary to say that the fundamental provision of article 224 of Ukrainian Economic Code is diversified by other provisions in the code itself as well as in Ukrainian laws in general. For instance, the drafters of the law separated the *compensation for moral damage*[32] which will be discussed further.

Moreover, the code expressly allows the application of **liquidated damages**:[33]

On mutual agreement, the parties of economic obligation shall be entitled to the ***right to agree the amount of losses*** to be compensated in the form of lump sum or interest rates depending on the amount of unfulfilled obligation or term of the delay in advance

[30] Ibid.
[31] Ibid.
[32] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012
[33] Ibid.

1.3.1 Losses vs. Damage

It is very important not to be confused by the terms **"losses"** and **"damage**". Ukrainian theory of law strictly divides these two notions: the term *"damage"* includes tangible and intangible characteristics, while the concept of losses covers only *tangible kind of damage*. The test which is usually applied by courts is that losses incurred by the party should have monetary expression and be real. The should constitute the objective fact which can be proved by evidence.

At the same time losses themselves are divided into two types:

- ***positive losses***, (direct losses), which have already being suffered by the party before the trial;
- ***lost profit***, which could have been obtained by the party if the contras was performed.

This means that intangible damage is usually not recoverable under the contract law. However, where it is possible to assess such damage in monetary sense, a party is not precluded to claim it. We will come back to this issue in discussion of damages for mental distress.

1.3.2 Recourse for Losses

Furthermore, the Ukrainian legislator provided the procedure of **recourse for losses** covered by debtors.[34] The debtor which compensated the creditor in the case of joint liability has a right to claim the compensation from other debtors. Basically, he steps into shoes of a creditor in his claim.

An interesting peculiarity of Ukrainian approach is that, while private parties have the *right* of recourse, communal or state enterprises are *obliged* to do it[35]. Moreover, when the employees of these enterprises caused the damage, not only contract law, but also labor law is applied. The main reasoning of such policy imposed by the law is the necessity to protect the property of the state.

[34] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012
[35] Ibid

Here the dispositive method will lead to the temptation of administration in a state or communal enterprise not to apply any sanctions, because the property is not private and there is no incentive to protect it. Only imperative method will guarantee that in case of every breach, which led to losses in state or communal property the state's interest will be secured. Otherwise, the liability up to criminal can be applied.

To sum up, while the main emphasis in the Ukrainian remedial system is made on specific performance, damages continue to play here a crucial role. The new Economic Code introduced three of the most important forms of damages which cover almost all possible types of losses: compensatory, consequential and liquidated. In fact, there was no need to include more sophisticated and specifically oriented kinds of damages which exist in common law countries. The reason is quite logical – there are a large number of other remedies to fulfill this task, including, but not limiting to: fines, penalties, and administrative sanctions, applied in commercial law.

Chapter 2 Compensatory Damages

The main role played by damages is, undoubtedly, to compensate loss suffered by an innocent party under the contract. This is why it is so important to analyze this type of damages in depth. In this chapter we will see that despite fundamental differences in legal doctrine and application in real life, the basic principle of compensation remains common for every system.

2.1 Application of Compensatory Damages in the Anglo-American legal System

It will be fair to start the analysis from the system where the concept of damages is developed the most, and for sure, the US and England are the best examples possible. The most important rules in the Anglo-American legal system are:

1. C**ompensatory damages** are damages which *directly follow from the breach* of a contract.

3. Their **primary aim** is to *compensate the innocent party for losses* which it incurred and put into position it would have had if breach had never happened.

2. They are usually calculated by a court as the *difference between the value of promised performance* and the v*alue of actual performance*.[36]

Bearing in mind the rules mentioned above, let us assume the following hypothetical: the parties agreed to paint the house for 250$. Suddenly, one party breaches without a plausible explanation. The aggrieved party seeks a substitute and concludes a new contract for 300$. Usually, the innocent party can recover the difference between the two contracts (300$ - 250$ = 50$).

One of the best scholars in the area of contract law, the receiver of a knighthood for services in law, Guenter Treitel, in his book "Remedies for breach of Contract" described 6 principles which characterize the nature of compensatory damages:[37]

[36] Roger LeRoy Miller, Gaylord A. Jentz Business law 338 Business Law Today: standard edition, South-Western, Cengage Learning, 2010, p.338

- they should not exceed the loss (otherwise, the mere compensation will be transformed into a penalty);
- plaintiff must suffer loss (if there is no actual loss, only nominal damages can be claimed);
- compensatory damages do not limit application of other damages;
- expectation interest should be protected;
- they cover loss suffered exactly by the claimant and nothing else.

The last principle should be explained in more detail. In fact it is applied with the rule that only actual loss suffered by the plaintiff will be compensated. The core of it is the following: when a party in breach refuses to perform its obligation under the contract in order to be involved in another one, the application of compensatory damages can not include the benefits the breaching party will receive under the new contract.[38] For example, if the defendant cancelled the sales contract to sell the same product for triple price to the third party, he will not be required to pay the innocent party the difference between the prices in these two contracts. Most likely, he will be obliged to pay the difference between the price of the contract and the price of such goods on the open market.

2.1.1 The concept of Incidental Damages

If the situation is more complex, and the innocent party incurs expenses connected with the search for a new contractor, the aggrieved party can claim **incidental damages** too. They are post-breach damages which the party can claim for incidental costs it had in reliance to the contract.[39] They can include, for instance, the payment for storage of goods which was necessary to prevent them from deteriorating.

[37] Treitel, *Remedies for breach of contract, a comparative account,* Oxford University Press, 1992, New York p. 75
[38] Ibid.
[39] Martin A. Frey *An Introduction to the Law of Contracts,* West Legal Studies is an imprint of Delmar, a division of Thomson Learning, 2000, 3-rd edition, p.378

In Ukrainian legislation incidental damages are included in the concept of "***additional expenses***".[40] The legislator made an open list for such economic losses and included there, for instance, penalties paid to third parties because of the breach of a contract.

An interesting issue described by Turner in his book "Contract law" is the situation when **claimant's ability to make profit is altered.**[41] The author demonstrates through two simple examples that the same set of facts, with the only difference in the capacity of the seller to sell the car can change the result to the opposite. He mentions the situation when the seller of the car contracts the buyer and the latter subsequently breaches. If the model of the car is popular and for the seller it will not be difficult to find another buyer, the only remedy will be nominal damages. If, however, the car did not win the price "the choice of consumers" and not many people are willing to buy it, then the seller can rightfully receive the full amount of damages.

Following Turner's logic, the second situation could be related to the **possibility to obtain the goods from other sources**. For example, the seller is in breach and the buyer claims for damages. If the car is unique, such as 1970 Porsche, the buyer will be granted compensatory damages in full because it would be difficult or even impossible to find the car with the same qualities. In contrast, if the model of the car is popular and can be easily bought from other sellers, the damages for breach will be either nominal or incidental, which will cover the expenditures to find another seller.

2.1 Law as a price – compensatory damages prospective

One more question should be raised - the problem of **law as a price** in relation to compensatory damages. As was discussed above concerning the issue of specific performance, some business actors prefer to cross the line and breach a contract in order to be better off. The trick is that sometimes such an approach *brings no harm* and can be even *beneficial for society* as a whole. A good hypothetical case could be if one party agrees to sell an old car for 1000€. Suddenly, a third party appears and is willing to pay 15 000€ for the same car because it is very rare and will pass

[40] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012
[41] Chris Turner,*Contract Law,* Hodder Education, 2007, second edition. p. 207

well to a third party's collection of unique cars. Obviously, in order to conclude this exceptionally beneficial contract, the first party should commit a breach. Most probably, it will be required to pay the compensatory damages and incidental (if the second party tries to find another car) and even consequential (if breach of the contract will preclude the second party from some profit). However, it will almost certainly not exceed the contract price of 1000€. Therefore, for both parties it will be at least not detrimental. For the third party it will definitely lead to benefit because it will have what it wants. For society as a whole it will also be quite beneficial because the rare object of particular value was preserved from being used improperly.

As a summary, it should be noted that despite the whole variety of damages available in the Anglo-American contract law doctrine, the concept of compensatory damages remains the most important. The reason of such significance is that the main aim of damages in general is to compensate the party for the particular losses it incurred in the concrete contract. Certainly, the idea of compensatory damages lies exactly within this principle.

2.2 Compensatory Damages: German Law Perception

While analyzing the German way to govern this type of damages, we should bear in mind the major principle of German Contract law – **damages are the secondary right** which is usually exercised when specific performance is not available or is unreasonable.

The second important principle is that **damages are calculated on the basis of loss** and usually can not exceed it.[42] Moreover, they are not used in the way of penalties and German courts are exceptionally hostile to executing foreign judgments to grant punitive damages.[43] This principle describes the core element of German theory of damages – they are a **compensatory remedy**.

[42] Lord Bingham, Dr. Günter Hirsch, *German Law of Contract, Comparative Tretise*, Oxford and Portland, Oregon, 2006 second edition, p.443
[43] Ibid.

However, it is remarkable that while prohibiting punitive damages, the German law expressly supports the application of penalty clauses. Article 339 of BGB [44]states:

Payability of contractual penalty

Where the obligor promises the obligee, in the event that he fails to perform his obligation or fails to do so properly, **payment of an amount of money as a penalty**, the **penalty is payable if he is in default**. If the performance owed consists in forbearance, the penalty is payable on breach.

In fact this approach is absolutely opposite to the Anglo-American legal system, where *penalty clauses are forbidden* and if liquidated damages are too excessive they are also equated to penalties.

Such discrepancies in remedial policies, causing no significant problems on the national level, introduce some misunderstandings internationally, when the question comes to implementing foreign courts' judgments. Most probably, in the future increasing globalization and strengthening of cooperation of judicial systems in order to regulate the activities, for instance, of international corporations, will lead to unification of these two approaches.

The **aim of damages** in German law is to put the creditor in the position she would experience if the contract would be performed fully.[45] In the doctrine of German contract law this principle is called *"the protection of expectation interest"* or *"Erfüllungsinteresse Verteidigung"*[46].

The main conclusion which follows from the German approach to damages is that they are **compensatory** in their nature with few exceptions, such as damages for loss of profit, which will be discussed later.

2.2.1 Damages in lieu of performance

The first type of compensatory damages is **damages in lieu of performance**. Scholars define three cases when they are usually applied:[47]

[44] http://www.gesetze-im-internet.de/englisch_bgb/german_civil_code.pdf Access: 12.03.2012
[45] Mathias Reimann, *Introduction to German Law,* Kluwer Law International, 2006, p.17
[46] Lord Bingham, Dr. Günter Hirsch, *German Law of Contract, Comparative Tretise*, Oxford and Portland, Oregon, 2006 second edition, p.442
[47] Mathias Reimann, *Introduction to German Law,* Kluwer Law International, 2006, p.17

1. When a debtor is at fault and performance is impossible.

2. When the performance of a debtor actually violated particular ancillary duties. For example, where the defendant agreed to paint the wall in the apartment of the claimant, and during his performance painted not only the wall but furniture as well. The damages will be the costs for new furniture.

3. When a debtor did not perform, and performance is still possible. In this case there is an obligation from the side of a debtor to grant a reasonable period for the debtor to perform.

A very important feature which marks out compensatory damages in German contract law is the obligatory **reasonable period for specific performance**. The main idea is to give the second party a chance to perform again. In comparison, the Ukrainian remedial system, which is also continental in its nature, does not have such principle. In fact, it is hard to judge which approach is better, because the pro-debtor rule of law, granted by the German system, imposes the additional burden on the innocent party which in case of non-compliance may be claimed to commit the breach itself. However, this policy definitely increases the percentage of performed contracts, even though as a result of the second attempt.

At the same time, the ***Nachfrist principle***, as the reasonable period of time to perform is called in German law, does not cover the loss which could not be recovered by the timely performance.[48] The main reasoning for this provision is the following: in the case when even performance in time can not guarantee the absence of loss, it will be pointless to make everything even more complex by imposition of the additional period of time, which from the very beginning will not improve the situation.

One more aspect which is raised in article 281of BGB is the *difference between partial performance and full performance* connected with the interest of the party to perform. If the performance is *partial*, then the aggrieved party can demand compensatory damages only if it has no interest in

[48] http://www.gesetze-im-internet.de/englisch_bgb/german_civil_code.pdf Access: 12.03.2012

partial performance.[49] This provision is quite logical because the main principle of priority of performance in specie is preserved: where the party is deemed to *have an interest* in partial performance (which can be concluded not only from its allegations, but also objectively from the previous practice and character of the business), the application of damages should be *excluded*.

The situation becomes even more sophisticated through implementing the next provision in article 281 concerning the *degree of breach*. If the breach of duty is immaterial, the obligee can not claim damages in lieu of performance.[50] This set of requirements even more narrows the granting of damages, adding the speculative term *immaterial breach*. The assessment of this category is made by a court through evaluation of facts of a particular case. As a result, article 281 of BGB is a powerful filter which sorts out as strictly as possible all kinds of breach which can be fixed by specific performance, and only if all conditions are met, a court will apply the remedy of damages.

It should be noted that along with protection of expectation interest (putting the innocent party into the position it would have had if a contract had been performed) the German law gives a party a choice to secure its **reliance interest**:[51]

Reimbursement for wasted expenditure

Instead of demanding compensation in lieu of performance, *the obligee may demand reimbursement of the expenditure which he has incurred in* ***reasonable reliance*** *on the receipt of performance,* save where the purpose of that expenditure would not have been achieved even if the obligor had not breached his duty.

This provision allows the innocent party to recover any expenditure the party incurred in reliance to the contracts. In fact, they are in general alike the *reliance damages* in Anglo-American legal system and have some similarity to *additional expenses* in Ukrainian legislation. All three types of remedies make it possible for an aggrieved party to obtain the same position it had before the contract was concluded.

[49] Ibid.
[50] http://www.gesetze-im-internet.de/englisch_bgb/german_civil_code.pdf Access: 12.03.2012
[51] Ibid.

However, this concept should not be confused with **incidental damages**, which are claimed for any loss *directly incurred because of breach of the contract*, for instance searching the performance from another source.[52] Reliance damages, in contrast, are the compensation for actions of the innocent party in reliance to the contract, such as preparation for performance. In fact, the Ukrainian legislation does not divide these two categories and unify them in one concept of *additional expenses.*

2.2.2 Damages for delay in performance

In the situation when the performance can be made (lack of impossibility), but a debtor nevertheless fails to perform timely, the innocent party can claim the special type of damages – **damages for delay**. Article 286 of BGB states:

> If the obligor, following a ***warning notice*** from the obligee that is made after performance is due, fails to perform, he is in default as a result of the warning notice. Bringing an action for performance and serving a demand for payment in summary debt proceedings for recovery of debt have the same effect as a warning notice.

As we can see, the formal requirement to the innocent party for claim of damages for delay is the so-called **warning notice (Mahnung).** The aim of such notice is to inform the party that performance is required. In fact, this provision is closely connected with the fault principle of German law. If a person did not know about the requirement to perform, it can not be guilty. That is why, Mahnung establishes the formal act of notification of the breaching party and guarantees that non-performance will occur only in case of fault, whether negligence or intention.

An excellent example concerning the issue of the form of the waning notice was given in the book "German Law of Contract – a Comparative Treatise". There the defendant alleged that Mahnung made by the claimant was void on the basis that it was done *in the form of poem*.[53] The decision of the court was even more shocking – it was expressed as the poem too! This example showed that

[52] Roger LeRoy Miller, Gaylord A. Jentz Business law 338 *Business Law Today: standard edition*, South-Western, Cengage Learning, 2010, p.338
[53] Lord Bingham, Dr. Günter Hirsch, *German Law of Contract, Comparative Tretise*, Oxford and Portland, Oregon, 2006 second edition, p.465

the form of Mahnung should not have any requirements except the specific application to a concrete person.

One more important rule concerning the damages for delay is that they ***do not prohibit the performance in specie***. This is not expressly stated in German legislature, but it is implied through the absence of notion to exclude the specific performance. This is especially favorable to the position of an innocent party, who is not limited to the mere execution of promised act, but also has a right to recover losses incurred in the course of delay.

Probably, there is no better example of an application of compensatory damages in continental legal system than that of Germany. Having the secondary role, they nevertheless effectively regulate the situations where compensation for direct losses is needed and performance in specie is not possible or is undesirable. Certainly, several peculiarities, such as the obligatory requirements of ***Nachfrist principle*** *and* ***Mahnung*** can lead to confusion for a lawyer, trained in a common law country. That is why it is extremely important to be aware of these differences in order to successfully work in the German legal environment.

2.3 Compensatory Damages in Ukraine

As the secondary remedy in the Ukrainian legal system, following the German approach, the main purpose of damages remains to be the **compensation for losses**. In fact, this is the main reason why the legislator decided to use exactly this term referring to monetary compensation instead of the word "damages" throughout the whole Ukrainian legislature.

Article 224 of the Ukrainian Economic Code defines two types of damages which have a compensatory nature:[54]

- expenses of the rightful party in relation to breach of a contract;
- loss or damage of its property;

[54] Milash, *Commercial Law of Ukraine*, Pravo, 2007, p. 143

Article 225 of the Economic Code of Ukraine provides the *instruction for calculation of damages*.[55] The basis of the calculation are the prices which existed at the location of the performance or, if there was no performance, on the date of filing the suit on compensation for losses. Moreover, this article gives power to the Cabinet of Ministers to adopt methods of calculation in the economic sector, which is novel in Ukrainian contract law.

2.3.1 The Issue of Notification

The essential provision in the Economic Code of Ukraine is the issue of **notification**. However, in Ukrainian legislation in contrast to German, the requirement of notification is put on a party in breach. Contrary to Mahnung, "the *party that has breached* its obligation or is sure to breach it on the performance date *shall immediately notify* thereof the other party. Otherwise it shall lose the right to blame the innocent party for not taking measures for prevention of losses and the right to demand the reduction of the amount of losses."[56]

Moreover, if, in case of rightful notification, the *second party failed* to prevent losses which could be prevented, this party will *lose* its right to damages.[57] The Ukrainian legislator shifted the burden of first reaction to the breaching party, but preserved the justice through imposition of obligation to timely act in order to mitigate possible losses to the second party.

Among all the legal systems discussed, the approach taken by the Ukrainian legislator is the most generalized. The main idea is to give the right to courts to apply the monetary compensation in appropriate cases. This way of relaxing the regulation gives space to implement other types of remedies, such as specific performance and different kinds of penalties.

[55] Kravchuk, *Economic Law of Ukraine*, Kondor, 2003, 364
[56] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012
[57] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012

Chapter 3 Specific Types of Damages

Obviously, the role of damages is not limited to mere compensation for direct loss related to breach. The development of legal doctrine, especially in common law jurisdictions, introduced more complex types of remedial instruments which are used to protect specific rights and interests of an innocent party. However, the civil law countries, particularly Ukraine and Germany also included types of damages which purpose goes beyond the mere compensation. This chapter contains the comparative analysis of the legal mechanisms applied by analyzed countries.

3.1 Consequential damages

The concept of consequential damages regardless of their name in different legal systems is the same: to ***compensate a party for the foreseeable, not direct losses*** which it incurred in relation with the contract. Let us analyze more deeply how this type of remedy is regulated in the Anglo-American system, German and Ukrainian law.

3.1.1 Anglo-American approach to consequential damages

In fact, courts quite actively apply this kind of damages in Anglo-American legal system. The possible example can be the situation when one party sells products to another one, which itself is a seller. In case of breach the second party will definitely lose the profit from the bargain which was not closed. Definitely, the second party may claim damages from the defendant to compensate the lost profit – **consequential damages**, or how lawyers call them, **consequentials**[58].

However, real-life situations are much more interesting. In order to better understand the nature of this kind of damages, let us examine three extremely important cases. The first one is the famous *Spartan Steel Alloys vs. Martin Co.*[59] Here a stainless steel factory used in production the electricity from a particular power station. The defendant was doing ground works nearby and accidentally

[58] Michael G. Bridge *Good faith and fault in contract law,* Claredon Press Oxford 1995, p.451
[59] http://www.bailii.org/ew/cases/EWCA/Civ/1972/3.html Access: 19.03.2012

damaged the cable which connected the station with the claimant. Consequently, the production was postponed for 15 hours. The claimant alleged that he was entitled to:

- compensatory damages for defective metal which was in the process of production when the electricity went down;
- loss of profit from selling of the metal;
- loss of profit which could be made by the factory from other melts during the time of standing idle;

Finally, the court refused to grant the third group of claims on the ground that it was too remote.

The second case is no less famous *Victoria Laundry vs. Newman Industries*[60]. In this case a laundry contracted to buy the boiler. The seller delayed in delivery, and the claimant required damages for:

- loss of profit which could have been got from new orders to laundry during the standing idle;
- loss of profit from the contract with the government which could have been concluded if the boiler had been delivered in time.

The court held that it would be unfair to make the defendant pay for the deal which *was totally unforeseeable* at the moment of conclusion of sales contract. At the same time the first claim was quite predictable because the laundry constantly took orders from its clients in the usual course of business.

Probably, the most well-known case is *Hadley vs. Baxendale.* In fact, this case is considered to be the first one which raised the issue of consequential damages on the world level. Here the crankshaft needed for the mill to operate properly was broken. The claimant hired the defendant to transport the broken crankshaft in order to repair it. Unfortunately, there was a delay on the side of the defendant, and the mill was closed during that time. The claimant sued for loss of profit for the

[60] http://www.legalmax.info/members2/conbook/victoria.htm

duration of standing idle. In order to understand the case right, it should be noted that mills usually had the second crankshaft exactly for the case of break. The claimant did not have the second one in reserve. The main question which appeared before the court was, as in previous cases, the ***issue of remoteness***. Everything depended on whether the defendant was aware of the claimant's impossibility to work in case of defendant's delay. The court concluded that the defendant was ignorant of this fact. Therefore, the ruling of the court was that the defendant was excused from payment of consequential damages.

From the cases discussed above the natural conclusion will be that the **remoteness of loss of profit** is the major factor in granting consequential damages. As legal practice shows, if the loss appears to be too remote, a court will most probably reluctant to award this remedy.

3.1.2 Germany: Consequential Damages

The most important article which regulates the application of consequential damages is article 252 of BGB:

Lost profits

The damage to be compensated for also comprises the lost profits. Those profits are considered lost that in the normal course of events or in the special circumstances, particularly due to the measures and precautions taken, *could probably be expected.*

The German legislator also expressly relied on the principle of remoteness of loss, stating in 252 BGB that it should be expected at the moment of contract formation.

However, the approach of German courts to cases related to granting the damages for lost profit differs from the Anglo-American reasoning. A good example will be a standard case where a wine dealer concluded the contract of sale and the buyer subsequently refused to take delivery.[61] Usually, the damages would be the difference between the contract price and the market price. However, in this case the seller managed to sell the wine to other buyer for the same price. Therefore, no actual loss was suffered. In such situation it is hard to claim damages for lost profit, because objectively it

[61] Roger LeRoy Miller, Gaylord A. Jentz Business law 338 *Business Law Today: standard edition,* South-Western, Cengage Learning, 2010, p. 481

was not lost. Probably, it would be wise to claim incidental damages for finding new contractors or reliance damages when some preparation under the contract was done by the seller. But the fact is that the claimant went further and required consequential damages, alleging that his new customers could have bought another portion of wine, and therefore, the loss of profit existed. The court ruled that according to the article 252 of BGB, the defendant could have expected that the claimant would lose the profit. Therefore, the loss is not remote and consequential damages should be granted. Most probably, that American or English court would reach another conclusion in the same case.

3.1.3 Consequential Damages: Ukrainian Perspective

Article 224 of the Economic Code of Ukraine includes among other kinds of damages **"profit that could have been received"** – which is nothing less than ***consequential damages***. The doctrine of Ukrainian contract law developed the open list of losses which a party may incur in relation to this issue:

- decrease in the rates of production;
- decrease in sales of products/rendering of services;
- forced change in products' assortment;
- deterioration of products etc.

The definition of the **loss of profit** in Ukrainian law is the following: "it is the design value of decrease in the expectation increment in property, based on the data of accounting which objectively evidences in favor of possible incomes which could be received by the aggrieved party."[62]

The loss of profit in Ukrainian legal doctrine has two types:[63]

- direct loss of profit for every unit of performance resulting from decrease in rates of production or forced change of assortment;

[62] Knishkevich, *Commercial Law of Ukraine - practical guidance*, Kneu, 2005, p. 362
[63] Mamutov K.L. *Commentary to Ukrainian Economic Code,* Pravovi nauki*, 2008, p. 354*

- average loss of profit due to increase in price of production because of decrease in rates of production or forced change of assortment.

In summary, despite particular differences in approaches, Ukrainian legislation perceives the issue of consequential damages similarly to German and Anglo-American legal systems.

3.2 Punitive Damages

The most important notion to be said at the very beginning is that **usually punitive damages are not granted within the limits of the contract law**. Still, due to their importance, we should discuss this type of damages too. The most frequent case when punitive damages, nevertheless, take place is the situation when the cause of action is combined with the *action in tort.*[64]

A very informative case concerning this issue is *Constantine vs. Imperial Hotels.*[65] Here the cricketer tried to book the hotel, but the administration refused to provide its service on the ground of race. Clearly, there was tremendous injustice in such actions, but the court granted only nominal damages because no monetary loss was suffered. Punitive damages were not granted because according to court's approach, a breach of a contract is not a crime. This case took place in 1944, and there is no need to explain that discrimination policy changed dramatically from that time: discrimination on the basis of race, origin or religion is abolished in all civilized countries. Most likely, nowadays punitive damages would be available in a similar case because the hotel administration would breach not only the obligation in contract law, but also will be held liable for an offence of discrimination on the grounds of race. This would lead to double action in contract and in tort, which would open the gate for punitive damages.

In ***German legal system*** the concept of punitive damages is not used at all. Moreover, courts try by any means to avoid recognition of foreign judgments, which was already discussed above.

[64] Roger LeRoy Miller, Gaylord A. Jentz Business law 338 *Business Law Today: standard edition,* South-Western, Cengage Learning, 2010, p. 343

[65] Samuel Geofrey *Law of Obligations and legal remedies,* Cavendish Publishing Limited, 2001 second edition, p.204

The ***Ukrainian legal system*** does not have such a mechanism as punitive damages. At the same time the legislation allows the application of **administrative economic sanctions**.[66] Their role is similar – to punish the defendant for particularly outrageous action. The first difference is that, contrary to punitive damages, they are freely used in the area of contract law. Secondly, that they are applied not only by courts, but by other state bodies. In addition, all money received from a defendant is directed not to a claimant, but to the state budget. We will look into this issue more deeply a little bit later.

3.3 Nominal Damages

The concept of nominal damages is applied in the Anglo-American legal system. The aim of this remedy is not to compensate the loss, but to obtain the formal judgment from a court that there was a breach on behalf of a second party.

Usually, a court grants small sums of money, such as 1$ in order to comply with the formal requirements of damages – granting of monetary compensation from the breaching party to the aggrieved. One of the most important requirements for this remedy is the absence of loss. This situation most often happens in sales contracts. For instance, one party agrees to sell an oven to the other and the buyer later refuses to perform his part of the obligation. If the second party sells the oven to another contractor for higher price, it will actually be better off. If the seller claims damages, a court will usually grant only nominal ones due to the absence of loss.

In fact, the closest remedy to nominal damages in German law is a comparatively rarely used ***declaration*** *by a court*. Claiming the declaration, an aggrieved party needs to obtain court's formal opinion concerning the facts of a case which will declare the fact of breach on the side of a second party. It does not grant any remedy except a legal opinion on a particular legal issue. However,

[66] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012

courts are reluctant to provide the sole declaration and usually grant this type of remedy along with traditional remedies within one proceeding.[67]

3.3.1 The meaning of declaration in the Anglo-American system

The **declaration** is used as an ***equitable instrument in the Anglo-American system***. However, it has three main differences with German approach. First, it is frequently used not to obtain the statement of breach, but to clarify the concrete situation from the legal perspective.[68] For instance, in *Airdale NHS Trust v Bland* the hospital used this remedy to obtain a decision from the court whether it is lawful to switch off the life support system of a patient whose sufferings were unbearable.[69] The second difference is that in the Anglo-American system the declaration can be used solely. Finally, the mere nature of the declaration in common law system is not remedial. It is the instrument of clarification and nothing more. The reasoning of such an approach is that the Anglo-American system has already the remedy of nominal damages whose role is to state the fact of breach. There is no need to duplicate this mechanism because it will just make the system excessively complex.

3.4 Liquidated damages

The concept of liquidated damages in ***Anglo-American legal system*** is extremely important. As was discussed above, some scholars even classify all damages as liquidated and unliquidated rather than on particular types. This is quite reasonable, because this remedy has the peculiarity which makes it unique – damages are stipulated by the parties themselves at the moment of contract formation and not by a court.

[67] Roger LeRoy Miller, Gaylord A. Jentz Business law 338 *Business Law Today: standard edition*, South-Western, Cengage Learning, 2010, p.541
[68] Samuel Geofrey *Law of Obligations and legal remedies*, Cavendish Publishing Limited, 2001 second edition, p.139
[69] http://www.swarb.co.uk/c/hl/1993airedale_bland.html, Access: 24.03.2012

It is necessary to discuss the main characteristics which damages should possess in order to be qualified as liquidated:[70]

- at the moment of contract formation it was hard or even impossible to predict the damages upon the occurrence of future breach;
- the clear intention of parties to fix a fair compensation;
- the amount stipulated is not disproportionate to possible loss.

The most important issue in liquidated damages is their **fairness**. If a court comes to the conclusion that they are *excessive*, they will be treated as a ***penalty*** and will be abolished. As was already mentioned, the Anglo-American legal system does not permit penalties in contract law, which is opposite to the German approach, where penalties are allowed, but at the same time punitive damages are prohibited. In fact, the relief against penalties was already granted in the early fifteenth century even though the main principles of protection against fraud were still not developed.[71]

A very important case connected to liquidated damages is *Dunlop Pneumatic Tyre Co v New Garage and Motor Co.*[72] Here the court gave an excellent test of assessment whether the clause stipulates truly liquidated damages or application of a penalty:

- extravagant sum of money is always considered a penalty;
- stipulation of large sum in relation to small debt will be a penalty too;
- single sum which applies to numerous breaches will likely be a penalty;
- it does not matter how parties named the clause – only content matters;
- there can be no prohibition of liquidation damages on the ground of impossibility to assess the probable loss at the moment of contract formation.

The ***Ukrainian legislature*** also incorporated the concept of liquidated damages. The Economic Code of Ukraine in article 225 states the following:[73]

[70] Samuel Geofrey *Law of Obligations and legal remedies,* Cavendish Publishing Limited, 2001 second edition, p.382
[71] L.L Fuller and Williwam R. Perdue, Jr. *Contract Law, volume II* Dartmouth publishment, p. 259
[72] Chris Turner,*Contract Law,* Hodder Education, 2007, second edition. p. 210

On mutual agreement, the parties of economic obligation shall be entitled to the *right to agree the amount of losses* to be compensated in the form of *lump sum* or *interest rates* depending on the amount of unfulfilled obligation or term of the delay in advance. Agreement on obligation provisioning limitation of liability by the parties shall be prohibited should the amount of liability for certain type of obligation be set forth by the law.

The approach taken by the legislator is that parties have a choice to agree beforehand on damages which can be calculated in two forms:

- the *lump sum of money* (usually for delay in delivery of goods);
- *interest rates* (used to calculate the compensation, for instance, for a standing idle).

The application of lump sums is quite easy and needs no explanation. Interest rates are usually applied through imposing of an interest per product unit for a particular period of time.[74]

One more very important rule embodied in article 225 of the Economic Code is the *prohibition of any limitations of parties' liability* if it is expressly regulated by law. Otherwise, it would be possible to bypass the obligatory requirements imposed by legislation on particular kinds of activities by merely limiting the liability in a contract. It would undermine the integrity of Ukrainian legislation and hinder its application. The principle of freedom of contract should be limited by the law in appropriate cases.

3.5 Action for debt

As the matter of fact, there is a remarkable unanimity in approaches of all three systems in regulation of such relevant issue as **action for debt**. The main principle, applied in every legal system under analysis is the strict liability of a debtor: he can not be excused for not having sufficient assets to repay his debt.

The position of the Anglo-American legal system was discussed above in the section "Damages versus debt". Therefore, it will be more useful to analyze the approaches of the German and Ukrainian legislations.

[73] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012
[74] Spasibo-Fateeva, General Civil Law of Ukraine, Yourizdat, 2008, p. 388

The ***German law*** perceives this issue not as a compensatory remedy but as a type of specific performance. That is why, the fault principle, applied for damages, does not work here. The debtor is obliged to perform his obligation of repayment regardless of his intention or negligence in breach. There is no excuse for inability to pay too. Moreover, the debtor is required to pay interest in case of delay:[75]

Default interest

(1) Interest is payable on a money debt during the period of default. The rate of default interest is 5% per annum above the basic interest rate.
(2) In the case of legal transactions to which a consumer is not a party the interest rate for claims for remuneration is 8% above the basic rate.
(3) The obligee may claim higher interest on a different legal basis.
(4) The right to claim additional loss is not excluded.

It should be noted that the rate of interest depends on the involvement of a consumer in a contract. We can see that the difference is 3% per annum. This provision protects the position of a weaker party and grants appreciable advantage in consumer's repayments.

The Ukrainian legal doctrine separates two types of obligations which arise in case of indebtedness:[76]

- independent obligation to pay the debt (the duty to return the debt under the credit contract);
- cross obligation (the duty of a buyer to pay for delivered goods).

According to Ukrainian legislature, a debtor along with the obligation to pay damages for breach faces the additional requirement of payment of a fine:[77]

Compensation for losses in case of breath of financial obligations

1. Breach of financial obligation shall not free the participant of economic relations from responsibility due to impossibility of performance, and shall compensate for the losses incurred in connection with non-performance and pay the fine, set forth by this Code and other laws.

[75] http://www.gesetze-im-internet.de/englisch_bgb/german_civil_code.pdf Access: 12.03.2012
[76] Milash, Commercial Law of Ukraine, Pravo, 2007, p. 143
[77] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012

The interconnection between payment of damages for delay and payment of fine is regulated by article 232 of the Economic Code of Ukraine, which states that damages are paid for loss not covered by imposition of a fine.[78] This provision is very important to secure the just use of remedies, because otherwise there would be a chance to require the debtor to pay twice for one breach of an obligation.

Following the German model, the Ukrainian legislation imposes the obligation to pay interest:[79]

Procedure for application of penalty sanctions

4. *Interest for improper use* of the other party's finances shall be charged until the date of repayment to the creditor unless otherwise provisioned by the law or agreement.
5. In case of financial obligation, the debtor shall not pay interest for the creditor's delay.

Contrary to the German approach, it does not matter whether the party in breach is a consumer or a legal person – the interest rates will be the same.

One more peculiarity is the statement that in the case of creditor's delay no interest should be paid on the side of a debtor. The legislator stated several situations when a creditor is considered to be in delay:[80]

- when he refused to take the delivery;
- if he delayed in performance of his obligations under the contract;
- if he failed to comply with the obligatory requirement imposed by the legislation.

That is why, in the case of any situation mentioned above a debtor can rightfully claim the excuse from payment of interest under monetary obligation. Moreover, he is entitled to recover damages in case of any loss caused by creditor's delay.[81]

[78] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012
[79] Ibid.
[80] Ibid.
[81] Ibid.

3.6 Damages for Mental Distress

The major principle in Anglo-American court proceedings is that damages for mental distress in contract law are usually not granted. The reasoning for such an approach is that contrary to actions in tort, where humiliation and severe distress are usually matter of fact, in contract law the relation between parties is of a financial nature. That means that mental suffering, which the party might experience in case of breach, can not be claimed as loss. Otherwise, basically any breach would become the ground for an action for recovery of this type of damages, which would undermine the whole concept of contract law.

However, there are some contracts with a strong connection to party's feelings and emotions. In order to understand their nature, several cases should be analyzed. The first one, *Jarvis v Swann Tours*,[82] dealt with the issue of ***enjoyment in service contracts***. Here the claimant ordered a holiday tour in Switzerland to spend there the Christmas. The brochure, provided by the defendant, stated that there will be several parties, dinner by candlelight and other activities where a lot of participants would be involved. It was also mentioned that the owner of the hotel fluently speaks English and that there will be an opportunity to go skiing in the Alps. Subsequently it appeared that there were other participants only during the first party, there were no special dinners and the owner of the hotel did not understand a word of English. Moreover, the skiing was possible with short types of skis, which caused particular problems for the claimant and significantly lessened his enjoyment. The decision of the court of first instance was quite positivistic. It followed the rule that in the area of contract there is no place for recovery of damages for mental distress. However, the court of appeals repealed its decision and granted this type of damages. In the reasoning it stated that in the particular case the enjoyment was the primary value of the contract, and it would be unjust not to grant the recovery for the claimant who was fully deprived of it.

[82] http://www.bailii.org/ew/cases/EWCA/Civ/1972/8.html Access: 26.03.2012

The second case, *Chaplin v. Hicks,*[83] dealt with the mental distress caused by the ***loss of chance***. Here the claimant was prevented from participating in the final stage of a beauty contest. The court assessed her chances to win as 25%. The issue appeared to be quite speculative in its nature, because there was the probability of 3 out of four that the claimant could have lost in the contest. Nevertheless, the judge ruled in favor of a weaker party, whose rights otherwise would not be protected.

The last case reveals the problem of balance between the right of a claimant to get exactly what was stated in the contract and the excessive costs which a defendant should undertake in this case. In *Ruxley Electronics & Construction Ltd v Forsyth*[84] the claimant agreed with the defendant to build the pool with exact parameters. However, it appeared later that the pool was slightly shallower than stipulated in the contract. The claimant alleged that the pool totally did not meet his expectations and claimed damages in full for rebuilding, which amounted to 21 560 £. The court of the first instance granted the damages for loss of pleasure of 2.500£ because the expertise showed that it was absolutely fit for diving and swimming. However, the court of appeals ruled to grant the 21 560 £, stating that otherwise the interest of the claimant would not be protected. Finally, the House of Lords returned to the amount of 2.500£. The reason was that the purpose of the contract was almost fully fulfilled, and only the difference in performance should be compensated.

The lesson from these three cases is that the application of damages for mental distress is a very tricky question. If the aim of a contract is strongly related to pleasure and enjoyment, then if a party was deprived of it, the damages should be granted. Even the quite speculative situations, where loss of chance takes place, could be the basis to grant this type of remedy. However, courts should rule within the limits of common sense and at least reject claims for destroyed lottery tickets or similar requests, where chances are relatively small. Finally, the equilibrium between the party's

[83] http://www.btinternet.com/~akme/chaplin.html Acces.26.03.2012
[84] http://www.nadr.co.uk/articles/published/ConstructionAdjudicationLawReports/Ruxley%20v%20Forsythe%201995.pdf Acces.26.03.2012

expectations and disproportionate losses should not be distorted because otherwise a party in breach will be excessively punished.

Ukrainian legislature also has a provision which regulates this type of compensation:[85]

> Losses to be compensated by the person who has committed economic offence shall include:
> … material compensation for moral damage in cases provisioned by the law.

The approach taken by Ukraine is to give the freedom of assessment and decision to courts. Several laws also contain provision concerning moral compensation, but they all are very generalized. Probably, the reason for such lack in regulation is that this issue is particularly delicate and the range of possible situations, where this remedy can be granted, is too wide. However, the legislator introduced the lowest threshold for compensation for moral damage which can not be less than 5 minimum salaries.[86]

3.7 Mitigation for Losses

Every analyzed system recognizes the obligation of a party to mitigate the losses under the contract. In fact, both sides of an obligation are exposed to this duty:

- an innocent party should mitigate the consequences of a breach, caused by a breaching party;
- a party in breach should take steps to reduce the amount of loss it made;

For the ***Anglo-American legal system*** the most frequent case where mitigation takes place are in labor contracts. There if a party after being fired did not attempt to find another job, a court will probably deduct from the amount of damages the possible salary the party would have received if it had chosen another position.

[85] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012
[86] Ibid.

The Anglo-American legal doctrine perceived this question from the other side, stating the steps which the mitigating party is not supposed to take:[87]

- actions made other than in the ordinary course of business;
- exposed itself to excessive financial risk;
- destroy or damage its own property;
- negatively affect third parties (for instance, breaching contracts with them in order to mitigate the consequences in another contract);
- harm its commercial reputation.

Having the similar provision with above mentioned, the ***German legislation*** also refers to the interconnection of mitigation with contributory negligence on the side of an innocent party. It developed three rules when the amount of damages can be reduced:[88]

- when a plaintiff failed to reduce the loss if it was possible;
- when there is a contributory negligence (actions of a claimant were the cause or at least contributed to the occurrence of breach);
- loss is unusually high.

In fact, the German law in article 254 of BGB imposes the obligation on an innocent party to warn a breaching party about possible or current loss, while the Anglo-American legal doctrine took a more discretionary approach: there is no obligation, but if a party decides to claim damages, then failure to warn will be taken by a court into account.

The way of regulating this issue, taken by the Ukrainian legislator, while being within the limits of the classical concept applied by Anglo-American system, is slightly different :[89]

[87] http://www.cannonway.com/web/page.php?page=152 Access: 27.03.2012
[88] Roger LeRoy Miller, Gaylord A. Jentz Business law 338 *Business Law Today: standard edition*, South-Western, Cengage Learning, 2010, p.475
[89] http://twinning-water-services.org.ua/en/documents/laws/C-economic_code_UA_eng.pdf Access 14.03.2012

The party under obligation shall be deprived of the right to compensation for losses if it has been timely warned by the other party about possible non-performance and could prevent losses by its acts, but failed to do so, save for the cases when otherwise provisioned by the law or the agreement.

Here the innocent party is deprived from compensation in case of failure to mitigate, but only in aggregate with the requirement to a breaching party to inform it. In contrast to German law, the duty of a party is not to warn, but to personally mitigate the losses.

To summarize, the assumption of the Ukrainian legislator is that a party in breach will warn the innocent party; the approach of German law is that the innocent party should warn the contractor about probable loss, but the fact is that in real life it depends on the situation who will have the relevant information about possible damage. The way these provisions should be interpreted is that both sides have equal obligations to warn and to personally mitigate the loss even if this is not expressly stated in legislation.

3.8 Joint Liability

A crucial instrument which secures the rights of a creditor to receive damages in case when several debtors are involved is the concept of **joint liability**. Every legal system under analysis developed its own tactics to deal with it, but the major principle appeared to be the same:

- in case of an expressed stipulation in a contract that more than one debtor is involved, the claimant can require the payment from any of them.

This rule is embodied in article 543 of the Civil Code of Ukraine:[90]

In case of joint liability of debtors the creditor has a right to claim the performance partially or in full from all debtors or from any particular debtor.

Moreover, this article grants the right to a creditor to claim the remained performance if he did not obtain it from the very beginning from one of the debtors. To compare, let us look into the Civil code of the State of California:[91]

[90] *Civil Code of Ukraine*, Pravo, 2009, p. 64
[91] Civil code of the State of California section 1431
http://www.leginfo.ca.gov/cgi-bin/displaycode?section=civ&group=01001-02000&file=1430-1432

Joint Liability

An obligation imposed upon several persons, or a right created in favor of several persons, is presumed to be joint, and not several, except as provided in Section 1431.2

Section 1431.2 imposes ***several liability*** in cases of *personal injury, property damage and wrongful death*.[92] Naturally, even if it is not provided expressly, the Ukrainian legislation treats this kind of liability the same way.

The ***German legislator***, putting the similar provision in article 221 that obligee can claim the performance from all debtors at once or from any of them particularly,[93] also regulated the cases of forgiveness and default by the creditor. Thus, if a creditor decides to forgive the whole debt of any debtor under the contract, then all debtors are excused too.[94] The reasoning of this provision is that the obligee can not interfere to the agreement between debtors to be liable under the obligation jointly, freeing one of them without the concern of others. The only situation when it would be fair is when all debtors are excused and the obligation is terminated. The second provision introduced by the German legislation is that in case of default by a creditor in relation to any obligee, the default will be effective to other debtors as well.[95] The cause of application of this rule is the nature of joint liability, where not only duties, but also rights of debtors are connected in relation to particular obligation. That is why, in case of default by the obligee it is presumed that default was made in relation to all debtors involved.

To conclude, even though the way of reasoning and form of relevant provisions differs, their content remains almost similar. Despite the distinctions in remedial systems of Anglo-American and continental legislation, the nature of joint liability dictates the universal rules which guarantee the protection of a creditor and at the same time do not put the joint debtors into unfairly burdensome condition.

[92] Civil code of the State of California section 1431.2
http://www.leginfo.ca.gov/cgi-bin/displaycode?section=civ&group=01001-02000&file=1430-1432
[93] http://www.gesetze-im-internet.de/englisch_bgb/german_civil_code.pdf Access: 12.03.2012
[94] Ibid.
[95] Ibid.

Conclusion

The given paper showed that the application of damages in the analyzed countries is very different and in some cases even opposite. This means that without specific knowledge in this area it would be absolutely impossible for international business lawyers to perform their work. That is why, every **common law- trained lawyer** should be aware that:

- there is no sense to insist on granting damages in a court of the civil law country;
- some types of damages are just not recognized. For instance, a German court will do everything possible to refrain from enforcing punitive damages. In addition, there is no room for nominal damages in civil law countries too.
- in some countries damages are strictly based on the existence of fault (intention or negligence) on the side of a debtor. That is why a court will be reluctant to grant damages if the guild is not involved;
- the application of some types of damages requires specific actions from parties (Mahnung or Nachfrist principle) etc.

The **civil law-trained lawyer** should not forget that:

- the chance to be granted the performance in specie in the US court is often a zero;
- the nature of certain types of damages in common law countries goes far beyond the familiar compensation for actual loss and includes loss of profit, losses incurred to find another contractor, compensation for mental distress in case of loss of chance or lack of enjoyment and many other exotic claims in the understanding of a European lawyer.

The comparative analysis made throughout the whole thesis showed that Ukrainian legislation is in several instances too general. Currently this level of regulation is sufficient, but the stronger integration with common law countries in the future can make the whole remedial system ineffective. That is why the information in the paper can be used in deeper research aimed to improve the Ukrainian system of damages and to introduce new types which will grant more protection for aggrieved parties.

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