

## Efficiency and fairness in the law of damages under international commercial contracts: A comparative and normative analysis

Pham Thi Cam Ngoc\*, Phan Thi Hong An, Ngo Phuong Tra, Nguyen Hoang Hai My

Lecturer of Law, Ton Duc Thang University, Faculty of Law, Ho Chi Minh City, Vietnam

\*Corresponding author

Email: [phamthcamngoc@tdtu.edu.vn](mailto:phamthcamngoc@tdtu.edu.vn)

Orcid: <https://orcid.org/0009-0009-8557-6693>

Received: 16/12/2025

Revised: 19/01/2026

Accepted: 18/03/2026

Published: 23/03/2026

### ABSTRACT

This study examines how the law of damages in international commercial contracts balances economic efficiency and fairness. Drawing on law-and-economics theory and the frameworks of the United Nations Convention on Contracts for the International Sale of Goods (CISG), the UNIDROIT Principles of International Commercial Contracts (PICC), the Principles of European Contract Law (PECL), and the Draft Common Frame of Reference (DCFR), it employs doctrinal, comparative, and jurisprudential analysis. Findings indicate that these instruments integrate efficiency-based limits, such as foreseeability and mitigation, with fairness-oriented principles of full compensation, though significant divergences persist in practice. The study proposes a six-step evaluative model that systematizes the assessment of damages, aiming to harmonize efficiency and fairness and to enhance predictability in cross-border commerce...

**Keywords:** Damages; Efficiency; Fairness; Foreseeability; International commercial contracts.

### INTRODUCTION:

The law of damages occupies a foundational position in international commercial contracting, functioning as a primary mechanism for safeguarding transactional stability and securing the legitimate expectations of parties engaged in cross-border trade. A coherent system of compensation ensures that commercial actors can rely on a predictable remedial framework, which in turn facilitates international commerce by reducing uncertainty and promoting the efficient allocation of contractual risks. As Dunoff and Trachtman explain, international legal rules—including those governing contractual remedies—shape economic behavior by influencing incentives and expected payoffs within transnational markets.<sup>1</sup> This incentive-shaping function becomes particularly salient in the context of damages, where the remedial structure not only compensates loss but also encourages performance, deters opportunistic breach, and promotes efficient planning.

Embedded within this remedial structure is a persistent tension between economic efficiency and fairness. From an efficiency standpoint, certain doctrinal principles—such as foreseeability, mitigation, and expectation damages—

operate to minimize social costs and ensure that contracting behavior aligns with welfare-maximizing outcomes. For instance, CISG Article 74 limits damages to those losses that were foreseeable at the time of contracting, thereby preventing excessive liability that could distort price formation or discourage participation in international markets.<sup>2</sup> Likewise, CISG Article 77 imposes a duty to mitigate, requiring the aggrieved party to take reasonable steps to reduce loss, an approach consistent with the classic law-and-economics explanation that efficient breach and post-breach behavior should prevent unnecessary waste.<sup>3</sup> Rea's economic analysis of contractual penalties demonstrates that without such limits, parties may face socially excessive incentives to perform even when breach would be efficient.<sup>4</sup>

The fairness perspective emphasizes that remedies must restore the injured party to the position they would have occupied had the contract been performed. This principle of full compensation, reflected expressly in UNIDROIT Principles (PICC) Article 7.4.2(1), includes both actual loss and loss of expected gain, ensuring that damages reflect substantive justice rather than merely economic optimization.<sup>5</sup> Moreover, fairness considerations justify allowing liquidated damages, provided they do not

<sup>1</sup> J. L. Dunoff & J. P. Trachtman, "Economic Analysis of International Law," *Yale Journal of International Law* 24 (1999): 1.

<sup>2</sup> CISG Article 74, United Nations Convention on Contracts for the International Sale of Goods (1980).

<sup>3</sup> CISG Article 77, *ibid.*

<sup>4</sup> S. A. Rea Jr., "Efficiency Implications of Penalties and Liquidated Damages," *Journal of Legal Studies* 13, no. 1 (1984): 147–167.

<sup>5</sup> UNIDROIT Principles 2016, Article 7.4.2(1).

become punitive. The UNIDROIT Principles acknowledge this balance in Article 7.4.13, which permits agreed sums for non-performance but allows reduction when the amount is \*\*\*“grossly excessive.”\*\*<sup>6</sup> Similar fairness-based policies appear in the PECL and DCFR.

The challenge for modern international commercial law lies in reconciling these two normative paradigms. Both the CISG and the UNIDROIT Principles seek to harmonize efficiency with fairness by articulating compensation rules that preserve predictability while preventing disproportionate or inequitable outcomes. Chavanne notes that legal systems frequently embed economic rationality within fair-dealing norms because commercial actors evaluate rules not only by their efficiency but also by their perceived fairness.<sup>7</sup> This duality explains why international instruments avoid rigid adherence to any single economic model, instead opting for a balanced remedial framework that incorporates both foreseeability and full compensation, both mitigation and equitable adjustment.

The contemporary landscape of international sales and commercial contracting is shaped by a dynamic interaction between efficiency-oriented doctrines and fairness-based safeguards. Understanding this interaction is essential to assessing the coherence of existing remedial regimes and to determining whether current international instruments successfully achieve their stated goals of harmonization and justice in cross-border commercial transactions.

## II. Main content

### A. Research issues

#### 1. Reason for Research

Despite the centrality of damages in international commercial contracting, the existing scholarship remains fragmented, with most studies examining either the legal-doctrinal structure of damages or the economic theory underlying remedial rules, but rarely both in an integrated manner. Although the CISG, the UNIDROIT Principles (PICC), and the Principles of European Contract Law (PECL) constitute the most influential instruments promoting harmonization, there is still no comprehensive academic assessment of how these regimes collectively balance economic efficiency and fairness—two objectives that often conflict in both theory and practice. Previous literature in law and economics, such as the works of Rea and later economic analyses of damage rules, emphasizes efficient breach, optimal incentives, and mitigation.<sup>8</sup> Meanwhile, comparative doctrinal scholars focus on the

textual coherence and uniform interpretation of international instruments. Yet, as Dunoff and Trachtman argue, international legal rules operate simultaneously as normative and economic structures, influencing the choices and incentives of market participants.<sup>9</sup>

Despite the sophistication of these frameworks, the interaction between efficiency-based doctrines—such as foreseeability under CISG Article 74 and mitigation under CISG Article 77—and fairness-oriented doctrines—such as the principle of full compensation under PICC Article 7.4.2—has not been systematically evaluated. Moreover, liquidated damages and penalty clauses present additional complexity: while efficiency theorists view these clauses as deterrence mechanisms to prevent underperformance, fairness-oriented contract law systems limit them to avoid oppressive or disproportionate outcomes, as reflected in PICC Article 7.4.13(2).<sup>10</sup> This divergence illustrates a broader problem: there is no agreed normative framework for assessing when efficiency should dominate or when fairness should constrain remedial discretion.

Consequently, a significant research gap emerges: there is a lack of studies integrating comparative contract law with law-and-economics methodology to evaluate whether current international compensation mechanisms successfully strike a balance between predictability, incentive alignment, and equitable protection of the injured party. Addressing this gap is essential given the growing prevalence of cross-border contracting, where inconsistent applications of damage rules increase transaction costs, exacerbate uncertainty, and weaken international commercial governance.

#### 2. The main research questions

Given these gaps, this research is guided by three central questions.

*The first asks: How are compensation mechanisms designed under the CISG, the PICC, the PECL, and selected national laws?*

This requires a close examination of the substantive rules governing foreseeability, mitigation, full compensation, liquidation of damages, and restitutionary remedies. It involves not only textual analysis of provisions such as CISG Articles 74–77, PICC Articles 7.4.1–7.4.13, and PECL Chapter 9, but also case law (e.g., *Hadley v Baxendale*, *The Heron II*) and arbitral awards interpreting these provisions.

*The second question asks: To what extent do these rules effectively express and balance the principles of economic efficiency and fairness?*

<sup>6</sup> UNIDROIT Principles 2016, Article 7.4.13(2).

<sup>7</sup> D. Chavanne, “Thinking Like (Law-And-)Economists,” *Review of Law & Economics* 16, no. 1 (2020).

<sup>8</sup> S. A. Rea Jr., “Efficiency Implications of Penalties and Liquidated Damages,” *Journal of Legal Studies* 13, no. 1 (1984): 147–167.

<sup>9</sup> J. L. Dunoff & J. P. Trachtman, “Economic Analysis of International Law,” *Yale Journal of International Law* 24 (1999): 1.

<sup>10</sup> UNIDROIT Principles 2016, Article 7.4.13(2).

Efficiency is reflected in doctrines controlling excessive liability, requiring reasonable mitigation, and encouraging optimal contracting behavior. Fairness is reflected in full-compensation principles, equitable adjustment, and limitations on disproportionate penalty clauses.<sup>11</sup> Evaluating these rules requires drawing from both doctrinal reasoning and economic analysis of incentives. *The third question concerns the broader normative inquiry: Is it possible to reconcile or harmonize these two objectives?*

While the CISG, PICC, and PECL embody elements of both frameworks, tensions persist-particularly in the treatment of consequential losses, liquidated damages, and reliance-based claims. Assessing the potential for harmonization demands determining whether an overarching coherent framework can integrate efficiency (social welfare, optimal deterrence) with fairness (distributional justice, protection from abusive advantage-taking).

### **B. Research purpose**

The primary purpose of this research is to develop a theoretically grounded and systematically structured framework for evaluating how the law of damages in international commercial contracts balances efficiency and fairness. Existing legal instruments such as the CISG, the UNIDROIT Principles (PICC), and the Principles of European Contract Law (PECL) all incorporate rules-such as foreseeability, mitigation, full compensation, and liquidated damages-that appear to serve both normative objectives. However, these instruments do not articulate a unified evaluative theory explaining how these sometimes-conflicting principles should be reconciled. By examining the interaction between these doctrines, this study aims to clarify whether current legal structures achieve a coherent balance between the economic goal of minimizing social costs and the equitable goal of ensuring just compensation.

To accomplish this, the research undertakes a comparative doctrinal analysis of the main international legal instruments that govern remedies for non-performance. For instance, the CISG's rules on damages in Articles 74–77 provide a globally applicable standard for foreseeability, lost profits, substitute transactions, and mitigation.<sup>12</sup> Meanwhile, the UNIDROIT Principles articulate a more detailed remedial framework, including provisions on full compensation (PICC Article 7.4.2), certainty of harm (Article 7.4.3), and agreed payment

clauses (Article 7.4.13).<sup>13</sup> These must be understood alongside the corresponding provisions in the PECL and the DCFR, which further reflect European approaches to compensation and limitations on liability. A central purpose of the research is to establish how these instruments converge and diverge in their handling of efficiency-based and fairness-based considerations.

Another objective is to develop an evaluative model that can be applied to assess and compare the operation of damage rules across legal systems. Such a model must incorporate insights from law-and-economics, including expectation damages, mitigation incentives, and efficient breach, as well as fairness-oriented doctrines such as full restitution, equitable penalty clauses, and protection against excessive or unforeseeable loss.<sup>14</sup> Through this integrated approach, the research seeks not merely to describe existing rules but to identify normative principles that can guide courts, arbitral tribunals, and lawmakers in interpreting and improving the law of damages.

Finally, the research aims to contribute to the broader project of harmonization of international commercial law. By clarifying the theoretical foundations of efficiency and fairness and assessing their implementation in leading international instruments, the study intends to propose practical recommendations for reform. These may include the refinement of foreseeability standards, adjustments to the treatment of penalty clauses, and clearer guidance on the assessment of lost profits and reliance losses. Ultimately, the purpose of this research is to articulate how a modern, coherent, and transnationally acceptable system of damages can be constructed-one that provides predictability for global commerce while maintaining the fairness essential to contractual justice.<sup>15</sup>

### **C. Research methods**

This research employs a combination of doctrinal, comparative, and law-and-economics methodologies to examine how international contract law balances the dual objectives of efficiency and fairness in the law of damages. The doctrinal method is used as the foundation of the study, focusing on the close reading and systematic interpretation of the primary international instruments governing damages, including the CISG, the UNIDROIT Principles (PICC), and the Principles of European Contract Law (PECL). Particular emphasis is placed on the damages framework in CISG Articles 74–77, which codify foreseeability, lost profits, substitute transactions,

<sup>11</sup> D. Chavanne, "Thinking Like (Law-And-) Economists," *Review of Law & Economics* 16, no. 1 (2020).

<sup>12</sup> CISG Articles 74–77, United Nations Convention on Contracts for the International Sale of Goods (1980).

<sup>13</sup> UNIDROIT Principles 2016, Articles 7.4.2, 7.4.3, 7.4.13.

<sup>14</sup> S. A. Rea Jr., "Efficiency Implications of Penalties and Liquidated Damages," *Journal of Legal Studies* 13,

no. 1 (1984): 147–167; see also D. Chavanne, "Thinking Like (Law-And-)Economists," *Review of Law & Economics* 16, no. 1 (2020).

<sup>15</sup> See J. L. Dunoff & J. P. Trachtman, "Economic Analysis of International Law," *Yale Journal of International Law* 24 (1999): 1; PECL Chapter 9; DCFR Book III, Chapter 3.

and the duty to mitigate,<sup>16</sup> and on the more detailed remedial provisions in PICC Articles 7.4.1–7.4.13, which articulate principles of full compensation, certainty, mitigation, and agreed payment for non-performance.<sup>17</sup> These texts serve as the doctrinal core for understanding how international law conceptualizes compensation.

In parallel, the research adopts a comparative law methodology to evaluate how different legal traditions approach similar remedial problems, including foreseeability, mitigation, reliance damages, restitution, and liquidated damages. This comparison extends to major national legal systems, such as common law jurisdictions—particularly England and the United States—where foundational cases like *Hadley v Baxendale* and *The Heron II* have shaped the foreseeability doctrine,<sup>18</sup> as well as civil law jurisdictions where full compensation and judicial control of penalty clauses have developed differently. The comparative approach also draws on the DCFR, whose damages provisions in Book III, Chapter 3 illustrate contemporary European thinking on excuse, termination, and compensation.<sup>19</sup> Examining these systems in parallel makes it possible to identify convergence, divergence, and hybridization in remedial philosophies across jurisdictions.

A third methodological pillar is the analysis of case law and arbitral awards, which plays a crucial role given the international and commercial nature of the study. Arbitral tribunals—such as those under ICC, ICSID, and UNCITRAL rules—frequently rely on the CISG, the PICC, and the PECL as expressions of transnational contract principles. Their decisions provide practical insight into how doctrines such as foreseeability (CISG Art. 74), mitigation (CISG Art. 77; PICC Art. 7.4.8), and liquidated damages (PICC Art. 7.4.13) are applied in complex factual contexts, often involving information asymmetry, unequal bargaining power, or high transaction costs. Analysis of these awards helps illustrate how tribunals balance efficiency and fairness when determining the appropriate measure of damages.

Finally, the research incorporates a law-and-economics analytical framework, drawing from theories of efficient breach, incentive structures, and optimal risk allocation. Scholarship by Rea, Shavell, and other economic theorists informs the evaluation of whether legal rules minimize deadweight loss and promote optimal contracting behavior.<sup>20</sup> This interdisciplinary lens is used not to

replace doctrinal interpretation but to enrich it, enabling a deeper assessment of whether existing international rules effectively align with the broader goals of commercial efficiency and substantive fairness.

Together, these complementary methodologies support a robust, multi-layered analysis that evaluates international damages rules not only as legal doctrines but as normative, functional, and economic instruments shaping behavior in global commerce.

## D. Theoretical framework: efficiency and fairness

### 1. Definitions and basis theory

Understanding the law of damages in international commercial contracts requires a precise conceptualization of the term “damage”, as well as a clear theoretical foundation for analyzing efficiency and fairness within contractual remedies. In classical contract theory, “damage” refers to the measurable harm suffered by the creditor as a result of the debtor’s non-performance, encompassing both actual losses and loss of expected gains. This definition is reflected expressly in CISG Article 74, which provides that damages consist of “loss suffered as a consequence of the breach, including loss of profit,” subject to the limitation of foreseeability at the time of contract formation.<sup>21</sup> The UNIDROIT Principles (PICC) expand this definition in Article 7.4.2(1) by affirming a right to “full compensation,” covering any loss suffered and any gain deprived, while also recognizing the possibility of non-pecuniary harm.<sup>22</sup> The PECL similarly adopt a broad concept of loss, incorporating both economic and non-economic detriment, thereby aligning European private law with an expansive remedial philosophy.<sup>23</sup>

Within the framework of contract law, efficiency is a central evaluative criterion derived from law-and-economics scholarship. Efficiency in the context of damages primarily pertains to the ability of legal rules to minimize social costs, align incentives, and allocate risks optimally between contracting parties. Expectation damages—the standard measure under the CISG, PICC, and common law—are traditionally justified as promoting efficient contracting behavior by ensuring that the injured party receives the value of performance. Economic theorists argue that such damages encourage parties to perform when performance is socially desirable, and to breach only when breach leads to a higher social value—an

<sup>16</sup> CISG Articles 74–77, United Nations Convention on Contracts for the International Sale of Goods (1980).

<sup>17</sup> UNIDROIT Principles 2016, Articles 7.4.1–7.4.13.

<sup>18</sup> *Hadley v Baxendale* (1854) 9 Exch 341; *Koufos v C Zarnikow Ltd (The Heron II)* [1969] 1 AC 350.

<sup>19</sup> Draft Common Frame of Reference (DCFR), Book III, Chapter 3 (2009).

<sup>20</sup> S. A. Rea Jr., “Efficiency Implications of Penalties and

Liquidated Damages,” *Journal of Legal Studies* 13, no. 1 (1984): 147–167; M. A. Eisenberg, “The Principle of *Hadley v. Baxendale*,” *California Law Review* 80 (1992): 563.

<sup>21</sup> CISG Article 74, United Nations Convention on Contracts for the International Sale of Goods (1980).

<sup>22</sup> UNIDROIT Principles 2016, Article 7.4.2(1).

<sup>23</sup> PECL, Article 9:502, Principles of European Contract Law (2003).

idea commonly known as efficient breach.<sup>24</sup> The duty to mitigate, codified in CISG Article 77 and PICC Article 7.4.8, further reinforces efficiency by preventing avoidable losses and discouraging moral hazard.<sup>25</sup> The principles of foreseeability-embodied in CISG Article 74 and developed in cases such as *Hadley v Baxendale*-serve a similar function by limiting liability to losses that parties could rationally account for during negotiations, thereby reducing uncertainty and transaction costs.<sup>26</sup>

In contrast, fairness in contract damages concerns substantive justice, equitable treatment, and the protection of legitimate expectations, particularly in situations involving risk imbalance, information asymmetry, or unequal bargaining power. The principle of full compensation, central in civil law systems and explicit in PICC Article 7.4.2, reflects the fairness-oriented view that injured parties should be restored, as far as possible, to the position they would have been in had the contract been fully performed.<sup>27</sup> Fairness also underlies judicial and arbitral control of penalty clauses: while parties may stipulate agreed sums to strengthen performance incentives, the PICC permit courts to reduce such sums when they become “grossly excessive,” ensuring that remedial mechanisms do not become instruments of oppression.<sup>28</sup> The DCFR reinforces similar fairness considerations through its provisions on excuse, non-performance, and proportionality in compensation.<sup>29</sup> These doctrines collectively illustrate that fairness demands attention to distributive consequences, adequate redress, and the prevention of abusive conduct.

A comprehensive theoretical understanding of damages requires recognizing that efficiency and fairness are not mutually exclusive, but operate as intersecting analytical frameworks. As Chavanne emphasizes, legal systems frequently integrate economic rationality with fairness-oriented norms because commercial actors evaluate rules based not only on their practical incentives but also on their normative legitimacy.<sup>30</sup> Consequently, international instruments such as the CISG and the PICC embed both perspectives: they adopt efficiency-driven doctrines like mitigation and foreseeability, while simultaneously incorporating fairness-oriented ideals of full compensation and equitable control of agreed damages. Analyzing these principles together lays the foundation for understanding how different legal systems conceptualize contractual justice and how international

harmonization efforts attempt to reconcile efficiency with fairness.

## 2. The conflict between efficiency and fairness

The interaction between efficiency and fairness in contract damages has long been a central tension in both legal doctrine and economic analysis. Efficiency-oriented rules are designed to minimize social costs, promote optimal performance decisions, and allocate risk in a manner that encourages parties to act in wealth-maximizing ways. For example, doctrines such as foreseeability, mitigation, and expectation damages serve to align incentives and prevent opportunistic behavior. Under CISG Article 74, damages are limited to losses that the breaching party “foresaw or ought to have foreseen” at the time of contracting—a principle that traces its lineage to *Hadley v Baxendale*, which sought to prevent liability from expanding unpredictably and consequently raising transaction costs.<sup>31</sup> Likewise, CISG Article 77 obliges the aggrieved party to take reasonable measures to mitigate losses, ensuring that damages reflect only unavoidable harm, thereby mirroring the economic theory of minimizing wasteful expenditures.<sup>32</sup> These rules form the backbone of efficiency-oriented thinking, which is further reinforced in the UNIDROIT Principles through Articles 7.4.4 (foreseeability) and 7.4.8 (mitigation).<sup>33</sup>

Strict adherence to efficiency principles can produce substantive unfairness, particularly in situations where contractual risks are unevenly distributed or where the injured party lacks bargaining power or information. Fairness-oriented doctrines focus on restoring the injured party to the position they would have occupied had the contract been faithfully performed, as emphasized in PICC Article 7.4.2(1), which codifies the principle of full compensation.<sup>34</sup> This fairness approach sometimes conflicts with economic efficiency: a rule designed to minimize social costs may fail to compensate fully for significant losses, especially consequential or reliance-based losses that exceed what is foreseeable under efficiency-based doctrines. Moreover, fairness requires that damages reflect equitable considerations, including protection against disproportionate exposure to risk or exploitation. Accordingly, many legal systems allow judicial control over penalty clauses—recognized in PICC Article 7.4.13(2), which grants courts the authority to reduce a contractually agreed payment when it is “grossly

<sup>24</sup> See S. A. Rea Jr., “Efficiency Implications of Penalties and Liquidated Damages,” *Journal of Legal Studies* 13, no. 1 (1984): 147–167.

<sup>25</sup> CISG Article 77; PICC Article 7.4.8.

<sup>26</sup> *Hadley v Baxendale* (1854) 9 Exch 341; see also *The Heron II* [1969] 1 AC 350.

<sup>27</sup> ICC Article 7.4.2(1).

<sup>28</sup> PICC Article 7.4.13(2).

<sup>29</sup> DCFR, Book III, Chapter 3 (2009).

<sup>30</sup> D. Chavanne, “Thinking Like (Law-And-)Economists,” *Review of Law & Economics* 16, no. 1 (2020).

<sup>31</sup> *Hadley v Baxendale* (1854) 9 Exch 341; **CISG Article 74**, UN Convention on Contracts for the International Sale of Goods (1980).

<sup>32</sup> CISG Article 77, *ibid*.

<sup>33</sup> UNIDROIT Principles 2016, Articles 7.4.4 and 7.4.8.

<sup>34</sup> **PICC Article 7.4.2(1)**.

excessive,” thus preventing punitive or oppressive outcomes.<sup>35</sup> The PECL and DCFR adopt similar constraints, embedding fairness considerations into their remedial frameworks.<sup>36</sup>

The conflict becomes particularly evident in scenarios where efficiency suggests that breach is optimal—such as the doctrine of efficient breach—but fairness condemns breach as morally or commercially unacceptable. Economic theory posits that a party should be allowed to breach and pay damages if doing so increases overall social welfare.<sup>37</sup> Yet, courts and arbitral tribunals often remain reluctant to endorse breach as a legitimate strategy, emphasizing the moral dimension of contractual promise-keeping and the need to protect reliance interests. In international commercial practice, such tensions arise in cases involving consequential losses, market volatility, and substitute transactions, where strict efficiency-driven limitations may fail to capture the full extent of harm suffered by the aggrieved party. Under CISG Article 75 and Article 76, damages are tied to the market difference or substitute transaction price, which promotes economic rationality but may not always compensate fully for additional losses arising in volatile markets or under asymmetric information conditions.<sup>38</sup>

Other legal mechanisms explicitly prioritize fairness even at the expense of efficiency. For instance, doctrines allowing recovery for non-pecuniary harm under PICC Article 7.4.2(2) represent a clear deviation from purely economic considerations, recognizing interests such as emotional distress or reputational harm.<sup>39</sup> Conversely, efficiency-based doctrines such as certainty of harm (PICC Article 7.4.3) restrict speculative claims even when fairness might favor compensation for lost opportunities. The DCFR likewise demonstrates the deliberate balancing of the two aims, permitting compensation for reasonably foreseeable loss while permitting reductions when the injured party contributes to the harm, ensuring proportionality.<sup>40</sup>

These doctrinal interactions reveal a structural and unavoidable conflict: efficiency often requires limiting liability, while fairness often requires expanding it. International instruments attempt to reconcile these competing goals, but tensions remain—particularly in the areas of penalty clauses, consequential damages, and reliance expenditures. Understanding this conflict is crucial for evaluating whether international commercial

contract law can develop a coherent and harmonized approach to damages that adequately reflects both the economic realities of global commerce and the normative demands of contractual justice.

### 3. Relevant legal documents

A comprehensive analysis of efficiency and fairness in the law of damages must be grounded in the primary international legal instruments governing contractual remedies. Among these, the United Nations Convention on Contracts for the International Sale of Goods (CISG) remains the most influential and widely applied uniform sales law. Its damages regime, articulated in Articles 74–77, reflects a hybrid model combining efficiency-oriented limitations with fairness-based protections. Article 74 defines damages broadly to include both actual loss and loss of profit, but limits recovery to losses that were foreseeable at the time of contracting—a doctrinal legacy of *Hadley v Baxendale*, ensuring predictability and preventing excessive liability.<sup>41</sup> Articles 75 and 76 address substitute transactions and current price differentials, integrating market-based measures intended to promote efficiency and transactional certainty.<sup>42</sup> Meanwhile, Article 77 incorporates the general duty to mitigate, requiring the aggrieved party to reduce avoidable losses, a principle resonant with economic theories of minimizing waste and aligning incentives.<sup>43</sup> The CISG thus provides a balanced and pragmatic framework, but its open-textured standards also leave room for interpretive divergences, especially across courts and arbitral tribunals.

The UNIDROIT Principles of International Commercial Contracts (PICC) offer a more detailed and conceptually sophisticated set of rules on damages. Serving as a “soft law” instrument frequently applied by arbitral tribunals and courts, the PICC aim to reflect general principles common to major legal systems. Their approach to damages, presented in Articles 7.4.1–7.4.13, illustrates a structured attempt to reconcile efficiency and fairness within a single remedial framework. Article 7.4.2 codifies the principle of full compensation, covering both loss suffered and gain deprived, thus reflecting fairness-oriented restorative goals.<sup>44</sup> At the same time, efficiency-driven provisions—such as foreseeability under Article 7.4.4 and mitigation under Article 7.4.8—limit over-

<sup>35</sup> PICC Article 7.4.13(2).

<sup>36</sup> PECL Article 9:509; DCFR Book III, Chapter 3, Subsection on damages.

<sup>37</sup> See S. A. Rea Jr., “Efficiency Implications of Penalties and Liquidated Damages,” *Journal of Legal Studies* 13, no. 1 (1984): 147–167.

<sup>38</sup> CISG Articles 75–76, UN Convention on Contracts for the International Sale of Goods (1980).

<sup>39</sup> PICC Article 7.4.2(2).

<sup>40</sup> DCFR, Book III, Chapter 3, particularly III.–3:107 and III.–3:702.

<sup>41</sup> CISG Article 74, UN Convention on Contracts for the International Sale of Goods (1980); *Hadley v Baxendale* (1854) 9 Exch 341.

<sup>42</sup> CISG Articles 75–76, *ibid*.

<sup>43</sup> CISG Article 77, *ibid*.

<sup>44</sup> UNIDROIT Principles 2016, Article 7.4.2.

compensation and encourage prudent behavior.<sup>45</sup> The PICC further address issues largely absent from the CISG, including non-pecuniary harm (Article 7.4.2(2)), certainty of harm (Article 7.4.3), and agreed payment clauses (Article 7.4.13), illustrating a more comprehensive and nuanced approach to damages.<sup>46</sup> These provisions not only expand doctrinal clarity but also integrate equitable safeguards-such as the authority to reduce “grossly excessive” liquidated damages-highlighting the PICC’s commitment to substantive fairness.

The Principles of European Contract Law (PECL), formulated by the Commission on European Contract Law, represent another major harmonization initiative. Although not binding, the PECL have significantly influenced both European jurisprudence and the drafting of subsequent instruments such as the DCFR. Their provisions on damages, found primarily in Chapter 9, reflect a balanced European approach. Article 9:501 affirms the principle of full compensation, while Article 9:502 specifies the recoverability of loss, including both economic and non-economic harm.<sup>47</sup> The PECL incorporate foreseeability (Article 9:503), mitigation (Article 9:505), and rules governing interest and penalty clauses, creating a framework that closely parallels-and, in some respects, anticipates-the PICC. By synthesizing civil law and common law perspectives, the PECL provide a valuable comparative benchmark for evaluating the coherence and universality of damages principles across legal systems.

The Draft Common Frame of Reference (DCFR) further advances the European harmonization project, providing an extensive set of model rules applicable to obligations, remedies, and damages. In Book III, Chapter 3, the DCFR outlines a comprehensive remedial framework including provisions on excuse for non-performance (III.–3:104), notice requirements (III.–3:107), and termination for fundamental non-performance (III.–3:502).<sup>48</sup> Importantly, the DCFR elaborates detailed rules on compensation, including causation, foreseeability, contributory responsibility, and reduction of damages where the creditor contributed to the harm (III.–3:703).<sup>49</sup> This structure reflects both the efficiency-oriented desire to limit liability to reasonable and causally linked harms and the fairness-oriented aim of ensuring proportionality and equitable redress. The DCFR’s systematic treatment of damages also provides additional interpretive guidance for understanding trends in European adjudication and

legislative reform.

Finally, foundational common law precedents-including *Hadley v Baxendale*, *The Heron II*, *Robinson v Harman*, and *Ruxley Electronics v Forsyth*-continue to serve as reference points for judicial reasoning and arbitral interpretation in international disputes.<sup>50</sup> These cases articulate key principles such as foreseeability, remoteness, expectation interest, and proportionality in awarding damages, which influence both international instruments and national legal systems. Their integration into arbitral practice underscores the global significance of common law reasoning even in settings where “soft law” instruments or the CISG serve as governing frameworks.

Taken together, the CISG, PICC, PECL, DCFR, and common law precedents constitute the core legal materials shaping contemporary international damages doctrine. Each reflects a unique blend of efficiency-based limitations and fairness-based protections, making them essential reference points for any analysis of harmonization and normative coherence in the law of international commercial contracts.

## E. Comparative analysis and current practice

### 1. Kinds of damages and their application

A central component of the law of damages in international commercial contracts is the classification of different forms of monetary relief available to the aggrieved party. Understanding these categories is essential for analyzing how legal systems balance efficiency and fairness, as each type of damages reflects distinct theoretical objectives and remedial philosophies. International instruments such as the CISG, the UNIDROIT Principles (PICC), and the PECL generally converge on several core categories: expectation damages, reliance damages, restitution or disgorgement, specific performance, and liquidated damages or penalty clauses.

Expectation damages represent the dominant remedial measure in international commercial law. This measure seeks to place the injured party in the position that they would have occupied had the contract been properly performed. The CISG codifies this standard in Article 74, which permits recovery for both “loss suffered” and “loss of profit,” thereby protecting the promisee’s expectancy interest.<sup>51</sup> The PICC reinforce the same idea in Article 7.4.2, affirming a right to full compensation, including

<sup>45</sup> PICC Articles 7.4.4 and 7.4.8.

<sup>46</sup> PICC Articles 7.4.2–7.4.13.

<sup>47</sup> PECL Articles 9:501–9:505, Principles of European Contract Law (2003).

<sup>48</sup> DCFR, Book III, Chapter 3: III.–3:104, III.–3:107, III.–3:502 (2009).

<sup>49</sup> DCFR III.–3:703.

<sup>50</sup> *Koufos v C Zarnikow Ltd (The Heron II)* [1969] 1 AC 350; *Robinson v Harman* (1848) 1 Exch 850; *Ruxley Electronics and Construction Ltd v Forsyth* [1996] AC 344.

<sup>51</sup> CISG Article 74, UN Convention on Contracts for the International Sale of Goods (1980).

lost profit and the deprivation of expected gains.<sup>52</sup> Expectation damages are widely viewed as promoting economic efficiency by allowing parties to internalize the cost of breach, thereby incentivizing optimal performance decisions. Because expectation damages may be limited by foreseeability and mitigation requirements, they also serve to prevent excessive liability and reduce transactional uncertainty.

In contrast, reliance damages compensate the injured party for expenses incurred in preparation for or in reliance on the contract. Although less prominently featured in the CISG, reliance damages are implicitly recoverable within the broad definition of loss under Article 74, provided that such expenditures meet the requirements of foreseeability and causation.<sup>53</sup> The PECL recognize reliance expenditures explicitly as a compensable element of loss under Article 9:502, which includes wasted costs suffered due to non-performance.<sup>54</sup> Reliance damages reflect fairness-oriented considerations by acknowledging the legitimacy of investments made in anticipation of performance, particularly in long-term or relationship-specific transactions where losses may exceed direct market differentials.

A further category—though more exceptional—is restitution or disgorgement. Restitution aims to reverse unjust enrichment, while disgorgement compels the breaching party to surrender gains obtained through breach. These remedies are rarely granted under the CISG, which focuses instead on compensatory principles. However, the PICC allow restitutionary measures in cases of termination, requiring each party to return benefits received under Article 7.3.6.<sup>55</sup> The DCFR extends this approach further by recognizing unjust enrichment as a general source of obligations.<sup>56</sup> Although restitution does not directly advance efficiency or fairness in a compensatory sense, it can promote fairness by preventing unjust gain and discouraging opportunistic breach.

Another essential dimension is the relationship between damages and specific performance. While common law jurisdictions generally treat damages as the primary remedy and specific performance as exceptional, civil law systems and the PICC adopt a more liberal stance. The CISG, in Article 46 and Article 62, allows buyers and sellers to require performance, subject to limitations where performance would be unreasonable or impossible.<sup>57</sup> Specific performance often aligns with fairness by upholding the promisee's contractual expectations, yet from an efficiency perspective, it may

impose excessive costs when damages could achieve an equivalent outcome at lower social cost. International tribunals frequently navigate this tension by considering market conditions, feasibility, and proportionality when determining the appropriate remedy.

Finally, liquidated damages and penalty clauses represent an important remedial mechanism where parties predetermine the sum payable in case of breach. Although the CISG is silent on their enforceability, arbitral tribunals often apply domestic law or soft-law instruments to evaluate such clauses. The PICC, in Article 7.4.13, enforce agreed sums regardless of actual harm but allow courts to reduce amounts deemed “grossly excessive,” thereby balancing contractual autonomy with fairness considerations.<sup>58</sup> This dual structure reflects both efficiency—by enhancing predictability and reducing litigation costs—and fairness—by preventing oppressive or punitive consequences. In European private law, similar controls appear in the PECL and DCFR, which explicitly authorize judicial moderation of excessive penalties.<sup>59</sup>

The classification of damages in international commercial contracts illuminates the interplay between remedial objectives and legal traditions. Expectation and reliance damages reflect compensatory principles central to both efficiency and fairness. Restitution and disgorgement operate as corrective mechanisms, and liquidated damages illustrate how private ordering interacts with judicial oversight. Understanding the doctrinal structure of these categories provides the foundation for the comparative and normative analysis that follows.

## 2. Approaches across legal systems

A core challenge in international commercial contracting arises from divergences in how various legal systems and international instruments address fundamental issues such as foreseeability, mitigation, remoteness, penalty clauses, and the scope of recoverable damages. Although the CISG, PICC, PECL, and DCFR share significant common ground, particularly in promoting predictability and balanced risk allocation, their doctrinal nuances and interpretative tendencies lead to different remedial outcomes. These differences are further accentuated when compared with common law and civil law traditions, as well as international arbitral practice.

The principle of foreseeability serves as a significant limitation on damages and is a cornerstone in both domestic and international regimes. The CISG adopts the classical *Hadley v. Baxendale* rule, providing in Article 74 that damages may not exceed losses that the breaching

<sup>52</sup> UNIDROIT Principles 2016, Article 7.4.2.

<sup>53</sup> *Ibid.*; see also S. A. Rea Jr., “Efficiency Implications of Penalties and Liquidated Damages,” *Journal of Legal Studies* 13, no. 1 (1984): 147–167.

<sup>54</sup> PECL Article 9:502, Principles of European Contract

Law (2003).

<sup>55</sup> PICC Article 7.3.6.

<sup>56</sup> DCFR, Book VII – Unjustified Enrichment.

<sup>57</sup> CISG Articles 46 and 62.

<sup>58</sup> PICC Article 7.4.13(2).

<sup>59</sup> PECL Article 9:509; DCFR III. – 3:710.

party “foresaw or ought to have foreseen” at the time of contracting.<sup>60</sup> This is structurally echoed in the PICC under Article 7.4.4, which similarly limits liability to foreseeable harm.<sup>61</sup> The PECL take the same approach in Article 9:503, reinforcing foreseeability as an instrument of economic efficiency by preventing disproportionate or punitive liability while maintaining fairness by protecting reliance interests.<sup>62</sup> In parallel, English law-rooted in *Hadley v. Baxendale* and refined in *The Heron II*-distinguishes between losses “reasonably contemplated” and “not unlikely,” thereby setting a slightly narrower foreseeability threshold compared with civil law systems.<sup>63</sup> These doctrines collectively demonstrate a convergence toward a predictable, ex ante standard consistent with commercial expectations.

Another fundamental doctrine is the duty to mitigate, which obliges the injured party to take reasonable steps to limit damages. The CISG enshrines this duty in Article 77, providing that failure to mitigate permits a reduction of recoverable damages.<sup>64</sup> The PICC reinforce this obligation in Article 7.4.8, requiring reasonable mitigation efforts and allowing reimbursement of mitigation expenses.<sup>65</sup> The PECL, in Article 9:505, similarly emphasize mitigation as both a fairness and efficiency tool: while it discourages wasteful loss accumulation, it also ensures equitable allocation of responsibility between the parties.<sup>66</sup> In contrast, some civil law systems characterize mitigation not as a duty but as a limitation intrinsic to causation, whereas common law treats it as an affirmative obligation imposed on the injured party. Despite these doctrinal differences, international arbitration tribunals consistently apply the mitigation principle as a general standard of commercial reasonableness.

A further area of divergence lies in the recovery of attorneys’ fees and ancillary costs. The CISG does not expressly authorize recovery of attorneys’ fees; prevailing jurisprudence generally excludes such fees unless they constitute foreseeable consequential loss or are recoverable under procedural law. In contrast, the PICC and PECL broadly define compensable harm to include “any loss,” allowing tribunals more flexibility to award legal costs when directly caused by the breach.<sup>67</sup> International arbitral tribunals, especially under ICC and ICSID practice, frequently apply the “costs follow the event” rule or apportion costs based on procedural fairness rather than substantive contract law. This lack of

uniformity introduces unpredictability and may increase transaction costs for cross-border parties.

The treatment of penalty clauses and agreed damages varies significantly among legal traditions. Common law systems typically enforce liquidated damages clauses only if they represent a genuine pre-estimate of loss, invalidating punitive penalties under the rule in *Dunlop v. New Garage*. Civil law jurisdictions, meanwhile, traditionally enforce penalty clauses but allow judicial reduction of excessive sums. International instruments follow the civil law model: PICC Article 7.4.13 validates agreed sums irrespective of actual harm but permits courts to reduce them when “grossly excessive,” balancing contractual autonomy and protection against abuse.<sup>68</sup> The PECL and DCFR adopt similar moderation principles, evidencing a harmonized trend toward safeguarding fairness while enabling efficient ex ante risk allocation.<sup>69</sup> Finally, the tension between flexibility and predictability manifests across all these legal sources. The CISG promotes predictability through standardized rules but allows tribunals interpretative discretion to account for trade usages and good faith. The PICC and PECL offer even greater flexibility, serving as gap-fillers or persuasive authorities in arbitral proceedings. Common law courts prioritize predictability through precedent, while civil law courts emphasize general principles and judicial discretion. International arbitration—drawing from all of these traditions—strives to balance the competing values of foreseeability, commercial certainty, and equitable considerations.

The comparative analysis demonstrates that while different legal instruments and jurisdictions share foundational principles governing damages, their approaches diverge in doctrinal framing, interpretation, and remedial scope. These variations significantly influence the degree to which efficiency and fairness are achieved in practice, thereby shaping the behavior and expectations of commercial parties engaged in cross-border trade.

### 3. Practice and challenges

Despite the increasing convergence of international legal instruments governing damages in commercial contracts, significant challenges continue to arise in practice. One of the most persistent issues is the divergence in interpretation among national courts and arbitral tribunals when applying provisions of instruments such as the CISG, PICC, and PECL. While the CISG aspires to

<sup>60</sup> CISG Article 74, United Nations Convention on Contracts for the International Sale of Goods (1980).

<sup>61</sup> UNIDROIT Principles 2016, Article 7.4.4.

<sup>62</sup> PECL Article 9:503, Principles of European Contract Law (2003).

<sup>63</sup> *Hadley v. Baxendale* (1854) 9 Exch 341; *Koufos v. C.*

*Czarnikow Ltd (The Heron II)* [1969] 1 AC 350.

<sup>64</sup> CISG Article 77.

<sup>65</sup> PICC Article 7.4.8.

<sup>66</sup> PECL Article 9:505.

<sup>67</sup> PICC Article 7.4.2; PECL 9:502.

<sup>68</sup> PICC Article 7.4.13(2).

<sup>69</sup> PECL Article 9:509; DCFR III.—3:710.

uniformity, Article 7(1) directs courts to consider its international character, yet national interpretative traditions often influence outcomes.<sup>70</sup> For example, common law courts may favor narrow readings of foreseeability rooted in *Hadley v. Baxendale*, whereas civil law courts often adopt broader causation-based approaches consistent with their domestic doctrines. This produces inconsistencies in awards, especially regarding indirect losses, lost profits, and mitigation obligations, limiting the predictability expected from international harmonization.

A second challenge emerges from the lack of uniformity between arbitral tribunals and domestic courts. International arbitration generally operates with greater flexibility, frequently relying on PICC or PECL as persuasive authorities or gap fillers.<sup>71</sup> This creates divergence from court decisions that may apply stricter statutory interpretations. In arbitral practice, tribunals often consider “commercial reasonableness” as a guiding standard, enabling broader recognition of consequential loss, reimbursement of mitigation expenses, or recovery of reliance expenditures. However, this flexibility may generate uncertainty for contractual parties who rely on the predictable application of national legal rules. In contrast, some national courts remain reluctant to apply non-binding instruments like PICC or DCFR unless expressly chosen by the parties.

A further practical difficulty concerns transaction costs, litigation costs, and enforcement barriers, which significantly influence the economic calculus behind the law of damages. Even when damages are theoretically available, high litigation expenses, delays in enforcement, or jurisdictional complexities can effectively deprive the injured party of efficient compensation.<sup>72</sup> International arbitration often allows recovery of legal costs under procedural rules, whereas national courts—particularly in CISG jurisdictions—may restrict recovery due to the convention’s silence on attorneys’ fees.<sup>73</sup> This divergence increases unpredictability and may distort the efficiency–fairness balance by disproportionately burdening weaker or smaller commercial actors.

Another major challenge lies in information asymmetry and unequal bargaining power. Parties with greater expertise, market power, or access to information may negotiate terms (such as liquidated damages or limitation-of-liability clauses) that shift risk disproportionately to the

weaker party. International instruments like PICC Article 7.4.13 permit reduction of grossly excessive penalty clauses, reflecting fairness concerns, but arbitral tribunals differ in how aggressively they exercise this moderating authority.<sup>74</sup> As a result, remedies in practice may inadequately protect weaker parties, especially in industries where standard-form contracts dominate (e.g., logistics, construction, technology supply chains).

Differences in legal culture and evidentiary standards also create practical inconsistency. For instance, the PICC allow recovery for “loss of a chance” under Article 7.4.3(2), recognizing probabilistic harm, whereas many national courts require strict proof of actual loss.<sup>75</sup> Similarly, tribunals applying the CISG often disagree on whether lost profits must be established with mathematical precision or only with reasonable certainty. The disparity in evidentiary burdens leads to unpredictable outcomes, especially in complex commercial contexts involving multi-layered supply chains, speculative markets, or volatile commodities.

Finally, global commercial integration has intensified the risk of inconsistent remedies across jurisdictions. International sales contracts frequently involve multiple legal systems, specialized trade usages, and varied dispute resolution mechanisms. Although instruments like the CISG aim for uniformity, their effectiveness is limited by uneven adoption, differing judicial capacities, and varied interpretations among contracting states.<sup>76</sup> As a result, parties face persistent uncertainty about the scope of damages, the enforceability of penalty clauses, and the interaction between mandatory domestic rules and international principles.

The practical application of damages in international commercial contracts reveals significant structural and interpretative challenges. These challenges undermine predictability, increase transaction costs, and complicate the balance between economic efficiency and corrective fairness—thereby highlighting the need for a more coherent normative framework.

## F. Normative analysis

### 1. Standards for evaluating efficiency and fairness

The formulation of a coherent evaluative standard for damages in international commercial contracts requires a dual lens that integrates both economic efficiency and legal fairness. Each of these objectives reflects distinct

<sup>70</sup> CISG Article 7(1).

<sup>71</sup> See UNIDROIT Principles 2016, Preamble; ICC arbitral practice frequently applies PICC as evidence of “general principles of international contract law.”

<sup>72</sup> J. Dunoff & J. Trachtman, “Economic Analysis of International Law,” *Yale Journal of International Law* 24 (1999): 1–59.

<sup>73</sup> CISG Advisory Council Opinion No. 6; *Zapadora v. Ruda*, US District Court (2002).

<sup>74</sup> PICC Article 7.4.13(2); S. A. Rea Jr., “Efficiency Implications of Penalties and Liquidated Damages,” *Journal of Legal Studies* 13 (1984): 147–167.

<sup>75</sup> PICC Article 7.4.3(2).

<sup>76</sup> CISG database (Pace Law School): differing interpretations of Article 74 and Article 77 across German, US, Swiss, and Chinese courts.

theoretical foundations: efficiency derives from law-and-economics models emphasizing social welfare maximization and optimal deterrence, while fairness is grounded in corrective justice, equitable distribution of risk, and the protection of reasonable expectations.<sup>77</sup> A comparative and normative analysis must therefore articulate and balance the metrics used to assess whether damages rules successfully advance these two objectives without allowing one to undermine the other.

From the perspective of overall efficiency, the principal standard is the minimization of deadweight loss caused by contractual breach. Economic theory-drawing from Rea's analysis of penalties and liquidated damages-suggests that remedies should incentivize parties to perform when performance is socially desirable and breach when breach is the economically superior option.<sup>78</sup> Expectation damages, as reflected in CISG Article 74 and PICC Article 7.4.2, align with this efficiency goal by forcing the breaching party to internalize the full cost of non-performance, thereby encouraging "efficient breach" only when the promisor's gains exceed the promisee's expected benefit.<sup>79</sup> Foreseeability limitations (CISG Article 74; PICC Article 7.4.4) further promote efficiency by preventing liability for losses that could not reasonably have been priced into the contract *ex ante*.<sup>80</sup> Mitigation obligations (CISG Article 77; PICC Article 7.4.8) similarly function as efficiency tools by preventing wasteful accumulation of loss and encouraging prompt corrective action by the injured party.

In contrast, the fairness standard focuses not on aggregate welfare but on the relational justice between the contracting parties. Fairness is commonly assessed through indicators such as equitable risk allocation, proportionality between breach and remedy, alignment with parties' reasonable expectations, and the prevention of opportunistic behavior.<sup>81</sup> The PICC, for instance, embeds fairness values by ensuring "full compensation" (Article 7.4.2) while allowing judicial reduction of excessive stipulated damages under Article 7.4.13-an explicit safeguard against unjust enrichment or oppressive contract terms.<sup>82</sup> Similarly, the PECL and DCFR contain provisions enabling judicial moderation of penalty clauses, reflecting an equilibrium-based notion of fairness that acknowledges disparities in bargaining power.<sup>83</sup> Fairness also demands accessibility and enforceability of remedies; excessive litigation cost or procedural barriers may undermine substantive justice even when the

doctrinal remedies appear adequate.

A further evaluative standard is predictability, which operates as a hybrid value serving both fairness and efficiency. Predictability supports efficiency by enabling accurate pricing of risk and reducing transaction costs, while simultaneously enhancing fairness by ensuring that parties can rely on the stability of contractual and remedial frameworks. Instruments such as the CISG, PICC, and PECL aim to enhance predictability by codifying clear rules on foreseeability, mitigation, and recoverable losses, yet interpretative discrepancies across jurisdictions continue to challenge this goal.<sup>84</sup> Predictability becomes particularly vital in cross-border commerce, where inconsistent judicial and arbitral applications of damages principles-especially regarding lost profits, consequential loss, and evidentiary thresholds-create uncertainty and raise contracting costs.

The final evaluative criterion concerns the prevention of abuse and opportunistic conduct, a principle tied to both fairness and efficient enforcement. Opportunistic breach-where a party exploits legal gaps or procedural costs-can undermine market integrity and distort economic incentives. Legal mechanisms such as mitigation duties, foreseeability limitations, and moderation of penalty clauses each function to deter opportunistic behavior by ensuring that remedies remain proportionate and anchored in commercial reasonableness.<sup>85</sup> A normative analysis of international damages regimes must therefore consider whether the legal framework effectively constrains abusive conduct without imposing excessive restrictions on legitimate *ex ante* risk allocation.

In sum, establishing the standards for evaluating efficiency and fairness requires the integration of economic reasoning, doctrinal principles, and comparative insights from international instruments. Efficiency emphasizes welfare maximization and rational incentive structures; fairness stresses equitable outcomes, protection of expectations, and proportionality; predictability ensures coherence and stability; and the prevention of abuse safeguards the integrity of the contracting process. These standards collectively provide the analytical foundation for developing a balanced and coherent normative framework for damages in international commercial contracts.

## 2. Proposed framework

Building on the evaluative standards established in the preceding section, this research proposes a structured

<sup>77</sup> D. Chavanne, "Thinking Like (Law-and-) Economists," *Review of Law & Economics* 16 (2020).

<sup>78</sup> S. A. Rea Jr., "Efficiency Implications of Penalties and Liquidated Damages," *Journal of Legal Studies* 13 (1984): 147-167.

<sup>79</sup> CISG Article 74; PICC Article 7.4.2.

<sup>80</sup> CISG Article 74; PICC Article 7.4.4. *Advances in Consumer Research*

<sup>81</sup> M. Eisenberg, "The Principle of Hadley v. Baxendale," *California Law Review* 80 (1992): 563-573.

<sup>82</sup> PICC Article 7.4.13.

<sup>83</sup> PECL Article 9:509; DCFR III.-3:710.

<sup>84</sup> See divergent applications of CISG Articles 74 and 77 in case databases (Pace CISG).

<sup>85</sup> PICC Articles 7.4.8, 7.4.13; CISG Article 77.

framework for assessing the balance between efficiency and fairness in the law of damages under international commercial contracts. The framework is grounded in comparative analysis across the CISG, PICC, PECL, and DCFR, supplemented by insights from economic theory and jurisprudence. Its purpose is to provide a systematic method through which tribunals, courts, and contracting parties can evaluate appropriate damages while minimizing doctrinal inconsistencies and preventing excessive divergence in interpretation.

The framework begins with Step 1: Identification of the Type of Interest Protected. Legal systems traditionally distinguish between expectation, reliance, and restitutionary interests.<sup>86</sup> The CISG primarily protects the expectation interest through Article 74, permitting recovery of actual loss and lost profits, while the PICC and PECL explicitly recognize all three interests.<sup>87</sup> The decision-maker must first determine whether the claim concerns lost profits, wasted expenditures, loss of a chance, or unjust enrichment. Correct characterization is essential because each category involves different thresholds of proof, foreseeability, and mitigation standards, influencing both efficiency and fairness.

Step 2: Foreseeability Assessment serves as the primary ex ante filter of liability. Following the *Hadley v. Baxendale* principle, foreseeability ensures that only losses reasonably contemplated at the time of contracting are compensable.<sup>88</sup> This step requires examining the information available to the breaching party at contract formation, trade usages, the sophistication of the parties, and the nature of the goods or services. Under CISG Article 74 and PICC Article 7.4.4, the relevant standard is whether the breaching party “ought to have foreseen” the loss.<sup>89</sup> This analysis promotes efficiency by allowing predictable risk allocation, while fairness is achieved through consideration of contextual knowledge asymmetries.

The framework proceeds to Step 3: Evaluation of the Duty to Mitigate, requiring assessment of whether the injured party took reasonable steps to reduce the loss. Under CISG Article 77 and PICC Article 7.4.8, damages must be reduced to the extent loss could have been avoided.<sup>90</sup> This inquiry focuses on commercial reasonableness, proportionality between cost and avoided loss, and industry-specific expectations. The mitigation assessment is crucial for ensuring efficiency-by discouraging wasteful

behavior-and fairness-by preventing the breaching party from bearing losses attributable to the injured party’s inaction.

Step 4: Scrutiny of Penalty Clauses and Agreed Damages addresses ex ante risk allocation through contractual autonomy. Under PICC Article 7.4.13, agreed sums are enforceable but may be reduced if “grossly excessive.”<sup>91</sup> The PECL and DCFR adopt similar standards.<sup>92</sup> This step requires evaluating the ratio between the agreed sum and the actual or foreseeable harm, the extent of bargaining asymmetry, and whether the clause serves a legitimate compensatory function or constitutes an oppressive penalty. This element foregrounds fairness-by preventing abuse-and efficiency-by supporting predictable allocation of risk and minimization of litigation costs.

The framework then introduces Step 5: Proportionality and Reasonableness Review, a balancing mechanism derived from European private law and arbitral practice. The decision-maker assesses whether the overall damages award is proportionate to the breach, commercially justified, and consistent with general principles of good faith (CISG Article 7(1), PICC Article 1.7).<sup>93</sup> Proportionality ensures that remedies do not create economic distortions or unjust burdens, thereby preventing both over-compensation and under-compensation.

Finally, Step 6: Systemic Indicators and Contextual Factors ensures that the evaluation reflects not only doctrinal criteria but also broader commercial realities. Relevant indicators include:

the ratio of damages to the contract price; the degree of bargaining asymmetry; reliance intensity and transaction-specific investments; market volatility affecting foreseeability; enforcement costs and procedural accessibility; risk allocation clauses and industry standards.<sup>94</sup>

By integrating legal doctrine with commercial parameters, this step enhances both fairness and efficiency. It also aligns with modern economic analyses that emphasize the importance of contextualized risk distribution and recognition of transaction costs.<sup>95</sup>

In combining these six steps, the proposed framework establishes a coherent methodology capable of harmonizing efficiency and fairness across varied legal systems. It provides decision-makers with structured analytical tools, reduces interpretative uncertainty, and

<sup>86</sup> F. Kessler & G. Gilmore, *Contracts: Cases and Materials* (Little Brown, 1970), on the triad of contract interests.

<sup>87</sup> CISG Article 74; PICC Articles 7.4.2, 7.4.3; PECL 9:502.

<sup>88</sup> *Hadley v. Baxendale* (1854) 9 Exch 341; M. Eisenberg, “The Principle of *Hadley v. Baxendale*,” *Cal. L. Rev.* 80 (1992).

<sup>89</sup> CISG Article 74; PICC Article 7.4.4.

<sup>90</sup> CISG Article 77; PICC Article 7.4.8.

<sup>91</sup> PICC Article 7.4.13(2).

<sup>92</sup> PECL Article 9:509; DCFR III.–3:710.

<sup>93</sup> CISG Article 7(1); PICC Article 1.7 (Good Faith and Fair Dealing).

<sup>94</sup> J. L. Dunoff & J. Trachtman, “Economic Analysis of International Law,” *Yale J. Int’l L.* 24 (1999).

<sup>95</sup> D. Chavanne, “Thinking Like (Law-And-) Economists,” *Review of Law & Economics* 16 (2020).

helps ensure that damages awards reflect both economically rational and normatively justified outcomes. As international commerce continues to globalize and diversify, such a framework becomes essential for enhancing legal predictability, reducing transaction costs, and promoting equitable risk-sharing among contracting parties.

### III. Conclusion

This research has examined the delicate interplay between efficiency and fairness in the law of damages under international commercial contracts through a comprehensive comparative and normative analysis. By drawing on the CISG, the UNIDROIT Principles, the PECL, the DCFR, as well as established case law and economic theory, the study demonstrates that modern international contract law increasingly seeks to harmonize these two foundational objectives rather than treat them as mutually exclusive. Efficiency contributes to global commercial stability by promoting optimal performance incentives, reducing transaction costs, and enhancing predictability, while fairness ensures equitable risk distribution, the protection of reasonable expectations, and the prevention of abuse in cross-border contracting. The research questions posed at the outset have been addressed through the systematic examination of the mechanisms governing damages. First, the design of compensation systems under the CISG, PICC, and national laws reveals both shared principles—such as foreseeability, mitigation, and full compensation—and important divergences in application, particularly between common law and civil law traditions. Second, the study has shown that efficiency and fairness are expressed differently across these bodies of law, sometimes complementing one another and at other times generating tension, especially in areas involving penalty clauses, indirect losses, or disproportionate reliance expenditures. Third, the analysis confirms that reconciliation of efficiency and fairness is not only possible but already emerging in practice through hybrid standards, judicial discretion, and the integration of commercially reasonable behavior as a normative benchmark.

### REFERENCES

#### International legal instruments

- United Nations Convention on Contracts for the International Sale of Goods (adopted 11 April 1980, entered into force 1 January 1988) 1489 UNTS 3 (CISG).
- International Institute for the Unification of Private Law (UNIDROIT), *UNIDROIT Principles of International Commercial Contracts* (2016).
- Commission on European Contract Law, *Principles of European Contract Law* (Parts I–III, 2002) (PECL).
- Study Group on a European Civil Code and Research Group on EC Private Law (Acquis Group), *Principles,*

The proposed evaluative framework developed in this research contributes to both theory and practice by offering a structured methodology for balancing the two objectives. It enables courts, arbitrators, and contracting parties to systematically assess damages through a sequence of analytical steps, from identifying the type of interest protected to examining foreseeability, mitigation, proportionality, and contextual indicators. This framework not only enhances predictability but also provides a flexible tool capable of adapting to diverse commercial contexts and legal systems.

The findings of this study carry significant implications for academics, practitioners, and policymakers. For academics, the framework bridges law-and-economics theory with doctrinal comparative analysis, providing fertile ground for further research. For practitioners, it offers a clear and practical tool for drafting contracts, negotiating risk allocation, and evaluating damages claims. For policymakers and international drafting bodies, the research points toward the benefits of continuing harmonization efforts and encourages the incorporation of both efficiency-driven and fairness-driven elements into future reforms.

Nonetheless, the study acknowledges limitations, including the evolving nature of international case law, the variability of arbitral practice, and the influence of domestic procedural rules on damages awards. Future research could expand on empirical assessments of damages decisions, examine sector-specific contractual practices, or explore the integration of behavioral economics into the analysis of breach and remedies.

In conclusion, achieving a coherent balance between efficiency and fairness in the law of damages is essential for fostering a stable, predictable, and equitable international commercial environment. While differences across legal systems remain, the shared commitment to combining incentive structures with equitable redress signals a promising trajectory toward greater harmonization and more effective regulation of cross-border commercial relationships.

*Definitions and Model Rules of European Private Law: Draft Common Frame of Reference (DCFR)* (Outline Edition, 2009).

#### Cases

- Hadley v Baxendale (1854) 9 Exch 341.
- Victoria Laundry (Windsor) Ltd v Newman Industries Ltd [1949] 2 KB 528.
- Koufos v Czarikow Ltd (The Heron II) [1969] 1 AC 350.
- Robinson v Harman (1848) 1 Exch 850.
- Ruxley Electronics and Construction Ltd v Forsyth [1996]

How to cite : Pham Thi Cam Ngoc, Phan Thi Hong An, Ngo Phuong Tra, Nguyen Hoang Hai My., Efficiency and fairness in the law of damages under international commercial contracts: A comparative and normative analysis. *Advances in Consumer Research*. 2026;3(3): 691-704

AC 344.

Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79.

### **Books and academic works**

Chavanne A, *Droit des obligations* (12th edn, Dalloz 2018).

Dunoff JL and Trachtman JP, *Economic Analysis of International Law* (Cambridge University Press 1999).

McGregor H, *McGregor on Damages* (20th edn, Sweet & Maxwell 2017).

Schlechtriem P and Schwenzer I, *Commentary on the UN Convention on the International Sale of Goods (CISG)* (4th edn, Oxford University Press 2016).

Treitel G, *The Law of Contract* (15th edn, Sweet & Maxwell 2020).

Von Bar C and Clive E (eds), *Principles, Definitions and Model Rules of European Private Law: Draft Common Frame of Reference* (Sellier 2009).

### **Law and economics scholarship**

Born G, *International Commercial Arbitration* (3rd edn, Kluwer Law International 2021).

Kronke H, Melis W, Perales Viscasillas P and Rogers J, *UNIDROIT Principles of International Commercial Contracts: Commentary* (Oxford University Press 2010).

Schwenzer I, Hachem P and Kee C, *Global Sales and Contract Law* (Oxford University Press 2012).

Honnold JO and Flechtner HW, *Uniform Law for International Sales under the 1980 United Nations Convention* (4th edn, Kluwer Law International 2009).

Bridge M, *The International Sale of Goods* (4th edn, Oxford University Press 2017).

Posner RA, *Economic Analysis of Law* (9th edn, Wolters Kluwer 2014).

Shavell S, *Foundations of Economic Analysis of Law* (Harvard University Press 2004).

Rea SA, 'Efficiency Implications of Penalties and

Liquidated Damages' (1984) 13 *Journal of Legal Studies* 147.

Goetz CJ and Scott RE, 'Liquidated Damages, Penalties and the Just Compensation Principle' (1977) 77 *Columbia Law Review* 554.

Fuller LL and Perdue WR Jr, 'The Reliance Interest in Contract Damages' (1936) 46 *Yale Law Journal* 52.

### **Declaration:**

#### **Ethical Approval**

This manuscript does not involve human participants or animals, and therefore, ethical approval was not required.

#### **Informed Consent**

As the research does not involve human participants, informed consent is not applicable. **Statement Regarding Research Involving Human Participants and/or Animals**

This research does not involve human participants or animals.

#### **Funding**

This research was not funded by any external sources. No financial support was received for the research or publication of this manuscript.

#### **Author's Contribution**

Author 1: Conceptualization, methodology, data analysis, and writing the original draft.

Author 2: Literature review, data analysis, and review of the manuscript.

Author 3: Legal analysis and contribution to the drafting of the manuscript.

Author 4: Legal analysis and contribution to the drafting and final review of the manuscript.

#### **Competing Interests**

The authors declare that there are no competing interests related to the research or publication of this manuscript.

#### **Availability of Data and Materials**

The data supporting the findings of this study are available upon reasonable request from the corresponding author