Application of the UN Convention in claims for damages

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In practice, there are cases where businesses located in different countries, having agreed to apply the laws of the Republic of Latvia (“RoL”) to a contract, are unaware or forget that not only the provisions of the Civil Law or the Commercial Law may apply, but also the United Nations Convention on Contracts for the International Sale of Goods (“Convention”), unless the contracting parties have excluded its application.

In this article, we look at the circumstances under which the Convention is applicable and how it can impact claims for damages.

General provisions

The Convention was adopted on 11 April 1980. 97 countries have joined it, including Latvia. According to Article 1, Paragraph 1 of the Convention, it applies to contracts for the sale of goods between businesses whose places of business are in different countries, if:

1. The businesses are located in one of the contracting states of the Convention;

2. The applicable law is that of a contracting state.

At the same time, certain cases are excluded from the scope of the Convention, such as the sale of goods by auction, the sale of aircraft and watercraft, the trading of shares and securities, as well as goods sold for personal use, i.e., for non-commercial purposes.

The above means that if a specific case is not excluded from the scope of the Convention, and one of the applicability criteria in Article 1, Paragraph 1 is met, the contractual relationship between businesses will be governed not by national law, but by the Convention.

For example, if the contracting parties agree to apply Latvian national law, the Convention must be applied automatically. This means that issues covered by the Convention will be regulated not by Latvian law (e.g., the Civil Law or the Commercial Law), but by the Convention.

Application of the Convention

Three key aspects must be taken into account when applying the Convention:

1. Article 7, paragraph 1 of the Convention establishes the obligation to “apply it uniformly”, which refers to its autonomous nature. This, in turn, imposes a duty on any authority applying the Convention to abstract from national law;

2. The Convention does not regulate all matters, so it is important to note that any gaps must be filled by applying general legal principles or legal rules indicated by the applicable conflict-of-law rules;

3. Although the case law of other countries is not legally binding, the interpretation of the Convention's provisions contained therein should be taken into account when applying the Convention.

In practice, this means that the provisions of the Convention must not be interpreted through the lens of national law but rather by using the Convention's preparatory materials, legal doctrine, and the case law of other countries. National law is only applicable in matters not regulated by the Convention.

Despite the fact that the Convention has been in force for 45 years and nearly 100 countries have joined it, its application is still not uniform, including in Latvia.

It is difficult to find court rulings in Latvian case law where the provisions of the Convention have been applied alongside an analysis of case law from other contracting states. As a result, the Convention is often not applied correctly or not applied at all.

At the same time, it should be noted that businesses may agree to exclude the Convention in their contracts under Article 6. If the Convention is not excluded in the contract, it will apply automatically.

Moreover, it should be noted that the Convention will apply even if the contract is not concluded in writing and its existence can be proven by other means, and if the applicable national legal framework does not impose an obligation for the contract to be concluded in writing.

Claiming damages

The Convention regulates a number of issues, including the recovery of damages. This regulation is included in Section II of Chapter V of the Convention, where Article 74 of the Convention states that *"... If a party fails to perform its obligations under the contract or a guarantee within the time specified by or agreed upon under the contract, the party suffering the breach may claim damages, including loss of profit, resulting from the breach. The damages must not exceed the loss, including loss of profit, which the party in breach foresaw or ought to have foreseen at the time of the conclusion of the contract, as a possible consequence of the breach, taking into account the facts of which the party in breach knew or ought to have known."*

Article 77 of the Convention provides that *"[..a party claiming damages must take reasonable measures to mitigate the loss, including loss of profit, resulting from the breach. If the party fails to take such measures, the damages may be reduced to the extent that the loss could have been avoided."*

Therefore, the application of the Convention requires a standard of reasonableness to assess the behaviour of the parties, to which reference can be made. This means that the injured party must be able to reasonably prove the existence of damages, while the breaching party must be able to reasonably foresee the potential damages. In this regard, it must also be taken into account that the parties, as commercial entities, should be aware of the potential commercial nature of goods, meaning that damages can often exceed the contract price.

Special emphasis must be placed on the fact that damages under the Convention should be interpreted broadly,[1] based on the principle of full compensation, which aims to ensure that the injured party is in the same economic position as it would have been had the contract been performed. In this regard, national practices of states that limit the amount of damages are not applicable. This means that the principle of full compensation may require the reimbursement of damages that would not be reimbursed under the applicable national laws of the respective country.

At the same time, the injured party has a reasonable obligation to mitigate damages, for example, by purchasing the goods from another seller at a higher price if the seller has refused to deliver the goods. Otherwise, the recoverable damages will have to be reduced.

However, in some cases, it will not be objectively possible to mitigate damages, for example, if the goods are defective or if such action could harm the reputation of the business. These circumstances will need to be assessed on a case-by-case basis.

Loss of profit

Article 74 of the Convention explicitly emphasises “loss of profit”, which seems to be comparable to the concept of “loss of expected profit” used in civil law. However, this is not the case. Therefore, a different term was deliberately used in the translation of the Convention’s provisions to discourage users from using the two terms interchangeably as much as possible.[2]

In the Civil Law, loss of profit is understood as a reduction in profit that would not have occurred if there had been no infringement. Court practice has recognised that when calculating lost profits, not only the income but also the expenses must be taken into account - taxes payable, production and distribution costs, including wages, administrative costs, expenses for utilities, transport, means of communication, social security contributions[3] etc.

What constitutes “lost profits" should be derived from the materials on the development of the Convention, doctrine and judicial practice in other countries and linked to the principle of full compensation. Indeed, the judicial practice of the member states of the Convention is consistent in that the VAT payable is deducted from the “loss of profit", as are the costs that would have been incurred regardless of the breach of contract. The costs of legal assistance should also not fall within the scope of “loss of profit" and should therefore be compensated under the applicable national legislation.

At the same time, the legal practice of the Member States shows that, e.g. administrative costs, maintenance costs as well as costs for product testing, business trips of employees etc., are not deducted from the “unrealised profit” if they are directly related to the product. For example, employees are sent on a business trip to rectify a fault in the product.

Consequently, when applying the provisions of the Convention, there is a possibility that the court will also recognise as recoverable costs that are not recoverable under the national law of the country, including that of the Republic of Latvia.

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[1] CISG Advisory Council Opinion No. 6 Calculation of Damages under CISG Article 74

[2] Ratniece L. Valodas jautājumi, interpretējot ANO Konvenciju par starptautiskajiem preču pirkuma-pārdevuma līgumiem. Jurista Vārds, 28.07.2020., Nr. 30 (1140), 7.-11 pages.

[3] Latvijas Republikas Augstākās tiesas 2024.gada 21.maija sprieduma SKC-41/2024 civillietā Nr.C68336121 (SKC-41/2024), 9.1. punktu.; Latvijas Republikas Senāta 2022.gada [..] spriedumu lietā Nr. [..], SKC-[H]/2022.