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LIMITATIONS ON LIABILITY FOR LOSS CAUSED BY A BREACH OF BUSINNES CONTRACTS - FROM THE PERSPECTIVE OF THE SERBIAN LAW ON OBLIGATIONS*

Ograničenja odgovornosti za štetu zbog povrede privrednih ugovora - Iz perspektive srpskog Zakona o obligacionim odnosima -

Abstract

This paper aims to analyse the rules concerning the limitations on liability for the loss arising out of business contracts from the perspective of the principle of full compensation as the general principle of the Law on Obligations (Law of Contracts and Torts) and its limitations by way of the foreseeability rule. Special attention is given to the rules of the Law concerning the proportionate reduction of damages in cases when the aggrieved party contributed to the occurrence or increase of the loss, and when the aggrieved party, as a result of the breach of contract, received certain benefit in addition to the loss suffered. Given that contractual liability may apply only if no circumstances that exclude it have occurred, the paper provides a careful analysis of the rules of the Law relating to the exemption of liability, as well as contractual clauses on the exclusion and limitation of liability in terms of their validity and legal effects. The analysis of these rules is followed by their general evaluation in the final considerations.

Keywords: *liability, limitation, loss, breach of contract, Law on Obligations*

Sažetak

Predmet rada predstavlja analiza pravila o ograničenju odgovornosti za štetu proisteklu iz privrednih ugovora sa stanovišta principa potpune naknade kao opšteg principa Zakona o obligacionim odnosima i njegovog ograničenja putem pravila predvidljivosti. Posebna pažnja posvećena je pravilima Zakona o srazmernom sniženju naknade u slučajevima kad je poverilac doprineo nastanku ili uvećanju štete i kad je za dužnika, usled povrede ugovora, pored štete nastala i izvesna korist. Kako ugovorna odgovornost može postojati samo ako nisu nastupile okolnosti koje je isključuju, u radu su posebno analizirana pravila Zakona o oslobađanju od odgovornosti, kao i ugovorne klauzule o isključenju i ograničenju odgovornosti sa stanovišta njihove punovažnosti i pravnih dejstava. Analiza pomenutih pravila praćena je njihovom opštom ocenom u okviru zaključnih razmatranja.

Ključne reči: *odgovornost, ograničenje, šteta, povreda ugovora, Zakon o obligacionim odnosima*

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Introduction

The contract must be binding on the contracting parties the same way as any law. This is one of the fundamental principles of the contract law (*pacta sunt servanda*), and a breach of contract triggers the breaching party's liability for damages. In the theory of the law of obligations, this type of liability is designated as contractual liability [12, pp. 199ff.], [28, pp. 991ff.], [27, pp. 437-535], [10, pp. 23-51]. For the aggrieved party to exercise the right to damages under contractual liability, it is necessary: 1) that one of the contracting parties has breached the contract; 2) that the aggrieved party, as a consequence of the breach of contract, has suffered loss that can be compensated under the law applicable to the contract, and 3) that there are no circumstances that may exclude the liability of the party in breach of the contract. In this respect, one of the most important issues relates to the scope of damages and the limitations on contractual liability.

In business contracts, the limitations on liability for the loss caused by a breach of contract are normally established by the agreement of wills of the contracting parties, which include the appropriate clause into the contract. In this regard, the contracting parties are free, within the limits of public policy, mandatory regulations and fair practices, to exclude or alter the rules of contractual liability as provided by the law. On the other hand, when this issue has not been provided for in the contract, or if the relevant contractual clause is null and void, the contract is governed by the regulations applicable to contractual liability. Since most disputes arising from business contracts are essentially a matter of contractual liability and the scope of damages, knowledge and proper understanding of the basic solutions of the Law on Obligations governing these issues are of particular importance for Serbian companies.

The purpose of this paper is to analyse the rules concerning the limitations on liability for the loss arising out of business contracts from the perspective of the full compensation principle as the general principle of the Law on Obligations (I) and its limitations by the foreseeability rule (II), as well as the rules on the reduction of damages in special cases (III). Given that contractual liability may apply only if no circumstances that exclude it have occurred, the paper provides a careful analysis of the rules of the Law relating to the exemption of liability (IV), as well as contractual clauses on the exclusion and limitation of liability in terms of their validity and legal effects (V). The analysis of these rules is followed by their general evaluation in the final considerations (VI).

Full compensation of loss as a general principle

The Law on Obligations sets forth a general rule for the recovery of damages for breach of contract specifying that: "A creditor shall be entitled to damages for the effective loss suffered and the lost profits, which at the time of entering into contract should have been foreseen by the debtor as a possible consequence of the breach of contract, in the light of the facts which at the time were known or should have been known to him." (Article 266, Paragraph 1).

The principle of full compensation provided under the Law on Obligations, whereby damages consist of the effective loss and lost profits, is widely recognised in the comparative law. Thus, for example, this principle is adopted in German, Austrian, French, Italian, Portuguese and Dutch laws, and in a large number of other national legal systems. Furthermore, this principle is also adopted in the sources of the uniform contract law: UN Convention on Contracts for the International Sale of Goods from 1980 – CISG,[1] (Article 74) [19, pp. 96-117], [20, pp. 571-604], [21, pp. 271-289], [26, pp. 1057-1087], [7, pp. 990-1011]. The UNIDROIT Principles of International Commercial Contracts (Article 7.4.2) [29, pp. 266-269] and the Principles of European Contract Law – PECL (Article 9:502) [24, pp. 438-441]. This principle derives from the idea of full compensation for the loss. According to this principle, the aggrieved party must be placed in the same financial position as they would have been in had the contract been performed in full. To that effect, the aggrieved party who has suffered loss due to a breach of contract is entitled to claim damages both for the effective loss and lost profits. A better understanding of this rule requires an answer to

1 For further details on the CISG and its application in the Serbian legal system, see [16, pp. 414ff.].

three fundamental questions: What is the meaning of a breach of contract? What does effective loss imply? and What do lost profits imply?

Only the loss caused directly or indirectly by a breach of contract may be recoverable. A breach of contract exists in case of failure to perform contractual obligations. This non-performance may be full – when the contractual obligation is not performed at all, and partial – which occurs in several cases: when contractual obligation is performed only in part, when the obligation is performed, but not as envisaged by the contract (for example, late performance or defective performance), and in case of performance of only one or two of a number of undertaken obligations [15, pp. 298-299]. In that regard, Serbian law is completely in line with the solutions offered by modern sources of the uniform contract law, which adopt the concept that the term "non-performance" includes all forms of defective performance, as well as full non-performance. Thus, for example, under the UNIDROIT Principles, non-performance is a failure by a party to perform any of their obligations under the contract, including defective performance or late performance (Article 7.1.1). The PECL contain a similar rule (Article 8:101). A claim for damages may be raised independently or concurrently with other remedies for breach of contract, such as the claim for contract performance, for reduction of the price or for avoidance of the contract.

Effective loss (*damnum emergens*) within the domain of contractual liability may be defined as a reduction of the aggrieved party's assets by a breach of contract. In the practice of business contracts, effective loss may consist, for example, of the costs one contracting party has incurred in preparing to perform their own contractual obligations, while the other party failed to perform their obligations, which led to avoidance of contract. The effective loss for the buyer may, for example, consist of the amount of damages they were obliged to pay to their own buyer because, due to the breach of contract by the seller, they were unable to perform the obligation of delivery of goods. By the same token, if a building contractor fails to complete the construction of business premises on time, thus causing the employer to take a lease on other business premises and pay the rent, the amount of the rent will be their effective loss [8, p. 607]. Speaking of contracts of international sale of goods governed by the CISG (providing under Article 74 for full compensation principle), direct loss is often measured by the difference between the value to the injured party of the performance that should have been received and the value to that party of what, if anything, was actually received [7, pp. 995-996]. In cases where the aggrieved party undertakes measures to be placed in the same position they would have been in had the contract been properly performed, the aggrieved party is entitled to recover the costs of those measures, provided that they were reasonable. To that effect, where a seller unjustifiably delays delivering the goods and the aggrieved buyer undertakes reasonable measures to overcome the temporary loss, the aggrieved buyer may be entitled to recover the expenses they incurred in overcoming the loss of the benefit of performance.[2]

On the other hand, lost profits (*lucrum cessans*), within the context of contractual liability, are the profits the aggrieved party would have made had the debtor delivered performance as contracted. Unlike the effective loss, which implies a reduction of the existing assets, lost profits cover any increase in the assets that would have occurred in the foreseeable future under normal, regular circumstances, but was prevented due to the breach of contract by the other contracting party. In Serbian law, the aggrieved party is entitled to damages for lost profits caused by a breach of contract if three requirements have been met: 1) that the loss in the form of lost profits is certain. In that regard, it does not suffice for the aggrieved party to have merely planned and assumed profits arising under the contract; the profits need to have been certain,

2 The CISG commentators [7, p. 996] provide the following example. The contract provided for the sale of 100 tons of grain for a total price of $50,000 FOB. When delivered, the grain had more moisture in it than allowed under the contract description and, as a result of the moisture, there had been some deteriorations in quality. The extra cost to buyer for drying the grain was $1,500. If the grain had been as contracted, its value would have been $55,000, but because of the deterioration caused by the moisture, after it was dried the grain was worth only $51,000.

Contract price	$50,000
Value the grain would have had if as contracted	$55,000
Value of grain as delivered	$51,000
Extra expenses of drying the grain	$4,000
	$1,500
Loss arising out of the breach	$5,500

i.e. to have been reasonably expected in the regular course of things as profits from the contract concluded. For example, for the seller, lost profits would be the regular margin they would have achieved by selling the goods to buyers, had the goods been delivered to them by the manufacturer in accordance with the contract [8, p. 609]; 2) that there are elements which may serve as a basis for determining the amount of lost profits, which means that the aggrieved party needs to prove the value of the loss suffered in the form of lost profits. However, lost profits need not be calculated with mathematical precision, as such a calculation may not be possible; in such cases it would be unfair to leave the aggrieved party without a remedy. Therefore, lost profits need only be established with reasonable certainty [7, p. 998]. In that regard, lost profits may also be future loss, i.e. a loss that did not yet occur at the time of calculating the compensation, but will rather occur later on. The aggrieved party will be, as a rule, entitled to compensation for future loss providing that such loss is certain and that the aggrieved party may prove its amount as explained above; 3) that lost profits would not be contrary to the applicable regulations and fair business practices, which means that the loss of profit that would have been generated through inadmissible actions or a breach of contract does not enjoy judicial protection in Serbian law. The loss of profit, as a rule, not only envisages the net profit, but also fixed costs (the so-called general expenses) on a pro rata basis. The loss of profit needs to be reduced by the expenses that would have been incurred when generating this profit [26, p. 1073]. The amount of damages is assessed based on the value of loss at the time of the court decision, not at the time when the benefit was not actualised. It should be noted, however, that the degree of the debtor's fault is irrelevant for assessing the amount of damages in Serbian law [22, pp. 80ff.]. In business contracts practice, a typical example of lost profits is the profit which the buyer could have generated in a resale, but which they have lost due to the seller's breach of contract. Also, it includes losses resulting from the inability to keep a business running caused by the breach of contract, as well as many other cases where the above requirements have been met.

Foreseeability rule as a limitation of the principle of full compensation

The foreseeability rule, emanating from French law[3] and the English leading case Hadley v. Baxendale (contemplation rule),[4] limits the extent of damages to the loss which the party in breach foresaw or ought to have foreseen at the time of concluding the contract. The foreseeability rule has been incorporated into a large number of national legal systems [19, pp. 101ff.], as well as into the sources of uniform rules of contract law: the CISG (Article 74), the UNIDROIT Principles (Article 7.4.4) and the PECL (Article 9:503). The limitation of liability to a foreseeable loss is justified by numerous arguments [25, p. 23] suggesting, among other things, that this rule enables the parties to consider and take into account, already at the time of concluding the contract, the potential financial consequences arising from a breach of contract [14, p. 490] and to prevent possible liability, and that the foreseeability rule allows for a fair and reasonable allocation of risk [26, p. 1001].

Under the foreseeability rule adopted in Serbian law, the debtor is liable only for the loss which at the time of entering into the contract he should have foreseen as a possible consequence of the breach of contract, in light of the facts which at the time were known or should have been known to him (Law on Obligations, Article 266, Paragraph 1). This solution of the Serbian Law, based on the full compensation principle and the principle of limitation on liability by the foreseeability rule, is in line

3 Although the notion of foreseeable loss is often associated with common law, it is worth noting that the legal framework for this term was embedded in French law. Already in the 16th century, Dumoulin formulated the rule whereby in determining the scope of damages, an account must be taken of the foreseeability of loss at the very time of concluding the contract. The foreseeability rule was recognised in French theory, therefore the Civil Code adopted the rule stating: "*Le débiteur n'est tenu que des dommages et intérets qui ont été prévus ou qui pouvaient être prévus lors de la conclusion du contrat, sauf lorsque l'inexécution est due à une faute loured ou dolosive.*" (Articles 1231-3). For further details on the foreseeability rule in French law, see [27, pp. 437-440].

4 A landmark case from 1854, setting the rule for the foreseeability of loss in the English law – contemplation rule. This rule was subsequently further interpreted in Victoria Laundry (Windsor) Ltd. v. Newsman Industries, Ltd. (1949). For further details on these cases, see [12, pp. 200ff.], [1, pp. 821ff.], and [3, pp. 571ff.].

with the modern solutions adopted in comparative law with regard to this issue.[5]

Foreseeability is generally determined by using an objective criterion (*in abstracto*). The decisive question in this regard is what an average person in the shoes of the debtor and aware of the circumstances at the time of concluding the contract should have foreseen as a possible consequence of a breach of contract. The determination begins with the appropriate standards (due care of *bonus pater familias*, prudent businessman, prudent professional)[6] whilst taking into account the circumstances of each particular case. When it comes to business contracts, the required standard of care is that of a prudent businessman as a higher level of care involving greater expert and professional liability in contract performance. The burden of proof that the loss was unforeseeable lies with the debtor. However, in addition to the objective criterion, the determination of foreseeability may also employ the subjective criterion (*in concreto*), which considers the consequences of the breach that the particular debtor should have foreseen in particular circumstances. This is particularly the case where the aggrieved party has drawn the debtor's attention to certain specific or exceptional circumstances that are objectively unforeseeable. The burden of proof in such cases rests with the aggrieved party [8, p. 613].

The relevant moment for determining foreseeability is the time of concluding the contract. It is thus irrelevant, for the purpose of limitations on the debtor's liability, whether or not the debtor, after this point in time, became aware of some specific circumstances or additional risks that may cause greater loss than might have been foreseen in the ordinary course of things. With regards to the degree of probability required to determine the foreseeability of loss, a loss that normally occurs due to a breach of contract of a particular type is deemed to be foreseeable. Conversely, such losses that only exceptionally occur due to a breach of contract of a particular type are not considered to be foreseeable within the meaning of the rules of the Law pertaining to the limitations on contractual liability [8, p. 615].

Under the foreseeability requirement, only the loss itself must have been foreseeable at the time of concluding the contract, not the breach of the contract which constitutes the basis for the damages claim. Within these considerations, the domestic doctrine and court practices hold that this requirement relates to the type of loss, not to its amount [10, p. 353]. Thus, for example, in a case from domestic court practice, the claimant performed certain construction works based on a contract with the employer, and he hired the respondent as the subcontractor. Due to the delay in work performance, the claimant was obliged to pay to the employer the liquidated damages in a sum higher than usual. Given that the said delay was caused by the respondent subcontractor, the claimant sought from the court to enjoin the respondent to compensate him for the amount of the liquidated damages he had paid to the employer. The court dismissed this claim as unfounded, maintaining that the respondent, having entered into the contract with the claimant, assumed the obligation to compensate the claimant for the loss the claimant would have incurred due to the respondent's delay in contract performance. The respondent, consequently, assumed the normal risk arising out of such contractual relationship; he did not assume any increased risk, in the sense of the risk related to the claimant's recovery of the liquidated damages paid by the claimant to the employer (Decision of the former Supreme Commercial Court, Ref No Sl. 1682/72).

On the other hand, views on this issue differ in international court and arbitral practice [19, pp. 105-107]. Thus, in a contract on international sale of goods, the buyer needed to take out a loan to make an advance payment to the seller. However, due to a breach of contract by the seller, the buyer was rendered unable to repay the loan on time and, as a result, had to pay additional interest on the sum in arrears. Deciding on the buyer's claim for damages filed against the seller, the District Court of Kuopio (Finland) held that the seller could not foresee the interest rate on the sum in arrears in the buyer's country (Lithuania), considering that it essentially differed from interest rates in Western Europe, and awarded damages

5 For differences between the solutions of the Serbian Law on Obligations and the CISG regarding the foreseeability rule, see [19, pp. 118-120].

6 See Article18 of the Law on Obligations.

to the buyer by reference to the rate which, in the court's opinion, would be foreseeable to the seller.[7]

In Serbian law, limitations of contractual liability to a foreseeable loss apply only to those cases where the loss was not caused through intent or gross negligence of the debtor. Conversely, if the loss occurred as a result of fraud (*fraus*), intentional non-performance (*dolus*) or gross negligence (*culpa lata*), the foreseeability rule does not apply. In this respect, the Law on Obligations provides that, in the event of fraud or intentional non-performance, as well as non-performance due to gross negligence, the aggrieved party is entitled to claim from the debtor the compensation for the entire loss caused by the breach of contract, regardless of the debtor not being aware of the special circumstances that brought about the loss (Article 266, Paragraph 2).

Rules on reduction of damages

In addition to the full compensation principle and its limitations by the foreseeability rule, the Law on Obligations provides for special rules on reduction of damages concerning substitute transactions, mitigation of loss and loss attributable to the aggrieved party.

In certain cases, in addition to loss, the aggrieved party may acquire certain benefit as a result of a breach of contract (for example, in case of purchase for cover in the context of Article 525 of the Law on Obligations). Taking this into account, the Law contains a rule providing that: "Should in the course of a breach of an obligation, in addition to loss, a profit be obtained for the creditor, it shall be taken into account to a reasonable degree in determining the amount of damages." (Article 266, Paragraph 3). This way, the Law has given courts the freedom to decide, taking account the circumstances of each particular case, whether or not the benefit acquired by the aggrieved party should be deducted from the loss suffered due to the breach of contract. This was also the guiding principle in adopting the solution for the contracts in international sale of goods provided in CISG. It says that, if a contract is avoided and if, in a reasonable manner and within a reasonable time after avoidance, the buyer has bought goods in replacement or the seller has resold the goods, the party claiming damages may recover the difference between the contract price and the price in the substitute transaction, as well as any further damages recoverable under the Convention (Article 75). The UNIDROIT Principles (Article 7.4.5) and the PECL (Article 9:506) provide for similar solutions for substitute transaction.

On the other hand, the Law adopts a rule on the aggrieved party's obligation to mitigate the loss due to a breach of contract. According to this rule: "A party claiming a breach of contract shall take all reasonable steps to mitigate the loss caused by such breach, since otherwise the other party may request reduction of damages." (Article 266, Paragraph 4). The failure to mitigate the loss may arise either because the aggrieved party incurs unnecessary or unreasonable expenditure or because they fail to take reasonable steps which would result in the reduction of loss or in offsetting gains [24, p. 445]. Thus, for example, if the buyer has refused, without justification, to accept the goods which are the subject of the contract, they shall be liable to compensate the seller for the costs of storage for such goods (Article 326, Paragraph3 of the Law on Obligations). If the storage of goods requires expenses not commensurate with their value, the seller may sell them in accordance with Article 333, Paragraph1 of the Law. If the seller was able to sell the goods to a third party, but failed to do so, thus incurring costs of storage incommensurably higher than the value of the goods, the buyer shall not be held liable to reimburse the seller for such costs, because the seller failed to take steps to mitigate the loss. Domestic court practice holds that the buyer who has refused, without justification, to accept the goods sent by the seller, shall be obliged to keep or deliver such goods to a public storehouse for keeping. The buyer may not return the goods to the seller unless they have received instructions from the seller to that effect, otherwise they shall not be entitled to a recovery of the costs of transport [8, p. 618].

An almost identical rule about the aggrieved party's obligation to mitigate the loss is contained in the

7 Decision 95/3214 of November 5th 1996 (Butter case) quoted in [25, p. 116]. Available at http://cisg3.law.pace.edu/cases/961105f5.html.

CISG, providing that: "A party who relies on a breach of contract must take such measures as are reasonable in the circumstances to mitigate the loss, including loss of profit, resulting from the breach. If he fails to take such measures, the party in breach may claim reduction in the damages in the amount by which the loss should have been mitigated." (Article 77). The comments to the Convention, provided in the context of applying this rule in international court and arbitral practice, give the example that a party may be obliged to take legal actions against governmental acts, e.g. against seizure of goods, which make it difficult or impossible for the other party to perform the contract. Where non-conforming goods are delivered, the buyer may be obliged to remedy the defect in order to prevent the defect from spreading and to avoid consequential losses, or to replace defective goods needed for running the production, or they may also be obliged to grant their customers a price reduction in order to prevent an increase of loss resulting from their customers avoiding the contracts, etc. [26, p. 1007]. UNIDROIT Principles (Article 7.4.8) and PECL (Article 9:505) also contain a rule on mitigation of the loss.

Finally, the Law sets forth a special rule for such cases where liability for the loss is borne in part by the aggrieved party. According to this rule: "In case of a fault of a creditor or a person under his responsibility, for the ensuing loss, or for the extent of such loss, or for making the debtor's position more difficult, the damages shall be reduced proportionally." (Article 267). While the above provision of Article 266, Paragraph 4 of the Law covers the creditor's conduct following the breach of contract by the debtor, this rule governs those cases where the creditor, through his conduct prior to the breach, contributed to the occurrence of the loss. The principle lying at the heart of this rule is that the creditor cannot recover the resulting loss to the extent that he contributed to the non-performance by his own act or omission [24, p. 444]. In the practice of business contracts, the creditor may contribute to the loss in different ways. Thus, for example, the domestic practice holds that the consignor who delivered the goods by rail contributed to the loss if he had loaded the goods onto the wagon with a defect that could have been observed even on a cursory inspection, or that the aggrieved party were themselves partly liable for the loss if they had entrusted the construction work to a person whom they knew, or must have known, had they exercised ordinary care, to be lacking relevant skills [8, p. 622]. The UNIDROIT Principles provide for similar rules on this issue: "Where the harm is due in part to an act or omission of the aggrieved party or to another event for which that party bears the risk, the amount of damages shall be reduced to the extent that these factors have contributed to the harm, having regard to the conduct of each of the parties." (Article 7.4.7), and likewise the PECL: "The non-performing party is not liable for loss suffered by the aggrieved party to the extent that the aggrieved party contributed to the non-performance or its effects." (Article 9:504).

Exemptions from liability under Article 263 of the Law on Obligations

The comparative law has widely recognised the principle whereby the debtor is released from liability in cases where performance has become impossible for reasons not attributable to the debtor or due to an impediment beyond his control [4, pp.75ff.].

Although the solutions of different national legal systems show differences within this general principle, [24, pp. 383-384], it is possible to pinpoint certain features common to the countries of the civil law system.[8] These are reflected in the requirement for the impossibility which excludes liability for non-performance, which means that: a) the impossibility of performance is a consequence of an external event beyond the contracting party's sphere of influence and control, and it could not have been foreseen, avoided or overcome; b) it is a subsequent impossibility, given that the impossibility that occurs at the time of concluding the contract as a rule causes the contract to be void (*impossibilium nulla obligatio*); c) it is an objective impossibility of performance, meaning that it does not suffice that the contracting party alone cannot perform the obligation, it has to be an obligation that cannot be performed objectively; d) the impossibility occurred during the term allowed for contract performance, i.e.

8 For this issue in the common law system, see [19, pp. 63-67].

before the party affected by the impossibility fell into delay. Otherwise, if the impossibility should occur after the party falls into delay, they shall be held liable to the other party for the loss, even if the impossibility did not arise through their fault [17, pp. 429ff.].

In Serbian law, release from liability for loss due to a breach of contract is provided in Article 263 of the Law on Obligations stating that: "A debtor shall be released from liability for loss upon proving that his inability to perform the obligation, or his delay in performing the obligation was due to the circumstances occurring after conclusion of the contract which he was unable to prevent, remove or avoid.". In order for the impossibility of performance to lead to a release from liability under Article 263 of the Law, the non-performing or late-performing party must prove: 1) that fulfilment of their contractual obligation at the time performance was due, was impossible, and 2) that the impossibility arose from circumstances that occurred after conclusion of the contract, which they were unable to prevent, remove or avoid.

In order to trigger release from liability, the impossibility, both in fact and law, must meet certain requirements. Thus, the impossibility must be full, given that the Law provides for special rules in case of partial impossibility (Article 138) and must be permanent because temporary impossibility, as a rule, does not lead to the extinguishment of the obligation, but rather to postponement of its performance. The impossibility must occur following the conclusion of the contract (subsequent impossibility), because the Serbian law takes the traditional position that impossibility which exists at the time of concluding a contract (initial impossibility), as a rule, causes the contract to be void (*impossibilium nulla obligatio*). In order for the debtor to be released from liability for loss, there has to be objective impossibility, which means that nobody, and not just the debtor, can fulfil the specific obligation.[9] The impossibility must occur before the performance becomes due; the debtor shall also be liable for partial or full impossibility of performance, even without being at fault, if the impossibility occurred after their falling into delay, for which they are held liable. However, the debtor shall be released from liability upon proving that the subject matter of performance would have perished by accident even if they had fulfilled their obligation on time.[10]

The Law requires that the impossibility should arise from the circumstances that occurred after concluding the contract, when the debtor was unable: a) to prevent – for example, if the seller, due to an economic embargo on the country of the buyer, is unable to deliver the goods to the buyer; b) to remove – for example, if the seller is unable to transport the goods by rail due to the destruction of a section of the railway caused by fire, he is obliged to use an alternative transport route and thus perform his contractual obligation; or c) to avoid – for example, if the manufacturer of goods is unable to make delivery due to a ban on import of the material required for production, they are obliged to use other materials available in the market [9, p. 594]. An analysis of these rules shows that the Law, unlike the uniform rules and the corresponding solutions of numerous other national laws, does not explicitly provide for the requirement of unforeseeability of the occurrence of circumstances that lead to the impossibility of performance. Based on a strict interpretation of the Law, a debtor shall be released from liability for damages even in case when they were able to foresee, at the time of concluding the contract, the occurrence of circumstances leading to the impossibility of performance, provided that they were able to prevent, remove or avoid such circumstances. Still, in this regard, it is necessary to take into account the general rule of the Law concerning the limitation of liability for loss by the foreseeability rule, provided in Article 266 of the Law.

Under the exemption rule adopted in the CISG: "A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of conclusion of the contract

9 This position is widely accepted in the doctrine of the Serbian Law on Obligations, as well as in court practice. See [23, p. 520]. However, certain authors take the view that distinguishing between subjective and objective impossibility is not relevant in Serbian law. Briefly about these views and criticism thereof in [9, pp. 590-592].

10 Article 262, Paragraphs 4 and 5 of the Law.

or to have avoided or overcome it or its consequences." (Article 79.1). The above rule of the Convention has made a significant impact on the corresponding solutions in other sources of uniform contract law, and in particular on the UNIDROIT Principles (Article 7.1.7) and the PECL (Article 8.108), which contain similar rules on exemption from liability. Similar solutions are also envisaged in the Force Majeure Model Clauses produced by international organisations.[11] These rules, therefore, may be considered as the general principle of exemption from liability accepted in the sources of uniform contract law. According to this principle, in order for a debtor to be released from liability for non-performance, the following requirements need to be fulfilled: a) that non-performance was due to an impediment beyond the debtor's control; b) that the debtor could not have foreseen the impediment at the time of concluding the contract; and c) that the debtor could not be reasonably expected to avoid or overcome such impediment and its consequences. The differences between the said principle of uniform rules and the corresponding solutions of national laws should be viewed in light of these requirements.[12]

In the practice of international commercial transactions, the following events and circumstances are usually defined as cases of Force Majeure: a) natural phenomena and disasters such as earthquake, hurricane, storm, fire, frost, shipwreck, epidemic, thunder/lightning, tsunami, flood, landslide, avalanche; b) armed conflicts such as war, war preparations, civil war, blockade, military operations of all types, revolution, coup d'état, insurrection, military mobilisation, invasion, civil commotion, civil disobedience; c) labour and social conflicts and problems which usually include certain external events of overwhelming proportions beyond the control of the contracting parties, such as general strike, strikes at national, regional or city level, industrial strike, general labour disturbance, lockout, union strike, occupation of factories; d) act of authority (*Le fait du Prince*) such as economic embargo, import or export ban, ban on foreign currency transactions, amendments or adoption of new laws, decrees and other regulations.[13]

Contractual clauses excluding or limiting liability

In business contracts, liability for a breach of contract is normally established by the agreement of wills of the contracting parties in appropriate contractual clauses. The contracting parties are free, within the limits of the public policy, mandatory regulations and fair practices, to provide for different modalities of contractual liability. These range from the exclusion of contractual liability, through its limitations, to the extension of contractual liability to cases which, under the rules of the applicable law, trigger no liability. The rules of the applicable law on exclusion and limitation of contractual liability apply when this issue is not governed by contractual clauses, or when the relevant contractual clauses have been affected by nullity. [18, p. 237].

Clauses excluding or limiting liability have been the object of much suspicion and guarded views in comparative law, being a deviation from the general rules on liability for damages arising from fundamental moral values and categories. One of the underlying principles of the law on obligations in comparative law is the principle of prohibition against causing loss, whereby any person causing loss to another must compensate such loss. Any departures from this principle may upset the delicate balance of rights and obligations of the parties, thus creating a high degree of legal uncertainty in contractual relations. Still, based on the freedom of contract principle, it is widely recognised that the parties, by mutual agreement, may exclude or limit liability for damages. Consequently, the clauses excluding or limiting liability, although subject to significant restrictions, are in general valid in most legal systems [6, pp. 383ff.].

In comparative law, there are different solutions for the validity and/or effectiveness of the clauses excluding or limiting liability. With regard to the sources of uniform rules of contract law, the UNIDROIT Principles provide that a clause limiting or excluding one party's liability for

11 See ICC Force Majeure Clause 2003, available at: https://iccwbo.org/publication/icc-force-majeure-clause-2003icc-hardship-clause-2003/. Detailed analysis of this Clause in [2, pp. 117ff.]. In that respect, see also the ITC Model Clause (International Trade Centre) in [13].

12 Detailed analysis in Perović, J. Standardne klauzule [19, pp. 68-76].

13 For further details, see [6, pp. 443ff.].

non-performance or which permits one party to render performance substantially different from what the other party reasonably expected may not be invoked if it would be grossly unfair to do so, taking into consideration the purpose of the contract (Article 7.1.6). On the other hand, the PECL expressly prevents the application of the clause excluding or limiting liability if it would be contrary to good faith and fair dealing to invoke it (Article 8:109). Consequently, "if to invoke the clause is found to be contrary to good faith and fair dealing, the exemption clause will not operate (whether it is treated as null, void or unenforceable)." [24, p. 388]. The validity of the exclusion or limitation clauses is not governed by the CISG; in principle, it is subject to the applicable domestic law. However, in determining the validity of these clauses in a contract governed by the CISG, the principles of the CISG are to be taken into account [26, p. 1023].

Speaking of domestic laws, express rules concerning the exclusion or limitation clauses are contained, for example, in the Swiss Code of Obligations (Article 100),[14] German Civil Code (Article 276), Italian Civil Code (Article 1229), Spanish Civil Code (Article 1102), Civil Code of Québec (Article 1474), American Uniform Commercial Code, under which a valid disclaimer requires special wording, (Articles 2–316, 2–719),[15] and others. In contrast, civil codes in some other domestic laws, such as the French and Belgian law, do not provide for express rules about this type of clauses, and the issue of their validity is settled in court practice.

The Serbian Law on Obligations contains detailed rules on the limitations and exclusion of liability. According to these rules, the parties cannot agree in advance to exclude debtor's liability for intent (*dolus*) or gross negligence (*culpa lata*). The court may, upon request of the interested contracting party, invalidate even the contractual provision on the exclusion of liability for simple negligence, should such agreement be the result of the debtor's monopoly position or generally of an unequal position of the contracting parties. The provision defining the highest amount of damages is valid unless such amount is in obvious disproportion to the loss, and unless the law provides otherwise for the particular case. Finally, in case of limiting the damages, the aggrieved party is entitled to full compensation when the impossibility of performance occurred as a result of the debtor's intent of gross negligence (Article 265). Cases where the exclusion or limitation of liability clause is contained in the general terms and conditions of the contracts of adhesion raise special concerns. Under the Serbian Law on Obligations, the provisions of the general terms and conditions are null and void if contrary to the very purpose of the contract concluded or fair business practices (Article 143, Paragraph 1). Additionally, the court may deny the application of certain provisions of the general terms and conditions which preclude the other party from raising objections, or deprive the party from their rights under the contract or the time limits allowed, or are otherwise unfair or excessively strict towards such party (Article 143, Paragraph2). Finally, the *contra preferentem* rule ought to be taken account, stating that any ambiguous clause of the contracts of adhesion should be interpreted by the court in favour of the party that entered into the contract of adhesion supplied by the other party (Article 100).

Analysis of the solutions offered in comparative law with regard to the clauses excluding or limiting liability leads to the conclusion that there are different criteria of validity and/or effectiveness of these clauses. In that regard, some sources of law expressly reject the application of clauses excluding or limiting liability if they would be contrary to good faith and fair dealing, some disallow clauses considered to be "unreasonable" or "grossly unfair", some require special wording for the validity of disclaimers, while some provide that liability may not be excluded in case of intent, whilst other extend this limitation to gross negligence.

In practice, the clauses excluding or limiting liability are often imposed by the economically stronger party, thus placing the other party in an unfair position. The party benefiting from the agreed exclusion or limitation of liability would often exercise less care in performance of their contractual obligations than that which would normally have been applied in the absence of such a clause. In extreme cases, such clauses may allow for total non-

14 For this issue in the Swiss law, see, for example [11, pp. 195ff.].

15 In that respect, see [5, p. 251].

performance of the obligations by the party to whose benefit they operate, leaving the other party with no recourse to claim damages or significantly limiting the scope of such a claim. As a rule, the limitation clauses, and in particular the exclusion clauses, carry a risk of non-performance of contractual obligations and may create uncertainty in contractual relationships, therefore contractual parties need to devote special attention to this issue.[16]

Conclusion

The Law on Obligations, as a general rule in the field of contractual liability, adopts the full compensation principle, whereby the aggrieved party must be placed in the same financial position as they would have been in had the contract been performed in full. The operation of this principle is limited by the foreseeability rule, requiring that the debtor be liable only for the loss which at the time of entering into contract they should have foreseen. Still, the limitation to the foreseeable loss does not apply if the loss occurred as a result of fraud, intentional non-performance or gross negligence, when the debtor is obliged to compensate for the entire loss. On the other hand, the Law contains special rules on proportionate reduction of damages in cases when the aggrieved party themselves contributed to the occurrence or increase of loss, and when the aggrieved party, due to a breach of contract, received certain benefit in addition to the loss suffered. Under the broadly recognised principle in comparative law, the debtor is not held liable for loss when requirements for release from liability provided by the law or the wills of the contacting parties have been met. In this context, the paper analyses the rules of the Law on Obligations governing the exemption of liability which apply unless the contracting parties have provided otherwise in the contract. When it comes to the contractual provisions on exemption and limitation of liability, the fundamental question relates to the validity and the effects of the exemption clauses, and the paper examines both the basic solutions of the Serbian Law and the solutions offered in comparative law. A comparative analysis of the above rules of the Law and the corresponding solutions in comparative law shows that, with respect to these issues, the Serbian Law largely reflects the views accepted in the sources of the uniform contract law which may be considered as expressions of contemporary tendencies in this field. In terms of the general conclusion, the following statement can be made: the Law on Obligations, with regard to the rules on liability for loss due to a breach of contract, and in terms of its solutions in their entirety, can rightfully be classified among the modern and successful codifications of the law of obligations. Although based on the principle of party autonomy, the contracting parties are free, within the limits of public policy, mandatory regulations and fair practices, to change or exclude the rules of this Law, they need to be carefully acquainted with them so as to be able to select the best solutions to be applied to their contract.

16 For more details on clauses excluding and limiting liability, see [19, pp. 95-135].

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