

Definition of Fundamental Breach under CISG's Art. 25 and Analysis of Recent Case Law

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I. INTRODUCTION

The United Nations Convention on Contracts for the International Sale of Goods (the “Convention” or “CISG”)² is a self-executing³ multilateral treaty enacted, in 1980, by the United Nations Commission on International Trade Law (UNCITRAL) with the mission to harmonize the applicable law in cross border transactions of sale of goods and to promote fairness in the relationships between contracting companies of the parties⁴.

The CISG came into force on January 1, 1988⁵. However, before that, the need of promoting uniformity within cross-border transactions had been noticed by the International Institute for the Unification of Private Law (UNIDROIT), which enacted two conventions, known as The Hague Conventions⁶, with the purpose of supporting equal legal treatment within international trade⁷. The Hague Conventions, however, did not attract a wide number of States,

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² S. Treaty Doc. No. 9, 98th Cong., 1st Sess. 22 (1983), 19 I.L.M 671, reprinted at 15 U.S.C. App. 52 (1997), also available at <http://www.uncitral.org/pdf/english/texts/sales/cisg/V1056997-CISG-e-book.pdf>

³ Once signed by a Contracting State, the CISG becomes automatically effective without the need of a domestic law to implement it; Harry M. Flechtner, *The United Nations Convention on Contracts for the International Sale of Goods* 1, United Nations Audiovisual Library of International Law, 1 (2009), available at http://legal.un.org/avl/pdf/ha/ccisg/ccisg_e.pdf.

⁴ Information provided by the UNCITRAL website, UNCITRAL Texts and Status, International Sale of Goods (CISG), (Dec. 11, 2016, 11:29AM), http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html.

⁵ *Id.*

⁶ The Uniform Law on the Formation of Contracts for the International Sale of Goods (ULF) and the Uniform Law for the International Sale of Goods (ULIS).

⁷ Harry M. Flechtner, *The United Nations Convention on Contracts for the International Sale of Goods* 1, United Nations Audiovisual Library of International Law, 1 (2009), available at http://legal.un.org/avl/pdf/ha/ccisg/ccisg_e.pdf.

mainly because many nations did not like their approach towards the Western European legal system⁸.

Thereupon, the UNCITRAL decided to revise The Hague Conventions, intending to engage a larger number of contracting States. To that extent, it seems as though the CISG's drafters sought to write the Convention in a fashion so as to avoid the use of words and expressions with national connotation and related to domestic legal doctrines⁹. The effort was worth it. At the time this paper is written (November 2016), 85 nations, including the United States, have adopted the CISG, since its promulgation in 1980¹⁰.

The CISG's applicability depends on if (i) the parties of a contract of sales of goods have their business places in different States, and both are contracting States of the CISG; or (ii) the rules of private international law lead to the application of the law of a contracting State¹¹; or (iii) by virtue of a choice of law clause included in the contract. In all circumstances, parties belonging to contracting States may also completely exclude the applicability of the CISG¹², derogate from or vary the effect of its provisions¹³.

However, even when the CISG is applicable it does not govern the contract as a whole, but only the formation of the contract and the rights and obligations of the seller and the buyer arising

⁸ DANIEL C. K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 170 (WOLTERS KLUWER EDS., 3RD ED. 2015).

⁹ Bruno Zeller, *Fundamental Breach and the CISG – a Unique Treatment or Failed Experiment?*, 8 VINDOBONA JOURNAL OF INTERNATIONAL COMMERCIAL LAW & ARBITRATION 81, 83 (2004), available at <http://www.cisg.law.pace.edu/cisg/biblio/zeller12.html>.

¹⁰ Information provided by the UNCITRAL website, UNCITRAL Texts and Status, International Sale of Goods (CISG), Status, (Dec. 11, 2016, 11:58AM), http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG_status.html.

¹¹ See CISG Article 1, and Article 95, *supra* note 2; Under the latter a Contracting State can declare not be bound by item (ii).

¹² See CISG Article 6, *supra* note 2.

¹³ See CISG Article 12, *supra* note 2.

from such contract¹⁴. All other issues left outside the CISG's scope may be governed by a choice of law made by the parties or by the international private law rules.

When dealing with matters related to the party's obligations, the CISG provides a very well-structured set of rules concerning the remedies available for both sides in case of non-performance by either party of the contract. As cross-border transactions involve a high level of complexity, those remedies were carefully designed in a way to preserve the life of the contract as long as possible in order to avoid extra costs and to maintain an economic balance between the parties¹⁵. Thereupon, the concept of fundamental breach provided by Article 25 of the CISG was developed to work, on a case-by-case basis, as a gatekeeper within this structure, permitting access to remedies of more rigorous consequences only when the maintenance of the contract is no longer feasible.

This structure is in conformity with the CISG's policy of promoting a "modern, uniform and fair regime for contracts for the international sale of goods"¹⁶ and benefits parties of different bargaining power because it does not favor any specific party side¹⁷.

The purpose of this paper is to understand the concept of fundamental breach within the CISG's structure and, upon this understanding, evaluate some recent case law on the applicability of Article 25. Following this introduction, a clarification on the definition of fundamental breach will be provided. Further, the interpretative rules set forth by the CISG will be analyzed to

¹⁴ See CISG Article 4 and Article 5, *supra* note 2.

¹⁵ Robert Koch, *The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)*, REVIEW OF THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG), 1998, KLUWER LAW INTERNATIONAL 177, 332-335 (1999), available at <http://cisgw3.law.pace.edu/cisg/biblio/koch.html>.

¹⁶ Information provided by the UNCITRAL website, UNCITRAL Texts and Status, International Sale of Goods (CISG), (Dec. 11, 2016, 12:21PM), available at http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html.

¹⁷ Andrew Babiak, *Defining "Fundamental Breach" Under the United Nations Convention on Contracts for the International Sale of Goods*, 6 TEMPLE INTERNATIONAL AND COMPARATIVE LAW JOURNAL 113, 114 (1992), also available at <http://www.cisg.law.pace.edu/cisg/biblio/babiak.html>.

demonstrate how it can help in the interpretation of fundamental breach as governed by Article 25. This paper will then explore, in detail, the process of identification of each of the elements of a fundamental breach. Lastly, recent court decisions regarding the occurrence of fundamental breach will be examined to understand how Article 25 has being recently applied and to assess its conformity with the CISG's provisions and purpose.

II. DEFINITION OF FUNDAMENTAL BREACH UNDER ART. 25 OF THE CISG

Article 25 provides the general definition of fundamental breach under the CISG:

“A breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result”¹⁸.

This definition plays a key role within the CISG as the remedies available to the aggrieved party when the breach is deemed fundamental differ greatly from the remedies available when the breach is viewed as non-fundamental¹⁹.

For instance, either party is only allowed to claim avoidance of the contract under the CISG -- without first resorting to any other remedy therein --, if the non-performance of the obligation by the breached party amounts a fundamental breach²⁰. As defined by Zeller, “the threshold test

¹⁸ See CISG Article 25, *supra* note 2.

¹⁹ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 489-490 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

²⁰ See CISG Article 49 (1) (a) and Article 64 (1) (a), *supra* note 2.

for avoidance is the notion of fundamental breach”²¹. Additionally, the buyer’s ability to request substitute goods²² or to claim any remedy available under the CISG despite of the risks having passed to him²³ depend on the existence of a fundamental breach.

Therefore, the language and structure of Article 25 combined with the CISG’s remedial system restricts the use of far-reaching remedies exclusively to situations where a fundamental breach has occurred. Conversely, it can be stated that, under the CISG’s provisions, cure of any default is preferred over the recourse to sever remedies, such as the breach of contract.

The rationale behind this approach is purely economic. Whenever the breach does not go to the root of the contract (non-fundamental), the CISG seeks to set aside unnecessary expenses that may be incurred by the parties – associated, for instance, with the return and storage of goods -- and also to deter the aggrieved party from taking any disproportional advantage to modify the contract due to a peculiar economic situation or to pass the risk of a change on the market condition to the defaulting party²⁴, which could compromise the basis of equality between the parties.

Despite Article 25’s significant function within the CISG’s remedial system, the attempt of the CISG’s drafters to encompass in its provision multiple interests from different legal systems, such as the civil law and the common law, prevented the drafting of a clearer and more specific definition of fundamental breach²⁵. Anyone reading Article 25 for the first time would have some

²¹ Bruno Zeller, *Fundamental Breach and the CISG – a Unique Treatment or Failed Experiment?*, 8 VINDOBONA JOURNAL OF INTERNATIONAL COMMERCIAL LAW & ARBITRATION 81, 90 (2004), available at <http://www.cisg.law.pace.edu/cisg/biblio/zeller12.html>.

²² See CISG Article 46 (2), *supra* note 2.

²³ See CISG Article 70, *supra* note 2.

²⁴ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 490-491 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

²⁵ Michael Will, *Article 25*, in BIANCA & BONELL, UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS COMMENTARY ON THE INTERNATIONAL SALES LAW: THE 1980 VIENNA SALES CONVENTION 205, 213 (Griuffrè: Milan eds., 1987), also available at <http://cisgw3.law.pace.edu/cisg/biblio/will-bb25.html>; Bruno Zeller, *Fundamental Breach and the CISG – a Unique Treatment or Failed Experiment?*, 8 VINDOBONA JOURNAL OF INTERNATIONAL COMMERCIAL LAW & ARBITRATION 81, 88 (2004), available at <http://www.cisg.law.pace.edu/cisg/biblio/zeller12.html>.

difficulty in understanding the concept of fundamental breach as its definition requires the comprehension of another subjective word, that is “substantially”.

As the author Michael Will has noted, “defining fundamental with substantial, to begin with, leaves an impression of playful tautology”²⁶. This writer agrees that the use of such words to define fundamental breach seems not to be very helpful to those who need to deal with the CISG’s remedial system, causing a feeling of uncertainty regarding its applicability. However, in this writer’s opinion, the structure and language of Article 25 serves the purpose of preserving the balance between the parties to the contract in international trade, which was recognized in the CISG’s preamble as an essential component for the achievement of uniformity²⁷.

The structure of Article 25, for instance, was developed with focus on the harm caused to the aggrieved party instead of the non-performance of the obligation itself, which indicates that Article 25 is clearly better concerned to the extent of deprivation than to the extent of the detriment²⁸. Moreover, the absence of any specific example of what could be treated as fundamental breach or substantial deprivation leaves those concepts open to fit different types of breach in different occasions.

The use of such abstract words, considered by many as vague²⁹ and nebulous, have been seen for some commentators as a gateway for uncertainty and unpredictability regarding Article

²⁶ Michael Will, *Article 25*, in BIANCA & BONELL, UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS COMMENTARY ON THE INTERNATIONAL SALES LAW: THE 1980 VIENNA SALES CONVENTION 205, 211 (Griuffrè: Milan eds., 1987), also available at <http://cisgw3.law.pace.edu/cisg/biblio/will-bb25.html>.

²⁷ See CISG Preamble, *supra* note 2.

²⁸ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 495-496 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

²⁹ Leonardo Graffi, *Case Law on the Concept of "Fundamental Breach" in the Vienna Sales Convention*, INTERNATIONAL BUSINESS LAW JOURNAL No. 3, Paris, Forum Européen de la Communication 338, 338 (2003), also available at <http://cisgw3.law.pace.edu/cisg/biblio/graffi.html>.

25's applicability³⁰. Nevertheless, this writer agrees with Franco Ferrari when he says "it is possible to define the concept of fundamental breach on the basis of the elements by which it is characterized (such as breach of an obligation, detriment, legitimate expectations, and foreseeability) in a way that can prove useful for the CISG's practical application"³¹.

The wording of Article 25 may not permit a definition, in closed terms, of what fundamental breach means (and this was never intended by the CISG's drafters). However, Article 25 gives to the CISG's interpreter the necessary tools -- breach, substantial deprivation (from the perspective of the legitimate expectation under the contract), and foreseeability -- that allows the concept of fundamental breach to be applied in a case-by-case analysis.

The uncertainty and unpredictability feared by some commentators may dissipate if courts, arbitrators and mediators make proper use of those tools, and simultaneously give special consideration to cases where courts have already applied the concept of fundamental breach in a specific context. As perfectly emphasized by Michael Will "meditation over terms as pregnant with connotations as 'fundamental', 'substantial' or 'foreseeable' never ends, nor does controversy about their meaning. But while philosophers have time to muse, lawyers usually have not; and merchants even less"³².

Therefore, instead of divagating on the meaning of those abstract words employed by Article 25, of greater importance is the understanding of the interpretative rules set forth by the CISG, which undoubtedly help to clarify the concept of fundamental breach in concrete situations.

³⁰ Sonakshi Verma, *Doctrine of Fundamental Breach: The CISG and The UCC*, (Dec. 11, 2016, 1:14PM), available at <http://www.lawctopus.com/academike/doctrine-of-fundamental-breach/>.

³¹ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 493 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

³² Michael Will, *Article 25*, in BIANCA & BONELL, UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS COMMENTARY ON THE INTERNATIONAL SALES LAW: THE 1980 VIENNA SALES CONVENTION 205, 209 (Griuffrè: Milan eds., 1987), also available at <http://cisgw3.law.pace.edu/cisg/biblio/will-bb25.html>.

III. CISG'S INTERPRETATIVE RULES APPLIED IN THE COMPREHENSION OF THE FUNDAMENTAL BREACH CONCEPT

As seen above, the reading of Article 25 alone does not provide sufficient information in order to permit a satisfactory definition of what fundamental breach is. This, however, is not a problem, because whenever a term within the CISG it is not well settled, Article 7 provides the necessary rules for the interpretation of those unsettled concepts³³:

“(1) In the interpretation of this Convention, regard is to be had to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.

(2) Questions concerning matters governed by this Convention which are not expressly settled in it are to be settled in conformity with the general principles on which it is based or, in the absence of such principles, in conformity with the law applicable by virtue of the rules of private international law.”³⁴

Pursuant to Article 7 (1)'s interpretative rule, three general principles should guide the applicability of the CISG: the international character, the promotion of uniformity, and good faith in international trade. Those principles read in conjunction mean that resorting to any domestic law should be avoided while international case law on the applicability of the CISG is needed in order to promote a uniform application of the Convention³⁵.

³³ Andrew Babiak, *Defining “Fundamental Breach” Under the United Nations Convention on Contracts for the International Sale of Goods*, 6 TEMPLE INTERNATIONAL AND COMPARATIVE LAW JOURNAL 113, 116 (1992), also available at <http://www.cisg.law.pace.edu/cisg/biblio/babiak.html>.

³⁴ See CISG Article 7, *supra* note 2.

³⁵ Andrew Babiak, *Defining “Fundamental Breach” Under the United Nations Convention on Contracts for the International Sale of Goods*, 6 TEMPLE INTERNATIONAL AND COMPARATIVE LAW JOURNAL 113, 116-118 (1992), also available at <http://www.cisg.law.pace.edu/cisg/biblio/babiak.html>; Robert Koch, *The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)*,

Furthermore, Article 7 (2)'s provision establishes that any gap existent within the CISG's content must be filled in conformity with the general principles upon which the CISG is based, and in the absence of those principles, through the application of domestic law after a choice of law analysis³⁶. Nevertheless, as correctly pointed out by Franco Ferrari, support in any national legal system for the comprehension and interpretation of the CISG's provisions is to be sought only when a specific term applied by the CISG has its origin in a particular domestic doctrine³⁷.

The concept of fundamental breach given by Article 25, however, although similar to some extent to the concept of material breach in American contract law³⁸, has no parallel term in any domestic law³⁹. For this conclusion, the legislative history of Article 25 is an important piece of evidence of the autonomous character of the fundamental breach term employed by CISG as it reveals the birth of a brand-new concept with no connection with any other similar expressions found in any particular national legal system⁴⁰. Therefore, in obedience to such interpretative rules, it becomes clear that any nationalistic interpretation of the concept of fundamental breach should be avoided, as it could endanger the CISG's purpose of harmonizing the applicable law in

REVIEW OF THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG), 1998, KLUWER LAW INTERNATIONAL 177, 206-211 (1999), available at <http://cisgw3.law.pace.edu/cisg/biblio/koch.html> (explaining the principle of good faith in international trade).

³⁶ DANIEL C. K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES, AND MATERIALS 183-184 (WOLTERS KLUWER EDS., 3rd ed. 2015).

³⁷ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG* - -, 25 JOURNAL OF LAW AND COMMERCE 489, 492 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

³⁸ Under American contract law, a material breach exists when the failure to perform an obligation under the contract leads to a situation where the contract is no longer of value to the aggrieved party, allowing such party to sue for breach of contract and to stop performing its own obligations. See Restatement (Second) of Contracts §241.

³⁹ Michael Will, *Article 25*, in BIANCA & BONELL, UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS COMMENTARY ON THE INTERNATIONAL SALES LAW: THE 1980 VIENNA SALES CONVENTION 205, 209-210 (Griuffrè: Milan eds., 1987), also available at <http://cisgw3.law.pace.edu/cisg/biblio/will-bb25.html>.

⁴⁰ *Id.*; Robert Koch, *The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)*, REVIEW OF THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG), 1998, KLUWER LAW INTERNATIONAL 177, 267-281 (1999), available at <http://cisgw3.law.pace.edu/cisg/biblio/koch.html>.

international trade⁴¹. In other words, the Convention itself must be considered as a whole (including its underlying policy and legislative history) in the interpretation of the fundamental breach concept.

Thereupon, special regard is to be had to the principles set forth by Articles 8 and 9⁴² upon which the CISG's provisions are based. Both Articles require the interpreter of the CISG to take into consideration not only the wording of the contract entered into by the parties, but also the whole context where the commercial relationship was established:

“Article 8

(1) For the purposes of this Convention statements made by and other conduct of a party are to be interpreted according to his intent where the other party knew or could not have been unaware what that intent was. (2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances. (3) In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties.

⁴¹ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 491-492 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

⁴² Bruno Zeller, *Fundamental Breach and the CISG – a Unique Treatment or Failed Experiment?*, 8 VINDOBONA JOURNAL OF INTERNATIONAL COMMERCIAL LAW & ARBITRATION 81, 87 (2004), available at <http://www.cisg.law.pace.edu/cisg/biblio/zeller12.html>.

Article 9

(1) The parties are bound by any usage to which they have agreed and by any practices which they have established between themselves. (2) The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.”

Pursuant to Article 8, the objective and subjective intent of the parties have to be sought when analyzing any statement or conduct related to the parties. Article 9, in turn, states that the parties are bound by the practice and usage established between themselves and/or by the international trade customs. Both provide essential guidance in the interpretation of Article 25.

For instance, for the comprehension of what may constitute a “breach of contract”, Articles 9 will have to be examined, as failing to comply with an obligation in accordance with the practice and usage can also result in a breach of contract.

Likewise, the interpretation of substantial deprivation will also depend on the analysis of the factors presented in Articles 8 and 9, so as to discover what the aggrieved party was truly entitled to expect under the contract, the intention of the parties and the context where the contract was signed will have to be taken into account.

Lastly, the comprehension of the foreseeability of the detriment, will also require the consultation of Articles 8 and 9, because the party’s ability to foresee a detriment depends on knowledge of the intention of the other parties and on the circumstances surrounding each case.

In summary, a fundamental breach can only be truly revealed if Articles 8 and 9 are taken into account⁴³. As section IV of this paper will demonstrate, by recourse to the interpretative set of rules provided by the CISG, the understanding of the concept of fundamental breach is possible notwithstanding the vagueness of Article 25's language.

IV. FUNDAMENTAL BREACH ELEMENTS

1. Breach of contract

The existence of a breach of a contract is the primary element of a fundamental breach under the CISG, thus without breach Article 25 is not applicable⁴⁴. What may constitute a breach of contract under the CISG is not specified in Article 25, as it does not spell out the occasions where a breach might occur. Therefore, the meaning of breach has to be sought in accordance with the interpretative guidance provided by the CISG, as discussed above.

There is no doubt that a breach of a contract can result from the non-performance of obligations described within the contract of sale of goods itself. Nevertheless, as provided by Article 9's provisions, a breach can also derive from a failure to comply with obligations arising from the practice and usage established between the parties⁴⁵.

Moreover, Article 25 does not differentiate principal from ancillary obligations⁴⁶. Consequently, even when the non-performance is of an ancillary obligation established under the contract, the breach can be deemed fundamental, allowing the aggrieved party, among other

⁴³ *Id.* at 89.

⁴⁴ Robert Koch, *The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)*, REVIEW OF THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG), 1998, KLUWER LAW INTERNATIONAL 177, 261 (1999), available at <http://cisgw3.law.pace.edu/cisg/biblio/koch.html>.

⁴⁵ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 493 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

⁴⁶ *Id.* at 493.

remedies, to avoid the contract⁴⁷. However, for such a result to happen, the ancillary obligation has to be governed by the CISG or closely connected to the sale of goods⁴⁸.

In a distributorship agreement, for example, where the sale of goods is governed by the CISG, if the parties to the contract agree that the distributor cannot sell the goods within a specific country or cannot violate the intellectual property licensing agreement established between them (both ancillary obligations under the contract, unless otherwise specified into the contract), the breach any of these obligations by the distributor may result in a fundamental breach of contract if the failure to comply with any of these ancillary obligations destroys the aggrieved party's legitimate expectations under the contract.

As it can be perceived, Article 25 was broadly designed to fit multiple situations where a breach might occur, meeting the intentions of the CISG to guard the balance of the contract in all situations. However, for a breach to be deemed fundamental, other two elements employed by Article 25 as tailoring tools need to be satisfied: the substantial deprivation and the foreseeability. Those additional elements, topic of the next two sections of this paper, restrict the occurrence of a fundamental breach to situations where the contract does not, in any way, meet the legitimate interest of the aggrieved party anymore.

⁴⁷ Leonardo Graffi, *Case Law on the Concept of "Fundamental Breach" in the Vienna Sales Convention*, INTERNATIONAL BUSINESS LAW JOURNAL No. 3, Paris, Forum Européen de la Communication 338, 339 (2003), also available at <http://cisgw3.law.pace.edu/cisg/biblio/graffi.html>; Case law on UNCITRAL texts (CLOUT) abstract no. 154, available at <http://cisgw3.law.pace.edu/cases/950222fl.html> (a French Court has applied article 25 to the breach of a re-import prohibition agreed upon the sales contract).

⁴⁸ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 495 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

2. The Substantial Deprivation (from the aggrieved party's legitimate contractual expectations perspective)

Once a breach of contract is identified, the wording of Article 25 requires the breach to result “in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract” for it to be termed fundamental. Although the focus here is on the substantial deprivation as to qualify as a fundamental breach, the meaning of the term ‘detriment’ has to be first established before taking the step further on the analysis of the deprivation.

To this extent, legal scholars have recognized that the term detriment within the CISG “comprises all (actual and future) negative consequence of any possible breach of contract, not only actual and future monetary loss, but also any other kind of negative consequences”⁴⁹. Conversely, detriment refers to any current or forthcoming unfavorable result caused to the aggrieved party, arising from the breach of contract, which can have or not have a monetary value.

Whenever a detriment (negative result) is found, the next action to be taken is to verify whether it substantially deprives the injured party of what he is entitled to expect under the contract. The extent of the detriment does not matter in this assessment, it is the extent of the deprivation that is on the spotlight here⁵⁰. In order to be fundamental, the detriment resulting from the breach must extensively hamper the legitimate contractual expectations of the aggrieved party in a fashion that normal remedies -- such as damages, price reduction or cure of the default -- will not satisfy the party's expectation⁵¹.

In this sense was the conclusion of the Appellate Court in Frankfurt, Germany -- Oberlandesgericht --, which stated that “a breach of contract is fundamental when the purpose of

⁴⁹ *Id.* at 495.

⁵⁰ *Id.* at 495-496.

⁵¹ *Id.* at 496.

the contract is endangered so seriously that, for the concerned party to the contract, interest in the fulfillment of the contract ceases to exist as a consequence of the breach of the contract”⁵².

As a result, the injured party’s legitimate expectations under the contract will serve as a scale to measure the extension of the deprivation, functioning as a parameter when deciding whether a breach is fundamental.

Sometimes the language of the contract will reveal what is considered in the parties’ point of view a fundamental obligation or detriment in accordance with their contractual interests, which facilitates the fundamental breach analysis⁵³. However, whenever this cannot be extracted directly from the contract itself, commentators have agreed that substantial deprivation “will be found not only in the language of the contract but in the circumstances surrounding the contractual relationship of the parties”⁵⁴, which is in perfect consonance with the provisions of Articles 8 and 9.

For instance, under Article 8, what the non-defaulting party is entitled to expect under the contract will depend on the true intent aimed by such party under the contract, whenever this is known by the other party or a reasonable person of the same kind would have known if in the same situation, considering the negotiations, practice established between the parties, usage and any other relevant conduct of the parties to the contract.

⁵² Case Law on the UNCITRAL Text (CLOUT) abstract no. 2 (1991), (Dec. 11, 2016, 2:07PM), available at <http://cisgw3.law.pace.edu/cases/910917g1.html>.

⁵³ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 498 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

⁵⁴ Andrew Babiak, *Defining “Fundamental Breach” Under the United Nations Convention on Contracts for the International Sale of Goods*, 6 TEMPLE INTERNATIONAL AND COMPARATIVE LAW JOURNAL 113, 120 (1992), also available at <http://www.cisg.law.pace.edu/cisg/biblio/babiak.html>; Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG --*, 25 JOURNAL OF LAW AND COMMERCE 489, 498 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

Additionally, Article 9, reinforces the idea that the parties are bound by the practices established between themselves and the usage agreed between them. Concerning the latter, if no usage was agreed in the contract, the usage which the parties knew or should have known, and which is widely accepted in international trade, specifically in sales of goods of the same particular type as the one concluded between the parties, will be applicable to the contract.

In any case, the legitimate expectation has to be assessed “under the contract” as prescribed by Article 25’s language. Thus, special regard here is to be had to “more objective contractual expectations as they result from the specific contract”⁵⁵. Any expectation assessed apart from the contract will not serve the purpose of verifying the contract’s feasibility upon the cure of the default, which is the main goal of Article 25.

In summary, a breach of contract will be assessed, on a case-by-case basis, in order to verify if a detriment (negative result) caused to the injured party, *de facto*, has frustrated the party’s true and legitimate expectation under the contract, causing it a substantial deprivation.

3. Foreseeability

In its final part, Article 25 defines an exception to fundamental breach by providing that, “unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result”. Thereupon, a breach that causes a detriment that substantially deprives the other party of what he was entitled to expect under the contract is not a fundamental breach if the detriment could not have been foreseen (1) by the defaulting party, and (2) by a reasonable person of the same kind under the same circumstances of the breaching

⁵⁵ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 497 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

party. The ‘and’ between both elements denotes that the detriment has to be unforeseeable under both perspectives for the breach not to be classified as fundamental.

This dual test required by Article 25 “adds objectivity”⁵⁶ into the identification process of a fundamental breach. The defaulting party’s point of view depends upon a very subjective element, that is the defaulting party’s knowledge of the contract and of the context where the contract was entered into, which could cause a hardship in the process of evaluating the foreseeable character of the detriment. Thereupon, the concept of a ‘reasonable person of the same kind and under the same circumstances’ was introduced in order to bring more objectivity⁵⁷ to the fundamental breach’s evaluation process and, consequently, to its definition, which is consonance with Article 8 (2) of the CISG⁵⁸.

As to the foreseeability under the defaulting party’s perspective, in order to investigate if the party in breach could have foreseen the detriment, the command of Article 8 has to be observed, which means that beyond the contract’s wording the intention of the parties has to be sought, taking into account all relevant circumstances of the case. Therefore, “factors such as the breaching party’s (in)experience, level of sophistication, and organizational abilities”⁵⁹ may be contemplated, as they indicate the party’s ability to recognize what can cause a negative result to the other party to the contract.

⁵⁶ Andrew Babiak, *Defining “Fundamental Breach” Under the United Nations Convention on Contracts for the International Sale of Goods*, 6 TEMPLE INTERNATIONAL AND COMPARATIVE LAW JOURNAL 113, 121 (1992), also available at <http://www.cisg.law.pace.edu/cisg/biblio/babiak.html>.

⁵⁷ Michael Will, *Article 25*, in BIANCA & BONELL, UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS COMMENTARY ON THE INTERNATIONAL SALES LAW: THE 1980 VIENNA SALES CONVENTION 205, 217-218 (Griuffrè: Milan eds., 1987), also available at <http://cisgw3.law.pace.edu/cisg/biblio/will-bb25.html>.

⁵⁸ “(2) If the preceding paragraph is not applicable, statements made by and other conduct of a party are to be interpreted according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances.”

⁵⁹ Andrew Babiak, *Defining “Fundamental Breach” Under the United Nations Convention on Contracts for the International Sale of Goods*, 6 TEMPLE INTERNATIONAL AND COMPARATIVE LAW JOURNAL 113, 122 (1992), also available at <http://www.cisg.law.pace.edu/cisg/biblio/babiak.html>.

⁵⁹ *Id.* at 122.

As to the foreseeability under the reasonable person perspective, in light of Article 2(a) of the CISG⁶⁰, the reasonable person has to be construed upon the concept of a reasonable merchant as, in international trade, businesses are presumably engaged by merchants⁶¹. Additionally, according to the command of Article 8 (3)⁶², the construction of a reasonable person has to be made taking into consideration all relevant factors related to the business concluded by the parties. Therefore, a reasonable person ‘of the same kind’ means a merchant doing the same business, within the same function, of the same professional expertise as of the defaulting party⁶³; and “in the same circumstances” refers to the conditions of the market, national and worldwide, encountered by the party in breach⁶⁴.

Article 25, however, does not indicate the point in time at which the detrimental result has to be foreseeable by the defaulting party. Should it be at the time of the conclusion of the contract, at the moment of the commitment of the breach, or does it depend on the circumstances of each case? While some legal scholars think the absence of a specific moment in time within the language of Article 25 had the intention to give courts alike the discretion to determine when the

⁶⁰ “Article 2. This Convention does not apply to sales: (a) of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, neither knew nor ought to have known that the goods were bought for any such use”.

⁶¹ Andrew Babiak, *Defining “Fundamental Breach” Under the United Nations Convention on Contracts for the International Sale of Goods*, 6 TEMPLE INTERNATIONAL AND COMPARATIVE LAW JOURNAL 113, 122 (1992), also available at <http://www.cisg.law.pace.edu/cisg/biblio/babiak.html>.

⁶² “(3) In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties”.

⁶³ Michael Will, *Article 25*, in BIANCA & BONELLI, UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS COMMENTARY ON THE INTERNATIONAL SALES LAW: THE 1980 VIENNA SALES CONVENTION 205, 219 (Griuffrè: Milan eds., 1987), also available at <http://cisgw3.law.pace.edu/cisg/biblio/will-bb25.html>.

⁶⁴ Andrew Babiak, *Defining “Fundamental Breach” Under the United Nations Convention on Contracts for the International Sale of Goods*, 6 TEMPLE INTERNATIONAL AND COMPARATIVE LAW JOURNAL 113, 122 (1992), also available at <http://www.cisg.law.pace.edu/cisg/biblio/babiak.html>.

foreseeability should be measured on a case-by-case basis⁶⁵, the majority consider the moment of the formation of the contract as the appropriate point in time⁶⁶.

As emphasized by Robert Koch “businessmen calculate potential transactional risks at the time of the formation of the contract. Taking account of events occurring after the closure, however, would allow one party to increase the risks of the other party”⁶⁷.

Moreover, Franco Ferrari states that “due to the fact that the fundamental character of the breach relates to the legitimate expectations ‘under the contract’, i.e., the expectations set forth in the contract and, thus, at the time of the conclusion of the contract”.

Additionally, under the CISG’s interpretative rules, the whole CISG has to be taken into account for defining the point in time when the foreseeability is to be measured. In this sense, special regard is to be had to Article 74 of the CISG⁶⁸, which limits damage recovery to the extent of the loss that the party at breach foresaw or ought to have foreseen ‘at the time of the conclusion of the contract’⁶⁹. Considering this provision, it seems as though that the detriment foreseeability, under Article 25, has to be measured also at the time of the conclusion of the contract, as a different

⁶⁵ *Id.* at 123-124.

⁶⁶ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 499-500 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

⁶⁷ Robert Koch, *The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)*, REVIEW OF THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG), 1998, KLUWER LAW INTERNATIONAL 177, 321-322 (1999), available at <http://cisgw3.law.pace.edu/cisg/biblio/koch.html>.

⁶⁸ “Damages for breach of contract by one party consist of a sum equal to the loss, including loss of profit, suffered by the other party as a consequence of the breach. Such damages may not exceed the loss which the party in breach foresaw or ought to have foreseen **at the time of the conclusion of the contract**, in the light of the facts and matters of which he then knew or ought to have known, as a possible consequence of the breach of contract.” [emphasis added].

⁶⁹ Jacob S. Ziegel, *The Remedial Provisions in the Vienna Sales Convention: Some Common Law Perspectives*, in MATTHEW BENDER, INTERNATIONAL SALES: THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS, CH. 9, 9-1, 9-20 (Galston & Smit ed., 1984), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ziegel6.html>.

interpretation may lead to an awkward situation where the recovery for damage is not available, but the avoidance of the contract is⁷⁰, which is not in accordance with the CISG's policy.

Lastly, although the burden of proving breach and detriment/substantial deprivation is on the aggrieved party, the employment of the word 'unless' by Article 25 indicates a shifting in the burden of proof from the injured party to the party at breach as to the foreseeability element⁷¹.

In conclusion, the unforeseeable character of a detriment, when proved by the defaulting party under the dual test required by Article 25, prevents the injured party from claiming drastic remedies despite the severity of the harm caused by the breach.

V. RECENT CASE LAW ON THE APPLICABILITY OF ARTICLE 25

As discussed herein so far, the fundamental breach is an open concept developed in accordance with the CISG's policy for the assurance of a modern and fair regime between the parties to the contract, and which, on a case-by-case analysis, can be verified by the identification of its elements (breach, substantial deprivation and foreseeability). On the other hand, the goal of promoting uniformity in its integrity, which is also within the CISG's policy scope, depends on the ability of courts alike to have recourse to international jurisprudence in order to confer better certainty and predictability to the fundamental breach analysis.

In the cases shown below, this writer provides a short summary of the relevant facts to the fundamental breach evaluation, followed by the court's holding on the issue, and, lastly, this writer's assessment of Article 25's applicability in each case.

⁷⁰ Robert Koch, *The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)*, REVIEW OF THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG), 1998, KLUWER LAW INTERNATIONAL 177, 322 (1999), available at <http://cisgw3.law.pace.edu/cisg/biblio/koch.html>.

⁷¹ Andrew Babiak, *Defining "Fundamental Breach" Under the United Nations Convention on Contracts for the International Sale of Goods*, 6 TEMPLE INTERNATIONAL AND COMPARATIVE LAW JOURNAL 113, 122 (1992), also available at <http://www.cisg.law.pace.edu/cisg/biblio/babiak.html>.

1. Printed Work Case, District Court of Cologne - Germany (May 29, 2012)⁷² – ‘Late Delivery of the Goods’

1.1. The Facts

The buyer, a German publisher, sued the seller, an Italian printing company (mainly conducting its printing in China), for damages for failing to deliver the ordered guide books at the specific date agreed by the parties. The parties agreed-upon a fixed date for the delivery because the buyer was supposed to re-sell the guide books to a supermarket, the Discounter Aldi, which would use the goods in connection with a promotional offer.

After negotiations, the German buyer sent a letter, through a trade broker, containing an unsigned offer for the printing of 124,104 guide books at a total purchase price of 58,949.40 €. The offer included a specific date, “07.15.2011 FOB fixed commercial date”⁷³, and requested the seller to “[...] send a binding order confirmation until the 04.21.2011”⁷⁴.

Thereupon, the President of the seller signed or initialed the buyer’s offer on the right bottom of each page and returned it to the broker with a cover letter saying “please find attached the signed offer”⁷⁵. The broker forwarded the signed offer to the buyer with an additional cover letter stating: “here is your order with a signature of the managing director of the [Seller] on every page to confirm”. Thereafter, the buyer understood the seller’s signature as an acceptance of the offer, and from this moment on both parties commenced with the performance of the obligations under the contract.

⁷² Köln Landgericht [LG] [District Court of Cologne] May 29, 2012, available at <http://cisgw3.law.pace.edu/cisg/wais/db/cases2/120529g1.html>.

⁷³ *Id.* at “Facts” section.

⁷⁴ *Id.*

⁷⁵ *Id.*

On July 10, 2011, the seller sent a letter to the buyer informing it that, due to paper shortages in China's facilities, the delivery could only be guaranteed for the August 12, 2011. The buyer answered the letter warning the seller of probable liability for failure to meet the agreed-upon delivery date and proposing the printing in Italy. Nevertheless, the seller did not perform the delivery on July 15, 2011. On this same date, the trade broker sent a letter to the buyer requesting a letter of credit to secure the buyer's performance. On July 18, 2011, seller's president rejected to deliver the guides from China via airmail, and stated that production in Italy was conditioned to the payment of a former order and the establishment of the letter of credit towards the current offer. Thereafter, on the same day (July 18, 2011), the buyer sent another letter to the seller informing it that he was no longer interested in receiving the guide books, and that the printing order was allocated to another company. On July 19, 2011, the buyer sent an additional letter terminating all business relations between them, as well as all pending offer for additional transactions.

1.2. Court's Holding with regard to Article 25

The District Court of Cologne, in evaluating the breach, concluded that "[t]he default on the FOB delivery date on the [07.15.2011] only constitutes a fundamental breach of contract if the delivery date was evidently of centrality and the Buyer had no or little interest in later delivery. This had to be evident for the Seller at contract conclusion"⁷⁶.

Therefore, because the offer signed by the seller contained the provision "[07.15.2011] FOB fixed commercial date", the District Court of Cologne understood that the parties at the conclusion of the contract had explicitly agreed on July 15, 2011 as a fixed date of delivery. Thereupon, the Court held that late delivery of the guide books constituted a fundamental breach under Article 25's provision.

⁷⁶ Id. Reasoning of the court, II, 2, b), aa).

1.3. Analysis of Article 25's applicability

Although the District Court of Cologne has mentioned in its decision three case law on late delivery under the CISG to support its holding (two from Germany and one from Switzerland), which is in pro of the uniformity, and, in fact, has reached a conclusion in accordance with the international jurisprudence on late delivery, the court failed to provide an analysis of the concrete case taking into account all the elements of fundamental breach given by Article 25 of the CISG.

Pursuant to 2012 and 2008 UNCITRAL Digest of Article 25 case law⁷⁷, the general rule on late delivery is that delays in the delivery of the goods only amount to a fundamental breach “when the time for performance is of essential importance either because it is so contracted or due to evident circumstances (e.g. seasonal goods)”⁷⁸.

One of the cases law that has helped on the construction of this general rule is a decision of the Appellate Court of Milan – Italy, rendered on March 20 of 1998, where the contract had a fixed date for delivery, but the date was not met by the seller⁷⁹. The Italian court held that the late delivery in the case constituted a fundamental breach, because, “taking into account clarifications between the parties in the days following the agreement, there [was] no doubt that the agreed time of the delivery was a fundamental term and that the contract turned on the availability of the goods just before the buyer’s end of the year sales”⁸⁰.

As it can be noted in this Italian case, the simple fact that a contract sets forth a fixed date for the delivery of the goods is not sufficient to justify a fundamental breach in the event of late

⁷⁷ For an explanation of what is the UNCITRAL Digest of Case Law on the United Nations Convention on Contracts for the International Sale of Goods, see the Introduction on pages ‘ix’ and ‘x’ available at <https://www.uncitral.org/pdf/english/clout/CISG-digest-2012-e.pdf>.

⁷⁸ Digest of Article 25 Case Law, 2012 edition, at Paragraph 7, available at <http://www.cisg.law.pace.edu/cisg/text/digest-2012-25.html>; Digest of Article 25 Case Law, 2008 edition, at Paragraph 6, available at <http://www.cisg.law.pace.edu/cisg/text/digest-art-25.html>.

⁷⁹ Corte di Appello Milano [Appellate Court of Milan], March 20, 1998, (Dec. 11, 2016, 4:14PM) available at <http://cisgw3.law.pace.edu/cases/980320i3.html>.

⁸⁰ *Id.* Reasoning.

delivery. The Italian court sought the legitimate interest of the parties by resorting to the clarifications given by the parties (subjective intention) in order to verify what the parties were entitled to expect under the contract, which is in accordance with the instruction provided by Article 8 of the CISG, and only then concluded for the fundamental breach because of the late delivery.

In the Printed Work case, however, the District Court of Cologne didn't seek for the legitimate interest of the parties before deciding for the occurrence of the fundamental breach. Note that the court's decision mentions "[t]hat the seller was aware that the order was fixed, as there was a following delivery obligation toward the Discounter Aldi"⁸¹, but it did not use this evidence as an argument to justify the fundamental breach conclusion. Nevertheless, this was a very important piece of evidence in confirming the occurrence of fundamental breach, because it proves that the seller knew from the moment of the formation of the contract that the time of the delivery was of the essence to the buyer and any failure to comply with the fixed date would substantially deprive the buyer of what it was entitled to expect under the contract (buyer's legitimate interest in the contract). The investigation of the intention of the parties to the contract and of whether the other party knew about this intention is in conformity with the command given by Article 8 of the CISG, and should have been followed by the court in the Printed Work case.

If the District Court of Cologne has done so, besides the breach, that was clear in the decision, the substantial deprivation and the foreseeability of the detriment, the other two essential elements of a fundamental breach analysis, would have been demonstrated, which would be in conformity with the fundamental breach concept explained herein and with the CISG's policy.

⁸¹ Köln Landgericht [LG] [District Court of Cologne] May 29, 2012, Reasoning of the Court, section II, 2, *bb*, available at <http://cisgw3.law.pace.edu/cisg/wais/db/cases2/120529g1.html>.

In consideration of the aforesaid, this writer concurs with the opinion held by the District Court of Cologne, which concluded that the late delivery of the goods amounts to a fundamental breach in light of the fixed delivery date known by the parties since the formation of the contract. However, to comply with the elements required by Article 25 of the CISG, the District Court of Cologne should have clarified the essence of the time fixed for the delivery, focusing on the awareness by the seller of the buyer's obligation to deliver the goods to the Discounter Aldi.

2. Women's Garments Case, Southern District Court of New York (May 29, 2009)⁸² – 'Late Payment'

2.1. The Facts

Between April and October 2007, a South Korean seller and an American buyer entered into several contracts for the manufacture, in Vietnam, of approximately 500,000 women's knit pant, dresses and tops ("garments"). The buyer agreed to pay the seller within 15 days of receipt of the garments.

In July and August 2007, the buyer ordered 77,528 garments with a total purchase price of \$381,026.10, which was delivered on or before September 7, 2007 (the "July & August Garments"). Despite the receipt of those garments, the buyer failed to perform payment within the 15 days agreed-upon by the parties. Thereafter, the seller sought and obtained from the buyer a payment assurance.

During October and November 2007, the seller made two additional orders, the first one of 157,092 garments at a total purchase price of \$659,059.74 (the "October Garment"), and the second of 249,293 garments at a total price of \$878,262.64 (the "Surplus Garment"). As to the

⁸² Southern District Court of New York, United States of America, May 29, 2009, available at <http://cisgw3.law.pace.edu/cases/090529u1.html>.

Surplus Garment, about 87% were scheduled to be shipped to the buyer in January 2008, as the buyer planned to re-sell it to K-Mart (the “K-Mart Garment”). End of November 2007, the buyer paid the seller \$200,000, which the seller credited against the October Garment order.

On November 25, 2007, the buyer ordered an extra 13,735 garments at a total purchase price of \$67,433.75 (the “November Garments”).

At this point, except for the \$200,000 payment, the seller did not receive any other payment from the buyer. Thereafter, on December 8, 2007, in response to a seller’s request of additional payment guarantee, the parties entered into a written agreement where the buyer promised to provide, by December 14, 2007, a letter of credit securing the K-Mart Garments payment, in exchange for a reduction and installment of the unpaid debt. Thereupon, pursuant to this modification agreement, the buyer would have to pay \$931,000, in five installments (1° - December 14, 2007; 2° - December 28, 2007; 3° - January 11, 2008; 4° - January 25, 2008; 5° - April 20, 2008), in satisfaction of all pending invoices received through December 30, 2007, plus the providing of a letter of credit to the extent of the price of the K-Mart Garments.

Notwithstanding, by mid-January 2008, the buyer had neither performed any of the promised installment payments or provided the letter of credit, which led the seller to suspend all scheduled garment deliveries to the buyer, that is the November Garments and the Surplus Garments.

The buyer then sued the seller claiming for damages for breach of contract under CISG’s provisions.

2.2. Court’s Holding with regard to Article 25

As to the garments that had been already delivered to the buyer (the July & August Garments and the October Garments), the court held that the “[the buyer] fundamentally breached

this obligation by paying [the seller] only \$200,000.00 for the garments and failing to pay the balance. [The buyer]'s payment of only a small fraction -- less than 20% -- of the purchase price substantially deprived [the seller] of the performance that it had a right to expect from [the buyer], *i.e.*, full payment within 15 days of delivery. CISG art. 25, 19 I.L.M. at 677 (A breach is fundamental if it "results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract, unless the party in breach did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result.")⁸³.

As to the garments which had been manufactured by the seller but not delivered, the court held that “[the seller] also permissibly cancelled the contract and permanently withheld delivery of the November Garments and the Surplus Garments because [the buyer]’s persistent failure to pay for the garments it ordered demonstrated that it was unable or unwilling to pay the agreed upon price for those garments [and, under Article 72 of the CISG,] if prior to the date for performance of the contract it is clear that one of the parties will commit a fundamental breach of contract, the other party may declare the contract avoided”⁸⁴.

The Court of New York emphasized that “[b]y the end of January 2008, [the buyer] had failed to secure the letter of credit for the K-Mart Garments, had failed to make the payments totaling \$530,000.00 that were due on December 14 and 28, 2007 and January 11 and 25, 2008, and had failed to give [the seller] any assurance that [the buyer] would be able to meet any of its obligations on the amounts owed to [the seller] from shipment previously accepted. Thus, it was

⁸³ *Id.* at paragraph 37.

⁸⁴ *Id.* at paragraph 41

evident that [the buyer] would likely continue to breach its obligations under both the Modification Agreement and the purchase orders”⁸⁵.

The court, therefore, treated the late payment, in both situations, as fundamental breaches of contract and approved the seller’s declaration of avoidance of the contract.

2.3. Analysis of Article 25’s applicability

According to commentators and case law, the late payment rule is: “mere delay in payment does not generally constitute a fundamental breach in the sense of Article 25 [as] the interests of the creditor seem sufficiently protected by the possibility for the creditor to claim [monetary] [...] damages and to start the process of avoidance of the contract by granting an additional period of time for performance”⁸⁶.

In the present case, as to the garments which had been delivered to the buyer, the Court of New York classified as fundamental breach the failure to pay a significant portion (more than 80%) of the total purchase price, because in the court’s reasoning the non-payment by the agreed-upon time had deprived the seller of what he was entitled to expect payment under contract, that is the payment within 15 days of delivery.

Although this writer agrees that the payment failure, as to the garments delivered, amounts a fundamental breach, the reasoning employed by the court is not aligned with the CISG’s provisions and policy. According to the general rule on late payment, a mere delay in payment does not constitute a fundamental breach⁸⁷. Therefore, the fact that the seller was entitled to expect payment within 15 days of delivery does not amount to a fundamental breach. The CISG, however,

⁸⁵ *Id.* at paragraph 41

⁸⁶ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 505 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

⁸⁷ Digest of Article 25 Case Law, 2012 edition, at Paragraph 7, available at <http://www.cisg.law.pace.edu/cisg/text/digest-2012-25.html>; Digest of Article 25 Case Law, 2008 edition, at Paragraph 6, available at <http://www.cisg.law.pace.edu/cisg/text/digest-art-25.html>.

allows the injured party to give additional time for the cure of the default, and if the defaulting party fails once again to perform payment, the breach will then be considered as fundamental⁸⁸.

To that extent, in a case law⁸⁹ where “the seller waited several months before declaring the contractual relations terminated, in spite of the fact that it was clear that the buyer did not have the financial resources [...] [the Court of Arbitration of the International Chamber of Commerce - ICC] regarded the period between the buyer’s default and the declaration of avoidance by the seller as an ‘additional period’ fixed by the seller under articles 63(1) CISG and 64(1)(b) CISG”⁹⁰ and concluded that a fundamental breach had occurred.

Similar to the waiting time in this ICC case law, in the Women’s Garments case the seller waited around 3 months for the buyer’s payment before terminating the business relationship, which could also be interpreted as an “additional period of time” given by the seller. Despite that, the seller actually offered the buyer additional time when the parties entered into a new written agreement allowing the buyer to pay the total outstanding balance in five installments and with a discount. Nevertheless, the seller remained in default, what, under the Article 64(1)(b), amounts to a fundamental breach. Based upon either arguments, the New York Court could have found for a fundamental breach, which in this writer’s opinion, would be better aligned with the CISG’s provisions and goal of promoting uniformity.

With regard to the goods not delivered to the buyer, the New York court stated that the non-payment of the price as agreed originally, then the failure to provide the letter of credit and to pay the majority of the installments, as furthered agreed, were a sufficient indicator that the buyer would fundamentally breach the contract. To this extent, this writer agrees with the court’s

⁸⁸ See CISG Articles 63(1) and 64(1)(b), *supra* note 2.

⁸⁹ Case law on UNCITRAL texts (CLOUT) abstract no. 301, (Dec. 11, 2016, 3:18PM), available at <http://cisgw3.law.pace.edu/cases/927585i1.html>.

⁹⁰ *Id.*

reasoning as the obligation to provide a letter of credit and to pay the price installments were already an opportunity offered by the seller to the buyer to cure his original contractual default. Therefore, the non-performing of the majority of those obligations clearly indicated the commitment of a fundamental breach, as required by Article 72 of the CISG.

In summary, if the New York Court had looked for CISG case law on fundamental breach within the same context of late payment, it would have given a more adequate reasoning to its decision.

3. Portuguese Flags Case, Madrid Provincial High Court (July 14, 2009)⁹¹ – Spain – ‘Defective Goods Delivered’

3.1. The Facts

A Chinese seller sued a Spanish buyer claiming for the remaining payment with regard to eighteen orders, placed between May 24 and July 10 of 2006, for the manufacture of a number of flags, and towards which the buyer had only made partial payment.

In its defense, the Spanish buyer offered a counterclaim arguing that the Chinese seller owes him a greater amount of money due to the delivery of defective goods related to an order placed in April 1, 2006. By means of this purchase order, the Spanish buyer and the Chinese seller entered into a contract of sales of goods for the manufacture of 198,000 Portugal flags with specific “dimensions, styles, autographs of Portuguese football players”⁹², as they were bound to be re-sold to a Portuguese client, that planned to use the flags as a promotional gift during the 2006 Football World Cup. The Portuguese client paid for the purchase price in full. However, upon receipt of the goods, the end customer rejected 118,000 flags because they were defective.

⁹¹ Audiencia Provincial Madrid [Madrid Provincial High Court], July 14 2009, (Dec. 11, 2016, 4:15PM), available at <http://cisgw3.law.pace.edu/cases/090714s4.html>.

⁹² *Id.* at Legal Background, First Section.

Both parties submitted expert reports concluding that the goods contained “defects such as stains on the fabric, frayed edged, irregular and asymmetrical knitting, smeared ink, defective prints of the player’s autograph, heart images, and the Portuguese coat of arms”⁹³. However, while the buyer’s expert concluded the good were not fit for the intended purpose, the seller’s expert concluded the flags were suitable as they were to be used as mere promotional gifts and were low cost.

The Madrid Court, in this case, had to analyze if either a fundamental or non-fundamental breach had occurred under the CISG, in order to decide the counterclaim offered by the Spanish buyer.

3.2. The Court’s Holding with regard to Article 25

The Madrid Court found that “the defects of the flags produced and supplied by the Seller, considered in light of their intent to be used as promotional gifts attached to publications sold to public, and further considering their low cost nature (conceded by both experts), do not support the finding that there was a fundamental or absolute breach of the obligation to deliver under Art. 25 of the CISG, but rather that the breach was a non-fundamental and does not absolve the Buyer of its payment obligations, but rather necessitates a reduction in the contract price”⁹⁴.

For this conclusion, the Madrid Court sought support in a Spain Supreme Court decision of January 17, 2008, that, interpreting Article 25 in conjunction with the CISG’s provisions, stated that: “[t]he structure of the Convention, which embodies the inspiring principles of common law, distinguishes a fundamental breach from a failure that might be described as non-fundamental. A

⁹³ Id. at Legal Background, Third Section.

⁹⁴ Id. at Legal Background, Fifth Section.

non-fundamental breach either does not produce significant injury, or results in injury that can be remedied with an award of damages or a reduction in the original contract price”⁹⁵.

3.3. Analysis of Article 25’s applicability

Pursuant to case law and commentators, the general rule for the delivery of defective goods is that “it only amounts to a fundamental breach of contract when the defect is such that the non-defaulting party cannot be expected to be satisfied with damages or a price reduction”⁹⁶.

As pointed out by the 2012 and 2008 UNCITRAL Digest of Article 25 case law, “[c]ourt decisions on this point have found that a non-conformity concerning quality remains a mere non-fundamental breach of contract as long as the buyer –without unreasonable inconvenience– can use the goods or resell them even at a discount”⁹⁷.

In the Portuguese Flags case, the Madrid Court emphasized that the defects found on the goods did not prevent its use as a promotional gift to accompany a sale publication, therefore it did not substantially deprive the injured party of what he was entitled to expect under the contract. Moreover, the Madrid Court also pointed out that the low manufacturing cost of the flags established in the contract needed also to be considered, as it is directly related to the legitimate expectations under the contract.

Although this writer agrees with the arguments brought by the decision, the terms upon which it was presented did not show a clear evaluation of all the elements of a fundamental breach analysis. As herein discussed, besides the breach of contract, that it is clear in this Portuguese Flag case as the flags were delivered with multiple types of defects confirmed by both parties’ experts,

⁹⁵ *Id.* at Legal Background, Forth Section.

⁹⁶ Franco Ferrari, *Fundamental Breach of Contract Under the UN Sales Convention -- 25 Years of Article 25 CISG -*, 25 JOURNAL OF LAW AND COMMERCE 489, 501 (Spring 2006), also available at <http://www.cisg.law.pace.edu/cisg/biblio/ferrari14.html>.

⁹⁷ Digest of Article 25 Case Law, 2012 edition, at Paragraph 8, available at <http://www.cisg.law.pace.edu/cisg/text/digest-2012-25.html>; Digest of Article 25 Case Law, 2008 edition, at Paragraph 7, available at <http://www.cisg.law.pace.edu/cisg/text/digest-art-25.html>.

for a fundamental breach to occur it is also necessary the presence of a substantial deprivation of the aggrieved party's legitimate interest and the foreseeability of the detriment by the defaulting party.

The Madrid Court did not mention expressly, however, it seems as though it sought recourse to the objective perspective provided by Article 8 (2) of the CISG to evaluate the legitimate interest of the parties under the contract and, consequently, to assess the substantial deprivation and the foreseeability elements. In analyzing the statements and conducts of the parties only, it may be very difficult sometimes to detect the true intent and legitimate interest of the parties under the contract, therefore an analysis under the reasonable person's point of view can add objectivity to this evaluation. In the present case, the Madrid Court could have expressly argued that a reasonable merchant of the same type of the buyer and in the same circumstance would have known that the low manufacturing cost of the flags implied a low quality of the products and that the delivery of goods with some sort of defects was already expected.

In this writer's opinion, the low price in fact indicates that the buyer was not expecting a state-of-the-art flag, thereupon, the delivery of flags with the kind of defects specified in the decision would not deprive the buyer of what he was entitled to expect when he entered into the contract. Therefore, no occurrence of fundamental breach was correctly held by the Madrid Court. Notwithstanding, it would have been more appropriate if the Madrid Court had presented in its reasoning a detailed explanation, using the guidance of Article 8 of the CISG to demonstrate that the substantial deprivation and foreseeability elements were not met. Furthermore, it would have been also more appropriate, under the CISG's purpose of uniformity, if the Madrid Court had sought recourse to an international jurisprudence besides its own national jurisprudence on Article 25 applicability.

VI. CONCLUSION

The concept and function of fundamental breach within the CISG is perfectly in accordance with the Convention's policy of preserving the life of the contract to the limit of its feasibility with special regard to the party's legitimate interest in the business. Although the wording of Article 25 is somehow imprecise, as herein analyzed, it provides the essential elements of a fundamental breach – breach of contract, substantial deprivation and foreseeability –, which work as tools in the identification of a situation where a fundamental breach has occurred.

Such elements, however, will only work as proper tools in the identification of a fundamental breach if courts, arbitrators, mediators follow the provisions of Article 8 and 9 of the CISG, which sets forth very important rules on the interpretation of the parties' statement, conduct and usage in business.

The three recent cases analyzed herein have shown that courts alike are somehow taking those elements into consideration when assessing the existence of a fundamental breach, but are failing to provide a detailed assessment of the substantial deprivation and foreseeability elements in accordance with the command of Article 8. Article 8's provisions requires the courts to interpret the statements and conduct of the parties according to its intent where this is known or should have been known by the other party (subjective perspective), and, whenever this is not possible, according to the understanding of a reasonable person of the same type of the parties to the contract and under the same circumstances (objective perspective). Article 9 plays also a very important role in this assessment as the business usage that the parties are bound to can give grounds to a fundamental breach and, therefore, must be also be taken into consideration by the courts. As it was presented in this paper, failure to apply those provisions may lead to decisions that are not in conformity with the CISG's policy, which is a concern and should be avoided.

Last but not least, courts must seek guidance for its decision in international jurisprudence and previous case law construed on the specific type of situation at judgement, which is essential for the promotion of uniformity aimed by the CISG.