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FORMAL AND OPERATIVE RULES OF THE CISG: CASE OF ARTICLE 25

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Larry A. DiMatteo[*]

I. INTRODUCTION

The United Nations Convention on Contracts for the International Sale of Goods (CISG) has been the law of some countries for the better party of forty years.[1] The case law (judicial and arbitral) has grown steadily over this time. Unfortunately, the case law is spread unevenly over its eighty-eight substantive articles. This Article will provide a framework for performing a factors analysis of one of its most important articles. CISG Article 25 sets the standard of fundamental breach for the type of breach that allows the non-breaching party to avoid or terminate the contract.

A factors analysis seeks to discover the key facts or factors that best predict a court's (and arbitral tribunal) decision on whether or not a breach is fundamental. The difference between formal and operative law can be drawn out by such an analysis. The difference between these two perspectives or types of rules can be depicted by two questions: In reading an article or rule of the CISG, what is the plain meaning or common sense meaning of the rule (formal rule)? In its application, what factors are most predictive of the decision involving the rule's application, irrespective of the rule's plain meaning (operative rule)? This analysis is founded on the simple premise that certain facts or factors in particular cases predict if and how a court applies a rule of law. This Article will focus on the interface between formal law and operative facts or factors.

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[1] United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, 98-9 S. TREATY DOCUMENT I (1980), 1489 U.N.T.S. 3 [hereinafter CISG].

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II. LAW IN BOOKS VERSUS LAW IN ACTION DEBATE

There has been a centuries-old debate over the distinction between law in books and law in action. In 1910, Roscoe Pound noted the divergence between contract doctrine and contract law as applied.[2] An example is found in an empirical study of cases involving the defense of unconscionability.[3] The statement of the law portrays it as a substantive fairness doctrine to be applied when a contract is so grossly one-sided that it "shocks the conscious."[4] The study showed that its application was mostly dependent on consent factors and not on one-sidedness. If the case facts show a strong manifestation of consent by the weaker party, then the contract is enforceable no matter how one-sided.[5]

The American legal realists of the 1930s focused on the difference between blackletter law and law as applied by the courts.[6] The realists correctly noted that case decisions were predicated not so much on formal law but on the operative facts of the case.[7] Pound also argued that lawyers should not be obsessed with formal law or doctrine as the "beginning of wisdom and the eternal jural order."[8] It is the job of the lawyer to "make the law in the books such that the law in action can conform to it."[9] In the CISG, as in all contract laws, well-reasoned arguments can change the law in the books so that it complies with real life realities and norms.

The analysis that such a dichotomy inspires is a part of the sociology of law. Some of the divergence is explainable by the gap between evolving society and evolving law or what Eugen Ehrlich, the founder of sociology of

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[2] *See* Roscoe Pound, *Law in Books and Law in Action*, 44 AM. L. REV. 12, 16 (1910).

[3] *See* Larry DiMatteo & Bruce Rich, *A Consent Theory of Unconscionability: An Empirical Analysis of Law in Action*, 33 FLA. ST. L. REV. 1067 (2006).

[4] *Unconscionable*, FREE DICTIONARY, https://legal-dictionary.thefreedictionary.com/unconscionable (last visited Oct. 23, 2023) (an unconscionable contract is one that is "unusually harsh and shocking to the conscience").

[5] DiMatteo & Rich, *supra* note 3.

[6] The legal realists focused on the law as it actually exists in practice, rather than how it exists in books. *See* Karl Llewellyn, *Some Realism about Realism: Responding to Dean Pound*, 44 HARV. L. REV. 1222 (1931).

[7] Arthur Corbin describes an operative fact as "any fact the existence of will cause new legal relations." Arthur L. Corbin, *Legal Analysis and Terminology*, 29 YALE L.J. 163, 164 (1919).

[8] Pound, *supra* note 2, at 35.

[9] *Id.* at 36.

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law, calls the *living law*.[10] He argued that law is more than the sum of all statutes and legal cases, and that social norms play an important role in how society is regulated. For Ehrlich, social norms (external factors) play an important role in how formal law is applied. The modern version of this idea is seen in the role played by trade usage and commercial practice, which is a core element of the CISG.[11] The idea of reasonableness is found throughout the CISG,[12] and its meaning is heavily reliant on what is considered reasonable in a particular trade or industry. These external facts or factors give meaning to the formal law, by influencing courts' interpretation of the formal rules.

At a more theoretical level, Jody Kraus asks whether theories of doctrinal areas should focus on what judges *say they are doing* (concepts used in their opinions) or on *what they are actually doing* (concepts that best correlate with the outcomes of cases).[13] A broad theory of contract law would not only justify so-called blackletter law, but also the outcomes of the cases. The interesting question posed here is whether contract theory, contract law, and contract practice are actually in sync with one another. The following analysis will attempt to determine the existence of divergences between these three levels of law.

III. ARTICLE 25: FUNDAMENTAL BREACH RULE

The fundamental breach rule is one of the most debated rules of the CISG.[14] It is different than most national laws that give buyers broad rights to reject defective products. For example, in American law, this right of rejection applies to minor defects in products that do not affect their market value. The American "perfect tender rule" states "that if the goods or the

[10] *See generally* LIVING LAW: RECONSIDERING EUGEN EHRLICH (Marc Hertogh ed., 2009); ROGER COTTERRELL, LIVING LAW: STUDIES IN LEGAL AND SOCIAL THEORY (2008).

[11] *See* CISG, *supra* note 1, arts. 8(3) & 9(2).

[12] The terms "reasonable," "reasonably," and "unreasonable" are used forty-five times in the CISG. *See* CISG, *supra* note 1.

[13] Jody S. Kraus, *From Langdell to Law and Economics: Two Conceptions of Stare Decisis in Contract Law and Theory*, 94 VA. L. REV. 157, 186–87 (2008).

[14] *See, e.g.*, Larry A. DiMatteo, Marta Infantino, Jingen Wang & Paola Monaco, *Once More unto the Breach: A Comparative Analysis of the Meaning of Breach in Contract Law*, 31 TRANSNAT'L L. & CONTEMP. PROBS. 33 (2021) (comparing the application of the fundamental breach rule in American, Chinese, French, German, and Italian law).

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tender of delivery fail in *any* respect to conform to the contract, the buyer may reject."[15] The key phrase being that the goods are defective "in any respect." Thus, the formal rule would allow a rejection of delivered goods if the count is 998 units and the contract stated 1,000 units. The only limitation to the right of the buyer to reject is in installment contracts,[16] if the rejection is an act of bad faith,[17] such as when it is made in response to a change in market prices, and not minor defects in the goods.

In contrast, Article 25 states that:

> 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 [the party] of what [the party] 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.

At first blush, the fundamental breach rule appears to be the complete opposite of the perfect tender rule. Not only is the buyer barred from rejecting goods with minor defects, but they must accept defective goods unless they substantially deprive the buyer of what was expected under the contract. The provision is more complicated than it seems since it implicates the subjective and objective theories of contract and consists of a litany of vague phrases. These issues are discussed below.

A. Theory of Fundamental Breach

The fundamental breach rule is a pro-seller rule. The buyer is required to accept defective goods that have some realizable value. It places the burden on the buyer to obtain value from the defective products: "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."[18] This essentially recognizes a presumption in favor of finding a non-fundamental breach. The Swiss Supreme Court held that fundamental breach is to be interpreted narrowly,

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[15] U.C.C. § 2-601 (emphasis added).

[16] *See* U.C.C. § 2-612.

[17] U.C.C. § 1-304 (good faith in performance of contract); U.C.C. 2-103(1)(b) (good faith defined as honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade).

[18] *See* Abstracts of Case Law on UNCITRAL Texts, U.N. COMM'N ON INT'L TRADE L., 115 (2016).

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so when in doubt, it should "generally be assumed that no fundamental breach is existent."[19]

This burden can be rationalized in a number of ways. First, it views the obtaining of some value from the goods as an act of mitigation. Second, it prevents waste because the buyer is in the best or more efficient position to realize the value of defective goods than a distant seller. The high threshold for fundamental breach makes avoidance (termination) the remedy of last resort. That said, a common feature of most contract law systems is that they all "draw a line between breaches which allow terminating the contract and breaches which should not."[20]

There is a plausible argument that, in international transactions, the fundamental breach rule is efficient since it is more difficult for a seller to find a readily available alternative buyer in a foreign market and because the costs of return or transshipment may be prohibitive. The buyer in most cases is the more efficient re-seller. If the defective goods are still useable by the buyer or resaleable, then it is more efficient if the buyer is forced to accept, obtain some value, and then seek redress through the price reduction remedy[21] or by a claim of breach of warranty.[22]

A hypothetical shows the scheme anticipated by Article 25. Party A is an American seller-exporter of corn and Party B is a Spanish buyer-importer of corn. They enter into a contract for the sale of twenty metric tons of Grade A corn. The corn that is subsequently delivered had deteriorated to Grade C corn. The Spanish importer's business involves the cleaning and canning of corn for sale to supermarkets and grocery stores for which it needs Grade A corn. Grade C corn is not fit for human consumption but is used to feed livestock and is readily resaleable to farmer coops and feed stores. The most efficient solution would be to have the buyer resell the corn since the nature of the deterioration of corn would render it useless if returned or transshipped. If the contract price is $15 per bushel of corn and the available market price for Grade C corn is $8 per bushel, then the buyer can resell the corn, unilaterally reduce the contract price by $7, and sue for damages.

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[19] Bundesgericht [Swiss Federal Supreme Court], Apr. 2, 2015, https://cisg-online.org/files/cases/7817/translationFile/1900_9043162.pdf (English translation).

[20] INTERNATIONAL SALES LAW 531 ¶ 99 (Larry DiMatteo, André Janssen, Ulrich Magnus & Reiner Schulze eds., 2d ed. 2021).

[21] *See* CISG, *supra* note 1, art. 50.

[22] *Id.* art. 45.

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This is efficient but does it meet the requirements of Article 25? Can the buyer simply reject the defective corn as a fundamental breach? Does not the defective corn substantially deprive the buyer of what it reasonably expected? What other factors would a court likely weigh in making this determination? Unsurprisingly, the case law shows that courts and arbitrators have answered such questions differently. Some have focused on the ability of the buyer to resell and prevent waste in determining that the breach was not fundamental.[23] The more common approach focuses on the buyer's expectation, along with the detriment inflicted, and not on the resaleability of the goods.[24] Numerous courts have held that a breach is fundamental if the defective goods do not serve the purpose of the contract, which in the hypothetical would require the delivery of Grade A corn.[25] The rest of this Article attempts to determine which of these factors most predict a court or arbitral tribunal's finding of fundamental breach.

B. Phraseology of Article 25

The shortness of Article 25's statement of the fundamental breach rule hides its complicated nature, especially when applied to various fact patterns. If Article 25 is broken into its independent phrases it gives judges and arbitrators plenty to decipher. The terms that the interpreter must deal with include: "fundamental," "such detriment," "substantially to deprive," "entitled to expect," "unless the party in breach did not foresee," and "a reasonable person of the same kind would not have foreseen." These phrases are vague, at best, and open to multiple interpretations, at worst. How does the interpreter determine what is a substantial detriment? What is a party entitled to expect and what is the threshold of diminished expectations that constitutes fundamental breach? How does one determine the reasonable expectations of the non-breaching party? The next section quickly dispatches the foreseeability requirement, which is more an issue in the application of Article 79's exemption of liability for breach due to an unforeseeable occurrence or non-occurrence and Article 74's limitation that only foreseeable damages are collectable. For purposes of Article 25, the cases

[23] *See* discussion *infra* Part IV.B.2.a.
[24] *See* discussion *infra* Part IV.B.2.b.
[25] *See* discussion *infra* Part IV.B.2.a, IV.B.2.c.

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generally assume the consequences of the breach were foreseeable by the breaching party.

1. Unforeseeability Requirement

The issue as to whether or not the breaching party foresaw the breach is more about the burden of proof. The dual requirement is that a breach is not fundamental if the breaching party did not foresee (actual) and should not have foreseen (reasonable person) the consequences of the breach. Thus, the unforeseeability requirement of Article 25 requires proof of subjective and objective unforeseeability. In practice, the foreseeability of the consequences of the breach is not a core element since the fundamental nature of a breach is determined post hoc. At best, the foreseeability issue can be seen as a defense to a claim of fundamental breach in which the breaching party would have to prove that it actually did not foresee the consequences of the breach and that a reasonable person would also not have foreseen the consequences.[26] To place the burden on the non-breaching party would be an undue burden. If it were placed there, then the "and" in Article 25 would have to be interpreted as an "or." Requiring the non-breaching party to prove the subjective element would be absurd. In the end, the reasonable person standard is the only view that matters. If the parties understood that one of the parties did not want to be held accountable for certain harms, foreseeable or unforeseeable, then they should have included provisions in the contract limiting liability (limitation of liability, limitation of remedy, definition of non-fundamental breach). If this is done, then any issue of subjective intent is erased because that intent would be objectified in the terms of the contract.

2. Operative Phrases of Article 25

This leaves the interpretive issues of Article 25 to the meaning of the standard-like phrases, "substantially to deprive" and "entitled to expect."

[26] *See* STEFAN KROLL ET AL., UN CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS: COMMENTARY 341 (2011) ("The burden of proof that the detriment was not foreseen, or foreseeable, lies on the breaching party."); *see also* Bundesgerichtsof [BGH] [Federal Court of Justice] Apr. 3, 1996 132 Entscheidungen des Bundesgerichtschofes in Zivilsachen [BGHZ] 290 (Ger.) [hereinafter CLOUT Case 171] *translation available at* https://cisg-online.org/files/cases/6113/translationFile/135_13548459.pdf.

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Article 25 fails to provide any guidance as to how these elements are to be determined. Although fixed rules provide greater certainty and clarity in application, standards are used in cases where a rule cannot serve to regulate a multitude of different scenarios or fact patterns.[27] The jurisprudence surrounding Article 25 will show how judges focus on certain factors in applying the standards component of Article 25.

IV. ARTICLE 25 AS APPLIED: A FACTORS ANALYSIS

Courts are often faced with similarly situated cases—that is, those with certain fact patterns. If numerous courts render similar decisions when a case includes similar facts, then that is meaningful. The operative facts in these cases are what the current article refers to as factors. This part will examine factors that should and do impact the application of the fundamental breach rule. This review will not discuss cases of nonconformity of documents in documentary transactions[28] since they are generally governed by rules outside of the CISG, such as the UCP.[29] The UCP rules are closer to the American perfect tender rule since the documents must strictly comply with the requirements of the contract or letter of credit. The exception being where a party fails to obtain a letter of credit as required by the contract. Such an occurrence is a fundamental breach of the contract. The more common fact scenario involving the issue of fundamental breach are cases involving the delivery of nonconforming products and delayed delivery. These cases will be the focus of the current analysis. The delivery of nonconforming goods is not by itself a fundamental breach: "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."[30] The first section provides a list of factors based on the nature

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[27] *See* Kathleen Sullivan, *The Justice of Rules and Standards*, 106 HARV. L. REV. 22, 59 (1992).

[28] Documentary transactions convert the sale of goods to a sale of documents in which the bill of lading (title document) is transferred to the buyer in exchange for payment or a promise of future payment (letter of credit) while the goods are in transit.

[29] *See generally* INT'L CHAMBER OF COM., UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (2007).

[30] *See* Abstracts of Case Law on UNCITRAL Texts, U.N. COMM'N ON INT'L TRADE L., 115 (Nov. 2016), https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/cisg_digest_2016.pdf; *see* CLOUT Case 171, *supra* note 26; *see* Bundesgericht [BGer] [Federal Supreme Court]

of breach. Many of these factors are discussed in the scholarly literature.[31] The second section is descriptive in nature based upon the reading of the case law (factors deemed important to a court or arbitral tribunal).

A. Hypothetical Factors

Determining the relevant factors in the application of a formal rule to find the operative version is a two-step process. First, conceptually, a scholar can do a thought experiment in which she envisions also possible fact patterns to determine what factors should be considered. This results in an external list of potential factors. Off hand, there are a myriad of factors that could be considered in the application of the fundamental breach rule, such as:

- Terms of the contract;
- Characteristics of the parties;
- Parties' conduct, business practices, customs and habits;
- Monetary value of the contract;
- Monetary harm caused by the breach;
- Extent to which the breach interferes with other activities of the injured party;[32]
- Unforeseeability ("aggrieved party special's interest does not follow from the terms of the contract or from the negotiations");[33]
- Unfulfillment of contractual purpose;
- Seller or buyer's behavior undermines the principle of good faith;

Oct. 28, 1998 4C.179/1998/odi (Switz.) [hereinafter CLOUT Case 248] *translation available at* https://cisg-online.org/files/cases/6384/translationFile/413_13546064.pdf.

[31] *See, e.g.*, Aneta Spaic, *Interpreting Fundamental Breach*, *in* INTERNATIONAL SALES LAW: A GLOBAL CHALLENGE 237 (2014) (discussing seven approaches which could be rewritten as factors: strict performance of written terms, economic loss, frustration of purpose, remedy-oriented, anticipatory breach, future performance, and offer to cure).

[32] U.N. Comm'n on Int'l Trade L., Report of the Working Group on the International Sale of Goods on the Work of its Seventh Session, U.N. Doc. A/CN.9/116 at 101 (Jan. 5–16, 1976).

[33] Robert Koch, *The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)*, *in* PACE REVIEW OF THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG) 25 (1999).

- Curability of nonconformity (seller's right to cure and whether the potential to remedy a breach means that it is not fundamental);[34]
- Whether the goods are easily repairable or are irreparable;
- Breach becomes fundamental if not effectively remedied;
- Essential delivery date;
- Importance of the product description;
- Nature or character of delivered product is different than description;
- Whether the goods can be easily resold on the market;
- Value of part performance relative to contract price;
- Bankruptcy or insolvency of one of the parties;[35]
- Extent of damage is uncertain.[36]

This list of factors indicates that determining whether a breach is fundamental is no easy thing, and the idea of uniformity of application is an impossible hope.

The second step is to look at the case law to determine what factors the courts actually give importance in assessing if a breach is fundamental. This knowledge is especially important to practitioners making arguments for or against a finding of fundamental breach. For the scholar, it is important to recognize any commonality or trends in the case law. Is fundamental breach circa 1995 the same as the meaning of fundamental breach circa 2022? The next section reviews the case law.

B. Operative Factors

The important or operative factors vary based on the type of breach being examined. This section divides breach cases into four types—easy cases, nonconformity of goods cases, delayed performance cases, and breach of collateral obligation cases.

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[34] Francesca Benatti, *Problematic Profiles of the Theory of Fundamental Breach Pursuant to Art. 25 of the CISG*, *in* THE TRANSNATIONAL SALES CONTRACT: 40 YEARS INFLUENCE OF THE CISG ON NATIONAL JURISDICTION 11 (S. Garcia Long & F. Viglione F Benatti eds., 2022).

[35] *See generally* Roder Zelt-und Hallenkonstruktionen GmbH v Rosedown Park Pty Ltd (1995) 17 ACSR 153 (Austl.), https://cisg-online.org/files/cases/6192/fullTextFile/218_56150197.pdf.

[36] BENATTI, *supra* note 34, at 11.

1. Easy Cases

Easy cases include breaches that are deemed fundamental as signaled by other provisions of the CISG. Thus, factors in a case that relate to other provisions of the CISG are the basis for a finding of fundamental breach. For example:

- Article 30: The seller must deliver the goods, hand over any documents relating to them, and transfer the property in the goods.
- Article 33: Seller must deliver the goods if a date is fixed on that date; in any other case, within a reasonable time after the conclusion of the contract.
- Article 34: Seller is bound to hand over documents relating to the goods, it must hand them over at the time and place and in the form required by the contract.
- Article 38: Buyer must examine the goods within as short a period as is practicable.
- Article 39: Buyer loses the right to rely on a lack of conformity if it does not give notice to the seller specifying the nature of the nonconformity within a reasonable time.
- Article 41: Seller must deliver goods which are free from any right or claim of a third party.
- Article 42: Seller must deliver goods which are free from any right or claim of a third based on intellectual property rights.
- Article 49: Non-delivery, if the seller does not deliver the goods within the additional period of time fixed by the buyer.
- Article 51: Declare the contract avoided in its entirety only if the failure to make delivery completely amounts to a fundamental breach (installment or partial delivery).
- Article 53: Buyer must pay the price for the goods and take delivery.
- Article 59: Buyer must pay the price on the date fixed.
- Article 64: Buyer does not perform, within the additional period fixed by seller.
- Article 71-73: Anticipatory breach where one party expressly or implicitly signals that it will not perform the contract in the future.[37]

[37] *See generally* Oberlandesgericht Düsseldorf, Apr. 24, 1997, 6 U 87/96, CISG Online (Ger.), https://cisg-online.org/files/cases/6357/translationFile/385_68189412.pdf.

A great deal of the CISG deals with buyer and seller obligations: seller's obligations (Articles 30–52), buyer's obligations (Articles 53–65), and seller-buyer obligations (Articles 71–77). When one of those essential obligations is broken it almost always amounts to a finding of fundamental breach. For example, a buyer's failure to make payment,[38] a party's failure to obtain a letter of credit,[39] a buyer's failure to take delivery,[40] and a buyer's failure to inspect[41] are easy cases of fundamental breach, because they are directly related to obligations enunciated elsewhere in the CISG.

2. Nonconformity of Goods

The great majority of difficult fundamental breach cases involve delivery of nonconforming goods. The factors that are most discussed in the cases are the usability or resaleability of the defective goods, failure of the root purpose of the contract, denial of expected benefits, and installment contracts.

a. Usability and Resaleability Factors

The theory of fundamental breach, discussed above in Section 2.A, places an emphasis on the usability and resaleability of the defective goods. The idea of keeping the non-breaching party in the contract and not allowing termination helps prevent waste and reduces damages. A Court of Appeals in *Düsseldorf* (Spanish orange juice case) decision involved the sale of pure orange juice.[42] The contract provided that the seller would deliver pure orange juice but delivered concentrated juice instead. The court focused not

[38] *See* Abstracts of Case Law on UNICTRAL Texts, U.N. COMM'N ON INT'L TRADE L., 3 (Aug. 3, 2010), https://documents-dds-ny.un.org/doc/UNDOC/GEN/V10/560/24/PDF/V1056024.pdf.

[39] *See* Abstracts of Case Law on UNCITRAL Texts, U.N. COMM'N ON INT'L TRADE L., 5 (June 3, 2009), https://documents-dds-ny.un.org/doc/UNDOC/GEN/V09/839/75/PDF/V0983975.pdf.

[40] *See* Abstracts of Case Law on UNCITRAL Texts, U.N. COMM'N ON INT'L TRADE L., 3-4 (July 11, 2006), https://documents-dds-ny.un.org/doc/UNDOC/GEN/V06/557/39/PDF/V0655739 .pdf?OpenElement.

[41] *See* Abstracts of Case Law on UNCITRAL Texts, U.N. COMM'N ON INT'L TRADE L., 5 (Aug. 30, 2010), https://documents-dds-ny.un.org/doc/UNDOC/GEN/V10/560/24/PDF/V1056024 .pdf?OpenElement.

[42] Oberlandesgericht Düsseldorf, July 9, 2010, I-17 U 132/08, CISG Online (Ger.), https://cisg-online.org/search-for-cases?caseId=8087.

on the low quality of the juice delivered, but on whether the difference impacted the use of the orange juice by the buyer. The court held that the seller had committed a fundamental breach because pure or direct orange juice could be used in ways that the concentrated form could not be used. It is important to note that the court did not factor in whether there was a secondary market that the buyer could have re-sold the concentrated juice and avoid waste.

In the *Generator II* case, Court of Appeal Koblenz, a buyer ordered an emergency power generator based on an internet advertisement of the seller.[43] The advertisement and the contract described the generator of having output power of 300 KVA. It actually produced less than 300 KVA. The court held that the lesser capacity was a fundamental breach. The court focused on the buyer's purpose for buying the generator, which was to provide an alternative source of power to fully supply its business operations and for that it needed a generator that produced 300 KVA.

In 2014, the German Federal Supreme Court remanded a decision involving defective tools, because the buyer still wanted to use the tools despite the defects and manifested an intent to attempt to repair them.[44] The court held that there were no grounds to recognize a fundamental breach because the avoidance (termination) remedy should only be allowed in cases of *extrema ratio* (extreme remedy). The 2015 *Volvo Tractor Units* case involved the sale of three Volvo tractors that were required to be equipped with EEV (enhanced environmentally friendly vehicle) technology.[45] The court ignored the importance of the EEV requirement and held the breach to be non-fundamental since the vehicles still operated as tractors.

Sinochem International (Overseas) Pte. Ltd. v. ThyssenKrupp Metallurgical Products GmbH[46] involved the sale of petroleum coke with a

[43] Oberlandesgericht Koblenz, Dec. 19, 2012, 2 U 1464/11 (Dec. 19, 2012), CISG Online (Ger.), https://cisg-online.org/search-for-cases?caseId=8384.

[44] Bundesgerichtshof, Sept. 24, 2014, VIII ZR 394/12, CISG Online (Ger.), https://cisg-online.org/search-for-cases?caseId=8459.

[45] Landgericht Stade, Apr. 16, 2015, 5 O 122/14, CISG Online (Ger.), https://cisg-online.org/search-for-cases?caseId=8582.

[46] ThyssenKrupp Metallurgical Products GmbH v. Sinochem Int'l (Overseas) Pte., Ltd. China Int'l Com. Ct. (China Int'l Com. Ct. June 3, 2014).

HGI range of 36-46, but the delivered coke was measured at 32 HGI.[47] The Chinese Supreme Court ruled that the nonconformity was not a fundamental breach for three reasons: (1) the coke still was usable, (2) the buyer's purpose of purchasing the petroleum coke was to resell, and (3) the buyer successfully resold the coke. As a rule, the court reasoned that no fundamental breach arose from the nonconformity of goods which did not give rise to "unreasonable difficulty for the buyer to use or resell the goods." This factor was also noted in another case where the court held that the buyer's ability to resell the goods in the "ordinary course of business" weighed against a finding of fundamental breach.[48] This was also the key factor in the breach analysis of a sale of below-quality meat.[49] A Swiss court held that the delivery of lower quality meat was not a fundamental breach because the buyer was able to sell the meat at a lower price at its business. The court did not assess whether the buyer's reputation was based on the sale of high-quality meats.

Whether something is useable or resalable is not the only factor weighed. Often, the more detailed question is from the perspective of the buyer. In one case, the seller sold software to an Austrian buyer.[50] The software itself was of satisfactory quality but it was missing modules needed to make it operable in Austria. Whether the software was resalable in another market was irrelevant since the focus was on its usability by the buyer. A more bizarre case involving the usability of goods, is a German case in which the court compartmentalized the products sold.[51] If the goods were taken as a whole, the nonconformity should have been held to be a fundamental breach since a major portion of the contract involved the assembly of (defective) parts. The contract was for the sale of two different things—fittings for a café and equipment for ice cream making. Because of defective

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[47] Qiao Liu, THE CHINESE JUDICIAL APPROACH TO CISG ARTICLE 25, *in* TRANSNATIONAL SALES CONTRACT: 40 YEARS INFLUENCE OF THE CISG ON NATIONAL JURISDICTIONS 459, 468 (Francesca Benatti, Sergio García Long & Filippo Viglione eds., 2022).

[48] Bundesgerichtshof, Apr. 3, 1996, VIII ZR 51/95, CISG Online (Ger.), https://cisg-online.org/search-for-cases?caseId=6113.

[49] Bundesgericht [BGer] [Federal Supreme Court] Oct. 28, 1999, 4C.179/1998 Schweizerische Zeitschrift für internationales und europäisches Recht (SZIER), 179-82 (Switz.).

[50] Oberster Gerichtshof [OGH] [Supreme Court], June 21, 2005, 5 Ob 45/05m, https://cisg-online.org/search-for-cases?caseId=6971 (Austria).

[51] *See* Abstracts of Case Law on UNCITRAL Texts, U.N. COMM'N ON INT'L TRADE L., 5 (Aug. 28, 2014), https://documents-dds-ny.un.org/doc/UNDOC/GEN/V14/055/40/PDF/V1405540.pdf?OpenElement.

parts, the ice cream maker could not be assembled and installed. Nonetheless, the court held there was no fundamental breach because the café fittings were useable. Allowing the buyer to avoid the contract as it related to the ice cream making equipment would have been a better decision, since the failure of any of its component parts resulted in a failure of the whole. As such, that part of the contract was wholly unusable.

b. Essential Purpose or Root of the Contract

Numerous courts have held that a breach is fundamental if the defect goes to the root of the contract. Mostly, these are cases of highly defective goods and whether they are resaleable is at best a minor factor in the decision. A 2018 Canadian case, *Pattison Outdoor Advertising Limited Partnership v. Zon LED LCC*, involved a commercial sale of LED lighting.[52] The court held that the lights failed in their particular purpose, and that constituted a fundamental breach. The buyer relied on the expertise of the lighting company to provide a product appropriate for outdoor illumination of billboards. The lights began to fail soon after installation. Expert testimony showed that the design of the lighting fixtures was not suitable for the variety of climates found in Canada. The seller and buyer made numerous attempts to cure the problem but were unable to find a permanent solution. The court noted that a breach is fundamental when it goes to the root of the contract, the performance was totally different than what was expected, or it renders the goods unfit for the purpose for which they were purchased, which it further defined as not reliable on a day-to-day basis. Interestingly, the fact that the lights had been installed and used for a period of time was ignored by the court. Instead of seeing the case as one of breach of warranty, it held that the defects were a fundamental breach of the contract, allowing the buyer to retroactively terminate the contract, receive a full refund, and sue for damages.[53]

[52] Pattison Outdoor Advert. Ltd. P'ship v. Zon LED LCC, 2018 BCSC 555.

[53] *Id.* ("I have allowed the claim for fundamental breach under the CISG. It is therefore not necessary for me to make a finding under the alternative claim for failure to perform warranty obligations.").

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A Danish court held that a lame pony failed in its essential purpose, constituting a fundamental breach.[54] The buyer purchased a pony to use in its riding school. It also was in the business of selling ponies. The pony was delivered in a lame condition which was due to a prior injury. As such, it could not be used in training young riders and had little resell value. Another case involved the sale of doors and door frames with the implied assumption that the number of doors and door frames to be delivered would be of relative equal quantities (119 doors and 123 door frames).[55] The seller instead delivered 22 doors and 174 door frames. The delivered goods were of sufficient quality, but the court held that the imbalance in quantities was a fundamental breach for they undermined the purpose of the contract—assembly into kits for resale. The court did not discuss the resaleability of the doors and frames delivered.

In one sense, no matter the degree of the nonconformity most goods are likely to have some degree of resaleability or useability. That said, courts often avoid assessing resaleability or usability in cases of highly defective or low-quality goods even if there is a plausible resale market. In one case involving the sale of shoes, the defects in the shoes were so pervasive that the buyer had no choice but to destroy them.[56] The court held that this was a clear case of fundamental breach. A seller knowingly suppling goods ill-suited to the buyer's particular use can be a fundamental breach. The Austrian software case discussed above can also be seen as an example of a product failing its essential purpose since the software was not functionable in the buyer's country.[57]

c. Detriment or Deprivation of Benefit Factor

The phrase "substantially to deprive" begs the question of what is substantial. The deprivation of benefits test focuses on the seriousness of the

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[54] *See* Abstracts of Case Law on UNCITRAL Texts, U.N. COMM'N ON INT'L TRADE L., 3 (Sept. 15, 2010), https://documents-dds-ny.un.org/doc/UNDOC/GEN/V10/564/59/PDF/V1056459.pdf?OpenElement.

[55] Clout Case 1153 (Slovenia) (Dec. 14, 2005).

[56] Landgericht Berlin, Sept. 15, 1994, 52 S 247/94, CISG-Online (Ger.), https://cisg-online.org/files/cases/6371/fullTextFile/399_77306085.pdf.

[57] Oberster Gerichtshof [OGH] [Supreme Court], June 21, 2005, 5 Ob 45/05m (Austria), https://cisg-online.org/search-for-cases?caseId=6971.

injury or damage caused, such as financial losses to the victim and impacts on its other activities.[58] Thus, goods that are either materially different from the goods contracted for or are a total loss due to the nonconformity, would be considered a fundamental breach. In one case, the court felt it unnecessary to determine the value of reselling the delivery of the wrong brand of champagne.[59] It might be that in such cases the delivery is of a clearly different thing, so there is no need to inquire as to what benefits the buyer expects to receive under the contract. When the difference is sufficiently evident and relates to the nature or character of what was expected it is a fundamental breach.

d. Installment Contracts

Often, partial performance occurs in installment sales where the general rule is a defect or delay in one installment is not a fundamental breach. Article 51(2) states that: "The buyer may declare the contract avoided in its entirety only if the failure to make delivery in conformity with the contract amounts to a fundamental breach of the contract." The presumption is that a partial non-performance is not fundamental because Article 51(1) refers to the options of price reduction and time extensions.[60] Two exceptions can be constructed. First, if the installment is of defective goods of integral parts or components that would render the end product unusable, then delivery of future installments would serve no purpose. A second exception was recognized by a German court, which held that when the defect or delay is in the first installment it is fundamental since it casts reasonable doubt regarding delivery of future installments.[61]

[58] Liu, *supra* note 47, at 464.
[59] *Id.* at 466.
[60] Source Requested.
[61] Handelsgericht des Kantons Zürich [Commercial Court Canton Zurich] Feb. 5, 1997, HG 950347 1 (Switz.).

3. Delayed Performance

This section reviews the general rule that delivery within in a reasonable time after the date fixed for delivery is not a fundamental breach and its two exceptions.

a. Delivery Within a Reasonable Time

The general rule is that late delivery, beyond the time fixed in the contract is not a fundamental breach unless the late delivery substantially deprives the buyer of its expected benefit.[62] Reasonableness of the delayed performance may be determined by the dealings of the parties (prior late deliveries), industry practice, and the nature of the goods (deteriorate in quality). The idea of a reasonable late delivery fits within the overall rationale of the CISG of preserving contract relationships and seeing avoidance as the remedy of last resort. This theme is evident in the CISG's adoption of *nachfrist* notice, which allows either party a right to request additional time to perform.[63] The exceptions to late performance as being non-fundamental are when time of delivery is an essential element of the contract or when the contract contains a time of the essence clause. The next section discusses these two exceptions.

b. Time Is of the Essence

A delivery after the date fixed in the contract is considered a fundamental breach if the time of delivery is an essential element of the contract (implicit) or the contract made time is of the essence a fundamental breach (express). In the 2013 *Hiking Guidebooks* case, a buyer hired a company to print and supply hiking guidebooks.[64] The court held that the

[62] Bundesgericht, Switzerland, 2 Apr. 2015, www.servat.unibe.ch (late delivery of documents not fundamental breach); Corte di Appello di Milano, Italy, 20 Mar. 1998, Unilex (late delivery); CLOUT case No. 275 [Oberlandesgericht Düsseldorf, Germany, 24 Apr. 1997 (late delivery), noted in CISG,UNCITRAL DIGEST OF CASE LAW ON THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS [CISG], Article 25 at 115 (2016).

[63] CISG, UNCITRAL DIGEST OF CASE LAW ON THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS, Article 47, 48, 63 at 225, 228, 291 (2016).

[64] Oberlandesgericht Köln [OLGZ] [Higher Regional Court of Cologne] Apr. 21, 2013, 16. Zivilsenat 1 (2014) (Ger.).

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nature of the goods made in time is of the essence since the books were needed before the beginning of the hiking season. Hence, the late delivery was a fundamental breach since adherence to the deadline was of central importance to the buyer to enable it to fill the orders of its customers. In the sale of seasonal goods, time is almost always a material term as was the case in *Italdecor s.a.s. v. Yiu's Industries (HK) Ltd.*,[65] which involved the late delivery of a spring clothes collection. In another delayed performance case, the court once again held that late delivery was a fundamental breach. The *German Fresh Pasta* case[66] involved a three-day late delivery. The contract guaranteed a shelf life of twenty-one days after timely delivery of the pasta. The court determined that the reduction of the shelf life to eighteen days constituted a fundamental breach.

In *Macromex S.r.l. v. Globex International Inc.*,[67] a seller was obligated to "ship chicken parts" to buyer no later than May 29, 2006. The seller delayed shipment and subsequently the buyer's government posed an import ban on the shipment of chickens (due to the spread of avian flu). Had the seller loaded the chicken parts within the two-week window expressly provided for in the contract, or even within a week thereafter, the chicken parts would have been allowed into the country of import. The question becomes: when does a delay constitute a fundamental breach? The arbitrator noted that there is no bright-line rule for what constitutes a reasonable delay and noted that there was no claim made by the buyer until the implementation of the ban on June 2. Ultimately, the arbitrator avoided the fundamental breach issue to focus on seller's claim of excuse under Article 79 (impediment) arguing that the government ban prevented performance.[68] The arbitrator rejected the seller's claim of exemption and awarded damages to the buyer because the seller did not deliver to an alternative port as suggested by the buyer and that constituted a fundamental breach.[69]

The more controversial issue is whether a time is of the essence clause should be given effect when the consequences of a late delivery do not

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[65] Corte di Appello di Milano, 20 marzo 1998 (It.).

[66] Oberlandesgericht Stuttgart [Court of Appeal Stuttgart] Nov. 27, 2019, 3. Zivilsenat 1, 1–2 (Ger.).

[67] Macromex Srl. v. Globex Int'l Inc., Arb. Award 1, 2 (Am. Arb. Ass'n 2007), https://unilex.info/cisg/case/1346.

[68] *Id. see* paras. 5 & 6 at https://cisg-online.org/files/cases/7572/fullTextFile/1653_59432040.pdf.

[69] *Id.*

amount to a substantial detriment. Extrinsic evidence, such as trade usage, may show that rejecting goods delivered within a reasonable time was an act of bad faith. Does the use of the time is of the essence clause necessarily make a fixed delivery date an essential element of the contract? A textual approach would enforce the express intent that the delivery date was a fundamental element of the contract. Therefore, the nature of the goods, business practice, or trade usage should not apply to determine that somehow the time is of the essence clause was unreasonable.[70] It is not unreasonable if the parties clearly agreed to make time is of the essence. In *Diversitel Communications Inc. v. Glacier Bay Inc.*, a Canadian court referenced the parties' conduct and communications to imply time is of the essence into their contract.[71] Nonetheless, courts often ignore the parties' clear intent in cases where a party requests a time extension under Articles 47, 48 and 63 of the CISG.

4. Breach of a Collateral Obligation

The UNCITRAL Digest notes that "even the breach of a collateral duty can give rise to a fundamental breach."[72] For example, where a manufacturer had a duty to reserve goods with a particular trademark exclusively for the buyer, and the manufacturer then displayed the trademarked goods at a fair on its own behalf, the manufacturer was found to have committed a fundamental breach.[73] In another case the breach of an exclusivity provision in a distribution contract was deemed to be fundamental.[74] But just as not all breaches are treated alike, so to with breaches of collateral obligations. The 1998 Oldenburg Court of Appeal decision[75] involved a contract for the sale of salmon for delivery to a cold-storage depot. The seller mistakenly delivered the salmon to the buyer's processing plant. The court held that the misdelivery was not a fundamental breach.

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[70] Bundesgericht/Tribunal fédéral [BGer/TF] [Federal Supreme Court], Sept. 15, 2000, 4P.75/2000 5–6 (Switz.).

[71] Diversitel Communications Inc. v. Glacier Bay Inc., 2003 CanLII 49351 (Can. ON S.C.).

[72] UNCITRAL DIGEST OF CASE LAW ON THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS [CISG], Article 25 at 116 (2016).

[73] **73** *Id.*, citing CLOUT case No. 2 [Oberlandesgericht Frankfurt a.M., Germany, 17 September 1991].

[74] Oberlandesgericht Koblenz [Court of Appeal Koblenz] Jan. 31, 1997, 2. Zivilsenat 1, 5 (Ger.).

[75] Oberlandesgericht Oldenburg [Court of Appeal Oldenburg] Sept. 22, 1998, 12. Zivilsenat 1, 5 (Ger.).

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V. FINDINGS AND SUMMARY

Because of the standard-like nature of the fundamental breach rule, what constitutes such a breach varies across cases since it is context-dependent. The variation across jurisdictions is to be expected for a number of reasons. First, the bias of different legal traditions plays at least a sub-conscious role with the common law tradition leaning towards strict enforcement of contracts and the civil law more willing to take principles such as good faith, hardship, and fairness into account. Second, the undefined and vague standards employed by Article 25 are susceptible to numerous, reasonable alternative interpretations. This is not a recipe for harmonized sales law in its application phase.

But all is not lost, with a careful study of the cases, some degree of concretization is possible.[76] The open-textured nature of Article 25's provisions allow for a factors analysis to see which facts or factors are most predictive of a courts or arbitral tribunals decision. From there, the shaping of the operative rule of fundamental breach can be discovered. In this way, imparting meaning to such phrases as "results in such detriment," "to substantially to deprive" and "entitled to expect" is possible. In the end, the best that can be hoped for is not a mechanical interpretation of such phrases uniform across all Article 25 cases, but a constrained set of alternative interpretations. The solid ground of such a standard-like rule is knowledge of what courts view as the operative facts used in determining if there had been a fundamental breach. Figure 1 presents a 'Matrix of Factors" taken from the case law.

[76] Concretization is a German law concept in which a general idea, such as fundamental breach, is made more definite or more specific. This is what a factors analysis attempts to do.

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Figure 1: Matrix of Factors

Type of Breach	Fundamental Breach	Factors
Non-Performance: Non-Delivery; Non-Payment, Failure to Obtain Letter of Credit	YES	Full Non-Performance
Anticipatory Breach	YES	Article 71-73
Non-Conformity of Goods: Useability	NO	Useable in Buyer's Business
Non-Conformity of Goods: Useability	YES	Fails of its Essential Purpose
Non-Conformity of Goods: Resaleability	Indeterminate	Domestic Market; Accessibility to Resale Marketplace; Fails of Essential Purpose
Partial Non-Conformity	Indeterminate	% of Non-conforming Goods; Nature of Defect; Reparability (Buyer); Curability (Seller)
Highly Defective or Extremely Low Quality	YES	Existence of Resale Market is Irrelevant
Nonconforming Installment	Indeterminate	Rejection Only of Installment; Exceptions: First Installment; Integral Part; Cumulative Series of Minor Breaches[77]
Late Delivery	NO	If Within Reasonable Time
Late Delivery	YES	Essential Element of Contract
Late Delivery	Indeterminate	Time of the Essence Clause
Failure of Purpose	Indeterminate	Majority: Yes (Resaleability is Irrelevant; No (Resaleability is Relevant)
Failed Attempt to Cure (Seller)	YES	Number of Attempts; Timeliness
Failed Mitigation Attempt (Buyer)	YES	Reasonable Effort[78]

This foray into a factors analysis of Article 25 is limited given the space allowed. There are hundreds of cases interpreting Article 25. Only a representative sample was presented here. But it is important to note that the

[77] Bundesgerichtshof [BGH] [Federal Court of Justice] Apr. 3, 1996, VIII. Zivilsenat 1 (Ger.) (held that cumulation of non-fundamental breaches may amount to a fundamental one).

[78] Chinese party v. Italian party, Shenzhen Court of Int'l Arb. (2013) (China) (goods were received at the buyer 's factory, the buyer tried twice to adjust them and gave notice that they were unfit for their purpose).

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cases presented represent numerous other cases that reached similar decisions on similar fact patterns. This analysis shows how certain factors, divorced from the formal words of Article 25, offer insight as to how the rule is applied in practice.

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