**Case Law on the Concept of "Fundamental Breach" in the Vienna Sales Convention**

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**Introduction**

Fundamental breach is a milestone concept of the United Nations Convention on Contracts for the International Sale of Goods (hereinafter CISG), since it is the necessary precondition for avoiding the contract under articles 49(1)(a) and 64(1)(a)). Fundamental breach of contract by the seller also entitles the buyer to claim delivery of substitute goods (art. 46(2)), and to enact remedies in spite of the risk having passed to him (art. 70). However, a mere non-fundamental breach will be sufficient to entitle the aggrieved party to claim damages (art. 74) and to claim a price reduction (art. 50).

This suggests that the drafters of the CISG had in mind a basic distinction between fundamental breach and non-fundamental breach. Fundamental breach entitles to remedies that leave more rigorous consequences to such as the termination of the contract. Thus, if a breach of contract takes place, one must first establish if it is a fundamental one that entitles a party to declare the avoidance of the contract.

Unfortunately, art. 25 CISG does not provide guidelines for a distinction between fundamental and non fundamental breach; it simply 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 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 have not foreseen such a result". This provision has been criticized, because it does not give a clear definition of fundamental breach.

Such vagueness is due to the differences existing in respect of the definitions of fundamental breach to be found in the various legal systems, which prevented the drafters from finding an agreement on the type of breach that leads to avoidance of contract. The Convention does not even provide an example of what may constitute a fundamental breach for the purpose of its application, it simply provides general interpretive guidelines.

First of all, in defining fundamental breach under the CISG legal scholars repeatedly urged interpreters to avoid recourse to domestic legal concepts, since the CISG itself calls under art. 7 for a uniform interpretation and application of its provisions. As often pointed out in legal writing and case law, the CISG should be interpreted autonomously and its interpretation should not depend on domestic legal concepts, neither of civil law nor common law origins. Various efforts have been made, especially in the last few years, towards the achievement of a uniform interpretation of the CISG and different solutions have been proposed. Yet, the CISG cannot rely on the binding interpretation of one court, such as the European Court of Justice case law or the International Court of Justice. Although foreign case law on the CISG is not binding, despite one opinion to the contrary, as recently pointed out in case law, it is still a useful instrument of persuasive nature for the judges and the arbitrators throughout the world, in accordance with the goal of uniform interpretation pointed out by many leading scholars. Under this view, probably the most neutral and effective contribution to a uniform interpretation of the CISG is the creation of free online databases which collect English case abstracts of CISG decisions. Amongst these, reference is to be made to the CLOUT system managed by the UNCITRAL Secretariat, and to the databases of other research centers such as UNILEX, and the databases of Pace Law School and Freiburg University. Considering the large number of decisions on the CISG, it is self-evident that not all of them are bringing a meaningful contribution to the uniform interpretation of the Convention. Indeed, many decisions are often misleading and diverging, since, as correctly pointed out by one scholar, "diverging interpretations by national courts is a problem of all international uniform laws." Thus, it would be unwise to leave judges or arbitrators with the time consuming task of evaluating which published decisions may lead to a uniform interpretation of the CISG. This paper endeavors to filter these decisions and to determine what constitutes a fundamental breach under the CISG. Thus, an attempt will be made to provide guidelines for judges, arbitrators and lawyers facing the issue of fundamental breach in international sales law litigation.

**The theoretical structure of art. 25 CISG**

The structure of art. 25 is extremely complex. The first part of art. 25 qualifies fundamental breach as the detriment caused by one party to the other party, which substantially deprives him of what he is entitled to expect under the contract. The second part of art. 25 is conditional, and allows the party in breach to prevent avoidance provided that he proves that he did not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result. The content of the provision relies on a distinction between elements relating to the aggrieved party and elements concerning the party in breach. The former elements are "substantial detriment" and "contractual expectation", whereas the latter elements are "foreseeability" and "the reasonable person of the same kind standard". A critical analysis of those elements will follow.

***Elements relating to the aggrieved party: "substantial detriment" and "contractual expectation"***

Speaking of substantial detriment, it appears that the provision makes a tautology between the adjectives fundamental and substantial, which makes it hard to establish when substantial detriment equals fundamental breach. Substantiality is tied to the aggrieved party's detriment and causes the breach to be fundamental. According to legal scholars and case law the breach is fundamental regardless of whether it occurred in respect of a main obligation or an ancillary obligation (even though this distinction is frequently used in civil law countries to classify the importance of an obligation). Moreover, as correctly pointed out by leading scholars, detriment does not equal damage, since under art. 74 CISG the party has a right to claim damages even if the breach is not fundamental (or substantial). It appears that the notion of detriment is much broader than that of damage, the economic loss suffered by the aggrieved party is not necessarily the only decisive element for establishing if a fundamental breach occurred. However, as will be shown below, a different view is expressed in case law, which often deems only relevant the gravity of the seller's breach and the consequent economical loss.

In spite of that, it should be noted that the party's special interest in receiving performance is also a key element for establishing whether a breach is substantial. This interest belongs to the subjective sphere of contractual expectation, which largely depends on the agreement between the parties. The parties are free to determine when and under which circumstances a breach of the contractual expectation is fundamental. Thus, it has been argued that the breach is fundamental when the buyer's intended use of the goods becomes impossible, or when the party has lost interest in receiving the performance. Moreover, it is unclear whether negotiations, trade usages, or other facts subsequent to the conclusion of the contract and not mentioned in the contract may also come into play, as suggested by some authors, for determining the party's contractual expectation.

It follows from the above that the objective element of substantial detriment and the subjective element of contractual expectation are two blended concepts, since detriment can lead to fundamental breach if the aggrieved party has lost interest in receiving performance.

Unfortunately, these elements are defined too generically to enable the interpreter to grasp the concept of fundamental breach. This inevitably calls for a case by case analysis, thus confirming the importance of a case law approach for a correct understanding of the issue.

***Elements concerning the party in breach: "foreseeability" and the "reasonable person of the same kind" standard***

The foreseeability element is a filter, which enables the party in breach to escape from contract avoidance. Lack of foreseeability of the substantial detriment is a ground of excuse, and, if proven, it will prevent the aggrieved party being entitled to declare the contract avoided. The circumstances in which the breaching party may invoke unforeseeability may vary in accordance with the contractual wording. When the contract expressly states that performance of an obligation is of essence, there will be little room for proving that the breach caused an unforeseeable detriment. This may be the case of goods that must be delivered within a fixed term, indicated by the buyer as essential. The transportation insurance for the goods [[30]](http://cisgw3.law.pace.edu/cisg/biblio/graffi.html#30) and the payment by means of letter of credit [[31]](http://cisgw3.law.pace.edu/cisg/biblio/graffi.html#31) may also constitute essential obligations, respectively for the buyer and for the seller. Conversely, when the contract does not clearly state the importance of an obligation, the conduct of the party in breach may be interpreted with more tolerance. According to some authors, the foreseeability test serves only to exempt the party in breach, and cannot contribute to qualifying breach as fundamental. Thus, under this view, foreseeability is only a conditional element that must be proven to prevent the contract from being avoided, substantial detriment and contractual expectation remain the key elements for establishing fundamental breach.

In the light of these considerations, it should be stressed that the burden of proving unforseeability rests with the breaching party. This only confirms the preferable view held by some authors and by several courts, according to which the issue of the allocation of the burden of proof is an issue implicitly governed by the CISG, in accordance with the latin brocard *onus probandi incumbit ei qui dicit*.

Further, it must be stressed that the personal qualities of the party in breach are not essential for the foreseeability test, since the test must be conducted on objective grounds. Thus, it will be preferable not only to evaluate whether a reasonable person of the same kind could foresee the event, but also to look if business people of the same trade sector would have foreseen the event. The importance of limiting the analysis to a specific trade sector must be stressed, since reasonableness standards may considerably differ from one sector to another. It has also been correctly pointed outthat if the party in question does foresee more than average, this will be relevant.

Probably, however, time is the most controversial issue of the foreseeability test. In legal writing different views are expressed as to when the party in breach must have foreseen the aggrieved party's interest in receiving the performance, i.e., of whether circumstances arising after the conclusion of the contract are relevant for determining fundamental breach. While some authors argue that the importance of an obligation must be determined only in light of the circumstances known at the conclusion of the contract, other authors deem equally important any subsequent information that may indicate the parties' interest in receiving performance.

The latter view seems to be preferable under the general principle of good faith which according to case law  underlies the Convention, at least to the extent that the party in breach was aware of that subsequent information.

**Fundamental breach in court and arbitral practice**

Given the complexity of the theoretical structure of art. 25 and given that the Convention does not provide the interpreter with specific interpretive guidelines, it may be useful to take a look at the case law on fundamental breach. As correctly pointed out by a scholar, any abstract definition of fundamental breach must expect criticism. This statement cannot surprise given the various standards for determining fundamental breach in case law. Since the outcome of these decisions largely depends on the circumstances of each case, it would be of little use to simply list all the decisions. Nevertheless, some types of controversies are likely to occur more often than others. Thus, an attempt has been made to classify the most typical controversies into broad categories, which are the expression of court practice trends.

***Late performance and fundamental breach***

In international sales transactions, late performance occurs rather frequently, due, amongst others, to the distances. Indeed, late performance may be caused either by the seller's late delivery of the goods or by the buyer's late payment or late taking over of the goods.

With respect to late delivery of the goods, both the case law and the legal authors hold that delay does not *per se* constitute a fundamental breach. Therefore, the seller's breach of the first delivery term should not lead to immediate avoidance and the buyer should grant him an additional period of time. Obviously, this interpretation serves the purpose of preserving contractual bonds, since considerable costs may arise in international trade if the standards of avoidance become too lax. Nevertheless, in case law several restrictions were applied to the general rule by making a distinction between essential and non-essential term for delivery. There is case law that holds that the breach of an essential term can constitute a fundamental breach "if delivery within a specific time is of special interest to the buyer", and therefore even if no additional term for delivery was fixed.

The most obvious way to determine if the term is essential is the existence of a contractual clause stating that delivery must be effected at an exact time. Yet, the term is to be considered essential not only when the parties specified it in the contract, but also in the light of the circumstances, customs, usage or other relevant factors. For instance, the term may be considered essential when the buyer "has informed the seller that he has fixed a date for delivery to his sub-buyers". Further, the term may be considered essential because of the nature of the goods. In case of seasonal goods (spring collection clothes), the Court of Appeals of Milan held that the term for delivery was of essential importance, since these clothes were unlikely to be worn in a different season. However, the delivery of summer clothes one day after the fixed time was not held to constitute a fundamental breach. The Hamburg Court of Appeals, seized of an action in respect of a CIF contract, held that in CIF contracts the term is essential "by definition". A term may also be considered essential *ipso facto*, as in a case decided by the Court of Parma, where a delay of two months in delivering the goods was considered a fundamental breach of contract.

The cases at hand show that the essentiality of a term must be determined according to the circumstances of each case and that many different factors may be relevant.

With regards to late payment, it is generally acknowledged  that late payment does not amount by itself to a fundamental breach. With regards to the issue of securities for payment, some decisions dealt with the issue of failure to open a letter of credit in due time. The Supreme Court of Queensland ruled that the buyer's failure to open a letter of credit in the time fixed in the contract does not constitute a fundamental breach and that the seller may declare the contract avoided only after the expiry of the additional term for performance granted to the buyer. Two ICC arbitral awards held that the buyer's delay in opening a documentary credit did not necessarily amount to a fundamental breach, unless the additional term fixed by the seller has expired.

A special case of delay is the late taking over of the goods by the buyer. A French court held that a delay of a few days only will not constitute a fundamental breach. In case of longer delay, which results in considerable costs of storage, the seller should still not be entitled to declare the contract avoided, but simply to claim damages.

A different conclusion may be reached when the buyer refused to take over the goods, since several courts held that final refusal by the buyer to take over the goods constitutes fundamental breach.

The aforementioned decisions show that that two different standards apply in case of late performance. In case of late delivery by the seller, the general rule that delay does not amount to a fundamental breach is not settled, since there are many exceptions to the rule. In case of late payment by the buyer, a different standard applies and more tolerance seems to be admissible. As stated by a scholar, "only in an exceptional case should a delay in payment by itself be a fundamental breach of contract". Yet, since in case of late performance it is often hard to determine when delay may amount to fundamental breach, it is always advisable that the parties fix an additional term for performance (the so called *Nachfrist*). At the expiration of this term, the aggrieved party will always be entitled to avoid the contract pursuant to articles 49(1)(b) or 64(1)(b), regardless of whether a fundamental breach occurred.

***Defective goods and fundamental breach: the economic loss approach***

The delivery of defective goods is certainly the most recurrent situation in international sales litigation. The number of decisions dealing with this issue is remarkably high, but often it is rather problematic to establish which kind of deficiencies in the goods may amount to a fundamental breach. In the CISG, the notion of lack of conformity is to be evinced from art. 35(1), which states that "the seller must deliver goods which are of the quantity, quality and description required by the contract and which are contained or packaged in the manner required by the contract". Art. 35(2) lists specific standards, which represent a *condicio sine qua non* for the conformity of the goods. In summary, except when the parties have agreed otherwise, the goods do not conform with the contract, as pointed out in case law: unless they are fit for the purposes for which goods of the description would ordinarily be used; unless they possess the qualities of goods which the seller has held out to the buyer as a model or sample; and unless the goods are packed in the usual and necessary manner (art. 35(2) CISG). Under the CISG, the delivery of an *aliud* is also treated as delivery of a non-conforming good (and not as non delivery), as pointed out by the German Supreme Court and by the Austrian Supreme Court. In any event, the buyer loses the right to avail himself of the remedies for non-conformity, if he fails to give notice to the seller within a reasonable time after discovering the defects pursuant to art. 39 CISG.

In determining what type of deficiency may lead to a fundamental breach, although without expressly saying so, case law seems to favour an economically oriented approach, based on the actual loss suffered by the aggrieved party.

Some courts decisions looked merely at the percentage of defective goods, or at the estimated cost of repair on the total value of the goods. Other court decisions, however, gave relevance to a criterion based on the merchantability of the defective goods. With regards to the first type of decisions, in the case of *Delchi v. Rotorex* first decided by the District Court of New York and later upheld by the Court of Appeals of the Second Circuit, both courts  stated that the buyer had a right to avoid the contract because 93% of the goods did not conform with the contracted samples and did not satisfy the quality controls standards (the air condition compressors had low cooling capacity). In another case, the Landshut District Court held that the buyer had suffered substantial detriment because the entire lump of sportswear delivered had shrunk about 10 to 15% after being washed. However, in a case decided by the Hamm Court of Appeals, the percentage of defective goods was considered too small to justify the buyer's declaration of avoidance (420 kilograms of defective goods out of 22 tons). It appears that only a very high percentage of defective goods (close to the full amount) may entitle the buyer to declare the contract avoided. In this kind of situation fundamental breach is easy to assess, since virtually all the goods are defective and they are useless for the buyer.

The estimated cost of repair is another criterion used by the courts. In an Austrian-Chinese dispute over unfit scaffoldings non-conforming to the sample, an ICC arbitral tribunal held that the buyer had a right to declare the contract avoided, since the costs for sorting out the defects would have compared to one third of the total purchase price.

Probably, however, the most interesting solution is that based on the merchantability of defective goods. This interpretive approach was first used by the Frankfurt Court of Appeals and later confirmed (albeit in a different case) by the German Supreme Court. The first case dealt with a delivery of shoes by an Italian seller to a German buyer. The German buyer stated that the contract was avoided due to late delivery and lack of conformity of the shoes. The court noted that the buyer did not specify whether the shoes were just below standards or totally unfit for resale. According to the Court, only in the latter case the buyer would have been entitled to declare the contract avoided. This concept is even more clearly defined in a decision by the German Supreme Court dealing with the sale by a Dutch company of four different quantities of cobalt sulphate to a German buyer. The parties agreed that the goods should be of British origin and that the seller should supply certificates of origin and of quality. After the receipt of the documents, the German buyer declared the contracts to be avoided, since the cobalt sulphate was made in South Africa and the certificate of origin was wrong. In determining if a fundamental breach exists, the German Supreme Court held that one must consider whether it can be expected for the buyer to put the goods to another reasonable use. Since the buyer had failed to show that the goods could not be resold in Germany or abroad, it was not entitled to avoid the contract under art. 49. Further, the Court held that the buyer failed to show that the breach by the seller amounted to a substantial deprivation of its contractual rights.

The merchantability of the goods was used as a criterion for determining fundamental breach also by the French Supreme Court. In a case dealing with a delivery of wine by an Italian seller to a French buyer, the French Supreme Court held that fundamental breach occurred as a result of the non merchantability of the wine on the French market. In the case at hand, the Italian buyer manipulated the wine by adding sugar to it in breach of French wine regulations. The seller's manipulation was said to affect the quality of the wine to the extent that its breach was considered a fundamental one. Eventually, the seller's conduct had affected irreparably the merchantability of the goods. However, in the case at hand, the French Supreme Court did not address the issue of whether the wine could be resold abroad (as the German Supreme Court did). In a German decision, however, the breach of German federal health department regulations was not considered to irreparably affect the merchantability of the goods. The case involved a Swiss seller and a German buyer, who concluded a contract for the sale of mussels from New Zealand. The mussels contained a quantity of cadmium exceeding the maximum level recommended by the German Health authority, but the German Supreme Court denied fundamental breach holding that the excessive quantity of cadmium could not affect the conformity of the goods. According to the German Supreme Court, "the standard for cadmium content in fish, in contrast to the standard for meat, does not have a legally binding character but only an administratively guiding character. Even if the standard is exceeded by more than 100%, one cannot assume that the food is no longer suitable for consumption, because mussels, contrary to basic food, are usually not consumed in large quantities within a short period of time and, therefore, even "peaks of contamination" are not harmful to one's health". Basically, the Court arguably held that the mussels were perfectly merchantable and edible, even though potentially toxic. The different approaches taken by the French and the German case law may serve as an example of the confusion that reigns on the interpretation of fundamental breach.

***Defective goods and fundamental breach: relevance of seller's offer to cure***

Much controversy exists on whether defects can be cured by the seller before the buyer can declare the contract avoided. In other words, it must be established if the offer by the seller to replace or repair the defective goods may halt the effects of the buyer's declaration of avoidance. The relationship between the seller's right to cure and the buyer's right to avoid is still unclear and is subject to diverging interpretations.

Several commentators  suggest that in case of delivery of defective goods there is no fundamental breach if the seller has made a serious offer to cure the defect. Another commentator  even suggests that there is no fundamental breach also in the absence of an offer to cure, as long as the breach remains curable. These authors base their conclusions on the wording of art. 48 CISG, which provides that the seller may, even after the date of delivery, remedy at his expense any failure to perform his obligations, provided that remedy takes place within a reasonable time and without causing unreasonable inconvenience to the buyer. They argue that a different interpretation would make art. 48 meaningless.

However, as correctly pointed out different authors, art. 48 CISG is subject to the art. 49 reservation, and thus, the seller's offer to cure cannot prevent the buyer from declaring the contract avoided. According to this stricter interpretation, the buyer has a right to declare the contract avoided if the lack of conformity amounts to a fundamental breach, regardless of whether the seller has made an offer to cure. In case of defective goods, the buyer's interest to avoid the contract should prevail on the seller's offer to cure. The subjective element of contractual expectation is essential for this type of analysis, since the seller committed the breach and the buyer must be entitled to decide whether to accept the offer to cure or not. The buyer cannot be barred from avoiding the contract pursuant to art. 49 only because the seller has made an offer to cure, but he must decide on his own if it is more convenient for him to accept the offer or to declare the contract avoided. Especially when the term for delivery is of essence, the buyer may have lost its interest in receiving the performance even if the defect may be cured swiftly and he must be free to decide whether the seller may still remedy the defect. Pursuant to this view, thebuyer may also decide not to avoid the contract if he is satisfied with the seller's offer to cure. Eventually, in case of defective goods it is the buyer's interest that must prevail. Obviously, the buyer may accept the seller's offer to cure the defects, and this will be intended as a waiver of his right of avoidance, as stated by one court.

This interpretation is criticized by those authors who believe that the seller should not be deprived of its right to cure the defects and that, if this were the case, the right to cure would lose any practical meaning. In Germany, the Court of Appeals of Koblenz  held that fundamental breach does not occur if there is a serious offer to cure by the seller. In a dispute over the delivery of acrylic blankets, the Court held that the seller's offer to cure the defect prevented the breach from being fundamental, even though the buyer had refused the offer. The Commercial Court of Zurich took a similar position, although only *obiter*.

It must be noted, however, that courts repeatedly affirmed that the buyer's right to avoid the contract should not be restricted by the seller's offer to cure. An ICC arbitral award, for instance, found that the buyer was entitled to rely on art. 49(1)(a) CISG for declaring the contract avoided, and that the seller was not entitled to supply substitute items after the delivery date specified in the contract without consent of the buyer. This arbitral award recognizes the principle that the buyer should have the last word on the avoidance of contract.

**Conclusions**

Although legal commentators argued that under the Convention the remedy of avoidance should be intended as the last resort (*ultima ratio*), to be applied only when it is no longer possible to continue the contractual relationship, case law seems, albeit with some exceptions , to use a less restrictive approach. Economic loss plays an important role in determining the relevance of breach, and, often, the case law pays little consideration to other factors such as contractual expectation or foreseeability. Such elements seem to be more relevant in scholarly writings, than in court practice. Further, due to the general definition of art. 25, evidence of the substantial detriment suffered seems often to play a more important role than statutory interpretation. Further, proof of the loss suffered, proof of the merchantability of the goods, proof of the seriousness of the offer to cure defects are often decisive elements for the interpreter and this causes the analysis of fundamental breach to be extremely fact based and linked to the circumstances of each case. This is the conclusion that can be drawn by looking at the aforementioned conflicting decisions rendered by the Supreme Courts of France and Germany. It follows that a uniform notion of fundamental breach is hardly achievable at least on a general base.

This does not mean, however, that uniformity cannot be achieved at all. This author suggests that uniformity may be reached on specific issues, where trends in case law exist, and not on the general notion of fundamental breach. As shown above, case law is starting to adopt a more uniform approach on some specific issues, such as late payment or the buyer's right to avoid the contract in spite of the seller's offer to cure. Thus, it seems preferable to break the broad notion of fundamental breach into smaller categories of breach and to strive for a uniform interpretation of these cases. This task could hardly be possible without a collection of English case abstracts on the CISG accessible online. As stated in the beginning of this paper, a constant analysis of case law trends is the only way to achieve uniformity in the interpretation of the CISG and, as pointed out by a distinguished legal scholar, judges and arbitrators should be encouraged to consider prior decisions in other States as persuasive.