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FUNDAMENTAL BREACH OF CONTRACT UNDER THE UN CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS

ABSTRACT: The concept of fundamental breach of contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG) of 1980 plays a pivotal role in determining the legal remedies available to the aggrieved party. It allows for contract termination only in instances where a breach is deemed fundamental. This paper delves into a comprehensive analysis of the institution of fundamental breach of contract and its characteristics, providing insight into how the Convention distinguishes between a fundamental breach and a non-fundamental breach. As a result, it assists in resolving potential uncertainties and dilemmas the aggrieved party might face concerning the choice of legal remedies. The analysis begins with an exploration of the background and drafting process of Article 25 of the Convention. The focus then shifts to an in-depth analysis of the institution of fundamental breach of contract. This covers how and why the distinction between a fundamental breach and a non-fundamental breach emerged, leading up to an intricate examination of all the conditions and features of a fundamental breach of contract, all with the aim of accurately defining this term in line with the provisions of the Convention. The study also encompasses a review of pertinent judicial

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and arbitral practices, aiding in a better understanding of the practical application and interpretation of the institution of fundamental breach of contract. Special attention is devoted to analyzing how the aggrieved party can be confident in its right to terminate the contract and how to sidestep potential hazards and consequences of an unjustified termination.

Through a detailed review of the Convention's provisions and both judicial and arbitral practices, this paper offers a succinct insight into the institution of fundamental breach of contract in the context of international sales of goods. It investigates how contracting parties can safeguard themselves and how they can act in accordance with the rights and obligations stipulated by the Convention.

Keywords: *breach, fundamental breach, contract, international sale of goods, detriment, damage, reasonable person, foreseeability.*

1. Introduction

In accordance with the United Nations Convention on Contracts for the International Sale of Goods of 1980 (hereinafter: the Vienna Convention, CISG), the seller in a contract for the international sale of goods undertakes to deliver the goods, hand over related documents, and transfer property in the goods in the manner provided in the contract and the CISG, while the buyer undertakes to pay the price and take delivery of the goods, as stipulated in the contract and CISG (Art. 30 and 53 of the United Nations Convention on Contracts for the International Sale of Goods, 1980). If one of the contracting parties fails to fulfill their obligation, or does so but not in the manner stipulated in the contract, the question arises whether this entails the possibility of contract termination. Indeed, the basis for termination of the contract can only be a non-performance of an obligation that deprives the other contracting party of the expected benefit, thereby questioning the purpose of the contract.

The Vienna Convention distinguishes between a fundamental breach of contract and a non-fundamental breach. Article 25 CISG stipulates that a breach of contract committed by one party is considered 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. Specifically, in cases of a fundamental breach of contract, the party remaining loyal to the contract is authorized to declare

an immediate termination of the contract, or has the option to insist on the contract's performance. Thus, defining what constitutes a fundamental breach is crucial in determining the legal remedies available to the aggrieved party in the event of such a breach. This is especially important as the aggrieved party can only terminate the contract in the event of a fundamental breach.

The subject of this paper is the analysis of the concept of a fundamental breach of contract and its characteristics. By clearly distinguishing between fundamental and non-fundamental breaches, situations where even the aggrieved party is uncertain whether the breach is fundamental or not can be avoided. This would create ambiguity about whether they are authorized to immediately terminate the contract or whether to employ another legal remedy available to them, to avoid jeopardizing themselves due to a potential unwarranted contract termination, which would entail certain legal consequences. In the following, the concept of a fundamental breach of contract will be concisely presented in as detailed and clear a manner as possible, starting from the drafting process of Article 25 CISG, through the precise definition of terms and conditions necessary for its existence, and up to judicial and arbitral practices.

2. Drafting Process of Article 25 CISG

In the early 20th century, numerous legal scholars emphasized the need for unification of rules governing international sales of goods (Vilus, Carić, Šogorov, Đurđev & Divljak, 2012, pp. 171–172). In 1930, the International Institute for the Unification of Private Law [UNIDROIT] decided to commence the drafting of an international law, aimed at regulating contracts for the international sale of goods (Vilus et al., 2012, p. 172). The prolonged effort, during which several drafts were developed, concluded in 1964 with the adoption of the Uniform Law on the Formation of Contracts for the International Sale of Goods [ULFIS] and the Uniform Law on the International Sale of Goods [ULIS].

Due to numerous objections to the reasonable person criterion introduced in ULIS, the working group of the United Nations Commission on International Trade Law [UNCITRAL] initially did not incorporate this criterion into the definition of a fundamental breach of contract, and it is not mentioned in the Convention drafts from 1976 and 1978 (United Nations [UN], 1991; Vilus, 1980, p. 86). However, at the Vienna Conference, the representative from Egypt pointed out that the fundamental breach, as regulated in Article 23 of the Draft Convention, was excessively subjective, as the assessment for

determining the fundamental breach of contract considers only the evaluation of the party committing the breach (UN, 1991). The Egyptian representative suggested the introduction of an objective criterion of a reasonable person, based on which the burden of proof would be placed on the party committing the breach. This party would have to prove that even a reasonable person of the same characteristics in the same situation would not have foreseen such consequences (UN, 1991). As these arguments appeared convincing at the Conference, the definition of the term fundamental breach of contract ended up including the reasonable person criterion (UN, 1991).

Along with the criterion of a reasonable person, during the preparatory works within UNCITRAL for the Vienna Convention, a very crucial issue was whether the term “substantial damage” could be used to assess a fundamental breach of contract (Schlechtriem & Schwenzer, 2016). Consequently, Article 9 of the Draft Convention was formulated as follows: “A breach by one contracting party is fundamental if it results in substantial damage to the other party, and the party committing the breach foresaw or was able to foresee such a consequence” (United Nations Commission on International Trade Law [UNCITRAL], 1977; Perović, 2004; Vilus, 1980, p. 87). Ultimately, it was decided that the gravity of a breach should no longer be assessed in relation to the extent of the resulting loss but in relation to the interests of the creditor, as precisely defined and limited by the contract, i.e., the breach is fundamental if it causes such damage that substantially deprives the other party of what he was entitled to expect under the contract (Schlechtriem & Schwenzer, 2016, p. 419; Schlechtriem, 1986). Also, during the preparatory works, the matter of foreseeability was the subject of additional proposals (UN, 1991; Schlechtriem, 1986). Hence, a proposal was made to introduce an “unless” clause. Thus, the formulation adopted in Article 23 of the 1978 UNCITRAL Draft Convention read “a breach by one contracting party is fundamental if it results in substantial damage to the other party unless the party committing the breach did not foresee and was not able to foresee such a consequence” (UN, 1991; Vilus, 1980, pp. 87-88; Perović, 2004, p. 130). The justification for this formulation was that a party should not be liable for a loss he caused if he did not foresee and could not have foreseen such loss. This allowed the party committing the breach the possibility to be relieved of liability if he proves that he neither foresaw such a consequence nor had reason to foresee it (Schlechtriem & Schwenzer, 2016, pp. 419-420). Therefore, it is not sufficient for the party committing the breach to simply prove that he did not foresee such a consequence; he also must prove that he had no reason to foresee it (Vilus, 1980, p. 89).

It was highlighted that the formulation of Article 23 of the 1978 UNCITRAL Draft Convention was significantly weakened by the subjective element, namely, by the fact that the party committing the breach neither foresaw nor was able to foresee the consequences resulting from the contract breach. This is because anyone who has breached a contract, causing substantial damage to the other party, will hardly admit that he could and were able to foresee such consequences (Vilus, 1980, p. 89; Will, 1987). Discussions about the elements constituting a fundamental breach of contract continued at the Vienna conference, leading to an ongoing search for a new, more objective definition of the concept of a fundamental breach of contract (UN, 1991; Liu, 2005). Specifically, the question was raised, if the party committing the breach could not foresee the consequences of the breach, then who could? (Will, 1987) Thus, the “reasonable person” criterion was accepted, which in ULIS was used to assess whether a breach is considered fundamental or not, with the term “of the same kind” being included in the definition of fundamental breach in the CISG. Notably, the reasonable person criterion from Article 25 CISG fully corresponds to the reasonable person criterion from Article 8(2) CISG, and objections to this criterion and to the formulations of both articles were very similar (UN, 1991; Will 1987). During the formulation of Article 25 CISG, efforts were made to avoid extremes in terms of mere subjectivization, as existed in the 1978 UNCITRAL Draft Convention, on the one hand, and objectivization, which could lead to abstract situations, on the other. Hoping to reduce the extent of speculation and to bring the hypothetical reasonable person closer to the actual position of the breaching party, the definition of the provision of Article 25 CISG uses two different elements: first, “of the same kind” and second, “under the same circumstances” (Liu, 2005; Will, 1987). Specifically, Article 25 CISG requires the party committing the breach of contract and invoking unforseeability to further prove that a reasonable person of the same nature under the same circumstances could not have foreseen the substantial damage.

After extensive discussions, the definition of the term fundamental breach of contract was finally formulated. Article 25 CISG stipulates that a breach of contract committed by one party is considered 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. Therefore, for a fundamental breach of contract to exist under Article 25 CISG, two conditions must be met: the occurrence of qualified damage and the foreseeability of such damage.

Moreover, it is interesting to point out that, unlike Article 10 ULIS, the final text of Article 25 CISG does not specify the moment when the consequences of substantial damage could have been foreseen. We assume that the working group believed it was not necessary to specify this moment. Therefore, the court or arbitration will have to make a decision on this in each specific case.

The provision on fundamental breach of contract was adopted with dissenting votes and continues to be the subject of sharp criticism and discussions in the doctrine and practice of international sale of goods (UN, 1991; Perović, 2004, p. 131).

As Ćirić and Cvetković (2008) state, “in determining and defining available legal remedies to the aggrieved party, it can be concluded that the institution of fundamental breach of contract is the supporting wall of the CISG” (p. 239). The existence of a fundamental breach of contract is crucial for determining the legal remedies available to the aggrieved party, in which case they can choose whether to terminate the contract or seek its performance. Additionally, the aggrieved party can only demand the delivery of substitute goods in cases of a fundamental breach of contract. A breach of contract will be considered fundamental if three conditions are met. These are the breach of contract, qualified damage and the rule of foreseeability.

3. Concept of Breach

In the Vienna Convention, we encounter two concepts: non-performance (or failure to perform) and breach of contract. The differences primarily arise due to the disparities between the common law and civil law systems. Specifically, in the civil law system, a contract creates various rights and obligations for the contracting parties, and thus, it can be breached by the non-performance of one or more obligations. On the other hand, in the common law system, the theory of frustration pertains to the breach of the contract as a whole. Consequently, the concept of a breach of contract is inherent to the common law system, while the concept of non-performance of one or more contractual obligations pertains to the civil law system (Fišer Šobot, 2014, p. 159).

In the Vienna Convention, the concepts of non-performance and breach of contract carry the same meaning. Thus, the breach of contract is understood in the broadest sense, and according to this, the term encompasses both untimely performance and defective performance (Fišer Šobot, 2014,

pp. 159-160). Therefore, according to the Vienna Convention, the difference between these two concepts is solely of a terminological nature.

A fundamental breach of contract is a qualified form of breach of contract, and it can occur in the case of a breach of any contractual obligation. When assessing a specific breach as fundamental, the following elements should be taken into consideration:

1. The nature of the contractual obligation;
2. The circumstances under which the breach occurred;
3. The possibility or impossibility of performance;
4. The readiness or unpreparedness to fulfill;
5. The lack of reliance on the other party regarding future performance;
6. The offer to remedy the defects;
7. The possibility of repair (Koch, 1998; Vukadinović, 2012, pp. 534-537; Spaić, 2009, pp. 110-114).

When discussing the nature of contractual obligations, parties can at the time of contracting specifically point out the importance of some obligations. They can do this explicitly, by contracting the right to terminate the contract in case of non-performance of those obligations (Vukadinović, 2012, p. 535). However, other circumstances can also indicate the importance of certain obligations, such as the nature of goods, customs, and business practices established between contractual parties. For example, when contractual parties designate the delivery time of goods as an essential element of the contract, specifically as a fixed date, the breach of that obligation will most often be qualified as a fundamental breach. Therefore, the delivery of goods at a precisely determined time can arise from the fact that contractual parties have designated the delivery date as an essential element of the contract, or as a fixed date, but it can also arise from the nature of the goods, if, for example, such goods have a market price or if they are seasonal (Vukadinović, 2012, p. 535). Additionally, the delivery of goods at a precisely determined time can also stem from the circumstances of payment and the time when the delivery is taken (Vukadinović, 2012, pp. 535-536).

As an example of non-performance of the obligation to deliver on time, the decision of the Swiss Bundesgericht can be cited. Specifically, in the case of FCF S.A. v. Adriafl Commerciale S.r.l., a seller from Italy and a buyer from Switzerland concluded a contract for the sale of Egyptian cotton in March 1994. The contract stipulated that the cotton would be delivered by June 5th in four shipments. After a month, the parties concluded another sales contract for an additional quantity of cotton. Given that the Egyptian authorities increased

the price of cotton, the seller requested the buyer to accept a price increase of 6 percent, which the buyer did. Since the seller did not timely inform the buyer that the delivery period from the first contract would not be respected, he requested the seller to fulfill his delivery obligation and then, in the absence of any response, had to purchase cotton from other suppliers, but at a higher price. The Swiss Bundesgericht referred to Article 25 CISG and held that the ultimate delivery date was of essential importance to the buyer. Thus, the court concluded that the seller committed a fundamental breach of the contract by not performing his delivery obligation, and that the buyer validly terminated the contract and was not obliged to set an additional time period for the seller to fulfill the obligation, in accordance with Article 47(1) CISG.¹

Koch, citing other authors, emphasizes that a breach of contract will be qualified as fundamental if the contractual parties expressly stipulate the quality of goods, for example, when the buyer insists that the goods be fit for a particular purpose and when he has unequivocally expressed his special interest in the goods being suitable for that purpose (Spaić, 2009, p. 101; Koch, 1998; Schlechtriem & Schwenzer, 2016, pp. 425-426).

When discussing the types of obligations, a fundamental breach can occur due to the violation of an obligation stipulated in the contract, as well as due to the violation of an obligation foreseen by the Vienna Convention. Also, by dividing obligations into principal and secondary, a fundamental breach will occur due to the violation of a principal obligation when the economic objective of the contract can no longer be achieved, or when the injured party no longer has an interest in the contract being performed (Perović, 2004, pp. 133-134). A breach of a secondary obligation most often will not be qualified as fundamental, although in some cases it may be, as precisely that obligation might be of essential importance to the other party. This may be the case with the breach of duties of information and consultation, maintenance of trade secrets, respect for industrial property rights, adherence to the terms of exclusive distribution between the contractual parties, etc. (Schlechtriem & Schwenzer, 2016, pp. 424-428).

In one case between a buyer from Germany and a seller, or manufacturer from Italy, the seller agreed to produce 130 pairs of shoes in accordance with the buyer's specification. The contract stipulated that the buyer had the exclusive right to sell the seller's goods (shoes). However, the seller displayed shoes at a fair, which were produced according to the buyer's specification and were

¹ Details, Switzerland, 15 September 2000, Bundesgericht. Downloaded 2021, April 27 from <http://cisgw3.law.pace.edu/cases/000915s2.html>

marked with the buyer's trademark. When the seller refused to remove the shoes, the buyer informed him the next day via telex that he was terminating the contract and would not pay for the given sample of shoes, which were no longer of any value to him. The German Oberlandesgericht Frankfurt determined that the buyer had timely and validly declared the termination of the contract and held that the breach of the exclusivity obligation actually constitutes a fundamental breach of the contract because it endangered the purpose and essence of the contract to such a degree that the buyer no longer had any interest in the execution of the contract.²

The non-performance of one of the obligations does not necessarily constitute a fundamental breach of the contract. However, if one party breaches multiple obligations, these multiple breaches together can represent a fundamental breach, assuming that the conditions provided by the provision of Article 25 CISG are met, namely, the existence of qualified damage and the foreseeability of the consequences of that damage.

Also, it is possible that a breach of the contract occurs even before its maturity. Specifically, if the situation changes during the performance of the contract, and one party assesses that the other will not be able to fulfill his obligations, the question arises whether, in such a case, the party faithful to the contract should wait (e.g., for the other party to become insolvent), or whether he could himself cease performance and seek additional guarantees from the other party and, if not received, terminate the contract (Vilus et al., 2012, p. 212). Article 71 CISG stipulates that one contracting party may suspend the performance of his obligations if, after the conclusion of the contract, it becomes apparent that the other party will not perform a substantial part of his obligations as a result of:

1. a serious deficiency in his ability to perform or in his credit-worthiness; or
2. his conduct in preparing to perform or in performing the contract.

In connection with the interpretation of this part of the provision of Article 71 CISG, the literature emphasizes that a practical problem will be determining the "serious deficiency in ability to perform", as well as conduct regarding "preparations to perform or the performance of the contract" that provide grounds for the other party to suspend performance (Vilus et al., 2012, pp. 212-213).

² Decision of the German Oberlandesgericht Frankfurt of 17 September 1991. Downloaded 2021, April 19 from <http://cisgw3.law.pace.edu/cases/910917g1.html#ua>

Further, Article 71 CISG stipulates that if the seller has already dispatched the goods before the grounds described in the preceding paragraph become evident, he may prevent the handing over of the goods to the buyer even though the buyer holds a document which entitles him to obtain them.

Article 72 CISG stipulates that 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. Examples justifying avoidance in such instances include the words or behavior of one contractual party or objective facts, such as the destruction of the seller's factory by fire (Vilus et al., 2012, p. 213). It is essential to emphasize that the contract party, wishing to avoid the contract before its due date, is obliged to inform the other party about it (Art. 71 and 72 of the UN Convention on Contracts for the International Sale of Goods, 1980).

In the case of Roder Zelt- und Hallenkonstruktionen GmbH v. Rosedown Park Pty Ltd et al., it was established that the buyer's insolvency and subsequent appointment of an administrator constitutes a fundamental breach of contract. A German company sold a tent hall to an Australian firm, which organizes large events like the Australian Grand Prix and other major festivals. The buyer agreed to pay for the goods according to a specific schedule but was late with payments and due to financial difficulties the company was placed under temporary administration. The seller requested the administrator to return the goods based on the retention clause provided in the sales contract, which stipulated that ownership cannot be transferred to the buyer until the price is fully paid. The administrator denied the existence of such a clause and refused to return the goods. The court held that the company's insolvency caused such damage to the seller, essentially depriving him of what he reasonably expected from the contract. Also, the administrator's denial of the retention clause was considered a fundamental breach of contract under Article 25 CISG.³

Finally, Article 73 CISG regulates fundamental breaches of contract in relation to future deliveries. It provides that in the case of a contract for delivery of goods by instalments, if the failure of one party to perform any of his obligations in respect of any instalment constitutes a fundamental breach of contract with respect to that instalment, the other party may declare the contract avoided with respect to that instalment. Further, if one party's failure to perform any of his obligations in respect of any instalment gives the other party good grounds to conclude that a fundamental breach of contract will

³ Decision of the Federal Court of Australia, South Australian District, Adelaide dated 28 April 1995. Downloaded 2021, May 10 from <http://cisgw3.law.pace.edu/cases/950428a2.html#ua>

occur with respect to future instalments, he may declare the contract avoided for the future, provided that he does so within a reasonable time. Lastly, a buyer who declares the contract avoided in respect of any delivery may, at the same time, declare it avoided in respect of deliveries already made or of future deliveries if, by reason of their interdependence, those deliveries could not be used for the purpose contemplated by the parties at the time of the conclusion of the contract. From all the above, it can be observed that, with contracts involving successive deliveries, a breach of contract may occur concerning one delivery, future deliveries, and both past and future deliveries.

In a dispute before the Swiss Handelsgericht Zürich, a seller from France and a buyer from Germany, who concluded a contract for the sale of sunflower oil, were involved. The contract provided for the delivery of oil to Romania, ranging from 2 to 4 million liters, at a specified price. The buyer timely executed the payment for the first delivery, while the seller did not deliver the goods to Romania. The buyer declared the contract avoided and sued the seller for the refund of the paid amount and compensation for damages. The court held that the buyer, due to the non-performance of the first delivery obligation by the seller, could reasonably conclude that the seller would commit a fundamental breach concerning future deliveries, and he had the right to avoid the contract. Hence, the seller had to refund the paid amount and compensate for the lost profits, as the buyer proved he could resell the first delivery of sunflower oil at a higher price.⁴

4. Qualified Damages

To assess a breach of contract as fundamental, it must result in damages whose consequences possess a certain nature and gravity. This means that the party suffering the breach has incurred damages essentially depriving it of what he had reasonably expected from the contract. Thus, such a breach must either nullify or substantially impair what the aggrieved party anticipated (UNCITRAL, 2012). The severity of the damages is evaluated based on the circumstances of each specific case, taking into account the value of the concluded contract, the amount of material damage caused by the breach, and the degree to which the legitimate expectations of the aggrieved contractual party are frustrated (Đorđević, 2012, p. 69).

⁴ Decision of the Swiss Handelsgericht Zürich dated February 5, 1997. Downloaded 2021, April 27 from <http://cisgw3.law.pace.edu/cases/970205s1.html#ua>

The Vienna Convention does not contain a definition for the term “detriment”, nor does it provide examples thereof. Indeed, the term “detriment” is new in the context of this subject matter and is not customary in either international legal documents or the common law system (Bianca & Bonell, 1987, p. 210; Perović, 2004, p. 132). Due to the absence of a precise definition, it appears that the term “detriment” should be interpreted in light of the legislative history of CISG, as well as its intended application (Jafarzadeh, 2001; Ćirić & Cvetković, 2008, p. 242). The legislative history of Article 25 CISG reveals that, during its process, a debate developed regarding the weaknesses of the ULIS criteria for defining the doctrine of a fundamental breach. The history of the term “detriment” in CISG is brief. The term was conceived in the UNCITRAL working group at the beginning of 1975 and was retained as such in the Draft Convention of 1978 (UN, 1991; Jafarzadeh, 2001; Will, 1987). The nature and concept of this term were not considered either during the UNCITRAL working group sessions or at the Vienna Conference in 1980. The only mention in relation to the term “detriment” is a quoted report from the UNCITRAL working group, emphasizing that “detriment” should be interpreted objectively and in a broader sense (UN, 1991; Jafarzadeh, 2001). Also, according to the preparatory documents preceding the Vienna Convention, “detriment” is not merely causing damage, nor is it equivalent to damage (Ćirić & Cvetković, 2008, p. 242; Jafarzadeh, 2001; Graffi, 2003). “Detriment” is a broader term than actual damage or similar loss, and thus commentators on CISG caution that, when translating it into other languages, it should not be tied to restrictive concepts of the domestic legal system (Perović, 2004, p. 132). Moreover, “detriment” does not necessarily have a material character. It primarily concerns “legal detriment”, which is distinct from “factual”, material detriment (Ćirić & Cvetković, 2008, p. 242). Detriment can also occur when no material damage has been inflicted (Ćirić & Cvetković, 2008, p. 242). For instance, if a seller fails to fulfill his obligation to package and insure the goods, but they are nevertheless safely delivered to the buyer, it would be considered that “detriment” exists if the buyer, as a result, could not resell the goods (Perović, 2004, pp. 132- 133). The term “detriment” can further be clarified considering its purpose. Its objective is simply to enable the aggrieved party to terminate the contract and seek other goods in exchange. Accordingly, considering the legislative history and the purpose of the term “detriment”, it is concluded that it must be interpreted in a broader sense and any narrower interpretation of this term must be excluded (Jafarzadeh, 2001). Therefore, it is considered that “detriment” exists if the realization of the contract’s purpose is prevented and if the aggrieved party no longer has an

interest in its performance but rather has an interest in terminating the contract as a consequence. However, in business relations, material damage is most commonly used as the criterion whether the contractual obligations, i.e., the contract, have been performed or not, while in Article 25 CISG, damage is not the key criterion (Enderlein & Maskow, 1992; Ćirić & Cvetković, 2008, p. 243). On the contrary, if damages are an adequate legal remedy for mitigating the consequences of non-performance, this means that the conditions for the existence of a fundamental breach according to Article 25 CISG are not met, nor according to the corresponding provisions of UPC and PECL (Enderlein & Maskow, 1992; Ćirić & Cvetković, 2008, p. 243).

The criterion of detriment is complex and does not allow for static interpretation (Ćirić & Cvetković, 2008, p. 243). Namely, Article 25 CISG requires the detriment to be fundamental, as can be unequivocally concluded from the linguistic interpretation of the said article. For instance, in contracts with a stipulated fixed delivery deadline, fundamental detriment occurs if this deadline is not respected, thus causing the buyer to suffer damage due to delivery delay (Perović, 2004, p. 133; Đorđević, 2012, p. 71). Naturally, regarding the notion of "fundamental detriment", a new question arises. This is how to ascertain the justified expectations of the aggrieved party. Theoretically, the conditions of Article 25 CISG are determined by the so-called "Contractual Expectations Test". This test has two focal points. The first is that the source of legitimate contractual expectations must be the contract itself, not merely the subjective feeling of the aggrieved party. Secondly, not only explicit conditions from the contract but also established practice between parties, customs, and other provisions of the Vienna Convention (or UPC and PECL, in case they are the *lex contractus* for the contract), can be considered a source for determining the content of legitimate expectations (Ćirić & Cvetković, 2008, pp. 243-244).

In other words, which expectations will be considered justified depend on each specific case, namely, on the specific contract and risk allocation envisaged by contract provisions, established practice between parties, customs, and provisions of CISG. For instance, buyers usually cannot expect that the delivered goods will comply with the regulations and official standards in their country. For example, in a case before the German Bundesgerichtshof, the delivery of shellfish with an excessive level of cadmium, i.e., a level above the recommended in the buyer's country, was not assessed as a fundamental breach of the contract (or as a breach at all) because the buyer could not expect the seller to meet those standards and because consuming such small quantities of this shellfish did not endanger the consumer's health (UNCITRAL, 2012).

Given that business people mostly conclude contracts for purely economic reasons and that, due to any loss arising from a breach, they can be fully compensated, some authors argue that it can be considered that a contractual party is fundamentally deprived of his justified expectations only when he cannot be fully indemnified (Koch, 1998). Thus, fundamental deprivation of justified expectations must be rooted in the essence of the contract, i.e., in what the aggrieved party intended when concluding the contract and what he committed to by the contract, and as a result, he no longer has an interest in the contract being performed, as due to the consequences that have occurred, such performance has lost its value to him.

5. The Rule of Foreseeability

Article 25 CISG further stipulates that a breach of contract is fundamental only if the party in breach could foresee such consequences, or if a reasonable person of the same attributes in the same circumstances could have foreseen them. In other words, if it is determined that the party, who by breaching the contract has inflicted damage on the other party, essentially depriving it of what it justifiably expected from the contract, had not foreseen this damage and its consequences, and that a reasonable person of the same kind in the same circumstances would not have foreseen them, then a fundamental breach of contract does not exist. Therefore, foreseeability is the final condition necessary for the occurrence of a fundamental breach of contract.

This solution has been criticized in literature (Perović, 2004, pp. 153-154). Some authors regard it as a “kind of limitation”, comparing it to that provided in Article 74 CISG (Schlechtriem & Schwenzer, 2016, p. 431). The mentioned article states that compensation for damage in case of a breach of contract committed by one party is equivalent to the suffered loss and lost profit incurred by the other party due to the breach, and that this compensation cannot exceed the loss that the party in breach foresaw or should have foreseen at the time of the conclusion of the contract as a possible consequence of the breach of contract, considering the facts known or should have known to her (Enderlein & Maskow, 1992). On the other hand, some authors regard the criterion of foreseeability as a “filter” (Liu, 2005), the lack of which serves as a ground for justification and, if proven, it will prevent the aggrieved party from terminating the contract. This essentially means that if the fundamental deprivation of what the aggrieved party justifiably expected from the contract comes as a surprise, whether the breach is committed by the buyer or the seller, the party committing the breach can avoid the consequences arising

in the case of a fundamental breach of contract if he proves that he could not foresee this negative outcome, nor could a reasonable person of the same kind in the same circumstances have foreseen it (Liu, 2005). There have always been opponents of such a solution, for fear that it would encourage the party committing the breach to plead ignorance and effectively “tie the hands” of the other party, thus avoiding the termination of the contract, as the most serious consequence in case of a fundamental breach (Will, 2005; Perović, 2004, pp. 153-154). Indeed, some authors argue that this solution only serves to enable the tortfeasor to escape the legal consequences of a fundamental breach and that it does not contribute to qualifying the breach as fundamental. Hence, foreseeability is merely a conditional element, which must be proven to prevent the aggrieved party from terminating the contract, and detriment or serious damage as a consequence of such detriment, and justified expectations of the other contractual party remain the key elements for determining a fundamental breach (Liu, 2005).

However, if some damage occurs, the injured party is obligated to prove that he has suffered such damage, which detriments him of what he justifiably expected from the contract. When such damage, a result of detriment, is established, the burden of proof shifts to the party who committed the breach. For the tortfeasor to successfully invoke unforeseeability, he must prove two things: first, that he could not have foreseen such damage, and second, that a reasonable person of the same kind in the same circumstances would not have been able to foresee it either. If he succeeds in this, then a fundamental breach does not exist. Thus, in the “Shoes case”⁵, or in the case where a manufacturer/seller from Italy agreed to produce 130 pairs of shoes in accordance with the specifications of a buyer from Germany, with the accompanying obligation of exclusivity, it was determined that the breach of the obligation of exclusivity actually constitutes a fundamental breach of the contract and that it jeopardized the purpose and sense of the contract to such a degree, which was foreseeable for the manufacturer, that the buyer no longer had any interest in the contract being fulfilled.

Namely, the most optimal situation occurs when the parties explicitly determine the significance of a certain obligation within the contract itself, as a condition without whose fulfillment one party would not have agreed to conclude the contract at all, thereby reducing the possibility for various interpretations. In this case, the requirement of foreseeability becomes irrelevant, as it can be easily proven that the significance of a certain obligation

⁵ See, Decision of the German OLG Frankfurt, dated September 17, 1991. Downloaded 2021, April 27 from <http://cisgw3.law.pace.edu/cases/910917g1.html>

was known to the other contractual party (Perović, 2004, pp. 156-157). The foreseeability requirement only gains relevance when the parties have not explicitly established the importance of a certain obligation by the contract, nor does it stem from the nature of the transaction or negotiations between the parties, opening then the need for interpretation (Perović, 2004, pp. 157-158). In assessing the significance of a certain obligation, the Vienna Convention has given two criteria to the condition of foreseeability. These are subjective and objective (Perović, 2004, pp. 157-158; Ćirić & Cvetković, 2008, p. 246).

The subjective criterion reflects the fact that the party who breached the contract must prove that he did not foresee the damage, which resulted as a consequence of fundamentally depriving the faithful contractual party. It is realistically expected that the party who committed the breach of the contract will utilize the opportunity to invoke the unforeseeability of the consequences of detriment, which it caused to the other party with its breach. As reliance on a subjective test of foreseeability is not feasible, it was necessary to introduce an objective test. During the Conference in Vienna, the question was raised: if the party, which committed the breach, could not foresee the consequences of that breach, then who could? (Will, 1987). Thus, an objective criterion, based on the standard of a reasonable person of the same kind in the same circumstances, was introduced into the definition of Article 25 CISG. In this manner, the personal attributes of the party that committed the breach do not have a decisive role in establishing the condition of foreseeability, and thus the existence of a fundamental breach of the contract, as this determination must also include objective criteria (Will, 1987; Ćirić & Cvetković, 2008, p. 246; Enderlein & Maskow, 1992).

The objective criterion is examined through the standard of a reasonable person of the same kind in the same circumstances. Therefore, the party that has breached the contract must concurrently demonstrate that the consequences of the inflicted damage would also not have been foreseen by a reasonable person of the same kind in the same circumstances. In accordance with Article 8(2) CISG, the standard of a reasonable person is used for interpreting statements and other behaviors of contractual parties, if the rule from Article 8(1) CISG cannot be applied, where statements and other behaviors of one party are interpreted in accordance with its intention when the other party knew or could not have been unaware of that intention. Article 8(3) CISG stipulates that 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.

The standard of a reasonable person was incorporated as early as in ULIS, serving as a concession to common law system countries. Consequently, an adequate standard of behavior is unknown in civil law system countries (Vilus, 1980, p. 25). However, Professor Goldštajn believed that the standard of a reasonable person is close to what was understood in Yugoslavian law as the concept of a good businessman (Vilus, 1980, p. 25). The standard of a reasonable person in Article 25 CISG is supplemented with two elements. The first element “of the same kind” implies a merchant from the same trade sector, fulfilling the same function. And not only must business practices be considered, but also the overall socio-economic circumstances, including religion, language, average professional standard, etc. The second element “in the same circumstances” considering the always varying situations, refers to the conditions present in global and regional markets, to legislation, policy, and climate, as well as to previous contacts and transactions, i.e., practice, and to all other relevant factors (Lorenz, 1998; Babiak, 1992; Will, 1987). In short, the entire spectrum of facts and events at a given moment (Will, 1987). As provided by Article 8(3) CISG, in determining the intention of one party or the understanding a reasonable person would have had, all relevant circumstances of the case should be taken into consideration (Will, 1987).

Thus, it is evaluated not only whether a reasonable person of the same kind could have foreseen the event but also whether business people, or merchants, from the same trade sector would have anticipated this event. Here, it is essential to limit oneself to the analysis of a specific trade sector, as standards may vary between different sectors. By proving that even a reasonable person of the same kind in the same circumstances would not have foreseen the detrimental outcome of the breach, the party committing the breach eliminates any possible doubt in its foreseeing (Liu, 2005; Will, 1987). Therefore, by posing the question of whether the party committing the breach anticipated that this breach would result in substantially depriving the other party of what he justifiably expected from the contract, and whether a reasonable person of the same kind in the same circumstances would have foreseen such an outcome, the court will, in each specific case, be required to view the contract from the subjective perspective of the breaching party, as well as from the objective perspective of a reasonable person of the same kind in the same circumstances (Liu, 2005).

Subjective and objective criteria for the conditions of foreseeability are set cumulatively. This means that a contract breach, even when it has led to substantial deprivation of the other contracting party of what was justifiably expected, will not be qualified as fundamental unless it is demonstrated that

this deprivation was unforeseeable applying both subjective and objective criteria (Ćirić & Cvetković, 2008, p. 246).

The significance of damage foreseeability for the existence of a fundamental breach of contract can be illustrated through the case SARL Ego Fruits v. Sté La Verja Begasti (Đorđević, 2012, pp. 71-72). A seller from Spain and a buyer from France concluded a contract for the sale of fresh orange juice, with several successive deliveries scheduled from May to December. In exchange for an appropriate reduction in price, the parties agreed that the delivery set for September would occur at the end of August. The buyer then proposed to delay the delivery for about ten more days, after which the seller had to preserve the juice. This caused the juice to lose quality, and the seller was unable to deliver fresh orange juice to the buyer after August and declared a contract termination. A dispute arose between the contracting parties as the buyer refused to pay the price for the goods delivered before August, arguing that from September to December, he had to purchase fresh orange juice at a higher price. The French Cour d'appel Grenoble held that there was no fundamental breach of contract, as the buyer could not have foreseen that his delay in taking delivery would cause such damage to the seller, substantially depriving him of what he justifiably expected from the contract, especially since the seller did not inform the buyer that fresh orange juice is perishable and must be preserved after August. Additionally, the court considered the fact that the buyer managed to purchase fresh orange juice from the same season elsewhere in December, indicating the absence of both subjective and objective reasons for foreseeing the damage. Based on all the aforementioned, the court concluded that the seller's termination was unwarranted.⁶

One of the controversial questions is the moment that is relevant for the existence of knowledge by the party who has committed a breach, regarding the consequences of that breach. Specifically, Article 25 CISG omits the time that would be significant for assessing the foreseeability of the consequences of qualified damage, which many considered to be a serious flaw in the definition of a fundamental breach of contract in Article 25 CISG (Vilus, 1980, pp. 13-14). The relevant moment of foreseeability remains contentious both in theory and in practice. Certainly, in the case of a dispute, this decision must be made by a court or arbitration, based on the specifics of each case. In theory, there is no consensus on which moment is pertinent for the application of the foreseeability rule. According to the prevailing view, advocated by

⁶ Decision of the French Cour d'appel Grenoble of 4 February 1999. Downloaded 2021, May 10 from <http://cisgw3.law.pace.edu/cases/990204f1.html>

Schlechtriem, foreseeability, as a factor in interpreting contracts, clearly demonstrates that the decisive moment can only be the moment of contract conclusion (Schlechtriem & Schwenzer, 2016, pp. 434-435). Ziegel interprets the foreseeability condition in Article 25 CISG by referring to the analogous application of Article 74 CISG, which employs this condition to define the amount of damage compensation. Such a position has been confirmed by case law. By the decision of the German Oberlandesgericht Düsseldorf in a case between a shoe seller from Italy and a buyer from Germany, the moment pertinent for the application of the foreseeability rule was explicitly determined to be the moment of contract conclusion (UNCITRAL, 2012). Conversely, some authors believe that the moment pertinent for the application of the foreseeability rule should be determined in relation to the breach of contract, or in relation to the circumstances that existed after the conclusion of the contract. Thus, Koch argues that the use of the present tense in the definition of the term fundamental breach of contract (the English text of the CISG reads "A breach of contract committed ... is fundamental if it results" in depriving the other party "of what he is entitled to expect under the contract") actually leads to the conclusion that the judge should consider the moment when the breach of contract occurred as the decisive moment for applying the foreseeability rule. However, Koch also notes that the French, Spanish, and Russian texts of the CISG suggest a completely different conclusion, namely, that the moment of contract conclusion is significant for applying the rule of foreseeability (Koch, 1998). When choosing arguments supporting one view or the other, it seems most beneficial to analyze this issue in light of the legislative history of CISG. For reference, Article 10 ULIS determined the moment of contract conclusion as the moment pertinent for applying the foreseeability rule. Also, in some cases, it is desirable to consider subsequent information, at least to the extent that the party committing the breach was aware of it. Thus, Honnold believes that, in addition to the moment of contract conclusion, some subsequent moments can also be significant, but only up until the contract performance or until the moment when the contract should have been performed. He cited a hypothetical case as an example, where the contractual parties concluded a contract for the sale of 100 bags of rice. The buyer's order specified that it was necessary for the rice to be packed in new bags. The seller, preparing the shipment, had used bags, which he believed were of the same quality as the new ones and would be acceptable to the buyer at the corresponding price. He packed the rice in them, even after receiving notice from the buyer that packing in new bags was of utmost importance to him. The buyer refused to receive the shipment due to the

risk of inability to resell, and he declared contract termination. Given that subsequent information, in the form of notice about the importance of packing rice in new bags, represents substantial significance to the buyer due to the possibility of resale, violating that requirement can rightly be considered a fundamental breach of contract (Honnold, 1999). The author opines that the moment relevant for assessing foreseeability can extend from the moment of contract conclusion to the commencement of its execution. This is because the author believes that contractual parties, even after concluding the contract, can reach an agreement on some terms that are of substantial importance to them, which they were unaware of, for some reason, at the moment of contract conclusion. In any case, regardless of advocating the first or second stance, all circumstances of the specific case must always be considered, and the principle of good faith and the principle of conscientiousness and fairness should be adhered to, which is certainly in the spirit of the Convention.

The aggrieved party is obliged to demonstrate that it has suffered damage, fundamentally depriving it of what it legitimately expected from the contract, and only once such damage resulting from substantial deprivation is established, the burden of proof will shift to the party who committed the breach. The theory from Article 25 CISG has indicated this, and jurisprudential and arbitral practice has accepted that the burden of proof lies with the party who breached the contract, in accordance with the Latin maxim “*Onus probandi incumbit ei qui dicit*” (Liu, 2005; Graffi, 2003). According to the prevailing viewpoint, the inclusion of the word “unless” (“... unless such a consequence was not foreseen by the party committing the breach...”) in the formulation of a fundamental breach of contract, points to the fact that the burden of proof is on the party who committed the breach (Perović, 2004, p. 162; Will, 1987; Liu, 2005, Graffi, 2003; Babiak, 1992; Lorenz, 1998). Therefore, the party who breached the contract must prove that he did not foresee the damage that occurred as a consequence of fundamentally depriving the other contractual party of what he legitimately expected from the contract. In addition, he must prove that a reasonable person of the same kind would not have foreseen the same in the circumstances.

6. Conclusion

Without a doubt, we conclude that the institution of fundamental breach of contract is of exceptional importance for understanding the rules regarding contract termination due to non-performance. Identifying the difference between breaches that are fundamental and those that are not, that is the process

that leads to the final qualification of a breach as fundamental is crucial in determining the legal remedies available to the aggrieved party in the event of a fundamental breach. Specifically, if a breach is qualified as fundamental, the aggrieved party has the authority to immediately terminate the contract. Since a contract is primarily a concordance of the wills of the contracting parties, it is also acceptable that if one contractual party no longer has an interest in its execution due to the damage inflicted by the other contractual party, which resulted in substantial deprivation of what was legitimately expected from the contract, the aggrieved party may, on his own initiative and through contract termination, exit the contractual relationship when the purpose for entering into that relationship ceases to exist for him. Although the Vienna Convention protects the interests of the aggrieved party in cases where a breach of contract occurs and when the loss of the aggrieved party cannot be fully covered by damages, termination of the contract by the creditor, without giving additional time to the debtor, always requires the existence of a fundamental breach of contract. Given that the provision of Article 25 CISG was adopted with dissenting votes and has been the subject of sharp criticisms and discussions from then until today, both in doctrine and in practice, it is not surprising that we now have disparate judicial and arbitral practice on this issue. However, to overcome this problem and to achieve uniformity in interpreting and applying Article 25 CISG, it is first necessary to fully understand the institution of a fundamental breach of contract, all its characteristics and the conditions necessary for such a breach to exist.

Moreover, considering that at the international level, in terms of applying Article 25 CISG, determining the existence of a fundamental breach largely depends on the perspective of the judge or arbitrator on the specific case, it is impossible not to wonder whether this leads to some uncertainty. It is inevitable that the institution of fundamental breach of contract will continue to develop consistently both through jurisprudence and doctrine, and it can undoubtedly be expected that this will achieve a uniform method in its interpretation and application, overcoming the difficulties encountered in today's practice. Certainly, the most important thing is for the contracting parties to adhere to the principle of good faith and the principle of conscientiousness and honesty when concluding and applying contracts. Also, it is crucial that the parties, when concluding a contract, strive to express their will clearly and precisely, by accurately defining their contractual obligations and the consequences of their non-performance, to avoid the need for contract interpretation, and thereby motivating them to honor their obligations and fulfill the purpose of the concluded contract.

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BITNA POVREDA UGOVORA PREMA KONVENCIJI UN O UGOVORIMA O MEĐUNARODNOJ PRODAJI ROBE

REZIME: Institut bitne povrede ugovora prema Konvenciji Ujedinjenih nacija o ugovorima o međunarodnoj prodaji robe iz 1980. godine igra ključnu ulogu u odabiru pravnih sredstava koja su dostupna oštećenoj strani, te se tako pruža mogućnost raskida ugovora samo u slučajevima u kojima se smatra da je došlo do bitne povrede. U ovom radu se podrobnije analizira institut bitne povrede ugovora i sve njegove karakteristike, pritom pružajući uvid u način na koji Konvencija pravi razliku između bitne povrede i one povrede koja nije bitna, te stoga pomaže u razrešenju potencijalnih neizvesnosti i dilema koje oštećena strana ima u pogledu izbora pravnih sredstava. Počev od istraživanja pozadine i toka izrade odredbe člana 25 Konvencije, fokus je stavljen na duboku analizu instituta bitne povrede ugovora, od toga kako i zašto je došlo do razlike između bitne povrede i povrede koja nije bitna, pa sve do detaljne analize svih uslova i karakteristika bitne povrede ugovora, sve sa ciljem preciznog definisanja ovog pojma u skladu sa odredbama Konvencije. Rad takođe obuhvata proučavanje relevantne sudske i arbitražne prakse, što pomaže u boljem razumevanju praktične primene i interpretacije instituta bitne povrede ugovora. Posebna pažnja posvećena je analizi kako oštećena strana može da bude sigurna u svoje pravo da raskine ugovor i kako da izbegne eventualne opasnosti i posledice neosnovanog raskida. Kroz detaljnu analizu odredaba Konvencije, sudske i arbitražne prakse, ovaj rad pruža jezgrovit uvid u institut bitne povrede ugovora u kontekstu međunarodne prodaje robe, istražujući pritom kako ugovorne strane mogu da se zaštite i kako mogu da deluju u skladu sa pravima i obavezama koje Konvencija propisuje.

Ključne reči: povreda, bitna povreda, ugovor, međunarodna prodaja robe, lišavanje, šteta, razumno lice, predvidljivost.

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