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THE CONCEPT OF FUNDAMENTAL BREACH OF THE CONTRACT IN A COMPARATIVE PERSPECTIVE

Master Thesis

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Consultant

Vilnius, 2011

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INTRODUCTION

Relevance and problems

Defining fundamental breach is always to some extent case-specific. The definition is so vague, that it is difficult to settle on strict rules for all cases. If the breach is regarded as fundamental, consequences,, such as termination of the contract, can be very serious. Prerequisites of a fundamental breach (foreseeability, substantial detriment, reasonable man criterion, intention or recklessness, strict compliance, the essence of the contract, loss of reliance, disproportionate loss) depend on 1) an objective criterion, i.e. conditions of express agreement, suffered damages; and 2) a subjective criterion, indicating the aggrieved party's expectations and each party's perception of the breach. Treatment of the contract, thus notion of fundamental breach, depends on the party's social, political and economical background, as well as legal traditions and usages between the parties. Therefore in an international context, the concept of fundamental breach of contract is the subject of discussion. International instruments for the regulation of international civil transactions (United Nations Convention on International Sales of Goods (CISG)[1], UNIDROIT Principles of International Commercial Contracts (PICC)[2] and European Union instruments concerning contract law (The Principles of European Contract Law (PECL)[3]) harmonize and unify the concept of the fundamental breach and are at the core of research. Principles, Definitions and Model Rules of European Private Law/ Draft Common Frame of Reference' (DCFR)[4] is an important source for defining the concept of the fundamental breach of contract, not only as an academic text, but also as "a possible model for an actual or 'political' Common Frame of Reference (CFR)[5]". To compare the concept of the fundamental breach/non-performance in common law and continental law we will review the regulation of this issue in English, German and French law. It is important to emphasize that most of the legal systems (*French, German laws – auth.)* do not apply the doctrine of fundamental non-performance, but approach it in other ways. Thus, French and German laws concerning termination as a remedy will be reviewed to compare the concept of the fundamental breach of contract in various legal systems.

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[1] http://www.cisg.law.pace.edu/cisg/text/treaty.html

[2] UNIDROIT principles on international commercial contracts 2004, International Institute for the Unification of Private Law

[3] The Commission of European Contract Law/ edited by Ole Lando, Hugh Beale 'Principle of European contract Law' Parts I and II, 2000, Kluwer Law

[4] Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) 'Principles, Definition and Model Rules of European Private Law/ Draft Common Frame of Reference (DCFR)'/ edited by Christian von Bar and Eric Clive, 2009, Munich

[5] Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) 'Principles, Definition and Model Rules of European Private Law/ Draft Common Frame of Reference (DCFR)'/ edited by Christian von Bar and Eric Clive, 2009, Munich, p. 3

The distinction between a fundamental breach/non-performance and a breach/non-performance plays crucial role in all previously mentioned international legal instruments with regard to remedial provisions. However, we will treat fundamental breachs with fundamental non-performance and breach with non-performance equally as the distinction is of minor importance when the amount of research is taken into account.

We will use the unitary concept of 'non-performance' analyzing CISG, PECL, PICC, French law ('*inexècution du contrat'*), and English law. This concept covers non-performance of any contractual obligations. Only under CISG does it involve both excused and non-excused performance. This is in contrast to English law, where only non-excused performance is under the concept of 'non-performance'. With regard to German law, 'non-performance' ('*Vertragsverletzung*') includes cases of impossibility, delayed performance, and 'positive breach of contract' ('positive *Vertragsverletzung*'), which includes breach duty of care to which the rules on delay are applied analogically. In the research it is treated as failure to perform an obligation under the contract in any way, whether by a complete failure to do anything, late performance or defective performance.

Objective masters thesis is review of the prerequisites of fundamental breach of the contract (foreseeability, substantial deprivation, reasonable man standard, intention, strict compliance, essence of the contract, loss of reliance, disproportionate loss) according to international and national instruments.

Subject-matter of master's theses is to analyze**:**

1) International instruments for the regulation of international civil transactions (CISG, PICC, PECL);

3) National legislation (United Kingdom, France, Germany);

4) Case law.

Aim of master's theses is to distinguish, analyze and compare the main prerequisites of fundamental breach of the contract according to relevant international legal instruments (CISG, PICC, PECL), and, to some extent, national legal instruments (United Kingdom, Germany, France), trying to find out similarities, differences, strengths and weaknesses.

Tasks of master theses are:

1. To settle certain list of criterions that help to determine whether the breach is fundamental.

2. Is it possible to treat market fluctuation as the ground for the termination? Should market fluctuation be treated as usual business risk, or could it be the motive for breach to be held as fundamental?

3. To analyze substantial deprivation criterion in the light of detriment (damages) and the expectations of the aggrieved party. Define the essence of the concept of 'substantial deprivation'? Is it 'suffered damages' or not fulfilled 'interests'? Examine how to determine whether the party was substantially deprived of what he or she was entitled to expect? Define the meaning of the reasonable use test for acknowledgement of substantial deprivation criterion.

4. To ascertain whether the reasonable man standard is explicit enough in CISG, PICC, and PECL. Whether in international legal instruments reasonable man criterion should be improved using the concept of 'reasonable international business man'.

5. To analyze foreseeability criterion determining whether or not the breach was fundamental. To ascertain when the party in the breach should foresee the aggrieved party's interests (at the conclusion of the contract or after delivering subsequent information).

6. To differentiate between a 'strict compliance' factor and 'substantial deprivation' factor.

7. To analyze whether restrictive interpretation of intention and recklessness criterion is reasonable. What is the meaning of intentionality and recklessness criterion in accordance with multiple breaches? Should criterions of '*intentionality or recklessness'* and '*non performance giving the aggrieved party to believe that it cannot rely on the other party's future performance'* be interpreted systematically as it is integrated in PECL?

8. What remedies are available for the aggrieved party if breach amounts to the fundamental? Which remedies are available exclusively for fundamental non-performance as a last-resort remedies?

9. What are the models of termination? Is it reasonable to grant the right of termination exclusively for the court? Could it be treated as source for uncertainty (it is not clear the decision) and the interruption to parties' right to enact freedom of the contract? Or could it be treated favorably as limitation mechanism for unreasonable avoidance? Whether period of grace is beneficial for the parties, or contrary, causes inconvenience?

10. To analyze the meaning of '*Nachfrist*' procedure: is it reasonable to regard breach as fundamental after additional period of time for performance expires?

Hypothesis: Even though international instruments attempt to harmonize and unify the concept of the fundamental breach of contract, the concept remains controversial. The concept can be defined only on a case-by-case basis through analyzing all prerequisites of the fundamental breach, the majority of which are based on subjectivity and a party's own understanding (which is also influenced by economical, political, legal regulation and usages in the party's country of residence).

Methods of the master theses. In order to make comprehensive analysis, various theoretical and empirical methods are used. The topic itself requires using the comparative method, which is the most important in the research while analyzing CISG, PICC, DCFR, PECL, national legal acts and scholar works as well as the case law. Systematic analysis, case analysis, logical, teleological, linguistic methods are also used in the research.

Sources for mater's theses. The crucial role in the research plays analysis of international instruments (CISG, PECL, PICC), because of harmonization and unification of the fundamental breach of the contract in international (CISG, PICC) or EU level (PECL). These instruments build pillars for the latter analysis of the fundamental breach of the contract. Furthermore, we overviewed such legal scholars as P. Schlechtriem and I. Schwenzer, S. Vogenauer and J. Kleinheisterkamp, O. Lando and H. Beale. We analyzed 'Principles, Definitions and Model Rules of European Private Law/ Draft Common Frame of Reference' (DCFR), made by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group), as not politically binding rather academic text. Official page of the Pace Law School was used as a great resource for articles. Finally, we explored to some extent national legislation of United Kingdom, Germany, and France. While revealing practical meaning of vague concept of fundamental breach of the contract, court practice is analyzed as well.

Structure of master's thesis. Theses are divided into two main parts: I) Prerequisites of Fundamental Breach; II) Termination as a Remedy for Fundamental Breach. First part consists of such sections: 1) Foreseeability; 2) Substantial deprivation and detriment; 3) Reasonable man standard; 4) Intention; 5) Strict compliance; 6) Loss of reliance; 7) Disproportionate loss. Second part consists of three sections: 1) Termination; 2) Right to require performance; 3) Right to require damages. Termination is analyzed through subsections: 1) Way of termination: by court, using *Nachfrist*, or by simple notice, 2) Specific case scenarios; 3) Anticipatory breach and termination. Right to require performance is analyzed in subsections: 1) Delivery of non-conforming goods and non-delivery; 2) Withholding performance. Right to require damages is revealed in subsections: 1) Right to require performance, price reduction and damages; 2) Avoidance of the contract and damages.

Master theses draw conclusions based on interpretation of prerequisites of the concept of fundamental breach of the contract and the analysis of termination of the contract. List of literature, summaries in English and Lithuanian are submitted in the end of the research.

I. THE PREREQUISITES OF FUNDAMENTAL BREACH

1. Foreseeability and knowledge

1.1. Importance of foreseeability

International and European Union legal instruments take into account the foreseeability test using reasonable man criterion. However, according to some legal scholars, "foreseeability" does not have impact on admitting non-performance as fundamental[6].

If the party in the breach could not foresee and a reasonable person of the same kind in the same circumstances would not have foreseen such a result, the breach is not regarded as fundamental (Article 25 of CISG). Therefore, analyzing structure of the fundamental breach according to CISG, it is clear, that even if the breach of contract results in detriment to the other party as to substantially to deprive him/her of what he/she is entitled to expect, but 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, the breach is not fundamental. Article 8:103 of PECL and Article 7.3.2.(1)(a) of PICC settles almost the same notion of foreseeability ('did not foresee and could not reasonably have foreseen'), which also clearly states that without this element, the breach of contract could not be fundamental. The use of 'reasonable foreseeability' rather than 'reasonable contemplation' under English law may include a wider cover of losses[7].

Scholars hold different opinion about the function of foreseeability and knowledge with regard to acknowledgment of the fundamental breach. Schlechtriem, analyzing CISG, separates three of them[8]:

1) Lack of foreseeability and knowledge is a kind of subjective ground for excusing the party in breach ;
2) Even though a breach causes material prejudice to the promisee, the breach is not fundamental if 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';
3) Knowledge or foreseeability of the promisee's expectations is relevant only for interpreting and assessing the importance of the obligation breached and its significance for the promisse[9]

[6] R. Balčikonis 'Sutarčių vykdymo teisinės problemos: esminis sutarties pažeidimas', dissertation, 2004, Vilnius, p. 103
[7] Richard Stone and Ralph Cunnington 'Text, Cases and Materials on Contract Law', Routledge-Cavendish Taylor and Francis Group, London and New York, 2007
[8] Schlechtriem 'Commentary on the UN Convention on the International Sale of Goods (CISG)', 1998, Munich, 290

Explicit agreement (in common law contractual term 'condition'), clearly stating the obligations and methods of performance, makes it impossible to use the foreseeability rule as grounds to avoid liability. Even if the parties have discussed the specific aspects of performance, but did not explicitly state them in the contract, the foreseeability criterion is still not relevant. In our opinion, the crucial role foreseeability plays, is the possibility to prove whether the obligations that were discussed and are binding. Thus, we will discuss the foreseeability criterion only in when there are no explicit contractual terms ('conditions') on certain performance of the obligations and/or there is no negotiation practice proving the existence of certain obligations[10].

Foreseeability depends on the interpretation of reasonable person of the same kind, 'i.e. one active in the same branch of the trade or economic sector, would have recognized its importance'[11]. Delivery of seasonal goods naturally counts exact terms of delivery if INCOTERMS are applied, the time is of the essence as well[12].

Legal scholars distinguish two criterions/function of foreseeability on the analysis of CISG Article 25:

1) *Objective criterion* ('a reasonable person in the same trade sector' – Schlechtriem[13]) *or procedural function* ('neither he nor any reasonable person in the same circumstances could have foreseen the result' – R. Kosch[14])

   To compare, in PICC Article 7.3.1.(2)(b) ignorance of the party in breach should be not due to his negligence[15]. It is objective criterion as compares party's in breach conduct with reasonable man conduct.

2) *Knowledge[16] criterion* ('whether the promisor nevertheless knew of ('did...foresee') the circumstances which made the obligation in question especially important' – Schlechtriem[17]) *or substantive function* ('foreseeability of harsh consequences of the breach' – R. Kosch[18]).

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[9] n. 8, p. 287
[10] According to Schletriem p.288-289
[11] n. 8, 289
[12] n. 8, p. 289, referring to Cf. App. Milano, 20 March 1998
[13] n. 8, p. 289
[14] *Robert Koch* 'The Concept of Fundamental Breach of Contract under the United Nations Convention on Contracts for the International Sale of Goods (CISG)', Pace ed., *Review of the Convention on Contracts for the International Sale of Goods (CISG) 1998*, Kluwer Law International (1999) 177 - 354.
[15] Stefan Vogenauer, Jan Kleinheusterkamp 'Commentary on the UNIDROIT principles of international commercial contracts (PICC)', p. 826
[16] *Knowledge criterion* – the name of criterion is not directly stated in Schlechtriem commentary, we are using it to see the core features of criterions.
[17] n. 8, p. 289-290
[18] n. 14

To compare, in PICC Article 7.3.1(2)(b) positive knowledge of the particular circumstances would be subjective criterion[19]. This criterion is parallel to Schlechtriem 'knowledge criterion', and contradicts with Kosch's 'harsh consequences criterion'.

The first group is linked with objectivity test, while the second group is based on subjective grounds. 'Knowledge criterion' focuses on foreseeability that certain obligations are crucial for the aggrieved party (the fact of non-performing). 'Substantive function' accentuates the foreseeability of harsh consequences. Legal scholars' interpretation on PICC Article 7.3.1.(2)(a) introduces a similar theory to 'substantive function', focusing on 'the consequence of the non-performance (…) therefore, it is irrelevant whether the non-performing party foresaw (or could have foreseen the non performance itself)'[20]. Even though foreseeability criterion is more a procedural way to protect party in breach interests, it might be understood as an essential criterion, indicating subjective ground for a fundamental breach. Thus, controversy exists on whether the party in breach should foresee the harsh consequences or the non-performance itself. In our opinion, it is not enough to see the non-performance factor itself, as the foreseeability test is applied only when there is no strict agreement between parties that certain obligations are crucial for the sake of interests of aggrieved party. Therefore, there is no need for strict compliance with the revealed conditions, if there are no harsh consequences in a case of non-performing of the obligation. Our opinion is based on the systematical analysis of international instruments, as the scope of our theses is to find differences between different regulations and point out the most valuable theories.

National regulation in many countries usually limits liability to foreseeable losses (English law (rule settled in Hadley v. Baxendale case), French law (only the possibility of the particular kind of damages needs to have been foreseeable)[21], Lithuanian (Article 6.217(2)(1) of the Civil Code[22] (CC) – uses the concept of PICC). German law applies "adequate causation" instead of a foreseeability test. This puts the creditor in a better position, while applying the standard of an experience observer at the time of the non-performance.[23]

[19] n. 15, p. 826
[20] n. 15, p. 826
[21] Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) 'Principles, Definition and Model Rules of European Private Law/ Draft Common Frame of Reference (DCFR)'/ edited by Christian von Bar and Eric Clive, 2009, Munich, p. 931-932
[22] Lietuvos Respublikos Civilinis Kodeksas (ratified on 18 July 2000, enforced on1 July, 2011.Lietuvos Respublikos Teisingumo ministerija, 2010)
[23] n. 21, p. 930

1. 2. Time requirement

Contractual expectations should be included in a contract. If not, contractual expectations might be admitted if they were discussed in negotiations or as a a part of trade usages. According to CISG the time of foreseeability is not clearly settled. Is it the conclusion of the contract or might it be based on knowledge obtained after conclusion of the contract? Legal scholars hold controversial opinions. However, the predominant approach among legal scholars is that the promisor should foresee the result at the time when the contract is concluded.[24] Consequently, by sending information, the promisee cannot avoid the contract should a breach occur which would not have been fundamental in the absence of such information.[25] In other words, the concept of foreseeability is restricted in order to prevent fraudulent and abusing promisee's position, when certain facts are revealed after conclusion of the contract since the promisor is already obliged. Positive knowledge is obtained at the time of conclusion of the contract in order to avoid unfair creditor behavior, while delivering such subsequent information, which would change the essence of the contract and the content of creditor's expectations. If the subsequent information would be delivered in the time of conclusion of the contract, it is possible, that the non-performing party would not conclude such an agreement[26]. With regard to PICC, the relevant issue for determining the foreseeability issue is the conclusion of the contract[27].

Due to DCFR Article 3:703, the requirement of foreseeability is defined more precisely. The defaulting party is liable for loss actually foreseen (…) when the contract was made[28]. On the ground of PECL Article 8:103, the consequences should be foreseen at the time of conclusion the contract[29].

English law limits liability to foreseeable losses (*Hadley v. Baxendale*), to the time when the contract was made[30]. French law uses broader concept of foreseeability, where only the possibility of a particular kind of damage needs to have been foreseeable.

In our opinion, the relevant time for foreseeability is at the time of the conclusion of the contract. Delivering latter subsequent information might infringe the balance of interests of the parties', which was settled concluding the contract. Delivering subsequent obligatory information could soon be used as a gap of proper regulation and possibility for fraudulent actions.

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[24] n. 6, p.103
[25] n. 8, p. 290
[26] n. 6, p. 103
[27] n. 15, p. 826
[28] n. 21, p. 930
[29] The Commission of European Contract Law/ edited by Ole Lando, Hugh Beale 'Principle of European contract Law' Parts I and II, 2000, Kluwer Law, p. 365
[30] n. 29, p. 365

2. Substantial deprivation and detriment

2.1. Substantial deprivation, detriment and damages

Article 25 of CISG presents the concept of 'substantial detriment', which 'is much broader than that of damage'. However, a different view is expressed in case law, which often deems only the gravity of the seller's breach and the consequential economical loss relevant[31]. Detriment is not necesairly damage, since under art. 74 CISG the party has a right to claim damages even if the breach is not fundamental (or substantial)[32]. The crucial element of Article 25 of CISG is the 'substantial deprivation test', whereas the 'detriment' requirement is less important[33]. The 'detriment' requirement is that, if the aggrieved party is substantially deprived of what it was entitled to expect under the contract, this alone constitutes a 'detriment'[34]. PICC excludes 'detriment', and literally focuses on 'substantial deprivation'. This clarifies that the reasonable interests of the aggrieved party under the contract plays crucial role and actual damages is not necessary prerequisite. According to CISG, 'detriment' is a wider concept than damage and is the same as substantial deprivation in PICC.

PICC adds an open-ended list of factors to be considered in order to establish whether a breach is material, PECL defines fundamental breach with more precision (there are three instances when the breach will be fundamental)[35]. The word 'or' after each of the case in PECL, explains that there is no necessity to apply all cases systematically. It is enough to prove the existence of one case for acknowledgment of fundamental non-performance. According to PECL Article 8:103(b), the essence is 'not at the strictness of the duty to perform but at the gravity of the consequences of non-performance[36].'This differs from PICC where ''substantial deprivation' is closely linked to the strict compliance factor '[37]. PECL, however, excludes the wording 'detriment', leaves 'substantial deprivation'. This wording essentially means that detriment is not necessarily a prerequisite for constitution of a fundamental breach. Where the effect of non-performance is substantial deprivation of the aggrieved party of its benefits, so that it loses its interest in performing the contract, then in general

[31] *Robert Koch* 'The Concept of Fundamental Breach of Contract under CISG'/ citation of: See, e.g., Bonell, 'The UNIDROIT Principles of International Commercial Contracts and the Vienna Sales Convention (CISG) - Alternatives of Complementary Instruments in Uniform L. Rev., 1996, p. 28, stating that the language of art. 25 is "vague and ambiguous"
[32] *Robert Koch* 'The Concept of Fundamental Breach of Contract under CISG'/ citation of: See Kritzer, Guide to Practical Applications of the United Nations Convention on Contracts for the International Sale of Goods, Deventer-Boston, 1989, p. 200 ff.
[33] n. 15, p. 822
[34] n. 15, p. 822
[35] According to 'European Contract Law Scots and South African Perpectives', edited by H. McQueen and R. Zimmermann/ 'Termination for Breach of Contract', Tjakie Naude, p. 284-285
[36] n. 29, p. 365
[37] n. 15, p. 823

the non-performance is fundamental'[38]. Thus, aggrieved party's expectations under the contract are crucial for non-performance to be regarded as fundamental. PECL separating strict compliance criterion from substantial deprivation criterion, making strict compliance criterion a more formal criterion, which depends on the explicit or implicit contractual agreement, even if there will be no gravity consequences for the aggrieved party. Substantial deprivation criterion is a more evaluative criterion, requiring the actual gravity of the breach, it might be not actual damages, but it must be lost the interest of the aggrieved party in latter performance of the contract.

PECL and DCFR illustrate the meaning of 'substantial deprivation'[39]: according to Illustration 1, a contractor did not pave the road leading to the garages, which he has built. The deadline is 1st of October, when the warehouse of the creditor is stored, and he could use the paved road. The deadline is missed, and it constitutes fundamental non-performance, as substantially it deprives the creditor from what he has expected under the contract. Illustration 2 is very similar, but the road to the garage is sufficiently smooth. Thus, the creditor may use it and is not substantially deprived of what he has expected. Non-performance does not constitute fundamental breach.

To conclude, the ratio of detriment and substantial deprivation in CISG, PICC, PECL and DCFR is considered to be almost the same. Even though wording differs (in CISG 'detriment' still resists, PECL separates 'strict compliance' criterion from criterion of 'substantial deprivation'), substantial deprivation is related with the expectations of the aggrieved party and actual detriment (damages) is not necessary prerequisite.

2. 2. Substantial detriment and interests

Thus, the party's special expectations, interests in performance of the contract are also relevant for admitting whether the breach was fundamental.

From the history of Article 25, it is clear that – unlike in the drafts – that does not refer to the extent of the damage, but instead to the importance of the interest which the contract and its individual obligations actually create for the promisee[40]. 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[41].

[38] n. 29, p. 365
[39] n. 21, p.854
[40] Leonardo Graffi 'Case Law on the Concept of 'Fundamental Breach' in the Vienna Sales Convention'/ CISG database/ Reproduced with permission of Revue de droit des affaires internationales / International Business Law Journal (2003) No. 3, 338-349 (Forum Europeén de la Communication) Paris
[41] n. 40

It is difficult, if not impossible, to find a precise definition of when a breach substantially deprives the aggrieved party of what it was entitled to expect under the contract[42]. PICC commentators also emphasizes that to define detriment. We therefore need to determine the aggrieved party's expectations under the contract. Strict compliance (PICC Article 7.3.1.(2)(b)) with a contractual agreement, objectivity criterion for evaluation of expectations, importance of the aggrieved party interests give guidelines to ascertain whether the detriment substantially deprived the aggrieved party from its expectations[43].

PICC commentary interprets 'substantial deprivation' by looking at the abundant case law of CISG and indicates on that basis relevant criterions as contractual agreement, seriousness of the breach, and reasonable use test criterions[44]. As Treitel has stated, 'the delicate balancing of interests that is required in this area is pre-eminently a matter for judicial discretion, and not one that can be determined in advance by fixed rules[45].'

However, case law usually links substantial deprivation with actual damages, as it is easier to prove the loss suffered. In case *Doolim Corp. v. R Doll,* Doll fundamentally breached this obligation by paying Doolim only $200,000.00 for the garments and failing to pay the balance. Doll's payment of only a small fraction - less than 20% - of the purchase price substantially deprived Doolim of the performance that it had a right to expect from Doll, *i.e.,* full payment within 15 days of delivery[46]. Thus, the substantial deprivation in this case is closely related with damages suffered. Nevertheless, Bunge Corp. v Tradax Export SA case (1981)[47] extends the concept of fundamental non-performance in English law, emphasizing that the substantial deprivation from the expected benefit is not the only factor determining whether the breach is fundamental. According to the case (Lord Roskill opinion) the contractual term might be assumed 'condition' even the breach of this term does not substantially deprive the innocent party from what she was entitled to benefit. Assuming the term as a condition in English law leads to the right of rescission, as a consequence of fundamental breach.

[42] n. 29, p. 823
[43] n. 29, p. 823-824
[44] n. 29, p. 824
[45] G. H. Treitel 'Remedies for Breach of Contract , 1988, p. 350
[46] 29 May 2009 United States District Court, Southern District of New York *Doolim Corp. v. R Doll, LLC, et al.,* No. 08 Civ. 1587(BSJ)(HBP).*37* http://cisgw3.law.pace.edu/cases/090529u1.html
[47] Bunge Corp. v Tradax Export SA case (1981) http://www.bailii.org/uk/cases/UKHL/1981/11.html

2. 3. Reasonable use test

Typical scenarios of non-performance might be divided into: delay in performance, definite non-performance and non-conforming performance, non-performance in documentary sales transactions, and breach of ancillary obligations[48]. The reasonable use test is used for non-conforming performance, 'which does not conform to the contractual requirements[49]'. This test shows 'whether the aggrieved party may make any other reasonable use of the non-conforming performance[50]'. However, there are judgments which regard fundamental breach without resorting to the reasonable use criterion[51].

With regard to non-conforming performance it is not fundamental. If the aggrieved party can make some reasonable use of the good anymore[52]. In a German court's judgment regarding an ended contract for the sale of a women's shoe stock, the buyer had only alleged that the shoes had "defects" and that they had been made with a material different from the material agreed upon by the parties; the buyer, however, had not proved that the shoes could not be reasonably used otherwise because of their defects[53]. The court, taking into account reasonable use criterion, decided that the buyer is not entitled to avoid the contract Thus, where it appears from commercial background that of the transaction that time and quality were of the essence of the contract, a non-conforming performance is fundamental from the outset. In these circumstances, there is no justification for conducting a reasonable use analysis[54]. In the previous case, the court's position was different. While comparing Schlechtriem's position on reasonable use test with the commentators on PICC, even a self-damaging defect does not necessarily mean termination, since it is possible to utilize it.

In the *Pressure cookers case* it was noted that the Seller 'under the obligation to supply pressure-cookers that were entirely safe, (…) has nevertheless delivered (…) appliances that despite an identical outward appearance, were of a substantially different design. **Some of these differences posed dangers to the user.** (…)Therefore (…) there has been a breach of the obligation of conformity imposed by the provisions of article 35 of the Vienna Convention on the delivery of 'goods which are of the quantity, quality and description required by the contract' and therefore of a consistent quality.

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[48] n. 15, p. 293-298
[49] n. 29, p. 824
[50] n. 29, p. 824
[51] n. 29, p. 825
[52] n. 15, p. 834
[53] Larry A. DiMatteo, Lucien Dhooge, Stephanie Greene, Virginia Maurer and Marisa Pagnattaro 'The Interpretive Turn in International Sales Law: An Analysis of Fifteen Years of CISG Jurisprudence', 34 Northwestern Journal of International Law and Business (Winter 2004) 299-440 (note 16 to Oberlandesgericht Frankfurt am Main of 18 January 1994 [5U 15/93], UNILEX, D. 1994-2 at 183)
[54] n. 15, p. 834

On this point, the **supply, under a single identification number, of appliances of a different design**, which did not provide the same safety guarantees for use, **constitutes a fundamental breach** of the obligation of the seller.' [55]

The reasonable use test has been developed by German and Swiss courts under CISG. The reasonable use criterion is used by PICC Article 7.3.1 to pursue the general objective of restricting opportunity of the aggrieved party to terminate the contract for the **defective performance and to award damages for any consequential loss instead of termination**[56]. However, using the reasonable test is restricted, otherwise it would not make sense to acknowledge a fundamental breach. Therefore, contractual agreement predominates, even when there would be reasonable use. It is usually possible to make some reasonable use of the goods despite delays so that the aggrieved party's interests are sufficiently protected by a claim of damages[57].

The reasonable use test can be applied to any type of contract where it is possible that the performance does not conform to the contractual or statutory standards, in particular contracts for work and services. Some legal scholars even claim that is should be possible to apply it to the other types of breach (late performance)[58].

The crucial question is under what circumstances the aggrieved party cannot make reasonable use of the goods anymore[59]. The commercial background of the transaction is of crucial importance.

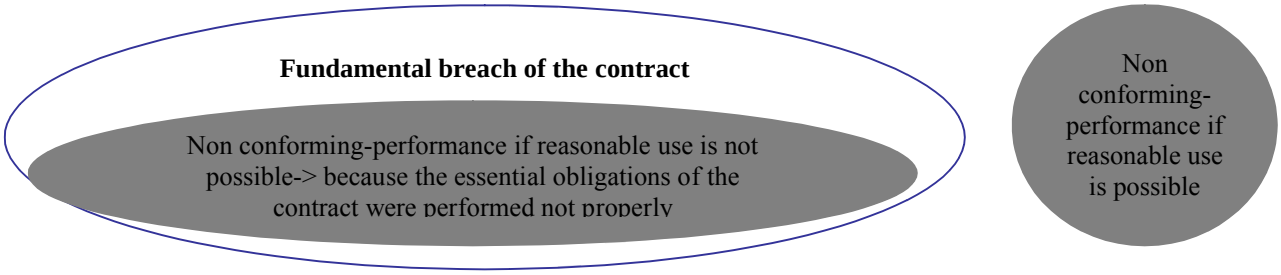
The scheme of reasonable use test would be:

What is the essence of the contract?-> If essential interest in the contract is for the time/quality/quantity/brand/etc. and the non-conforming performance in part non-performs strictly this requirement-> Such non-conforming performance causes substantial detriment and fundamental breach is regarded.-> There is no possibility to adopt reasonable use test.

We will analyze criterion of strict compliance under the contract further in our research.

[55] France 4 June 2004 Appellate Court Paris (*Pressure cookers case*) http://cisgw3.law.pace.edu/cases/040604f1.html
[56] n. 29, p. 825
[57] n. 15, p. 832
[58] n. 29, p. 825
[59] n. 29, p. 834

Ratio between reasonable test use and the fundamental breach of the contract is:



To conclude, reasonable use is not possible if the certain conditions are essential for the aggrieved party and it is expressly or implicitly stated in the contract, thus breach of them is regarded as fundamental. Thus, we should analyze explicit and/or implicit contractual agreement and takes prominent position solving the reasonable use test.

2. 4. Contractual agreement, intermediate term and seriousness of the breach

Explicit contractual agreement (written agreement) informs us about the interests of the parties. Implicit contractual agreement is based on business usages between the parties, the interpretation of a written agreement, and correspondence before the contract was concluded. Controversy arises on whether the implicit agreement might be based on subsequent delivered information. Implicit agreement also refers to party's expectations, but its typically harder to prove such agreement in a case of a dispute with non-performing party. Parties might agree that non-performance of some obligation constitutes fundamental breach and special remedies are possible. Such a condition clearly shows the importance of certain obligation and the seriousness of the breach if obligation is not performed properly. According to PICC interpretations normally the consequences of a delay for the aggrieved party will not be so serious as to deprive it of its substantial interest in the contract ('seriousness criterion'), but parties may agree the opposite[60]. Moreover, a definite failure to perform usually constitutes a fundamental non-performance, resulting primarily from the substantial deprivation factor[61]. Breaches, relating to the documents in documentary sales transactions should be treated like breaches relating to the goods, taking into account seriousness of the breach and the reasonability test[62]. Under CISG, the delivery of non-conforming documents only amounts to a fundamental breach if the buyer can not reasonably be expected to obtain conforming documents themself[63]. Thus CISG leaves room for the buyer to act in order to avoid a fundamental breach of contract. According to objective

[60] n. 15, p.832
[61] n. 15, p. 833
[62] n. 8 Art. 49 par. 11
[63] n. 15, p. 836, referring to BGH 3 April 1996 (VIII ZR 51/95), CISG-online 135

criterion (express contractual agreement), such a scheme leads to acknowledgement of fundamental breach:

Intention to conclude a contract and to seek certain benefit (fulfillment of interests)→ deprivation from such interests causes substantial detriment and is expressly defined in a contract as a fundamental breach.

According to subjective criterion (implicit contractual agreement), such a scheme leads to acknowledgement of fundamental breach:

Why the contract was concluded? →It provides certain benefit for both parties (economical benefit is the essence of commercial contracts). →**What benefit** the contract provides to each of the party? →**Which obligations are crucial** for creating benefit? →Breach of such obligations is fundamental.

PECL Article 8:103 (b), as well as CISG Article 25 and PICC Article 7.1.3.2(a) are 'closer to an intermediate term'[64]. According to English law, the breach of the term constitutes fundamental non-performance if it 'deprives the party not in breach of substantially the whole benefit which it was intended that he should obtain from the contract'[65]. Thus, the origin of intermediate the term is to be found in the decision of previously mentioned case[66]. Intermediate or innominate terms are paying regard to the serious consequences of the breach while determining whether the breach is repudiatory. Primary sorting of contractual terms was based on differences between 'conditions' and 'warranties', the previous being the ground for termination of the contract, because the breach of such a term was regarded as fundamental for the 'nature of the term broken[67]'. The general view is that there are three classes of contractual terms: conditions (…) the breach of which gives the rise to rescind; warranties, the breach of which gives rise only to a right to damages; and intermediate terms, the breach of which gives rise to a right to rescind if it is sufficiently serious, but otherwise sound only in damages[68]. Therefore, in case of breach of intermediate or innominate terms, the termination of a contract is possible if the consequences of the breach cause substantial deprivation.

Thus, in English law, the 'nature of the term broken' (i.e. 'condition') and 'the consequences of the breach' (i.e. 'intermediate term') are two main grounds to declare a breach fundamental. These two

[64]Ewan McKendrick 'Text, Cases, and Materials',Oxford University press, 2008 p. 791
[65] Hon Kong Fir Shipping Co Ltd v. Kawasaki Kisen Kaisha Ltd (1962))
http://www.bailii.org/ew/cases/EWCA/Civ/1961/7.html
[66] n. 64, p. 790
[67] n. 64, p. 790
[68] Sir Guenter Treitel 'The Law of contract' Thomson, 2003, p. 796

'strike the balance between certainty and fairness[69]'. Certainty is expressed by the use of conditions, fairness is provided by the use of more flexible intermediate terms. The essential difference between the conditions and intermediate terms is that the party 'may rescind for a breach of an intermediate term if, but only if, the requirement of substantial failure is satisfied[70]'. We will discuss the breach of 'conditions' and the evaluation of fundamental non-performance in English law later (*see below chapter of 'Strict compliance'*).

However, there is discussion for the expressed term of 'warranty' and 'condition' in its technical sense. On one hand, parties' interests should be taken into account, especially in English law where the freedom of contract prevails. On the other hand, if the use of the term is sophisticated and the expressed term is not based on real grounds, the 'term of warranty should not act as a barrier to a party terminating the contract where the consequences of the breach are serious[71]'.

Is any breach of the intermediate term is fundamental or only a breach which leads to termination? As it was above stated, 'in the absence of any clear agreement or prior decision that this was to be a condition, the court should lean the favor of construing this provision as to impurities as an intermediate term, only a serious and substantial breach of which entitled rejection'[72]. It means, that if the breach is not serious and substantial (i.e. fundamental), then termination of the contract in the case of intermediate terms breach is not possible. Therefore, if the court states that termination of contract is possible, this fact merely proves, that the breach of intermediate term was fundamental.

With English law, however, using intermediate terms pose a question: how serious should consequences be in order to regard breach as fundamental? As Dilpock LJ stated in Hong Kong Fir Shipping case, the breach should deprive the aggrieved party of 'substantially the whole benefit which it was intended that he should obtain from the contract'[73]. What is the ratio between the loss of interest and actual damages suffered according to English intermediate terms? Should serious consequence include not only to actual damages, but substantial deprivation from expected interests as well? According to case law, such factors are crucial for determining whether the breach is sufficiently serious:

1) Losses caused by the breach *(as we understood, actual damages or* ***consequential losses*** *– (auth.));*

[69] n. 64, p. 775
[70] n. 68, p. 795
[71] n. 64, p. 790
[72] Federal Commerce and Navigation v. Molena Alpha (1979)
[73] n. 65

2) Cost of making performance comply with the terms of the contract *(is it possible to remedy the breach at all/ and if possible – without unreasonable costs (auth.));*
3) Value of the performance that has been received by the innocent party *(for the sake of interests balance between the parties and taking into account party's in breach interests (auth.));*
4) Willingness of the party in the breach to make things right *(even intentionality criterion does not play crucial role in English law (auth.));*
5) Consequences of the breach *(in a perspective of the aggrieved party's interests (auth.))*;
6) Likelihood of a further breach by the party in breach *(is the party in breach is able to maintain its latter obligations –it is similar to the reliance on future performance criterion (auth.));*
7) Adequacy of damages as a remedy to the innocent party *(is it just and fair for the aggrieved party's interests to evaluate loss suffered by a lump sum of damages (auth.))*[74].

On the other hand, a 'party who purports to terminate a contract when it is not in fact entitled to do so will be held to have repudiated the contract[75]'.

To conclude, the seriousness of the breach under CISG, PECL, PICC is similar to the concept of 'intermediate term' in English law and might be interpreted using objective or subjective criterion. According to objective criterion, the intention to conclude a contract and to seek for certain benefit (fulfillment of interests) that leads to deprivation from such interests, causes substantial detriment and is expressly defined as a fundamental breach of the contract.

According to subjective criterion (implicit contractual agreement), a such scheme leads to acknowledgement of fundamental breach:

→**Why the contract was concluded**? It provides certain benefit for both parties (economical benefit is the essence of commercial contracts).

→ **What benefit** does the contract provides to each party? **Which obligations are crucial** for creating these benefits? A breach of such obligations is fundamental.

A fundamental breach in common law is admitted if it is a breach of condition or a breach of intermediate terms (and it leads to termination of the contract). While analyzing a remedial system for a fundamental breach of contract, we will discuss whether a breach of warranties might end in the termination of the contract could be called fundamental breach. Using the term 'warranty' in a technical sense, when the consequences of a breached term are serious, should not prevent a

[74] n. 64, p. 795-796
[75] n. 64, p. 796

termination from happening. Thus, the parties' expressed will should not contradict the good faith criterion. Otherwise, the consequences might be different then was foreseen in the contract. Thus, the termination of the contract is even possible when the term 'warranty' is used in its 'technical sense'

3. Reasonable man standard

The reasonableness criterion is revealed in PECL Article 1:302: 'Under these Principles reasonableness is to be judged by which persons acting *in good faith* and in the same situation as the parties would consider to be reasonable. In particular, in assessing criterion of reasonableness, we should be taking into account the *nature and purpose of the contract, the circumstances of the case and the usages and practices of the trades or professions*. Commentary indicates, that the term 'reasonable', (*auth.* as it is understood according to PECL Article 1:302) is used to express various requirements (i.e. what may one expect a party to know or to take into account according to 8:103 (2)) and in deciding what is reasonable all relevant factors should be taken into consideration.[76] Thus the criterion of reasonableness in PECL Article 8:103(2) is not what the party in the breach did not foresee or could not foreseen because of certain conditions, but what another reasonable person, acting in good faith in a same circumstances would not have foreseen. This makes the foreseeability criterion more objective. PECL Article 1:302 expresses what seems to be a common core of the legal systems[77].

CISG also uses the 'reasonable person of the same kind in the same circumstances' criterion in Article 25. The 'reasonable person' test was introduced in an effort to make the Vienna Convention more objective than the ULIS[78]. One criticism is that "there is no indication whether the test is for a 'reasonable man' or 'reasonable international businessman', and which reasonable businessman, operating in which trading conditions"[79]. Thus, it will be preferable not only to evaluate whether a reasonable person of the same kind could foresee the event, but also to determine whether a businessman of the same trade sector would have foreseen the event[80]. Importance of specific trade sectors does not address another problem however. What is the outcome if the reasonable man standard is used for the same trade sector but standards for the trade differ between countries? Should we look

[76] n. 29, p. 126
[77] n. 29, p. 128
[78] Maria O' Neill 'Contracts for the International Sale of Goods - the Significance of 'Fundamental Breach in the Viena Convention, 1980'/ Irish Business Law, Ir. BL 1999 2(3), p. 82-87
[79] n. 78
[80] n. 8, p. 179

into the aggrieved party's national standards or the party in breach national standards of reasonable businessman?

The 'reasonable business man' criterion makes foreseeability criterion more objective. If CISG concept 'reasonable man' is linked with the concept of a 'reasonable business man in the international context', what are the legal acts and usages defining reasonable international businessman criterion? In our opinion, usages between the parties (if it is not the first contract), contractual background are the basis for 'reasonable international business man' criterion. The 'reasonable international business man' criterion should exclude deviations which might be common only for 'reasonable man' criterion in a certain region. It is fair and reasonable to require approach of 'international business man', because parties concluding contract should foreseen that different usages in their country are not widely used as a standard abroad. On the other hand, though 'reasonable international business man' is aware of the main differences in commercial usages in certain region in order to reduce business risk, he still may rely on the nature and purpose of the contract, the circumstances of the case, and the usages and practices of the trades or professions.

4. Strict compliance

4.1. International approach

PECL 8:103(a) is almost similar with the concept of the fundamental breach according to PICC 7.3.1(2)(b). According to PICC Article 7.3.1(2)(b), regard shall be placed on whether strict compliance with the obligation which has not been performed is 'of the essence'[81]. As we already mentioned, a 'substantial deprivation' (7.3.1(2)(a)) factor is closely linked to the 'strict compliance' factor. The main difference between PICC Article 7.3.1(2)(a) and 7.3.1(2)(b) is the requirement for detriment, which is not relevant as a 'strict compliance' criterion. Because the obligation is of the essence of the contract, this fact of non-performance alone is enough to constitute fundamental breach. 7.3.1(2)(b) looks not at the actual gravity of the non-performance, but at the nature of contractual obligations for which strict performance might be of essence[82].

Strict compliance should be taken into account if it is expressly (a breach leads to a termination of a contract) or implicitly (i.e. 'at the latest', 'precisely' at he given time) characterized in contractual agreement. Furthermore, the intention of the parties in determining whether the breached obligation

[81] n. 15, p. 827
[82] 'UNIDROIT principles on international commercial contracts 2004', International Institute for the Unification of Private Law, p. 222

was ‘of the essence’ may be obvious from the circumstance of the case, in particular from the commercial background of the transaction[83].

Time is frequently of the essence in mercantile contracts[84]. As a rule, the mere fact that a party has not performed on the agreed date for performance does not amount to a fundamental non-performance and the *Nachfrist* mechanism would be meaningless if every delay constituted a fundamental breach under PICC Article 7.3.1(1)[85]. Official Comment on PICC states that time is normally considered to be of the essence in contracts for the sale of commodities and that strict compliance must be made with the terms of the letter of credit in documentary credit transactions[86]. In sales contracts concluded under the trade terms ‘CIF (INCOTERMS)’ or ‘FOB (INCOTERMS)’, time is usually of the essence with respect to delivery-related obligations. Moreover, when goods are strictly seasonal or perishable, or where ‘today’s buyer may be tomorrow’s seller’, time is usually of the essence[87]. However, time in many cases is not the essence of the contract: in sale of machinery, in contracts for the construction of the buildings or sites.

When the goods are used as raw materials for production, and the seller provides lower quality goods, such non-conforming performance is fundamental, if the quality of goods is the essence of the contract and the buyer can not reasonably use lower quality goods: it might be objective ground for reasonable use of lower quality goods, but it would cause damage for the reputation and brand of the buyer[88].

When the aggrieved party required performance for operative use in the production process (i.e. purchase of a production machine), it often appears from the commercial background that a non-conforming performance (i.e. the machine is not properly working) is not of any reasonable use to the aggrieved party (i.e. because its business relies upon fully operational machines)[89]. Thus, in case of non-conforming performance, strict compliance with the contract is usually not explicitly or implicitly expressed in contractual agreement, but is clear from the commercial background of the contract. If the buyer buys goods for resale purposes, the main question is whether buyer sells only high quality goods[90]. Business requires higher reasonable man standards than normal. Parties should take into account not only explicit agreements, but also must analyze all commercial backgrounds, business usages in the party’s country, the party’s interests in performance of the contract, and economical

[83] n. 15, p. 827
[84] n. 15, p. 832
[85] n. 15, p. 831
[86] n. 82, p. 222
[87] n. 15, p. 832
[88] n. 15, p. 835
[89] n. 15, p. 835
[90] n. 15, p. 835

meaning of commercial transaction for the party. Thus, a non-performance of an obligation constitutes a fundamental breach, even if the party in the breach was not expressly informed that the aggrieved party is the owner of well known regional trademark and for that reason could not use lower quality goods as a raw material for its production. It is reasonable for ordinary businessman to find out the main information about the other party in the time of pre-contractual relations, before the conclusion of the contract.

4.2. English law tradition: 'conditions'

The concept of fundamental non-performance of the contract according to PECL 8:103(a) and PICC 7.3.1(2)(b) corresponds very closely to English law and could be better explained by taking into account the theory of 'conditions' according to common law tradition.

According to common law tradition, the conclusion of the contract is possible in a breach of intermediate terms or in a breach of condition[91]. A warranty is a lesser, subsidiary term of the contract, the breach of which gives rise to a claim for damages, but does not give an innocent party the right to terminate further performance of the contract[92]. 'Condition is a contractual term, the breach of which gives the injured party to rescind the contract'[93]. The contract may be terminated nonetheless depending on the amount of damages if breached term can be classified as a 'condition'[94]. Whether the contractual term is a condition depends on the 'commercial importance of the term to the injured party[95]'. Otherwise, 'the court will base its decision on its own view of the commercial importance of the term'[96].

Distinction between warranties and conditions is based on importance of contractual terms for the parties', i.e. is a it substantial or subsidiary element of the contract. Whether the breached term is substantial for the aggrieved party becomes clear from expressed intention of the parties or from the implicit intention of the parties. Implicit intention becomes clear from the interpretation of the contract (i.e. 'general requirement of substantial failure in performance'[97]). In comparison with the CISG, English law places considerable emphasis on freedom of contract in the sense that it gives to

[91] n. 8, p. 104
[92] n. 64, p. 789
[93] n. 68, p. 788
[94] n. 8, p. 104
[95] n. 68, p. 790
[96] n. 68, p. 790
[97] n. 68, p. 790

contracting parties considerable freedom to decide for themselves when the right to terminate will arise (it is open to the parties to classify any term they like as a condition)[98].

The general requirement of substantial failure in performance to play a crucial role for determining whether the term is regarded as a condition, might be emphasized by two different approaches. Firstly, the Honking Fir Shipping case explains that the term is a condition if 'every breach (…) deprives the party not in the breach of substantially the whole benefit which it was intended that he should obtain from the contract'[99]. Secondly, a 'general requirement of substantial deprivation' has an exception, when the term is regarded as a condition even if there is no substantial detriment suffered and the right to rescind is available 'without regard of the magnitude of the breach[100]'. This approach was revealed by the case Bunge Corp. v. Tradax S.A.(1981)[101], in which the concept of 'condition' in common law tradition becomes wider, because it emphasized the importance of strict compliance of the obligation, even if there is no substantial detriment caused. 'Many cases (…) where the terms of breaches of which do not deprive the innocent party of substantially the whole benefit which he was intended to receive from the contract were nonetheless held to be conditions any breach of which entitled to rescind'[102].

Thus, the term is a condition if:

1) It is clearly expressed by the parties' in the contract itself;

2) It is implicit from the interpretation of the contract, i.e. when the court relies on the general requirement of substantial failure in performance, when 'performance of the stipulation (went) to the root (…) of the contract[103]';

2.1. Substantial failure in performance is possible when the substantial detriment is suffered;

2.2. Substantial failure in performance is possible when substantial detriment is not suffered. Consequently strict compliance with the term is essential.

3) It is determined by law (previous judicial decision or statute).

Thus, in Parliament, contracting parties themselves and the courts might determine term as a condition[104]. An example of conditions determined by the Parliament might be found in The Sale of Goods Act 1979, which classifies that a term is condition if:

a) Goods sold by description shall correspond with the contractual description[105];

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[98] n. 64, p. 814
[99] n. 65
[100] Lombard North Central plc. v. Butterworth (1987)
[101] Bunge Corp. v. Tradax S.A.(1981) http://www.bailii.org/uk/cases/UKHL/1981/11.html
[102] n. 100
[103] Glahom v. Hays
[104] n. 64, p. 776

b) Goods sold by sample should correspond to the sample[106];

c) In certain cases goods should be of satisfactory quality and fit for a particular purpose[107].

However, such certainty provided by legal acts establishing conditions, might be abused by the buyers, who might seek to rescind the contract even if a trivial breach was made. Thus, the stability of commercial relationships might be affected. According to the Sale of Goods Act 1979 Article 15A, a buyer would, have the right to reject goods by reason of a breach on the part of the seller of a term implied by section 13, 14 or 15, but if the breach is so slight that it would be unreasonable for him to reject them, then, if the buyer does not deal as consumer, the breach is not to be treated as a breach of condition but can be treated as a breach of warranty. The aim of this provision is to stop buyers rejecting goods for what may be termed 'technical' reasons[108].

In case Arcos Ltd v. E A Ronaasen and Son (1933), the parties entered into agreement for the sale of timber staves cut to thickness of ½ inch. The buyers, however, claimed that the thickness of presented staves was wrong (9/16 inch)[109]. The House of Lord stated that the buyers may reject the timber, even if their real motivation was a fall in the market price of timber, what resulted in not useful bargain for the buyer. In a falling market (…) buyers are often as eager to insist on their legal rights[110]. Section 15A restricts such rights, if it is reasonable. Three criterions are used in determining whether it is reasonable, the buyer should not deal as a consumer, the breach is slight, and it is unreasonable to reject the goods.

Furthermore, freedom of contract prevails in English law. This is in contrast to French law, where only the courts have jurisdiction to terminate a contract. Therefore, the freedom of the contract (thus, the terms, settling the life and end of the contract) prevails among pacta sunt servanda principle. However, it is necessary for the contracting parties to make it clear that it was their intention to classify term as a condition[111], otherwise in the case of dispute, the trivial breach of the term might be not regarded only as a 'technical' condition, potentially prohibiting the right to rescind the contract.

In case of quantitative defects, rescission is always possible, thus the distinction between warranties and conditions is not made[112].

Hence, the condition is used for two functions:

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[105] Sale of Goods Act 1979, s 13
[106] n. 105, s 15
[107] n. 105, s 14
[108] n. 64, p. 776
[109] Arcos Ltd v. E A Ronaasen and Son
[110] n. 109
[111] n. 64, p. 777
[112] n. 68, p. 793, Sale of Goods Act 1979, s 30 (1), 30 (2)

1) To rescind the contract when substantial detriment is suffered (but the detriment is not essential);
2) To rescind the contract, when unfulfilled obligation seems crucial for the contract even without prejudice.

On one hand, the parties are free to determine which term is crucial and constitutes the essence of the contract, thus the term should be strictly complied with. "Once a term has been classified as a 'condition' the injured party can safely rescind for breach of it without having to consider the often difficult question whether the breach amounted to a 'substantial' failure to the performance"[113]. In a case *Financings Ltd. V. Baldock (1963)* the contract stipulated that 'should the buyer pay initial installments (…) or any subsequent installment (…) within ten days after the same shall have become due or if he shall die (…) the owner may (…) the owner may by written notice (…) forthwith and for all purposes terminate the hiring[114]'. It was held, that the term for termination is not a condition, thus the breach of the term does not constitute repudiatory breach. Hence, the stipulated clause for termination does itself constitute condition. According to case law, it is important to emphasize expressly that the term is a 'condition' or 'of the essence of the contract' to prove the importance of term and to allocate certain remedies. Contrary to the previous case, in *Lombard North Central plc. v. Butterworth (1987)'* the contract stipulated, that time was of the essence with regard to payment of the quarterly rentals[115]'. This case is a good example of a well drafted contract with the certain clause of the condition and the available remedy of termination of the contract along with 'the damages recoverable upon the termination of the contract'[116].

Furthermore, Treitel states, if the term can be broken in a way which will cause only trifling (if any) losses, the court may hold that such a breach will not justify rescission, even though the so called term is a 'condition' in the contract[117]. The question arises, whether it restricts the freedom of the contract and the will of the parties. If the parties clearly expressed that the term is regarded as a condition, we may presume that strict compliance with this term plays a crucial role for the parties. However, Treitel presents a case in which the court decided that it is important to take into account the intentions of the party; formal naming of the term as a condition is not enough. In *Wickman Ltd. V. Schuler AG*[118], the 'condition' of a four-year distributorship agreement was that a distributor should

[113] n. 68, p.794
[114] *Financings Ltd. V. Baldock (1963)*
[115] *Lombard North Central plc. v. Butterworth (1987)*
[116] n. 64, p. 789
[117] n. 68, p. 792
[118] Wickman Ltd. V. Schuler AG

visit six named customers once a weak[119]. The Reasonability criterion is used in determining whether the breach of the obligation may constitute fundamental non-performance and if it is crucial for the parties. Thus, expressed in the contract, the condition should not contradict with the good faith and reasonable business man criterion, as the main principles of commercial law.

The main difference between 'strict compliance' and 'substantial deprivation' is the requirement for detriment, which is not relevant for 'strict compliance' criterion. This is because the obligation is the essence of the contract and proof of non-performance enough to constitute a fundamental breach. PECL Article 8:103, defining fundamental non-performance 'to English eyes (…) is very different from Vienna Convention: the vital difference is paragraph (a) which seems to approximate to a condition[120]'. Thus, strict compliance with the contractual obligations, as it is understood under PICC and PECL, resembles the common law notion of strict compliance with the 'conditions'. Commercial background of the contract plays crucial role for determining whether the term breached is a condition/ the essence of the contract.

5. Intention

According to PICC Article 7.3.1.2(c) non-performance constitutes fundamental breach if it is intentional or recklessness. 'However, the factor should be applied restrictively[121]'. The arguments for restricting application of intentionality and recklessness are:

1) Good faith principle. Official Comment in PICC states, that it may be contrary to the good faith principle (PICC Article 1.7.) to terminate the contract if non-performance, although intentional, is insignificant[122].

2) Has less weight than other factors. The other PICC criterions predominantly determine whether the breach is fundamental. Thus, intent or recklessness are considered as aggravating circumstances of non-performance, leading to a fundamental breach of contract if it is not possible to apply other criterions (PICC Article 7.3.1.2(a)(b)(d)). 'The isolated focus on the 'state of mind' of the non-performing party (…) should therefore be given less weight than the other factors (…)'[123].

3) Liability under PICC Article 7.1.3 is not fault-based. 'PICC generally does not place a great emphasis on the fault requirement'[124].

[119] n. 68, p. 792
[120] n. 64, p. 815
[121] n. 15, p. 828.
[122] n. 82, p. 222
[123] n. 15, p. 828
[124] n. 15, p. 828

Huber states, that 'there is no need to resort to the good faith principle in order to[125]' restrict application of intentionality criterion. However, we claim that the principle of good faith is the background for 'less weight theory'. Otherwise, there is no justification for the 'less weight' theory, as PICC Article 7.3.1(2) treats all criterions equally (the word 'whether' proves it). According to PECL, if the non-performance of an obligation does not substantially deprive the creditor of what the creditor could have expected to receive, the creditor may treat the non-performance as fundamental if both intentionality and loss of reliance in future performance criterions may be applied[126]. Even PICC, contrary to PECL, presents a non-exhaustive list of criterions. We therefore presume, that all listed criterions are material, unless systematic interpretation of PICC Article 7.3.1 leads to another opinion.

Distinction between intentional and unintentional non-performance, addressed in PECL Article 8:103(c) and in PICC Article 7.1.3(2)(c), is not generally drawn in English law[127]. Common law tradition states, that intentional non-performance is not enough to terminate a contract[128]. Termination of the contract is possible, if an intentional breach of the contract would be fraudulent or is considered as 'an intention no longer to be bound by the contract'[129]. Thus, intentionality criterion under PECL and PICC has no equivalent in English law[130]. In English law even an unintentional breach may give rise to an anticipatory repudiation[131].

PECL 8:103(c) integrates PICC 7.1.3(2)(c)(d). PECL provides an exhaustive list of criterions for assuming the non performance of obligations as fundamental breach and therefore presents stricter requirement for using the intentionality criterion than PICC. According to Schlechtriem, PICC Article 7.3.1(2)(c) 'that an intentional or reckless breach of contractual obligations which in itself does not yet constitute a fundamental breach may have destroyed the confidence of the other party in the reliability of the obligor, so that the obligee can no longer be expected to be bound by the contract.'[132]. Schlechtriem explanation is contrary to Huber's opinion, who states that if the breach is intentional and there is no-reliance on future trust, the 7.3.1(2)(d) prevails instead of part (c)[133]. Huber's opinion is based on Official Commentary on PICC Article 7.3.1.2(d), 'Sometimes an intentional breach may show that the party may not be trusted'[134].

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[125] n. 15, p. 828
[126] n. 5, p. 855
[127] n. 64, p. 815
[128] n. 8, p. 107
[129] n. 8, p. 107
[130] Richard Stone 'The Modern Law of Contract', Cavendish Publishing Limited, 2005, p. 436
[131] n. 21, p. 857
[132] n. 8, p. 107
[133] n. 15, p. 828
[134] n. 82, p. 223

'CISG has no provision on intentional non-performance like the one provided in PECL Article 8:101(3)'[135]. 'It is the prevailing view that in sales governed by CISG the remedies for fraud are to be found in national law'[136]. Thus, according to CISG the fault of the obligor in fundamental breach is of no importance for the remedy of termination. Consequently, there is no room for the application of the approach found in the UNIDROIT Principles treating intentional non-performance as fundamental.[137]

To conclude, intentionality criterion should be used restrictively in accordance with good faith criterion and it 'has less weight than other factors' because the breach itself is insignificant (if it would be significant, the other criterions (PICC Article 7.3.1(2)(a)/(b)/(d) would be applied). Thus, construction of PICC 7.3.1.(2)(c) should be improved by adding the 'good faith criterion': intentional or recklessness non-performance is fundamental if it does not contradict to good faith principle[138]. 'Intentionality' criterion should conjunct with 'loss of reliance' criterion (as in PECL 8:103 (c)). redundancy might show loss of reliance on the party in breach, what might be declared as an outcome of intentionality. However, it can not be presumed and it is always case-specific.

6. Loss of reliance

According to PICC Article 7.3.1.(2)(e), the breach is fundamental, if the non-performing party gives the aggrieved party reason to believe that it cannot rely on the other party's future performance. The concept of 'future performance' refers to the 'cases where the performance has to be made in several steps or over a certain period of time[139]'. 'If a party is to make its performance in installments and if it is clear that a defect found in one of the earlier performances will be repeated in all performances, the aggrieved party may terminate the contract even if the defects in the early installment would not of themselves justify termination[140]'. Thus, loss of reliance is common for long term contracts and means that performance is divisible (such as in an installment contract)[141].

According to the commentators of PICC, non-performance must give the aggrieved party a reason to objectively to prove that it can no longer rely upon the other party's future performance[142]. Again, the reasonable man criterion plays crucial role for determining whether the non-performance is grounds for non-reliance in future performance. Objective grounds for the loss of reliance could be an

[135] Editor Hossam El-Saghir 'Guide to Artcle 25 Comparison with Principles of European Contract Law (PECL)', July 2000
[136] n. 130 referring to John HONNOLD, Uniform Law for International Sales under the 1980 United Nations Convention, third edition, (1999) at 67.
[137] n. 14
[138] We agree with R. Balčikonis, n. 6
[139] n. 15, p. 828
[140] n. 15, p. 222
[141] n. 15, p. 828
[142] n. 15, p. 828

'intentional breach'[143], when there are reasonable doubts on whether the other party is *capable* of makeing proper future performances. This applies if the present non-performance indicates that the other party is unreliable, when the supplier is not able to avoid delivering defective goods in the future[144].

Further expected non-performance should be so serious as to substantially deprive the aggrieved party from what she is entitled to expect with regard to the entire contract (PICC Article 7.3.1(2)(a)) and strict compliance of the obligation is the essence of the contract (PICC Article 7.3.1.(2)(b))[145]. Huber claims, that this preposition is supported by CISG Article 73(2): the installment contract is avoided for the future if there are positive grounds to believe that a fundamental breach will occur in future installments[146].

PICC Article 7.3.1(2)(d) is only concerned with the question of whether or not the breach of one installment or obligation entitles the aggrieved party to terminate the entire contract.

As mentioned above, PECL Article 8:103 (c) integrates PICC Article 7.3.1(2)(c) and (d), i.e. even when the broken contractual term is minor and the consequences of the non-performance do not substantially deprive the aggrieved party of the benefit of the bargain, it may treat the non-performance as fundamental if it was intentional and gave it reason to believe that it could not rely on the other party's future performance[147]. Thus, the intentionality and loss of reliance criterions are applied together, contrary to PICC. According to PICC, it is enough to prove existence one of those factors to prove a breach is fundamental. PECL considers fault (intentionality) as not enough to regard a breach as fundamental if 'no future performance is due from the non-performing party, other than the remedying non-performance itself or (…) there is no reason to suppose that it will not properly perform its future obligations[148]'. In our opinion, it is reasonable to conjunct 'intentionality' and 'loss of reliance '. Intentionality itself has 'less weight' than other criterions and in conjunction it becomes more serious ground for termination. Moreover, the redundancy of breaches may be easier to use as the grounds for fundamental breach, as redundancy, logically, might show the loss of reliance of what might be the outcome of intentionality. On the other hand, loss of reliance and intentionality are in their very nature similar. An intentional breach by party consequently leads to lost reliance.

[143] n. 82, p. 222
[144] n. 15, p. 828
[145] n. 15, p. 829
[146] n. 15, p 829
[147] n. 15, p. 366
[148] n. 15, p. 366

7. Disproportionate loss

PICC Article 7.3.1(2)(e) focuses on the non-performing party's interests and is a ground for the exclusion of the 7.3.1(2)(e) criterions. However, it is hard to imagine a case in which an intentional or recklessness non-performance (PICC Article 7.3.1(2)(c)) can be 'neutralized' by the disproportionate loss factor under Article 7.3.1(2)(e)[149], since Official Commentary on PICC claims that Article 7.3.1(2)(e) is based upon the reliance of non-performing party[150]. This factor is relevant if doubts arise on whether the other factors in Article 7.3.1(2) are sufficient to establish the fundamental breach[151].

Thus, the goal of the criterion of disproportionate loss is to protect the interests of the non-performing party. If in case of termination, the non-performing party will suffer disproportionate loss and the non-performance occurred unintentionally, the breach should not be assumed as fundamental, in order to strike a balance between the parties. To determine and apply remedies, interests of both parties should be taken into account. Thus, all remedies should be applied in accordance with fairness, reasonableness and justice[152].

[149] n. 15, p. 831
[150] n. 82, p. 223
[151] n. 15, p. 831
[152] Valentinas Mikelėnas ‚Sutarčių teisė Bendrieji sutarčių teisės klausimai: lyginamoji studija', Justitia Vilnius 1996, p. 508

II REMEDIAL SYSTEM FOR THE FUNDAMENTAL BREACH OF THE CONTRACT

The right to require performance, the right to avoidance, the right to price reduction, and the right to claim damages constitutes the framework of most remedial systems. The right to cure defects, partial non-performance (if it does not constitute fundamental breach of the contract), premature delivery, and the delivery of a larger quantity than agreed upon, may be treated as supplementary remedies. In analyzing the Concept of the Fundamental Breach of Contract in a Comparative Perspective we will overview remedial system for the fundamental breach of contract, accentuating avoidance as the most severe remedy. We will discuss specific performance, reduction of price, damages, and to a lesser extent, other remedies, comparing peculiarities of remedies for fundamental non-performance in different systems. In our research we are trying to seek a deeper analysis. Thus, an over extensive profile of remedies will negate the benefit of our work. CISG, PICC, PECL is based on *favor contractus* principle. *Favor contractus*, reasonableness, good faith, and fair commercial practice principles reduces the cases of when validity of contract is considered and termination, substitute delivery, damages and other remedies might be applied. Thus, analyzing remedial system for the fundamental breach of contract we will take into account these principles.

The peculiarity of CISG is that remedies are distinguished into remedies available to the buyer and remedies available to the seller. All remedies are available for the aggrieved party in the case of a fundamental breach (if it is possible, of course). Under the remedial system of PICC (7.3.1), CISG (49, 64), PECL (9:302), Article 1184 of French Cc, and certain clauses of German law, avoidance of the contract is the most severe remedy (as it can determine the life or death of the contract[153]). Thus other remedies, if available, take precedence in order to save the contract. According to English law termination is possible if breach of conditions or intermediate terms, or terminating clauses occur. Even though avoidance is treated as the harshest remedy, it is not too difficult for the parties to terminate the contract, that is, if the terms of avoidance are well-drafted in the contract. Use of term 'rescission' is controversial under English law. 'Rescission' (of breach) differs for 'rescission' (of frustration), as the first leads to prospective termination and the latter leads to retrospective termination. In our research we will use the term 'rescission' prospectively as a consequence of the breach.

[153] M. Will, in Bianca-Bonell, 'Commentary on the International Sales Law', Giuffrè:Milan, 1987, p. 210.

A. TERMINATION

1. Way of termination: by the court, using *Nachfrist* or by simple notice

According to PECL 9:303, CISG 49, 64, PICC 7.3.2, and English law provisions, it is enough merely notice the non-conforming party of termination. Article 1184 of French Cc requires that *rėsolution be* by judicial pronouncement and that the court must decide whether the non-performance is sufficient to justify ending the contract[154]. This approach is different to PICC, CISG, PECL and English law in which the parties may rescind the contract without the court. According to English law, the expressed will in the contract, determining the term as a condition, which leads to the termination, takes important place. French law has reduces unreasonable termination by providing discretion for the court to review whether the breach is serious enough. This approach is criticized. Such regulation reduces commercial contracts, i.e. the party should wait for court decision in order to hire other contractor[155]. Avoidance of the contract dependence on court discretion deprives from possibility to foreseen the possible decision of the court, thus creates uncertainty and takes long time[156]. However, in French law, clauses allowing automatic termination (clauses *rėsolutoire de plein droit*) are permitted[157] and it is said, that its judicial character is no longer 'as pre-eminent as it used to be'[158]. Express clauses which qualify or even take away its judicial character have always been recognized as valid, an nowadays, case law has recognized that in certain cases unilateral *rėsolution* as valid[159]. However, it is court discretion to review unilateral termination and to decide whether it is well founded. In case *Cass Civ Ire, 28 april 1987 'Faulty alarm system'* court has held: 'a very serious non-performance may justify the creditor in terminating the contract without an action for *rėsolution*'[160]. Thus, in case of fundamental non-performance, the unilateral termination is possible, but still the courts have discretion to review its foundation.

Aside from legal systems which essentially allow termination only by judgment of a court and in which the court determines the prerequisites of termination *(France (auth.))*, two models can be found[161]:

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[154] n. 29, p. 411
[155] n. 6, p. 71
[156] n. 6, p. 70, referring to Treitel 'Termination of Contract', p. 324
[157] n. 29, p. 411
[158] Hugh Beale, Benedicte Fauvarque-Cosson, Jacobien Rutgers, Denis Tallon, Stefan Vogenauer 'Cases, Materials and Text on Contract Law', Hart Publishing, Oxfprd and Portland, Oregon, 2010, p. 916
[159] n. 158, p. 961
[160] *Cass Civ Ire, 28 april 1987 'Faulty alarm system'*
[161] P. Schlechtriem 'The German Act to Modernize the Law of Obligations in the Context of Common principles and structures of the Law of Obligations in Europe' Oxford u Comparative L Forum 2 at ouclf.iuscomp.org, 2002

1) The first model (CISG, PICC and PECL, English law), states that termination is allowed only in case of a fundamental breach. When the seriousness of breach might be uncertain; the termination is possible by setting a *Nachfrist* which makes time of the essence.

2) The second model (German law) is based on a general requirement that the obligee first has to set an additional period of time to allow the obligor a second chance, but that such an additional period of time is considered unnecessary in cases of an obvious fundamental or incurable breach.

These models are based on the use of 'Nachfrist' criterion and on possibility to use termination as the remedy:

1*.

Breach or fundamental breach?	→	*Nachfrist*	→	If party did not perform →Termination
Fundamental Breach	→	Termination		

2*.

Breach	→	*Nachfrist*	→	If party did not perform →Termination
Fundamental Breach	→	Termination		
Incurable breach	→	With regard to impossibility certain clauses are applied	→	Termination

*These schemes concentrate on possibility to choose termination as a remedy. Of course, it does not mean that other remedies are not possible.

The difference between these two models in reality seems not so significant. Obviously, fundamental breach literally expression is essentially equal to concept of 'fundamental breach', 'when seriousness of breach is certain'. Thus, according to German law and CISG, PICC, PECL, English law, immediate termination without additional period settled is applied in the same circumstances. Thus, first and second model with regard to termination when *'Nachrist'* period is not necessary, are similar. The difference is that incurable breach is not regarded as fundamental, as there are different clauses regulating the cases of impossibility, when tender to cure is not possible. The other difference is the use of *'Nachfrist'* period settled. According to German law, to settle *'Nachfrist'* period is a general rule, obligation. According to PICC, CISG and PECL it is not the premature and obligatory step leading to termination. It is used only as an additional possibility for the termination. However, according to both

models, first should be done preliminary verification whether the breach constitutes to fundamental, what leads to immediate termination. Different use of '*Nachfrist*' does not constitute does not constitute essentially different results for termination. French law uses period of grace, which might be treated similar as *'Nachfrist'* for delaying time of termination.

German law uses the *Nachfrist* procedure which may require that the debtor will be given reasonable notice before the contract is terminated, even in cases other than simple delay[162]. In Lithuania the party may avoid the contract unilaterally, through a consensus between the parties or by the court. Thus, Lithuania's model unites both French and English law (Article 6.217 (1)(4)(5) of Lithuanian Cc). Most norms of Lithuania's Civil Code regulating a fundamental breach of contract are based on PICC structure. However, similar results for terminating are reached in most systems, even those which rely strictly on judicial discretion to decide when a contract should be terminated[163].

Although basic notion of termination seems similar, the essential difference is whether the process is seen as retrospective or prospective[164]. Under English law, termination wipes away the contract for the future, but not in the past[165], thus prospective approach is applied. 'Strictly speaking, to say that on acceptance of the renunciation of a contract the contract is rescinded is incorrect. In such a case the injured party may accept the renunciation as a breach going to the root of the whole of the consideration. By that acceptance he is discharged from further performance and may bring an action for damages, but the contract itself is not rescinded[166]'. Besides, in the case use of the term 'rescission' is criticized as controversial. Contrary to English law, French law uses retrospective approach: 'the contract is treated almost as if it has been annulled and there will have to be mutual restitution of benefits'[167]. Where performance takes place over a period of time it may be impractical to restore the benefits received and then the contract may simply be terminated for the future[168]. In the case of recurring obligations under German law termination has generally no retroactive effect because of the difficulties of unwinding recurrent performances, such as, the use of a thing or services. It instead, dissolves the contractual bond only - but immediately - from the time the notice of termination is received by the party in the breach[169]. However, German law recognizes termination in both senses, as

[162] n. 29, p. 416
[163] n. 29, p. 411
[164] Hugh Beale, Benedicte Fauvarque-Cosson, Jacobien Rutgers, Denis Tallon, Stefan Vogenauer 'Cases, Materials and Text on Contract Law', Hart Publishing, Oxfprd and Portland, Oregon, 2010, p. 916
[165] Andrew Burrows 'A Casebook on Contract', Oxford and Portland, Oregon, 2007, p. 306
[166] Heyman v. Darwins Ltd. (1942) A.C. 356, 399
[167] n. 158, p. 916
[168] n, 158, p. 916
[169] n. 168

in French law, if contractual obligations are to be performed over an extended period, a party will in general be permitted to terminate only with effect for the future[170].

It is important to distinguish definitions for 'notice of termination' and an 'additional period settled'(*Nachfrist*). Notice of termination enacts the informative function about termination of the contract. Additional period enacts a precautionary function about future termination if the obligation will not be performed. German law widely uses *Nachfrist* before termination. If *Nachfrist* can not be used, the aggrieved party should be notified promptly about the termination. Contrary to German law, English law allows termination by simple notice without prior warning, according to which, the termination can not be done earlier than before the additional period lapses. PECL 9:303(3)(b) does not have an equivalent to other legal systems. It protects non-performing but willing to perform party's interests, when the aggrieved party knows about the tender, but still enacts termination. It bears some resemblance to doctrine of good faith.

When non-performance is fundamental, PECL (9:301), CISG (45(3)), 65(3)) and PICC 7.3.1 does not provide the party with the additional period of time. According to Article 1184 of French Cc, avoidance is granted by a judgment establishing or altering a legal relationship; the judge may grant the debtor a delay at first according to the circumstances (so called period of grace)[171]. Period of grace has similar function to *'Nachfrist'* procedure. It enables party-in breach to perform a contract by giving so called 'second chance'. CISG 45(3) and 61(3) excludes period of grace, during which the party's remedies are temporarily suspended, and excludes the application of Article 1244(2) of French Cc, which gives the court a right to grant an extension of time for payment in respect of contractual obligation of all kinds, including the obligations to pay damages[172]. Thus, CISG 45(3), 61(3) excludes the conflicts of *lex fori*, if one of contracting parties would be from France or other territories (Quebec, Louisiana, etc.) in which the grace period is allowed. Common law uses relief against forfeiture, which can be compared to a similar approach to the period of French *dèlai de gráce* (f. e. a tenant may be able to obtain relief against forfeiture of a lease by the landlord for non-payment of rent) [173]. Grace period is prolonging application time for certain remedy. We are criticizing such approach as intervening into parties' commercial relationships, producing uncertainty with regard to fulfillment of contractual expectations. In commercial relationships, time is usually of the essence and every delayed day might have rigorous consequences.

[170] n. 158, p. 917
[171] n. 8, p. 530, note 61
[172] n. 8, p. 530
[173] n. 29, p. 411

Most of legal systems do not apply the doctrine of fundamental breach of the contract (as CISG, PICC, PECL, DCFR – *auth*.), but approach it in various ways[174]. English concept of fundamental breach is similar to these acts, as national legislation is the background for conventions. German and French law does not have such a strict concept of the fundamental breach of contract. However, avoidance is available in such systems if a serious breach takes place. Even the fundamental breach doctrine is not implemented, an equivalent of this theory exists in these systems through the avoidance mechanism. In German law the approach that a fundamental breach should always grant the right of termination of the contract is restricted in Article 324 of BGB[175]. By using the condition that obligor 'can no longer reasonably be expected to abide by the contract' instead of the 'fundamental breach' and restricting the termination to cases when protective duties of care are violated[176]. According to Article 314(1) BGB termination is possible without the *Nachfrist* procedure for a 'compelling reason'. Article 314(1) BGB uses the same construction equivalent to the concept of the fundamental breach in that, termination is possible when 'terminating party (…) cannot reasonably be expected to continue the contractual relationship'[177].

When does the termination clause in English law means that the breach must amount to repudiatory? *Rice (t/a Garden Guardian) v. Great Yarmouth Borough Council* (2000)[178] provide three distinct categories for termination:

1) 'Where the parties have agreed that the term either is so important that it will justify termination' (*repudiatory breach – auth.*);
2) 'Where contractors 'simply walk from their obligations thus clearly indicating an intention no longer to be bound' (*Thus rejection is possible even the breach is not repudiatory. – auth.);*
3) 'Where cumulative effect of the breaches which have taken place is sufficiently serious to justify the innocent party in bringing a party in a premature end' (*In this case rejection is based on the breach of repudiatory term. – auth.*).

According to this case analysis, termination not necessarily amount to fundamental in English law. We will analyze the termination as a consequence of fundamental breach of the contract.

[174] n. 3, p. 367
[175] Revocation for breach of a duty under section 241 (2) If the obligor, in the case of a reciprocal contract, breaches a duty under section 241 (2), the obligee may revoke the contract if he can no longer reasonably be expected to uphold the contract. (BGB 324)
[176] n. 168
[177] BGB 314(1)
[178] *Rice (t/a Garden Guardian) v. Great Yarmouth Borough Council* (2000)

'*Nachfris't* procedure in case of fundamental breach, this procedure is not necessary, but it may revert a non-fundamental breach into a fundamental one if after the expiration of a settled additional period of time, the obligor does not perform. 'Reverting' non-fundamental breach to fundamental to our opinion is more artificial element. It is not based on fundamental breach of the contract doctrine and it does not include prerequisites of fundamental breach (substantial deprivation, strict compliance, etc.). However, the mere fact that under additional period party in breach still did not performed, could lead to fundamental breach. It might be held, that good faith principle to perform is breached by the party when additional possibility is provided. Thus, intentionality not to perform might be admitted. Minor breaches are excluded from such possibility. Of course, in some systems (CISG), the intentionality criterion is not important. The *Nachfrist* period is beneficial as it reduces the cases of unreasonable avoidance, i. e. when there is ground for termination, but there is a possibility to cure. The *Nachfrist* procedure gives for the party in the breach a second chance and checks the intentionality criterion (whether the other party is willing to perform or not). Grace period in French law has a similar function as '*Nachfrist'*. It reduces unreasonable avoidance. However, grace period is regarded as intervention to the parties' contractual relationships as it creates uncertainty about judicial decision. Moreover, business transactions are usually a part of string, thus time is of the essence and delay for court procedures may cause big losses. Use of '*Nachfrist*' procedure in German and other systems (PICC, CISG, PECL), inflicts the same consequences: first verification whether the breach is fundamental should be done. Secondly, in case breach does not constitute fundamental, '*Nachfrist'* period is settled and after expire of it, termination is possible. In our opinion, granting the right of termination exclusively to the court diminishes the party's' freedom to express certain provisions in the contract. It also reduces certainty that in the breach of certain clause, the contract might be terminated.

2. Specific case scenarios

2.1. Delay in performance

Review of separate cases of non-performance reveals the relevant factors for determining non-performance as fundamental in international instruments (CISG, PICC, PECL) as well as at the national level (German, English, French law).

Mere failure to observe the delivery date, with delivery as such still being possible, is not generally to be regarded as a fundamental breach of contract under CISG[179], PICC[180], PECL. Delay amounts to fundamental non-performance if 'substantial deprivation' or 'strict compliance criterion'

[179] n. 9, p. 576
[180] n. 15, p. 831

exits according to which 'time is of the essence' (under PICC Article 7.3.1(2)(a) in particular, also under Article 7.3.1(2)(b)). The length of time can be held to be of the essence if it is expressly stated in the contract or it is clear from the commercial background. In English law if the contractual term is a 'condition', non-performance constitutes fundamental and termination is possible. *Bunge Corporation New York v. Tradax Export SA* case (1981) gives a list of factors important in determining whether or not the term is a condition:

1) In order to amount to a condition, the breach must not be such as to deprive the innocent party of substantially the whole benefit which it was intended that he should receive from the contract. (This is the most important statement of the case.)
2) Necessity of certainty, especially when today's buyer may be tomorrow's seller.
3) Usually the businessmen has many ongoing contracts simultaneously, thus the proper performance of legal duties and certainty are eligible.
4) It is very difficult to evaluate damages.
5) The experience of the businessman.

Thus, when the time clause in the contract has above mentioned features (first criterion is used in conjunction with any other criterion), the clause is a condition. It means that the time is regarded as of the essence.

Ewan McKendrick claims that *Bunge* stands as authority for the proposition that a clause should be classified as a condition where this is required by the demands of commerce but that otherwise a term should be classified as intermediate[181]. In our opinion, *Bunge* case accentuates demands of commerce (contrary to the English law position, in which the motivation to terminate a contract is not essential factor), just because of a specific issue of the case in that it is a breach of time stipulation. According to English law, terms settling time should be strictly complied with.

Examples when the time is held to be of the essence of the contract:

1) Sale of commodities[182];
2) In documentary credit transactions when the documents tendered must conform strictly to the terms of the letter of credit[183];
3) Usually under trade terms 'CIF' ('INCOTERMS') or 'FOB' ('INCOTERMS') with respect of delivery related obligations[184];
4) 'Just in time' delivery agreed;

[181] n. 64, p. 805
[182] n. 82, p. 222
[183] n. 82, p. 222
[184] Bunge Corp. v. Tradax S.A.(1981) http://www.bailii.org/uk/cases/UKHL/1981/11.html

5) According to the nature of the goods (i.e. perishable goods);

6) Relevant seasonal goods;

7) The time within which the ship must be nominated or is expected ready to load under a charter party[185];

8) The time when contractor is to be paid under a time charter.

Therefore, commercial nature of the contract may initially determine whether the time is of the essence. Of course, certain commercial background may change it. Contrary to English law, where the breach of 'time stipulation, no matter how small, entitles the innocent party to bring the contract to an end[186]', under PICC regulation, it cannot be presumed that 'time is of the essence in everyday commercial contract[187]'. In the *Bunge* case, the parties did not expressly classify the term as a 'condition'. 'But English law has generally taken a strict approach to time stipulation in commercial contracts (with the exception of the time of payment)[188]' Thus according to PICC the presumption should be that the delay does not amount fundamental non-performance if it is not stipulated in the contract or is clear from commercial background that time is of the essence for contract. Sale of machinery or contracts for building or site construction does not make time of the essence of the contract, but 'a delay may become fundamental after the expiry of a certain time,' 'due to the extent to its duration'[189]. CISG and PECL holds the same position as PECL.

Even if it is not clearly stated in a contract, the court may admit a breach as a repudiatory because of certain factors proving the seriousness of the breach. The question is whether the term is an 'intermediate term', 'warranty,' or a 'condition' reveals what remedies are available to the aggrieved party. In the case of *Maredelanto Compania Naviera SA v. Bergbau-Handel GmbH (The Mihalis Angelos) (1971)*[190] the charter party was to transport the cargo of apatite from Vietnam to Europe, but there was no apatite ore available in Vietnam. Because there was a war in Vietnam, the charter party explained the lack of apatite was a consequence of the war and terminated a contract on the grounds of forced majeure. In the contract, Clause 1 stipulated that the vessel 'was expected ready to loan under this charter about 1 July 1965'. However, in reality the vessel was expected to arrive for loading between 13 and 14 of July, as it was on the other voyage. The other party claimed that it was a

[185] *Maredelanto Compania Naviera SA v. Bergbau-Handel GmbH (The Mihalis Angelos) (1971)* http://www.bailii.org/ew/cases/EWCA/Civ/1970/4.html
[186] n. 64, p. 836
[187] n. 15, p. 833
[188] n. 64, p. 805
[189] n. 15, p. 833
[190] n. 29

repudiation of the contract with regard clause 1. The Court of Appeals held that Clause 1 was a condition and a ground for the charterers to terminate the contract. The grounds for termination were:

1) 'Certainty of the law'. 'Where justice does not require greater flexibility, there is everything to be said for, and nothing against, a degree of rigidity in legal principle'. (Different position to French law, where judiciary character of termination creates uncertainty of law.)

2) 'It would (…) only be in the rarest case, if ever, that a shipowner could legitimately feel that he had suffered an injustice by reason of the law having given to a charterer the right to put an end to the contract because of the breach of shipowner of clause such as this'.

3)' (…) where a clause 'expected ready to load' is included in a contract for the sales of goods to be carried by sea, that clause is a condition, in the sense that any breach of it enables the buyer to reject goods without having to show that the dishonest or unreasonable expectation of the seller has in fact been prejudicial to the buyer.'

This decision might be a good precedent for French courts, which have wide discretion for termination. Following the principle that certainty of law should prevail, the contractual clauses and commercial background must be thoroughly analyzed by the court. Thus, parties' legitimate expectations and interests of concluding the contract would be taken into account and the decision would me more predictable.

a) Termination after expiry of an additional period of time for performance

In English law time requirement should be very strictly complied with, especially when it is expressly stated that time is of the essence (in 'conditions'). Furthermore, when the essence of the commercial contract is related with exact performance in certain time, even without conditional clause the courts have right to admit that time is of essence. Delay is a breach of certainty of law principle, as time might be crucial for parties. In English case law, time is regarded of the essence without requirement of substantial deprivation. Strict compliance criterion is used. This approach reveals that in English law time is usually presumed as of the essence. It differs under PICC, CISG and PECL regulations. According these regulations, thorough fundamental breach analysis should be made. The seriousness of the breach criterion (i. e. when time is of the essence, other factors) reduces unreasonable rejections of the contract for the breach of the delay. The *Nachfrist* mechanism (PICC 7.3.1(3), CISG 49(1)(b), PECL 8:106) have the same function. The roots of the *Nachfrist* mechanism lie in German law. According to English law tradition, the aggrieved party sometimes may be able to 'make time of the essence' once the date for performance has passed by serving on the non-performing

party a notice to perform within a reasonable time; if the non-performance continues the aggrieved party may terminate at the end of the period[191].

German law requires additional period of time granted before the termination is available. There are exceptions to this criterion under BGB in certain cases of a serious breach (i. e Article 323 of BGB)[192]. Sometimes, however, even a notice of termination is dispensable because the contract is terminated automatically[193]. Article 326 of BGB relates to cases of impossibility, PECL 9:303(4) refers to the situation where a party is excused under PECL 8:108 in view of an impediment which is total and permanent, but PICC does not have rule comparable to PECL 9:304(4). In our opinion, difference between immediate termination and termination by notice is not so important, thus we will not go into further analysis to this issue.

The German *Nachfrist* procedure applies to all kinds of delay in performance except in cases of impossibility, *Fixgeschäft* or where the non-performing party has repudiated, or positive *Vertragsverletzung*[194]. This procedure was a background for PECL 8:106, PICC 7.3.1(3) and CISG (49). This provision requires in general, an additional period of time to be set by the obligee before the contract can be terminated. However, subsection (2) dispenses from this requirement if the obligor refuses to perform, and if time was of the essence or in other "special circumstances", which, having due regard to the parties' interests, justify immediate termination. The *Nachfrist* procedure is used for termination only if a delay in performance occurred. In respect with other breaches (i. e. defective performance, etc.), it is possible to settle on an additional period. This might be very useful in certain cases for further cooperation between the parties, but termination is not possible after the extra time expires. However, it does not apply in cases of defective performance[195], given notice is termination is clear.

According to PICC, 7.3.1(3) in the case of delay, the aggrieved party may automatically terminate the contract after the time allowed to in PICC 7.1.5 has expired, even the delay does not constitute fundamental non-performance. With regard to other breaches, the *Nachfrist* period leads to termination only for fundamental non-performance (PICC 7.3.1(1) and 7.3.1(2)). Therefore, if the notice period is settled in the case of non-conformity, or breach in documentary sales, the contract might be avoided only if the breach is determined to be fundamental. The aggrieved party is free to choose whether to use the *Nachfrist* procedure. With regard to delay, the *Nachfrist* procedure is a

[191] n. 29, p. 377
[192] Reinhard Zimmermann 'The New German Law of Obligations. Historical and Comparative Perspectives', Oxford University Press, 2005, p. 74
[193] n. 196, p. 73
[194] n. 29, p. 377
[195] n.196, p. 74

possibility to terminate non-fundamental performance. We assume that, similar to English law, time clauses are usually of the essence under PICC. On the other hand, additional period helps to prevent termination when it is possible to implement other remedies for the sake of the continuation of a contractual relationship. Why breach other than delay after additional period lapses, does not constitute fundamental breach? In case of delay, additional period time settled provides party with possibility to perform. Furthermore, it helps to find out whether the party is willing to perform, or acts intentionally and non-perform. With regard to other breaches, the reason of non-performance is not just delay (i.e. defective performance). Thus, providing party with an additional time does not excludes the reason of non-performance. Thus it cannot create actual possibility to perform, so called 'second chance'.

English law does not use additional period of time to such extent as German law. House of Lords in *Bunge Corp. v. Tradax SA (1981)* and *United Scientific Holdings Ltd. V. Burnley Borough Council (1978)* cases admitted that the time may be of the essence where 'a party who has been subjected to unreasonable delay gives notice to the 'party in default making time of the essence'[196]. This precedent resembles the previously discussed international view. However, it is not as strict an approach as in German law. The mere fact of additional period fixed is not enough, the nature or the subject matter of the contract, or the circumstances of the case should require explicit compliance. The avoidance after additional period of time, when the breach is not fundamental, is not dealt with in the French law system, which use grace period for delay. Grace period, discussed above may have the same consequences. In German law, an additional period must be extended before expiration, in order to require performance in nature. In English law, it is possible simply to refresh the additional period.

The aim of Nachfrist (additional time fixed) under CISG, PECL, PICC, and German law is similar: the procedure is used if major obligation was breached. In the case of a breached minor obligation, the aggrieved party can only avail himself of this procedure if the breach of the obligation imperils the purpose of the whole transaction[197]. Thus there are limitations on the *Nachfrist* procedure. According to PICC 7.1.5(4) if the obligation which has been performed is only a minor part of the entire contractual obligation, the *Nachfrist* procedure is excluded. Practically, it might be difficult to delineate whether the obligation is a minor part, or whether it is crucial. However, even if the obligation that is only a minor part of the entire contractual obligation, in certain instances, it might be important to fulfill. PICC 7.1.5(4) raises the question of whether an obligation which is not of the essence of the contract is automatically held as a minor part of the entire obligation. What constitutes a

[196] *Bunge Corp. v. Tradax SA (1981)* and *United Scientific Holdings Ltd. V. Burnley Borough Council (1978)* cases
[197] n. 29, p. 377

'minor part of the entire obligation'? If in case of delay the *Nachfrist* can be used to terminate the breaches which are not fundamental, as the time is of essence of the contract. This statement is contrary to PICC 7.1.5(4) which excludes the *Nachfrist* procedure when the obligation is a minor part of the entire contractual obligation. But the breach is non-fundamental, if the obligation is not the essence of the contract thus the breach does not substantially deprive the party of what she was entitled to expect; if obligation should not be treated in strict compliance according to commercial background of the contract or explicit contract, or legal regulation of Parliament/ court precedents (what comes from the concept of 'condition' in English law); or there is no fault of non-performing party and loss of future reliance is not possible. Consequently, the obligation is not of the essence, thus, it constitutes a minor part of the entire contractual obligation (which might be held as essential).

The *Nachfrist* period is not necessary for termination due to a fundamental breach under PICC, PECL, and CISG, as well as under a serious breach in German law. The *Nachfrist* period could be grounds for non-fundamental breach to become fundamental, when the breach is uncertain and the additional time given expires without the performance of the obligor. The length time is 'of the essence' according to contractual term ('conditions' in English law) or contract express stipulation ('just in time') as well as implicit contractual terms (nature of the goods, certain type of the contract, etc.). The *Nachfrist* procedure is an option for the aggrieved party, even if it is more strictly used in German law.

b) Badly drafted contract: immediate termination v. termination after the expiry of notice period

Immediate avoidance of the contract is more favorable for the aggrieved party. However, the breach might be so serious, that only immediate termination is appropriate for the parties. This depends on the contractual expectations (commercial background, expressed contractual clauses) and whether the breach is held to be serious enough for immediate termination. Giving a notice period is 'a common form of clause found in commercial contracts as it strikes a balance between the competing interests of the parties by giving the defaulting party an opportunity to make good his breach, but at the same time it protects the position of the innocent party by giving him an express right to terminate the contract in the event that the breach is not made good'[198]. As the commercial background differs, the notice period is not always a beneficial and just remedy for both parties. As already discussed, the seriousness of the term breached (i. e. whether the term is fundamental or not) might be settled by the parties, by the

[198] n. 64, p. 783

Parliament, or admitted by the courts (it depends also on national legislation). At the international level, CISG, PICC, PECL are provide the guidelines for what might be constitute fundamental breach of the contract.

Every breach of contract is grounds for commercial uncertainty and social conflict[199]. In English law the parties may express in the contract whether the term is a 'condition'. Consequently, the breach of such a term leads to the rescission of the contract. The problem is when the contract is badly drafted, i. e. there are controversial clauses with regard to termination of the contract. In the of case *L. Schuler AG v. Wickman Machine Tool Sales Ltd (1974)*[200]the contract between the parties was badly drafted. Clause 7(b) conferred to Schuler's immediate right to terminate contract, while Clause 11 required Schuler to give notice to Wickman and then gave Wickman a period of time in which to remedy the breach[201]. The House of Lords held, that the Schuler was 'exposed to a claim for damages by Wickman because they were held to have wrongfully terminated the contract between the parties'[202]. Thus, the party terminating the contract without the right to rescind is liable in damages for the losses suffered by the other party for the wrongful termination, as a decision to termination 'carries with it a risk[203]'. This is reasonable, because termination of the contract is used as *ultima ratio* remedy and it can not be abused. The aggrieved party may resort the other remedy, i. e. claiming the loss suffered. In the previously mentioned case, it is unlikely, that the claim for loss suffered would be satisfied, 'because of the probable difficulty in proving'[204].

The law of contracts should employ precautionary function which should written with such conditions as to reduce amount of breaches[205]. This is possible only if the clauses, regulating civil liability are well drafted, when the norms enhance cooperation, give right to withhold performance of the contract, etc.[206] The word 'condition' or the expression 'of the essence' in a well drafted contract should generally suffice to demonstrate what is intended and that a breach of this clause should give rise to the right to terminate[207]. Well drafted contract in case of breach creates certainty for remedies applied.

[199] n. 152, p. 508
[200] L. Schuler AG v. Wickman Machine Tool Sales Ltd (1974)
[201] n. 64, p. 783
[202] n. 64, p. 784
[203] n. 64, p. 796
[204] n. 64, p. 784
[205] n. 152, p. 508
[206] n. 152, p. 508
[207] n. 64, p.784

2.2. Definite non-performance

We distinguish definite non-performance as a separate group of specific cases according to Huber's classification[208]. Definite non-performance means that the grounds for non-performance are clear and obvious. Usually when the prerequisite of 'substantial deprivation' (PICC 7.3.1(2)(a), CISG 25, PECL 9:301) exists, the non-performance amounts to be fundamental. Definite non-performance occurs due to the following reasons:

1) Performance has become impossible (PICC Article 7.2.2(a), PECL 9:301) or the non-performing party is no longer bound to perform under the unreasonability exception (PICC Article 7.2.2(b)). CISG 79(1) conjuncts impediment requirement and unreasonability criterion. Such impossibility may exist either objectively or subjectively and before or after the delivery date[209].

Thus if under PICC 7.2.2(a)(b) or CISG 79(1), the performance as a remedy is not available, termination as a harshest remedy takes place in order to protect the aggrieved party's interests. In such way remedial system operates: from less severe remedy to the stricter, leading to the death of the contract. Performance primarily seeking to save the contract must be in accordance with pacta sunt servanda principle. Whether the non-performance was excused or not, PECL (9:302) uses the same rules for termination and the aggrieved party may give notice of avoidance of the contract[210]. PICC (7.3.1) and CISG (79), use a similar rule to take a analogous approach. It is in contrast to other systems, in which in case of termination of a contract which has become impossible, is treated separately from the case of termination because of a breach of the contract[211]. Conversely to these regulations, in French law, in cases of impossibility, the contract will be determined according to the theory of risks (Cc 1302). In German law, a separate paragraph of Article 323 of BGB, applies to impossibility due to circumstances for which neither party is responsible. In common law, the doctrine of frustration will apply[212]. Using different clauses for impossibility to perform and for termination because of breach, shows that breach occurred because of the impossibility is not held as breach. Thus, different clauses for excused and non-excused termination might emphasizes different nature of non-performance. Roots for the breach are taking into account.

2) The Non-performing party earnestly declares that it will definitely refuse performance. (*In such cases, 'substantial deprivation' criterion is breached. I.e. in the load of one specific ship, the seller informs the buyer that he or she has sold and delivered the item to a third*

[208] n. 15, p. 831-837
[209] n. 8, p. 577
[210] n. 29, p. 411
[211] n. 29, p. 411
[212] n. 29, p. 411

party[213]*.)*. Such a refusal to perform may exist if a seller wrongly pleads a right to refuse performance, invalidity of the contract, the existence of force majeure, or if he attempts to enforce an unjustified price increase[214].

In our research, we do not analyze the availability of tender to cure. Declaration on on-performance enables party quicker to rebuilt beneficial situation and to solve the problem which occurred for non-performance.

2.3. Non-conforming performance

Non-conforming performance raises 'the most difficult issues with respect to the fundamental breach doctrine[215]'. 'Substantial deprivation' (PICC 7.3.1(2)(a)) and 'strict compliance' (PICC 7.3.1(2)(b)) factors are taken into account for determining whether non-conformity constitutes fundamental non-performance. As previously discussed, the expressed will of the parties, commercial background of the contract, and the seriousness of the breach factor all play a role in determining non-performance. The CISG holds the same position. 'If the defect in the item is only of subordinate significance, the buyer also cannot acquire the right to avoid the contract by fixing an additional period of time for the seller to remedy it[216]'. According to CISG, the importance of the parties' autonomy (CISG 35(1)) is taken into account for determining the amount of non-conformity. While implied agreements under CISG 35(2)(b), in particular features are required to meet the 'fitness for a particular purpose' test, may also influence the weight of non-conformity[217]. In German judicature, the underlying policy is to prevent the winding of the contract or the delivery of substitute goods, which would cause additional losses and – in international trade – additional risks for the goods, which would have to be stored and transported back to the seller[218]. CISG holds the same position.

With regard to non-conformity, Schletriem's analysis of CISG is more focuses less on 'substantial deprivation criterion', but focuses more on the reasonable use criterion and on any possible use criterion. 'As long as the goods are not totally useless, the buyer should be restricted to claims for damages and the right to price reduction[219]'. In our opinion, such an approach is too strict and limits the freedom for parties to agree on which terms are essential for them. This approach also losses its sense of certainty, diminishing the contractual relationship. Furthermore, we oppose to the opinion that

[213] n. 15, p. 833
[214] n. 8, p.577
[215] n. 15, p. 834
[216] n. 8, p. 576
[217] n. 8, p. 296
[218] n. 8, p.296
[219] n. 8, p.294

even if the goods can be resold in a giveaway price, no avoidance (or claim for substitute goods) should be allowed[220]. In such approach, termination is restricted, but the aggrieved party suffers unreasonable inconvenience. However, even if termination should be limited for the sake of contractual relationships continuation, the aggrieved party should not suffer additional inconvenience for the non-performing party's fault. Where safety regulations are breached, if the non-conformity may cause the destruction of the goods, when several non-conformities could be cumulative and constitute fundamental breach, the avoidance or substitution of goods is possible[221].

The reasonable use test is widely used to evaluate non-conforming performance. 'The non-performance is not treated as fundamental if the aggrieved party can make some reasonable use of the performance despite the non-conformity[222]'. If the performance might be reasonably used, the non-performing party may be entitled to pay damages for financial loss, instead of avoiding the contract. (F. e. the non-performing party may resell the goods). Reasonable use is not possible, if it is clear from the contract or commercial background of the contract that 'time and quality were of the essence of the contract, (thus) the non-performing is fundamental from the outset[223]'. It would be unreasonable to use non-conforming goods if, through using them, party risks loosing the good reputation of its brand. In other words, if the aggrieved party is the owner of a well-known trademark, it would be unreasonable to claim from the party, lower quality goods than usual. A good's quality is important if the goods are to be used as raw materials for production. In latter case, even if the aggrieved party is not the owner of a well-known trademark, lower quality goods are usually not acceptable and therefore constitutes fundamental non-performance. The delivering of *aliud* (as it is regarded as non-conformity, not delay in performance) does not necessarily constitute a fundamental breach[224]. Reasonable use is always case-specific. i. e if the party is the owner of well-known trademark, even resell in giveaway price might cause damage causing damage for reputation.

If the performance was required for operative use in the production process (i. e. purchase of a production machine, etc.), the non-performance usually is considered fundamental because machine will not work properly. If the non-conforming performance is done due to the service contracts, the same criterions (substantial deprivation and strict compliance) are applied. In Arthur Andersen's arbitration[225], non-performance in efforts to coordinate the member firms' practices, substantially

[220] n. 8, p. 296
[221] n.8, p. 296
[222] n. 15, p. 834
[223] n. 15, p. 834
[224] n. 8, p. 296
[225] Andersen Consulting Business Unit Member Firms v. Arthur Andersen Business Unit Member Firms and Andersen Worldwide Societe Coopeative ICC case no 9797, Arbitral Award 28 July 2000 (Geneva)

deprived the aggrieved party of the cooperative benefit they reasonably expected under the contract. Moreover, strict compliance to coordinate was of the essence of the inter-firm agreements and was necessary to achieve the cooperative goals of the Preamble[226]. The factor of loss-of reliance and that the non-performing party will not suffer the disproportionate loss if the contract was terminated, were also admitted by the arbitral award. However, Huber criticizes the last argument as 'it is not easy to see why the 'instrumentality' argument as such, should lead to the conclusion that the respondent might not suffer loss if its preparation were frustrated'[227].

In our opinion, utilization of non-conforming goods should not be excluded from the concept of a fundamental breach of contract. For example, when red wine contained too much sugar, but could be resold to manufacturer of vinegar, the breach was still regarded as fundamental[228]. (Schletriem holds the opposite opinion with regard to the latter case[229].) Even if it was possible to utilize it, but it is too far from the essence of the contract, thus it should lie only on the aggrieved party's good will. Otherwise, reasonable use is interpreted too wide and the fundamental breach looses its sense. Parties are concluding contract for specific purposes. Therefore, even it is possible to use goods for the other reason (such as simply utilize them), still the essence of the contract is not fulfilled. As we already analyzed in first part of the research, reasonable use is not possible, if the breach is regarded as fundamental (or the opposite).

Thus, non-conforming performance requires a thorough analysis of commercial background and expressed contractual clauses. It is important to evaluate how important the conformity of performance is to the aggrieved party's business for both latter transactions (if this transaction is a part of string transactions, it also should be taken into account) and for the brand's and reputation. In the arbitration case, the breach was fundamental because the central obligation was breached, which was essential for the proper fulfillment of parties' expectations. Therefore, whether the duty is major or ancillary should be also evaluated. The most important criteria are those of 'substantial deprivation' and 'strict compliance,' but as cases show, other criterions ('loss of reliance ', 'disproportionate losses) should also be taken into account. The possibility to remedy could change this classification as well. Some interpreters on CISG appeal to case law; 'even a grave defect is not a fundamental breach, if the seller is willing to deliver substitute goods without causing unreasonable inconvenience for the buyer[230]'. Probably, exclusion of unreasonable inconvenience means possibility of reasonable use. Reasonable

[226] n. 15, p. 835-836
[227] n. 15, p. 836
[228] Civ 1, 23 January 1996, CISG-online 159, JCP 1996, II 2234 – cisg 297
[229] n. 8, p. 294
[230] OLG Köln, 14 October 2002, CISG-online 709

use is applicable, when it dos not cause unreasonable inconvenience. According to this interpretation, there should be no fundamental breach if the seller can (and will) solve the problem without delay, which as a delay in delivery in itself would constitute fundamental breach, and if a cure as such would not cause the buyer unreasonable inconvenience[231]. However, a controversial opinion is that 'possibility of cure in itself does not exclude a fundamental breach[232]'. In our opinion, the possibility to cure does not exclude itself from the fact of fundamental breach of contract. Even if, for the sake of contractual relationship continuation, using this approach would be beneficial. In our opinion, aggrieved party has right to choose whether he accepts tender as a resolution in fundamental breach of contract cases. Tender to cure might exclude a fundamental breach, when the aggrieved party is willing to accept the tender. This approach is based on the distinction between a fundamental and non-fundamental breach: even if in case of fundamental breach the party in breach may choose the right to cure, the difference between the fundamental and non-fundamental breach ends. Usually non-conformity leads to termination when the breach is fundamental. If there is possibility of reasonable use, the breach is regarded as fundamental and the aggrieved party may accept or reject the tender to cure. But it did not revert fundamental breach to non-fundamental. If the party suffers substantial deprivation, but theoretically, reasonable use is possible, could we claim that the breach is not fundamental? To our opinion, it would be unfair if reasonable use of the non-conforming goods would be possibility to escape from contractual obligations, which are the essence of the contract. In such situation, wide application of reasonable use diminishes the meaning of fundamental breach doctrine.

2.4. Defective documents

Under CISG, the delivery of non-conforming documents only amounts fundamental breach if the buyer cannot reasonably be expected to obtain conforming documents itself[233]. Breaches of documentary-sales transactions should be treated as breaches relating to the goods[234]. Usually a fundamental breach would occur if: documents should entitle buyer to dispose goods; proper documents are needed for the agreed payment mechanism (i.e. letter of the credit, etc.); or the buyer is in the business of reselling the goods under such payment terms. Logically, if a document conforms to the contract and shows that the goods are not in conformity, the question of whether or not avoidance of the contract is justified is based upon the deviation in the nature of goods[235]. However, the buyer's

[231] n.8, p. 296
[232] n. 8, p. 577
[233] n. 15, p. 836 according to BGH 3 April, 1966 (VIII ZR 51/96), CISG online 135 (?)
[234] n .15, p. 836
[235] n. 8, p. 579

expectation should be taken into account, as certain documents might not be necessary. Thus, it is important for the objective necessity of documents in each situation.

2.5. Breach of ancillary obligation

The fundamental breach of contract usually deals with the central (main) obligation of the contract. Ancillary obligations are not the essence of the contract, but in certain cases their violation may constitute a fundamental breach of the contract. These might be duties to instruct the buyer, to provide additional services, or to respect exclusive distribution agreements.[236] The duties which are not related to the non-conformity should be treated in a more restrictive manner and only be regarded as fundamental if the entire circumstances are such that it would be unacceptable for the aggrieved party to continue its commercial relationships with the non-performing party[237].

2.6. Termination for partial non-performance

Most systems admit that the party may refuse its partial performance or refuse to accept its future performance, but the party may be entitled to refuse future performance when partial non-performance affects the whole contract[238]. This is provided in Sale of Goods Act 1979 s.31(2). German law does not recognize a single principle but reaches similar results. Termination is possible when the aggrieved party's interest in performing has fallen away[239]. In France, the courts may partially terminate the contract. In French law, non-performance of the contract includes, the impossibility to perform, partial non-performance, and delayed performance[240].

Analyzing CISG 73, concepts such as partial fundamental breach or fundamental breach for future non-performance arise. The contract may be terminated partially because of a fundamental breach in partial obligation or the party may declare avoidance for future installments of performance if they clearly know that it would constitute to fundamental breach. Systematical interpretation of CISG reveals that if the partial non-performance is of such importance as to amount to the fundamental breach of entire contract, article CISG 49, or 64 is applied for termination of entire contract. However, with regard to application of CISG 64, it is not so common that partial non-payment would constitute fundamental breach for the entire contract. PECL 9:302 is similar to CISG regulation. PICC takes a slightly different approach, focusing more on future partial performance. Unlike German law, CISG, or

[236] n. 15, p. 837
[237] n.15 p. 837
[238] n. 29, p. 413
[239] n. 29, p. 413
[240] n. 6, p. 69

PECL, the PICC does not provide a rule which treats partial performance as a case of non-conformity[241].

Thus, the rejection of the whole performance, not partial performance, is possible when the breach is fundamental. According to PICC 6.1.3, the aggrieved party may reject the partial performance and according to PICC 7.3.1(1) and PICC 7.3.1(2) may terminate entire contract if it proves that 'the partial non-performance amounts to a fundamental breach of the contract as a whole[242]'. PICC does not provide specific provisions for a partial termination, in relation to installment and long-term contracts. It is necessary to apply PICC 7.3.1 with a limited focus, in other words, by only looking only at the missing parts[243]. Termination is then available if the aggrieved party was to receive the missing part later time (this amounts to fundamental breach with regard to that missing part (PICC 7.3.1(1) and (2)) and time was of the essence or if the aggrieved party has fixed an additional period of time for performance under PICC 7.3.1(3) and PICC 7.1.5[244].

3. Anticipatory fundamental breach

The doctrine of the anticipatory breach or repudiation is derived from English law[245]. The basic requirement for an anticipatory breach is an intention not to perform[246]. Remedies for an anticipatory breach depend on its nature[247]. Anticipatory breachs are regulated under international conventions and domestic legal regulations. The PICC 7.3.3 provision deals with contract termination, when prior to the date of expected performance, there is very high probability there will be a fundamental breach. It is almost identical to PECL 9:304, CISG 72(2), and similar to the German Cc Article 323. PICC 7.3.4, determining that the termination of the contract is when required adequate assurance of due performance is not provided and the party reasonably believes that fundamental performance will happen. It is also similar to PECL 8:105, and to CISG 71-72. Other legal systems (Article 1613 French Cc, Article 321 German Cc), focus on whether or not there has been serious deterioration in the other party's financial situation which endangers the party's future performance[248]. An anticipatory breach relates to the 'cases where before the date for performance there are reasons to believe that there will be

[241] n. 25, p. 839
[242] n.. 25, p.839
[243] n. 15, p. 839
[244] n. 15, p. 839
[245] n. 130, p. 288
[246] *Decro-Wall International SA v. Practitioners Marketing Ltd (1971*
[247] n. 64, p.
[248] n. 15, p. 849

a non-performance from the other party[249]'. Even though the German BGB does not express this provision, there is unanimity with in the BGB that an unambiguous and definite refusal to perform is a non-performance, which is analagous to Articles 280, 286, 325, 326 of BGB.

3.1. Assurance due to performance

Adequate assurance is regulated by PICC 7.3.4, PECL 8.105 and has similarities with CISG 71-72 (72(2)). Adequate assurance is demanded of due performance and should provide reasonable security for future performances. The termination of the contract is not possible, if the aggrieved party demands specific adequate assurance, which is held to be irreasonable in certain circumstances, especially when the other party is willing to afford another type of adequate assurance. Thus, assurance due to performance, should not become a reason to unfairly burden the other party through abusing such a right. Thus, termination hinders an easily attainable remedy.

3.2. Right to withhold own performance due to future non-performance

Right to withhold own performance is implemented by PICC 7.3.4(1), PECL 8:105. PECL emphasizes that withhold of own performance may continue 'as long as such reasonable belief continues'. However the literally expression 'meanwhile' practically is the same, as exact duration can not be precisely described. 'Meanwhile' to our opinion continues while there is reasonable ground to believe that fundamental non-performance will be. As Huber states, there is no substantial difference between these provisions as the usual way of overcoming such belief is to provide adequate assurance[250]. If the future non-performance is related to the part of the performance, usually the entire performance of the aggrieved party may be withhold. Because it is difficult to separate the part of the performance and requirement of fundamental breach covers entire contract, not part of it.

3. 3.Termination

If the anticipatory breach is a repudiatory breach of contract, then the innocent party can terminate the contract and seek damages to compensate for loss of his bargain[251]. Most anticipatory breaches are repudiatory breaches because they take the form of a clear and unequivocal declaration stating that performance will not be forthcoming[252].

Conditions for termination include instances when:

[249] n. 15, p. 845
[250] n. 15, p 852
[251] n. 64, p. 820
[252] n. 64, p. 820

1) When a party which reasonably believes that there will be a fundamental non-performance by the other party may demand adequate assurance of due performance and may meanwhile withhold thier own performance. If the other party will not provide the adequate assurance within a reasonable time, the demanding party may terminate the contract (PICC 7.3.4). A reasonable time length should be calculated in such a way as to enable the other party to organize and obtain the necessary components for adequate assurance[253].

2) When prior to the date for performance by one of the parties, it is clear that there will be a fundamental non-performance by that party, the other party may terminate the contract (PICC 7.3.3.).

The difference between these articles is the evaluation of probability of fundamental breach in the future. In PICC 7.3.4 the probability criterion is not very high and it is sufficient for the aggrieved party to 'reasonably believe' that a fundamental breach is imminent. There may a possibility that the other party will or can still perform, but the aggreiving party has reason to believe that the other will be unable or unwilling to perform[254]. Their reason should meet objective reasonability criterion[255]. In PICC 7.3.3 the expectation of fundamental non-performance is equated to the fundamental non-performance which occurres at the time when the performance is due[256].

Termination in both provisions is applied 'prior to the date for performance'. It has been suggested that the aggrieved party's readiness and willingness to perform its own obligations should be considered as an implicit requirement for the right to terminate the contract under PICC 7.3.3 (as is arguably case in common law jurisdictions)[257]. It is not clear from literal expression of the provision, thus it might be considered as a useful guideline drawn by legal scholars. But, under PICC 'the fairness preventing parties from escaping from a contract which becomes undesirable, may to certain extent, be expected[258]'. In this instance, both parties are unwilling or ready to perform, therefore, the right to terminate under PICC 7.3.3 belongs to the party which announces this fact later[259]. Because the termination is focused on future non-performance, the party which later expresses the wish to terminate the contract is enabled to do so. However, is seems the fact which party is entitled to terminate if both are unwilling to perform does not create additional benefit to one of the party. In instances when the

[253] n. 15, p. 853
[254] n. 82, p. 226
[255] n. 15, p. 850
[256] n. 82, p. 225
[257] n. 15, p. 846 according to D. Saidov 'Anticipatory Non-Performance and Underlying Values of the UNIDROIT Principles' (2006) 795, 808-810
[258] n. 15, p. 847
[259] n. 15, p. 847

party claiming damages was itself, not ready or willing to perform, this fact is taken into consideration when calculating the quantity of the damages[260].

In the cased of *Decro-Wall International SA v. Practitioners Marketing Ltd (1971)*, the Court of Appeal was solving the question of 'whether (…) past failures to pay on the due date, coupled with the likelihood of similar failures, constituted a repudiation of the contract'[261], which are grounds for termination of the contract. It is possible to accumulate several breaches, and, if their seriousness amounts to repudiatory breach, the contract may be terminated. In this case, the court held that 'the breaches which had occurred, and what was likely to happen in the future, did not go to the root of the contract. The plaintiffs never doubted that they would receive payment for goods delivered even though it might often be late. Furthermore, the tardiness of payments caused them little damage[262]'.

A party's unwillingness or un-readiness to perform might be clear from its declaration, or from the circumstances. When it is clear that the other party will not perform the contract (for example, when delivery date is of the essence and the contract ship is far enough from port, that it is impossible to reach it in time)[263], termination under PICC 7.3.3 and 7.3.4(2) should be exercised by giving notice to terminate. Time limits in PICC 7.3.2(2) do not apply to the right to declare a contract avoided. Anticipatory breach is important for our research as it is connected with fundamental breach. Anticipatory breach is equaled to future fundamental non-performance. To settle whether the breach is anticipatory, it should be clear whether the foreseen breach would amount to fundamental. This analysis is made evaluating seriousness of possible breach: whether it could cause substantial deprivation, whether strict compliance with the contract criterion could be breached, etc. Thus prerequisites of fundamental breach should be taken into account in order to determine whether the breach is anticipatory.

B. RIGHT TO REQUIRE PERFORMANCE

Under German law, an obligee generally can always claim - and sue for - specific performance. This seems to be a fundamental difference between German and common law systems[264]. In civilian law, specific performance is available as a right when it is the primary remedy for a breached contract. English law, however, continues to recognize specific performance as the secondary remedy for breach

[260] n. 15, p. 847 according to D. Saidov 'Anticipatory Non-Performance and Underlying Values of the UNIDROIT Principles' (2006) 809-810
[261] *Decro-Wall International SA v. Practitioners Marketing Ltd (1971*
[262] Laurence Koffman, Elizabeth Macdonald 'The Law of Contract', Oxford University Press, New York, 2007, p.506
[263] n. 82, p. 225
[264] P. Schlechtriem 'The German Act to Modernize the Law of Obligations in the Context of Common principles and structures of the Law of Obligations in Europe' Oxford u Comparative L Forum 2 at ouclf.iuscomp.org, 2002

of contract[265]. PECL 9:102 attempts to reach a compromise position between common law and civil law[266]. Specific performance is regarded as primary the remedy in civil law, in accordance with damages. PECL 9:102(1) entitles the aggrieved party to specific performance (based on civil law), while PECL 9:102(2) and PECL 9:102(3) limits the exercise of specific performance (resembling English law). Interpreting 'Unreasonable effort or expense' and 'reasonable time' reveals similarities between PECL and English law. There were attempts to change the English position claiming that 'specific performance is a superior method for achieving the compensation goal (…). An expanded specific performance remedy would not generate greater transaction costs than the damage remedy involves, nor would its increased use interfere unduly with the liberty interests of promisors'[267]. French law favours specific performance, not in the name of the supposedly underlying economic efficiency of this remedy, but of enforceability[268].

1. Delivery of non-conforming goods and non-delivery

In case of delivering of non-conforming goods, the right to require performance is limited. The buyer may require delivery of substitute goods only if the non-conformity with the contract amounts to a fundamental breach of contract (CISG 46(2))[269]. In cases of non-delivery the requirement for performance is not limited. A delivery of '*aliud'* means a delivery of something other than the goods agreed to be sold or, in the case of generic goods, delivery of goods of a different type[270]. Thus, the essential question is whether the error amounts to a non-delivery or the delivery of non-conforming goods. It would be reasonable to treat the delivery of *'aliud'* as non-conforming delivery. This is because delivery of non-conforming goods can not be treated as non-delivery, as certain actions by the party in breach were excecuted, and the aggrieved party has received certain goods. Thus, we should determine whether these goods conform to the contract. In the case in which it does not conform, we should analyze whether or not it constitutes fundamental breach and if delivery of substitute goods is available. When it does not constitute fundamental breach, other remedies (i.e. damages, etc.) are available.

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[265] Richard Stone and Ralph Cunnington 'Text, Cases and Materials on Contract Law', Routledge-Cavendish Taylor and Francis Group, London and New York, 2007, p. 1178
[266] n. 273 p. 1178
[267] Schwartz, A, 'The Case for Specific Performance' (1979) 89 YLJ 271, 305-306
[268] Yves-Marie Laithier 'Comparative Reflections on the French Law of Remedies for Breach of Contract', chapter from' Comparative Remedies for Breach of Contract', edited by Nili Cohen and Ewan McKendrick, Oxford and Portland, Oregon, 2005, p.108
[269] n. 8, p. 522
[270] n. 8, p. 522

If the goods are non-conforming, the buyer may pick which remedy to use, these being, a: reduction of price (CISG 50), avoidance of the contract (CISG 49), or to require performance (CISG 46). In case of price reduction, the restitution or substitute of goods do not take place because non-conforming goods are retained by the buyer. If when delivering back non-conforming goods, the, party suffers huge costs, it might be reasonable for both party's to seek a price reduction. The aggrieved party may wish to resell or use the goods in another way if shipping costs are high or if the goods will perish after the time it takes for redelivery..

The party is free to change the remedy from requiring performance, to the avoidance of the contract, or claim for price reduction if there are grounds for all of these remedies, and if the change would not be a misuse of the right. This is applied both for non-delivery and non-conforming performances. Thus, the good faith criterion and intentionality implicitly become important in CISG, because if the aggrieved party starts to intentionally to abuse his right to change the remedy after the first option was done, and the non-performing party would suffer unreasonable loss because of it. Such an infraction is regarded as not possible and should be limited. Avoidance of the contract might be changed if the buyer is not bound by the declaration of avoidance yet and may retract the declaration. When the seller consents to the avoidance expressly or implicitly by corresponding actions, the irrevocability of the declaration is established and it is no longer possible for the buyer to retract the avoidance of the contract[271]. This approach strikes a balance between interests of the parties. When the buyer prefers to change from the reduction of the price to avoidance of the contract, or to the right to claim performance, it would be possible only if the receipt has not occurred, 'since the seller need not be protected against retraction prior to that point[272]'. The law protects the interest of the seller in this case, assuming that even there is no protest from the seller; This is assumed because he has changed his position in reliance with price reduction. A swift change from price reduction to another remedy, might not have any negative consequences, but when the reasonable time criterion for declaration to avoid the contract or for required performance has passed, it is not possible to change. Otherwise, certainty in the law would be affected. The reasonable time criterion is expressed in CISG 46(2), CISG 46(3), CISG 49(2)(b). The time for choosing the remedy is also limited according to reasonable time criterion.

[271] n. 8, p. 525
[272] n. 8, p.526 according to Hirner pp 290-1

2. Withholding performance

CISG does not contain any rule which grants a party the general right to suspend performance, as PICC in cases of a breached contract by the other party[273]. However, systematical analysis of separate CISG articles reveals that suspension of performance exists under CISG 58(1)(2) and (2), 71, 85 sentence 2, 86(1)(2). In the common law countries, the right to withhold performance is restricted to cases where the contact expresses or implies that the obligations conditional upon one another and to cases of fundamental non-performance; in other cases the aggrieved party must perform its obligations in full (though if non-performance is a breach, the party may have a claim for damages)'[274].

English law treats withholding as a harsh remedy, not suitable for minor breach. Other legal systems (PECL 9:201, PICC 7.1.3) are more flexible, using withholding even if fundamental breaches do not occur, taking into account proportionality and the good faith principle. Official Comment on PICC states, that if a non-performance is minor the performance still might be held only in accordance with principle of good faith[275]. According to Schelhaas, contrary to CISG, fundamental non-performance is not required for a party to use its right to withhold in PICC 7.1.3[276]. According to CISG 71(1)(a), the fundamental breach might be understood from the wording 'the other party will not perform *a substantial part of his obligations* as a result of a *serious deficiency'*. With regard to other provisions (CISG 58(1)(2), 85 sentence 2, 86(1)(2)), this approach is criticized, as withholding of performance is possible even if the breach is not fundamental. Furthermore, in CISG, the general right to refuse performance until counter-performance has been effected can be inferred in the case of non-performance of all obligations that are of *any weight*[277]. 'Any weight' includes essential and minor obligations and therefore, both fundamental and non-fundamental breaches.

C. RIGHT TO REQUIRE DAMAGES

1. Right to require performance, price reduction and damages

In addition to performance, delivery of substitute goods or repair, under CISG 46, the buyer can claim damages only due to the delay and for ancillary and consequential losses, since his immediate interest in the performance has already been satisfied[278]. The resultant loss of defective goods might also be regarded as damages, if the substitute goods were not delivered instead. The seller might be

[273] n. 8, p.527
[274] n. 29, p. 405
[275] n. 82, p. 196
[276] n. 15, p. 741
[277] n. 8, p. 527
[278] n. 8, p. 529

awarded damages under CISG 74, in addition to performance, under CISG 62. Damages may be awarded together with price reduction. The amount claimed by price reduction reduces overall damages payable[279]. Thus, CISG 50 is applied together with CISG 74. It is clear that PECL (9:102) does not go as far as English law, in that it does not require damages to be inadequate as a prerequisite to order specific performance, as English law does[280]. Thus, damages in English law are regarded as the primary remedy, and only in cases of inadequacy is the aggrieved party is entitled to the right to require performance.

2. Avoidance of the contract and damages

If the contract is avoided, the aggrieved party is entitled to receive damages for the losses suffered. These may include, costs for removal of a non-conforming item or substitute sale or compensation for damages due to delay and to ancillary and consequential losses[281]. Thus, either CISG 49 or CISG 64 is applied together with CISG 75 or CISG 76.

Elevation of a term to the status of a condition can be important, not only in relation to the right to terminate, but also for the damages recoverable upon the termination of the contract[282]. To compare, in *Financings Ltd. v. Baldock (1963)* the non-performing party should recover damages for the unpaid installments at the date of termination, but not for the loss of the future installments. In *Lombard North Central plc. v. Butterworth*, the party in the breach was required to pay damages for the unpaid installments up to the date of termination as well as for the loss of the future installments.

Thus, the sum of awarded damages may differ. In the case of a repudiatory breach, the party in breach is entitled to recover loss of bargain damages, including payments for future installments. According to Treitel, it is only when the breach is repudiatory under the general law and is apart from the expressed agreement of the parties, that the owner is entitled to recover loss of bargain damages[283]. Thus, the loss of bargain damages should not be available when the owner rescinds for a minor breach of expressed terms in a contract condition[284]. The difficulty is that the law does generally distinguish between a condition that arises under the general law and a condition that has been created by an express provision in the contract[285].

[279] n. 8, p. 529
[280] n. 273, p. 1178
[281] n. 8, p. 529
[282] n. 64, p 789
[283] n. 64, p 789 quotation of Treitel 'Damages on Rescission for Breach of Contract' (1987)
[284] n. 64, p 789 quotation of Treitel 'Damages on Rescission for Breach of Contract' (1987)
[285] n. 64, p. 789

Contrary to the *Mihalis Angelos*[286] decision, in *Cehave NV v. Bremen Handelsgesellschaft mbH (The Hansa Nord) (1976*[287]*)* the term was held to be an intermediate. The parties concluded a contract for citrus pulp pellets. According to Clause 7: 'Shipment to be made in good condition (…) each shipment to be considered a separate contract'. The party rejected all contracts as part of the cargo was found to be damaged. Consequently, the Court of Appeals concluded that the buyers are entitled to get damages and not to reject the contract, as it was a breached intermediate term and the deficiency was not serious and substantial'.

2.1. Whims of market fluctuation

In the *Hansa Nord* case, the market price for goods had dropped to £86,000, 'so that the buyers had an economic interest to find a way out of the contract in order to purchase alternative goods in the marketplace at a lower price[288]'. In this case, the Court of Appeal took a stand not only against 'bad faith', but more generally against economic opportunism within a contractual relationship[289]'. On the other hand, law cannot guarantee proper performance of the contract. If economic and social circumstances such as inflation, price jump, crises of banks and other financial institutions are unfavorable, proper performance of the contracts can become objectively burdensome, actively encouraging breaches of contracts[290]. Moreover, such interpretation reveals that English law presently does not examine the motivation of the party seeking to exercise the right to terminate[291]. The entitlement of termination is more important than the motives for termination.

In our opinion, this might lead unfairness, as the aim of commercial contracts is to reach the better part of bulk; both parties conclude the contract for economical benefit. In commercial contracts the parties' interest to seek the economical benefit (the crux of the contract) should prevail over *pacta sunt servanda* principle. Yet, market fluctuation does not depend on the party in breach actions, thus the contract can not be rejected only for such conditions, since business risk based on market fluctuation. As both parties are businessman, reasonable businessmen should take into account possible business risks as an everyday factor.

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[286] Maredelanto Compania Naviera SA v. Bergbau-Handel GmbH (The Mihalis Angelos) (1971) http://www.bailii.org/ew/cases/EWCA/Civ/1970/4.html

[287] *Cehave NV v. Bremen Handelsgesellschaft mbH (The Hansa Nord) (1976)* http://www.lawofcontract.co.uk/cases/170.php

[288] n. 64, p. 799

[289] n. 64, according to Brownsword 'Retrieving Reasons, Retrieving Rationality? A New Look to the Right Withdraw for Breach of Contract (1992)' 5 Journal of Contract Law 83, 91

[290] n. 152 p. 508

[291] n. 64, p. 799

CONCLUSIONS

1. Fundamental breach of the contract is a question of the fact and it is complex and elaborative legal concept. Our comparative analysis reveals that it is possible to set certain (but not final) list of criterions, which guides solving whether the breach is fundamental, these criterions are: substantial deprivation, foreseeability, strict compliance with the obligation, reasonable man, international business man, intention, loss of reliance and disproportionate loss criterions.

2. Market fluctuation is considered as usual business risk rather than prerequisite of the fundamental breach. However, it will be unfair, if solving whether the breach was fundamental, motives to conclude a contract will not be analyzed in accordance with market fluctuation, as usually motive of commercial contracts is to seek economic benefit and market fluctuation might substantially deprive party from what she was entitled to expect.

3. Breach of contract is fundamental if the aggrieved party suffers substantial deprivation of what he was entitled to expect, unless the party in breach did not foresee and a reasonable man would not have foreseen such a result. Substantial deprivation refers to foreseeable not-fulfilled material interests of the aggrieved party, actual detriment (damages) is not essential for the acknowledgment of fundamental breach. If substantial deprivation was suffered and it constitutes fundamental non-conforming performance, reasonable use of goods is not possible, as it is possible only if the breach is not-fundamental.

4. Reasonable man criterion, which makes foreseeability criterion more objective, in commercial contracts refers to an average business man of a specific trade sector acting in the same circumstances. In international transactions we suggest to use international business man criterion which could exclude ambiguity in foreseeability criterion, when the parties are from different regions.

5. With respect to foreseeability, while determining whether the contracting parties foresaw the consequences of the fundamental breach regard shall be given to the criterion on time and knowledge. Only knowledge obtained prior and at the moment of conclusion of the contract plays a major role.

6. Breach constitutes fundamental, when strict compliance with essential to the contract obligation is required. Differently from substantial deprivation criterion (material criterion), for strict compliance criterion (formal criterion) actual gravity of the breach is not taken into account.

7. Intentional breach may amount to fundamental, but it has less weight than other criterions and is applied when it is not possible to use substantial deprivation and strict compliance criterions.

It is restricted by good faith principle and used in conjunction with loss of reliance criterion. Multiple breaches might indicate intentionality and loss of reliance.

8. According to the comparative analysis, in the event of fundamental breach, the aggrieved party may choose any available remedy: to require performance, to withhold performance, to claim damages, to require price reduction, to require termination, to require substitute delivery. Avoidance of the contract and substitute delivery of goods are last-resort remedies, available only in case of fundamental breach. Termination of the contract is especially harsh remedy, as inflicts prospective or retrospective restitution, full compensation of harm.

9. Two models of termination of the contract in case of fundamental breach can be found: when court has wide discretion to terminate the contract, or give period of grace during which the parties' remedies are temporarily suspended; when parties may terminate the contract by simple notice where the seriousness of the breach is certain and where termination is possible by setting a *Nachfrist* when seriousness of the breach is not certain.

10. It is not reasonable to grant the right to termination exclusively to the court, because it diminishes the parties' freedom to express their will and unpredictability. Period of grace might cause inconvenience to the parties, as usually commercial transactions are a part of string and time is of the essence.

11. It is regarded that *Nachfrist* procedure makes time of the essence thus after expire of additional time, non-fundamental breach amounts to fundamental. To our opinion, it is derivative concept of fundamental breach, as the breach in advance does not include the prerequisites of fundamental breach.

SANTRAUKA

Magistriniame darbe pateikiama esminio sandorio pažeidimo lyginamoji analizė. Analizė atlikta lyginant Didžiosios Britanijos, Vokietijos, Prancūzijos valstybių teisės aktus ir teismų praktiką. Didelis dėmesys skiriamas šių teisinių instrumentų analizei: 1980 metų Jungtinių Tautų konvencijai dėl tarptautinių prekių pirkimo – pardavimo sutarčių, Europos sutarčių teisės principams (PECL), 2004 Tarptautinių sutarčių teisės principams ((UNIDROIT), darbe naudojama PICC santrumpa), Bendrųjų principų sistemos projektas (DCFR).

Pirmoje darbo dalyje gvildenamos atskiros sąlygos, būtinos esminiam sandorio pažeidimui nustatyti: numatomumo kriterijus, esminio netekimo kriterijus, protingo asmens kriterijus, griežto sutarties sąlygų laikymosi kriterijus, kaltės kriterijus, pasitikėjimo praradimo kriterijus. Antrojoje dalyje analizuojama teisinių gynybos priemonių sistema, taikoma esant esminiui sandorio pažeidimui. Platesne apimtimi aptariamas sutarties nutraukimas, kaip pati griežčiausia priemonė nukentėjusios šalies interesams apginti.

Esminį sandorio pažeidimą paprastai lemia esminis netekimas to, kas pagrįstai buvo tikėtasi nukentėjusios šalies arba griežtų sąlygų pažeidimas. Esminio sandorio pažeidimo nustatymas svarbus teisinių priemonių gynybos būdams taikyti, pvz. tik jam esant galimas prekių pakeitimas tinkamomis, tai vienas iš pagrindų sutarčiai nutraukti, tai turi įtakos skaičiuojant nuostolius.

Magistro darbe plėtojama hipotezė, jog esminio sandorio pažeidimo samprata, nors ir unifikuota tarptautinių teisės instrumentų, išlieka labai prieštaringa, kadangi priklauso nuo bylų analizės ir esminio sandorio pažeidimo prielaidų interpretavimo. Hipotezė yra paneigiama, nes tiek esminio sandorio pažeidimo sąlygų interpretavimas, tiek teisinių gynybos priemonių taikymas esant esminiam sandorio pažeidimui skirtingose teisės sistemose iš esmės įgyvendinamas panašiai.

SUMMARY

Research analyzes the Concept of the Fundamental Breach of Contract through Comparative Perspective. Research is based on the comparison of English, German, and French legal acts as well as case law. A more thorough analysis is given for the United Nations Convention on Contracts for the International Sale of Goods (1980), The Principles of European Contract Law, UNIDROIT Principles of International Commercial Contracts (2004), Draft Common Frame of Reference (DCFR).

The first part of this research reviews the following prerequisites for the fundamental breach of contract: foreseeability, substantial deprivation, reasonable business man, strict compliance with the obligation, intentionality, loss of reliance, and disproportionate loss criterions. The second part of the research is analyzes remedial systems for the fundamental breach of contract, accentuating that the avoidance of the contract is the harshest remedy.

A breach of the contract is fundamental, if the aggrieved party was substantially deprived from what she was entitled to expect or if the party in the breach did not perform in strict compliance with the contractual obligation. If the breach is fundamental, avoidance of the contract or substitute delivery of goods is possible. The amount of damages may depend on whether the breach was fundamental. Our research hypothesis was: '**Even though international instruments attempt to harmonize and unify the concept of the fundamental breach of contract, the concept remains controversial.** The concept can be defined only on a case-by-case basis through analyzing all prerequisites of the fundamental breach, the majority of which are based on subjectivity and a party's own understanding (which is also influenced by economical, political, legal regulation and usages in the party's country of residence).'

Our hypothesis was refuted, because our analysis revealed that the interpretation of prerequisites for the fundamental breach of contract and the implementation of remedies in different legal systems were found to be very similar.

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