FUNDAMENTAL BREACH OF CONTRACT AND DEBTOR'S CONDUCT: WHAT'S FAULT GOT TO DO WITH IT?

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Abstract

Although an autonomous legal institute of international contract law, the seeds of the doctrine of fundamental breach of contract may be followed to the 'seriousness' requirement present in comparative contract law. Notwithstanding its autonomous notion, the article examines the role of debtor's conduct in finding a case of fundamental breach. Comparative, international and European legal rules and practice are hence analyzed by putting emphasis on the role of debtor's conduct. In terms of current legal rules, one may certainly draw a conclusion that debtor's conduct, especially where it amounts to a fault of a greater degree, makes the finding of a case of fundamental breach of contract more probable. Available case law demonstrates the continuous relevancy of debtor's fault for finding that fundamental breach has occurred. Such a relevancy, in the view of the authors, is inherent to the morality of promising and cannot be bypassed by introducing a neutral concept of fundamental breach of contract. Analyzed case law shows that courts and arbitrators do consider debtor's fault; although by omitting its express mentioning. The authors contend that debtor's fault does and should play a role for the purposes of establishing a uniform notion of fundamental breach of contract. At the end of the day, this is an inevitable consequence of the inherent morality of contractual obligations.

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1. Introduction

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Due to significant differences present in comparative contract law, international and regional rule-makers have strived to develop a concept of breach that could be, as a rule, associated with certain legal remedies. This is how the doctrine of the so-called fundamental breach or non-performance was developed. In other words, the finding of fundamental breach, in objective terms, is coupled with the right of the creditor to declare the contract terminated immediately. Termination is hence one of the appropriate legal remedies. The purpose of this article is not to question the feasibility of the fundamental breach doctrine, by itself, or to offer further arguments on the adequacy of contractual remedies supplied for cases of fundamental breach. This article rather attempts to restate arguments on the relevancy of debtor's conduct in ascertaining the existence of fundamental breach. It argues, thus, that approaches directed to full objectification of the fundamental breach may have been misguided and that behavioral arguments may and should be further developed and used in order to determine the existence of fundamental breach. The core of such arguments can be found in the treatment of debtor's conduct in terms of morality (Fried, 2007; Atiyah, 1981), notwithstanding the existence of different approaches to the issue.

The issue discussed here relates to the relevant requirements, deemed as factors, which are utilized in ascertaining the existence of fundamental breach: from the viewpoint of debtor's conduct. At first glance, the good faith principle may play the role of such a factor, as witnessed by, for e.g. §241(e) of the Restatement (Second) of Contracts. This is certainly so if one accepts that a certain conduct of the parties involves acts contrary to the morality requirement embedded in the good faith principle to such an extent that the other party cannot rely on the contract. The general principle of good faith, on the other hand, is not present in some legal systems, for e.g. in English law (Brownsword, 2006, pp. 111-114), although it would be false to suppose that legal systems that do not recognize a clear-cut good faith doctrine are barred from achieving similar results by other means. In any case, in order to attain a broader scope of the discussion and ultimately bypass clear-cut good faith arguments, this article focuses on something known in all legal systems: fault.

This article draws on the common or traditional supposition that a case of fundamental breach results in the right of the creditor to declare the contract terminated immediately, i.e. without providing additional time for (proper) performance. It also focuses only on the role of fault in terms of termination as an available remedy and not in terms of the general role of fault for ascertaining the mere existence of the breach, be it fundamental or not (Treitel, 1988, Chapter II). On the other hand, it assumes that debtor's fault is nevertheless still relevant in cases of contractual breach, although international legal sources have strived to develop an objective concept of fundamental breach. Fault, in other words, still plays a role, although rarely expressly stated in case law and relevant rules. Finally, the role of fault is discussed not in terms of its mere presence but in terms of its gravity; meaning that debtor's fault is relevant in cases where it manifests itself in the form of intent and gross negligence by following the maxim *culpa lata dolo aequiparatur*. On such assumptions, Part 2 of the article offers some practical examples found in case law on international sale contracts that relate to the relevance of fault and its role in the reasoning process

of courts and arbitrators. After the analysis of the comparative law background of the fundamental breach concept in Part 3, Part 4 of the article discusses the impact of debtor's fault when finding a case of fundamental breach. Following such discussions, Part 4 draws conclusions on the relevance and the role of fault.

2. Debtor's Conduct in Various Situations

Due to the *favor contractus* principle, terminating the transaction constitutes the last recourse in reacting to the other party´s breach of contract that is so essential that it deprives that party of its interest in the fulfilment of the contract. This is the basic approach established by the 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG). It has latter been upgraded by the 2016 UNIDROIT Principles of International Commercial Contracts (UPICC), by the Principles of European Contract Law (PECL), by the Draft Common Frame of Reference (DCFR) and even by the proposed Common European Sales Law (CESL). The text that follows summarizes the case law in the most typical situations of breaches of sale contracts, by attempting to establish the relevancy and the role of debtor's fault.

2.1. Non-Conformity

Cases involving non-conformity are the most common in practice. On debtor's conduct, in one case the seller undertook an obligation to supply an industrial machine to the buyer. It was to be resold to a third party. The machine failed to function upon delivery, notwithstanding several attempts to fix it with the seller's involvement. On the buyer's claims for lack of conformity, the seller claimed that he was not in breach of the contract because the third party's conduct had led to the failure of the equipment and not the equipment itself. The court found that the machine was not fit for its purpose and the conditions under which it should be used would have had to be known by the buyer, at the time of the conclusion of the contract, in order to be relevant. A case of fundamental breach by the seller was found (Audiencia Provincial de Madrid, 22 March 2007, CISG-online 1960; see also Audiencia Provincial de Palencia, 26 September 2005, CISG-online 1673). It is interesting to note that the failure of the seller to give specifications on the use of the machine, in terms of its placement, the kind of paper to be used, etc., had deprived the buyer of what he was entitled to expect under the contract. The court reached such a conclusion since, *inter alia*, the seller had failed to inform the buyer of the correct way to use the machine. In other words, he had a duty to do so. A 'should have' argument is therefore important in cases of fundamental breach (*Medical Marketing International, Inc. v. Internazionale Medico Scientifica S.r.l.* Civ. A. 90-0380, 17 May 1999, CISG-online 387). Actual knowledge or the need of knowledge can also be drawn from previous commercial relationships (LG Ellwangen, 21 August 1995, CISG-online 279). In some cases, the seller has also admitted that he was aware of the lack of conformity of the goods before their delivery to the buyer (LG Landshut, 5 April 1995, CISG-online 193).

In a case concerning a contract for sale of mountain bikes, the seller presented the buyer with a model of a 'specially milled frame' and, during the presentation, the parties discussed about

the potential success of a bicycle with such a frame in the buyer's country. The buyer subsequently ordered a certain number of bicycles but those supplied did not have the type of frame presented to him. After the buyer claimed non-conformity, the seller responded stating that the buyer had never requested milled frame bicycles. The court found a case of fundamental breach (OGH, 11 March 1999, CISG-online 524). Here the seller obviously acted contrary to what he had presented to the buyer so the latter was substantially deprived of what he was entitled to expect under the contract. The foreseeability requirement was met as the seller had presented a model with 'specially milled frame' to the buyer. Debtor's conduct is also relevant in cases where the seller supplied imitations of Intel Pentium CPUs in their original packaging (OGH, 5 July 2001, CISG-online 652), or where the seller had not attempted to remedy the non-conformity under Article 48 CISG but merely contested the non-conformity (Hof van Hoger Beroep Gent, 10 May 2004, CISG-online 991).

2.2. Delay

Although not every case of late delivery amounts to a fundamental breach, case law has developed criteria for determining when delay is fundamental. In some cases, the essentiality of the delivery deadline appears from the contract (OLG Hamburg, 28 February 1997, CISG-online 261). Previous negotiations and business relations between the parties have significant influence here. In one case, the tribunal found that a relevant delay might constitute fundamental breach if it appears from the circumstances that the date of delivery is of particular significance to the buyer and that the seller had knowledge thereof. In the particular case, the seller knew that the goods were to be delivered by the buyer to a third party and that, in case of late delivery, the buyer had to pay a contractual penalty as well as additional costs incurred by a substitute purchase of the goods (ICC Ct. Arb., 8128/1995, CISG-online 526). In a case where the parties entered into a contract for the supply of vacuum panel insulation and the buyer fixed a specific schedule for delivery in order to meet the terms of a pre-existing agreement, the court found that fundamental breach has occurred (Ontario Supreme Court of Justice, 6 October 2003, CISG-online 1436). Here the seller also had knowledge that the buyer had to comply with a pre-existing agreement concluded with another party and that the equipment had to be installed in a short time.

In other cases, the seller 'should have known' that the delivery deadline is substantial for the buyer. In one case, the seller undertook an obligation to supply knitted goods to the buyer on 3 December 1990. The parties had concluded the contract on 28 November 1990. After the date of delivery had expired, the buyer cancelled the purchase order. The court held that since the seller had failed to deliver the goods at the date fixed by the contract the buyer was entitled to declare the contract terminated because the delivery clause in the contract was concise and its precise observance was of fundamental importance to the buyer. The delay in delivery was therefore a fundamental breach (App. Milano, 20 March 1998, CISG-online 348). The importance of the precise observance by the seller of the date for delivery was also ascertained by taking into account clarifications between the parties in the days following the contract. The court found that the conduct of the seller, who had let the fixed time pass without any excuse, is unjustifiable. The

seasonable character of the goods, the short delivery period and the foreseeability on the part of the seller justified the termination (cancellation of the purchase order). In terms of the 1964 Uniform Law on the International Sale of Goods (ULIS), the buyer would not have entered into the contract if he had foreseen the breach and its effects.

2.3. Partial Delivery

In practice, partial non-performance may coincide with delay (OLG Celle, 24 May 1995, CISG-online 152). The fundamental character of partial (non-) delivery is hard to find in cases where the buyer can obtain substitute goods. Debtor's conduct can nevertheless play a determining role. In one case, the buyer ordered plastic knapsacks, wallets and bags from the seller by stating delivery within 10 to 15 days. Two months later the seller asked the buyer to renew its order after assuring him that all the goods would be dispatched within a week. The buyer did not yet receive the goods almost two months after paying the price. Two months from the conclusion of the contract, the seller had delivered only one third of the goods and the buyer terminated the contract (Pretura di Parma-Fidenza, 24 November 1989, CISG-online 316). Here the court found a case of fundamental breach due to the duration of the delay and on the partiality of the delivery. It is important to note that the seller admitted that it had handed over the goods to the carrier only after receiving the notice of cancellation from the buyer and that the delivery was partial. In such cases, the conduct of the debtor is manifestly contrary to the good faith principle. Therefore, in cases like this one, the determining criterion cannot be the possibility of the creditor to obtain substitute goods but the agreed terms should stand on their own.

2.4. Non-Delivery

On non-delivery, in one case, the court found a fundamental breach of the contract because the seller did not deliver the goods, although the price had been paid, arguing a lack of documentation required in the buyer's country that should have been provided by him (Audiencia Provincial de Barcelona, 12 February 2002, CISG-online 1324). The court did not find such an obligation on part of the buyer. It was also reasoned that the seller advertised as an exporter and therefore ought to know the requirements and procedures necessary for the delivery of goods and, on the other hand, he had sent a first batch even when it did not have the certificate of origin that he had subsequently claimed to be essential to export. In addition, fundamental breach was found in a case where the seller failed to make delivery of rabbits with certain genetic qualities that were supplied to him by a third party. Because there were problems with the delivered animals, the buyer asked the seller to acquire the reproduction rabbits from a different company. The latter refused to supply the new type of rabbits to the seller on the ground that the hygienic conditions on the seller's farm were inadequate. The court found that all parties involved had known from the outset that the seller, in the particular circumstances, would not have been in a position to deliver the rabbits for several months (Trib. Padova, 11 January 2005, CISG-online 967).

In a case decided under the UPICC, the defendant undertook an obligation to produce specific quantities of squash and cucumbers and to provide them to the claimant on an exclusive basis. The defendant breached the contract by not providing the goods referred to in the contract and by violating the exclusivity clause. A breach of the exclusivity clause was found only in one concrete case of the defendant's contracting with a third person. The tribunal concluded that the breach was fundamental, among other things, due to fact that the defendant's violation of the exclusivity clause was intentional (Centro de Arbitraje de México, 30 November 2006, UNILEX). As can be seen, the breach may be treated as a minor one, but Article 7.3.1(2)(c) UPICC clearly applies to such breaches also. Truth the told, the tribunal also draw a conclusion that the existence of the intentional breach, *inter alia*, was sufficient to give the claimant reason to believe that it could not rely on defendant's future performance. Intentional or reckless behavior could certainly guide the tribunal in reaching such a conclusion. On the other hand, even if future performance was not due, Article 7.3.1(2)(c) UPICC stands as a clear-cut rule.

In one case, the seller was not able to meet the deadline for delivery and had asked the buyer to extend the loading time provided on the letter of credit and its expiration time accordingly. The buyer terminated the contract on the same day of the expiry of the letter of credit. The tribunal found that a fundamental breach had occurred although, at the time the buyer notified the seller that it considered the contract terminated, the letter of credit had not yet expired. The tribunal also drew such a conclusion because the seller had declared that it was not willing to perform until a dispute, which had arisen under another contract between the parties, had been settled (CIETAC, 1 February 2000, UNILEX). In another case, the tribunal found that the seller had committed a fundamental breach of the contract due to non-delivery because the seller was not an owner of the goods at the time of conclusion of the contract (ICC Ct. Arb., 9978/1999, CISG-online 708).

2.5. Non-Payment

Non-payment does not generally amount to a fundamental breach. It was thus held that late payment could not be treated as a case of fundamental breach if time is not of the essence (OLG Düsseldorf, 22 July 2004, CISG-online 916). In one case, after the conclusion of a contract for sale of scrap steel the buyer changed its management (July 1996). The management introduced new procedures concerning the issuing of letters of credits. Pursuant to the contract, the buyer agreed on payment by an irrevocable letter of credit for 60 days, which should have been issued on 1 August 1996. Before the termination of the contract, he wrote to the seller that the new management was still studying the matter. A contractual obligation was pending in the particular case and notwithstanding the change of buyer's internal policies for issuing of a letter of credit, which may have been well advised, the seller undertook activities to show that he will honor the contract. After the extension granted by the seller for issuing the letter of credit, by 7 August 1996 at the latest, the following day he also gave the buyer another possibility, although a prompt one: to honor the contract by 9 August 1996. He finally terminated the contract because the letter of credit was not issued, on that same day. The court found a case of fundamental breach (*Downs Investments Pty Ltd. v. Perjawa Steel SDN BHD* [2000] QSC 421, 17 November 2000, CISG-

online 587). In another case involving letters of credit, the arbitrator held that, although a delay in opening the documentary credit does not necessarily amount to a fundamental breach, in itself, one has nevertheless occurred as the buyer failed to do so after three and a half months (ICC Ct. Arb., 7585/1992, CISG-online 105). It is interesting to note that the arbitrator awarded the seller the contractually agreed 'compensation fee' which was to be paid where 'the agreement is terminated by fault or request of the purchaser'.

In another case, the tribunal had to decide on the performance of a contract, regarding the payment of the price, where the seller undertook an obligation to deliver 5.000 tons of coal to the buyer, at the buyer's option up to 10.000 tons that could be exercised within one month. The seller delivered 5.000 tons of coal. The buyer refused to pay the price and made a claim in damages due to the seller's failure to deliver the coal in the quantity required by the contract. The tribunal granted the seller's claim for payment for the coal shipped to the buyer and held that the conduct of the buyer, who had made the payment for the goods conditional to the seller's guarantee for complete performance of the contract and had subsequently refused to pay for the goods, sharply contradicted the contract. This was also contrary to Article 53 CISG under which the payment for the goods is an unconditional obligation of the buyer. The buyer's breach was therefore treated as fundamental (Russian CCI Int. Arb. Ct., 4 April 1998, CISG-online 1334). A court has also found that the appointment of an administrator by the buyer, which could be evaluated as an acknowledgment by the buyer himself that he was insolvent, constituted a fundamental breach (*Roder Zelt- und Hallenkonstruktionen GmbH v. Rosedown Park Pty Ltd.* 57 FCR 216, 28 April 1995, CISG-online 218). In one case the buyer was obligated under a sale contract to pay the seller within fifteen days of the receipt of women's custom-made garments. After the seller shipped a part of the order, the buyer failed to pay. During the following couple of months, the seller continued delivery after having obtained assurances from the buyer that he would pay for the delivered items. Due to further non-payment, the seller even agreed to be paid a discounted price in five instalments but, since the buyer continuously failed to make the scheduled payments, he suspended all further deliveries and held some of the garments. This is also a case where the court found a fundamental breach (*Doolim Corp. v. R Doll, LLC, et al.* No. 08 Civ. 1587 (BSJ)(HBP), 29 May 2009, CISG-online 1892).

3. The Comparative Background

It is clear that the concept of fundamental breach is an autonomous concept that should not be confused with the identically termed doctrine of English law. English law, on the other hand, has functionally played a significant role in determining the scope of contractual liability for breach that, under the CISG and other relevant sources, is unitary, strict and not based on fault. Historically, the concept of strict liability in English law is founded on the fact that the debtor has promised something and has then failed to do so (Ibbetson, 1997). The approaches in comparative law are therefore relevant not in terms of understanding the concept of fundamental breach, as being developed from a particular legal system, but in order to establish its autonomy and the

special traits which distinguish it. It was thus held in practice that, as a rule, the recourse to domestic law is not admissible in interpreting the CISG (BGH, 3 April 1996, CISG-online 135).

Functionally, bearing in mind the coupling of the fundamental breach with the right of the creditor to declare the contract terminated immediately, most of the legal systems have put emphasis on the seriousness of the breach. Thus, for English law, one is directed to the distinction between conditions and warranties. Under s. 11(3) of the Sale of Goods Act 1979, the breach of a condition may give rise to a right to treat the contract as repudiated while the breach of a warranty may give rise to a claim for damages but not to a right to reject the goods and treat the contract as repudiated. The treatment depends, in each case, on the construction of the contract. Therefore, a stipulation may be a condition though called a warranty in the contract. The distinction could be previously found in s. 11(1)(b) of the Sale of Goods Act 1893. As said by Fletcher Moulton LJ in *Wallis, Son & Wells v. Pratt and Haynes* [1911] AC 394, conditions 'go so directly to the substance of the contract or, in other words, are so essential to its very nature that their non-performance may fairly be considered by the other party as a substantial failure to perform the contract at all'. On the other hand, warranties 'are not so vital that a failure to perform them goes to the substance of the contract'.

Traditionally, the breach of a condition may lead to termination as a remedy (*Bunge Corp v. Tradax Export SA* [1981] 1 WLR 711) while the breach of a warranty may only lead to a claim for compensation of damages. One should, therefore, classify contract terms as conditions and warranties *a priori* and then determine the legal consequence of the breach, without taking into account the seriousness of the breach in the particular situation (Beale et al., 2010, p. 931). Nevertheless, the seriousness of the breach plays a significant role in English law (Goode, 2004, pp. 124-125). A more flexible approach than that of conditions and warranties has hence followed in *Hong Kong Fir Shipping Co Ltd v. Kawasaki Kisen Kaisha* [1962] 1 All ER 474 (Devlin, 1966). In the words of Upjohn LJ:

> ... the question to be answered is, does the breach of the stipulation go so much to the root of the contract that it makes further commercial performance of the contract impossible, or in other words is the whole contract frustrated? If yea, the innocent party may treat the contract as at an end. If nay, his claim sounds in damages only. This is a question of fact fit for the determination of a jury.

Such an approach puts the emphasis on the consequences of the breach. A third type of terms, the so-called innominate or intermediate terms, is therefore introduced (Murray et al., 2007, pp. 96-98; Carter et al., 2006). In the words of Diplock LJ:

> What the learned judge had to do in the present case as in any other case where one party to a contract relies upon a breach by the other party as giving him a right to elect to rescind the contract, was to look at the events which had occurred as a result of the breach at the time at which the charterers purported to rescind the charter-party and to decide whether

> the occurrence of those events deprived the charterers of substantially the whole benefit which it was the intention of the parties as expressed in the charter-party that the charterers should obtain from the further performance of their own contractual undertakings.

The seriousness (*Cehave NV v. Bremer Handelsgesellschaft mbH* [1975] 3 All ER 739) of breach can also be found in s. 15A of the Sale of Goods Act 1979 that speaks of 'slight' breaches in commercial cases, which do not give rise to the right of termination. Contractual liability in English law is, with some exceptions, strict (Treitel, 1988, pp. 346-448), but fault plays a role that has been obscured due to the concept of implied terms (Nicholas, 1995, pp. 345, 349). On the role of fault (Lawson, 1975), as reasoned in *Universal Cargo Carriers Corp v. Citati* [1957] 2 WLR 713, (anticipatory) breach 'was not devised as a whip to be used for the chastisement of deliberate contract-breakers, but from which the shiftless, the dilatory, or the unfortunate are to be spared'. It is not, therefore, 'confined to any particular class of breach, deliberate or blameworthy or otherwise; it covers all breaches that are bound to happen'. The influence of English law on the CISG and other relevant sources can be asserted only in such terms. Early concerns on the functionality of the concept established by the ULIS (Ellwood, 1964, pp. 45-46), especially in relation to the common law concepts, were thus found to be overstated (Szakats, 1966, pp. 766-767).

Under French law, which also recognizes a unitary concept of breach of contract, termination may generally be granted by courts where the non-performance is total. In other cases, it is left to the discretion of the court to grant termination by assessing the gravity of the breach while taking into account whether the creditor would enter into the contract had he foreseen the non-performance (whether the non-performed element of the contract is the *cause* of the creditor's obligation). The influence of French law on the ULIS is evident here. The latest reform of the French Civil Code also provides for an express provision that a contract can be terminated if the breach is sufficiently serious (Article 1224). Here the contract is terminated by notice, although significant limitations in terms of the court's role remain (Rowan, 2017, pp. 823-824). Debtor's conduct also plays a role so the court can order termination even for small breaches where the debtor has acted in bad faith (Nicholas, 1992, pp. 242-243). In those terms, a court is more likely to terminate the contract if the seller knew about the defects of the goods (Carbonnier, 2004, p. 2233). In addition, pursuant to Article 1455 of the Italian Civil Code, the contract cannot be terminated if the failure to perform of either party has little importance, having regard to the interest of the other.

As for German law, the old system of the Civil Code (BGB) and the practice developed under it made distinctions between the cases of impossibility, delay, positive breach of contract and defects in performance (Zweigert & Kötz, 1998, pp. 488-496). Termination was generally coupled with the fault of the debtor (Zimmermann, 2002, p. 278). On the other hand, fault was not relevant for the claims for termination and reduction of the price, but only for the claim for damages, under the rules for liability for defects (breach of warranty) (Zweigert, 1964, p. 2). The relevant rules are somewhat different after the amendments of the BGB in 2001. Under the new

system of the BGB, save the cases where there is an automatic release of the creditor due to impossibility (§326 BGB), termination is generally available after an additional period for performance or cure. The latter may be dispensed with in certain cases (§§323 and 324 BGB). The provisions mentioned apply where the debtor does not perform or does not perform properly. As for the lack of conformity, the termination as a remedy is mainly in line with general rules on termination in cases of breach of contract (§§437(2) and 440 BGB). Fault is not required for termination in terms of the new system of the BGB, as a rule, but still plays a role (Zimmermann, 2005, pp. 68-72, 107-108; Aksoy, 2014, pp. 30-32). A system similar to the original BGB is also present in the North Macedonian Law on Obligations (Gavrilović & Tushevska, 2013, pp. 13-17). Such was also the system of the former Yugoslavian Law on Obligations. Although structured in such a manner, fault is generally not a prerequisite for termination (Gavrilović, 2010, pp. 660-661), as is the case of the Swiss Code of Obligations (Article 102).

The requirement of seriousness of the breach is also relevant under US law. The Uniform Commercial Code (UCC) differentiates between situations where the buyer accepts goods and situations where he does not. In the first case, the buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him (s. 2-608(1) UCC). In the second case, on the other hand, if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may reject the whole (s. 2-601(a) UCC). This is the so-called 'perfect-tender' rule. Further, pursuant to Article 6:265 of the Dutch Civil Code, every failure of a party in the performance of one of its obligations gives the opposite party the right to terminate the mutual agreement in full or in part unless the failure, given its specific nature or minor importance, does not justify this termination and its legal effects. Also, under the Finnish Sale of Goods Act, the creditor may terminate the contract only if debtor's breach (delay in delivery, non-conformity of goods, delay in payment, or lack of cooperation) is substantial to the creditor and the debtor knew or ought to have known this (ss. 25(1), 39(1), 54(1) and 55(1)).

4. Discussion on the Role of Debtor's Fault

The approaches in comparative law discussed above lead to a conclusion that debtor's fault plays a role in finding that a breach is sufficient to terminate the contract, although not a predominant one. It seems that fault is here intrinsically included in the 'seriousness' requirement. In terms of international sales law, the concept of fundamental breach was meant to apply regardless of fault. Consequently, literature and case law are clear that fault is not relevant (Magnus, 2005, p. 426; BGH, 24 March 1999, CISG-online 396). On the other hand, case law has demonstrated certain strictness in applying Article 25 CISG (Bridge, 2013, pp. 568-569). This applies, *mutatis mutandis*, to the role of fault. The cases discussed above reveal that courts and arbitrators are hesitant to implicate fault-based reasoning in their deliberation although debtor's conduct demonstrates, in a clear-cut manner, the presence of fault. In other words, debtor's conduct would amount to sufficient demonstration of fault in fault-based systems of contractual liability. This is not to say, of course, that fault becomes an irreplaceable condition for debtor's liability or even for finding a case of fundamental breach. Rules contained in international and regional

sources and projects may have done well by removing fault from the equation. Fault, nevertheless, finds a way to affirm its continuous relevance (Pichonnaz, 2010).

Case law, at least indirectly, proves such a supposition but direct involvements of debtor's fault are not present. For e.g., the relevance of fraud was mentioned in a one case; however, as fraud was not found its impact on the character of the breach could not be ascertained (OLG Hamburg, 14 December 1994, CISG-online 216; Treitel, 2003, p. 807). There have been, on the other hand, cases where the relevance of debtor's fault is evident. Such are, for e.g., cases of denial of contractual rights as is the case where the debtor had denied the creditor's retention of title clause (*Roder Zelt- und Hallenkonstruktionen GmbH v. Rosedown Park Pty Ltd.* 57 FCR 216, 28 April 1995, CISG-online 218). In addition, in one case the seller refused to supply the buyer with the pairs of shoes ordered from him by claiming that the contract was not validly concluded although, according to practices previously established between the parties, the seller was used to performing the orders without expressly accepting them (CA Grenoble, 21 October 1999, CISG-online 574). In other cases, debtor's conduct demonstrates continuous breach. Thus, in one case the buyer ordered basic gable plates to be processed and assembled according to its customers' needs. The plates supplied were defective and the seller replaced them. The buyer subsequently placed a new order and took delivery of the goods. The delivered plates were defective once again (RB Utrecht, 18 July 2007, CISG-online 1551). In such cases, the creditor does not have grounds to rely on debtor's proper performance. Debtor's conduct demonstrates that his (continuous) breach, notwithstanding whether goods are supplied in instalments or whether orders are made on continuous business cooperation, 'kills' creditor's reliance on the debtor's performance. The totality of previous breaches is therefore relevant although, for e.g., the existence of several types of breaches was not found to be fundamental in practice (BGH, 3 April 1996, CISG-online 135).

In one case, the buyer terminated the contract for sale of sunflower oil where the sellers, upon an additional period for performance set by the buyer, have failed to deliver the first instalment of oil to the buyer's customer. The court held that the buyer had validly terminated the contract as the sellers' failure to perform their obligations in respect to the first instalment gave the buyer good grounds for concluding that a fundamental breach would likewise occur with respect to future instalments (HGer Zürich, 5 February 1997, CISG-online 327). Further, in a case involving a contract for the purchase of steel bars, the seller threatened not to perform its contractual obligations when the buyer refused to modify the letter of credit issued for payment. The buyer brought an action for anticipatory breach of contract. The court found that the seller's threat not to perform its contractual obligations, if the letter of credit was not amended, amounted to an anticipatory breach of contract because the seller clearly intended to breach the contract before the contractual performance date (*Magellan International Corporation v. Salzgitter Handel GMBH* 76 F.Supp.2d 919, 7 December 1999, CISG-online 439). Reliance on the future proper performance of the contract is consequently of great importance where debtor's conduct, who is obviously at fault, precludes the creditor to rely on debtor's pending performance.

The creditor sometimes cannot rely not only on future performance but also on the properness of tendered performance. In one case, the court had to decide on the breach of a contract for sale of springs where the buyer's order contained an indication of two periods of delivery for each half quantity of the goods. The seller had accepted those terms as fixed dates. After the first three shipments of the goods were delivered with delay, the buyer asked the seller for 'annulment' for the goods that had not yet been delivered, specifically keeping out of the request for termination related to the deliveries of the springs that had already occurred. According to the contract, 6.000 springs should have been delivered within mid-April, whereas only 1.000 springs were delivered by mid of May, and other 3.000 by mid of June. The court found a case of fundamental breach as the buyer's production process had been affected (Audiencia Provincial de Barcelona, 3 November 1997, CISG-online 442). In another case, the seller undertook an obligation to supply a second-hand truck and the buyer, two months after delivery, notified the seller that the delivered truck was not the one he intended to buy. The seller acknowledged that the wrong truck had been delivered. He offered to supply the right truck and to take back the wrong truck at its expense. After one month, the buyer offered to buy the delivered wrong truck and the seller agreed while assuring the buyer that he would supply the correct truck within 'the following week'. Two additional months later, the right truck had not yet been delivered (Rechtbank van Koophandel Kortrijk, 4 June 2004, CISG-online 945).

Debtor's subsequent conduct also plays a role in finding a case of fundamental breach. In one case, the parties entered into a contract for the sale of nine items related to printing machinery where the goods were to be delivered in two consignments of six and three items, respectively. The seller only delivered three of the first consignment of six items, to a value lower than the part of the total price paid by the buyer for the first six items. After expiration of the deadlines for delivery of both the first and the second consignments, the buyer fixed an additional period of eleven days for delivery of all of the missing items. After the additional term fixed by the buyer had expired, the seller offered to deliver different goods (OLG Celle, 24 May 1995, CISG-online 152). In another case, the seller delivered goods to the buyer that turned out to be defective. The buyer notified the seller of the lack of conformity and requested the latter to arrange for the return of the goods and to cancel payment under the letter of credit. The seller did not act as required and the bank paid the whole price. The seller subsequently agreed to the goods' return to their place of origin and the buyer arranged for the return at its own expense. The seller also promised to compensate the buyer for the costs incurred as soon as the goods were resold to a third party. Nonetheless, in the five months subsequent to the arrival of the goods to their place of origin the seller continuously refused to take delivery of the goods as well as to pay back the contract price and to compensate the buyer (CIETAC, 18 April 2008, CISG-online 2057). Seller's ultimate refusal to deliver the goods was also found to amount to a fundamental breach (American Arbitration Association, 50181T 0036406/1997, CISG-online 1647).

In such cases, of course, foreseeability on the part of the debtor is important. International and autonomous legal sources speak not only of an objective foreseeability but also of situations

where the debtor subjectively 'did ... foresee' that the creditor is substantially deprived of what he is entitled to expect under the contract. Fault plays a role here, although it is not expressly stated as relevant. Thus, in one case the parties entered into a contract for supply of shoes where the buyer was granted an exclusive right to distribute the shoes produced according to its design. The seller displayed the shoes at a trade fair without the buyer's consent and refused to remove them after the receipt of notice to do so. The court found that the buyer was entitled to terminate the contract as the display of the shoes by the seller led the public to believe that the seller also distributed the shoes. Such a conduct by the seller has cast serious doubts on his future compliance with the contract and amounted to a fundamental breach of the contract (OLG Frankfurt a M, 17 September 1991, CISG-online 28). All those cases show that fault cannot be completely disregarded neither in international neither in comparative contract law (Rowan, 2011). Its role is not limited only to the conduct of the debtor, which we discuss here, but also applies on the part of the creditor (Palmer & Davies, 1980; Tribunal de Justiça do Rio Grande do Sul, 4 April 2012, UNILEX), in cases of inducing breach of contract (Simester & Chan, 2004) and, in some instances, in terms of the liability for damages, even in strict liability surroundings (Riesenhuber, 2008; Lando, 2009).

5. Conclusions

As stated above, what we discuss here is the finding of a fundamental breach and not the justification of imposing of the legal consequences correlative to it. By developing an abstract concept of fundamental breach, international and regional rule-makers have certainly attempted to establish a concept that will be applicable to a variety of situations dependent on the relevant facts of the particular case. In doing so, they have clearly provided courts and arbitrators with a certain leverage in finding fundamental breach on the given facts. Abstract concepts are hence useful but, on the other hand, practice is unsurprisingly directed to identify a body of guidelines for ascertaining a case of fundamental breach, particularly in order to make an abstract notion more hands-on. This may seem contradictory at first. Then again, this is actually a well-established legal methodology which has functioned in practice for centuries; maybe not flawlessly but commendably. By developing guidelines for ascertaining a case of fundamental breach, practice actually identifies the factors predominately applied when determining whether a fundamental breach of contract has occurred in a particular case. Analyzed case law shows that practice has undeniably been restrictive by inferring from the supposition that the termination of the contract should be the creditor's last resort. On the other hand, the facts that a (harsh) legal remedy is coupled with the occurrence of a fundamental breach cannot limit it finding for this reason only.

On the abstract concept and its factors, analyzed case law shows that, while abstract notions are useful, total objectification is not. This is where fault comes into play. We speak of fault in terms of breach of a standard of due care and diligence and by drawing from the good faith principle. By the expulsion of fault, understood in such terms, the contract is ultimately stripped from the relevance of debtor's conduct. Breach ultimately amounts to certain acts of the debtor demonstrated in the course of his conduct. The breach of the good faith principle, bearing in mind the reasonable contemplation of the parties, results in a breach of the contract (Burton, 1980).

Truth be told, the involvement of fault may put too much emphasis on the importance of the breach. The CISG and other relevant sources and projects, on the other hand, focus on the 'impairment of an (important) interest of the creditor'. In those terms, 'only where the malicious behavior negatively impacts the trust between the parties that is essential to the contractual relationship … can the maliciousness itself turn an ordinary breach into a fundamental one' (Ferrari, 2006, p. 507). Fault may not be eventually essential for finding contractual breach. Hence, we do not claim that a debtor must be at fault in order for its acts to amount to breach or non-performance, fundamental or not. We only claim that the presence of fault of a certain degree may and should be regarded as relevant where debtor's conduct demonstrates such inconsistencies with the good faith principle that the creditor cannot rely on the contract.

We speak therefore of reliance on the contract and not only on its future performance. In other words, the contract may be performed, although defectively, partially or in delay. If fundamental breach is conceived to be the last resort, because it is coupled with the possibility of immediate termination, then courts and arbitrators would be hesitant to find it due to the so-called *favor contractus* principle (Mullis, 1999, p. 354). On the other hand, the possibility of immediate termination is only the legal consequence or remedy of finding a breach to be fundamental. Courts and arbitrators should therefore disregard the consequence if the requirements of fundamental breach are met. The structure of legal remedies (Farnsworth, 1970) can therefore be misconceived but it should not impair the basic concept of fundamental breach. We thus argue that the *favor contractus* principle does not and should not play a role in finding that the debtor has breached the contract, fundamentally or not. Moreover, if fundamental breach is conceived and applied in terms of its legal consequence, the creditor becomes trapped in a 'loveless marriage' only because courts or arbitrators find that termination is not justified; by omitting deliberation on whether the creditor's interest is probably and seriously brought into question. Debtor's conduct, fault included, puts the emphasis on the impact of such conduct on creditor's interest because the latter may be impaired due to the fact that the mutual trust between the parties was put to the test and has ultimately failed. Debtor's fault, *mutatis mutandis*, is relevant for determining whether a certain breach is fundamental, notwithstanding the availability of adequate legal remedies.

The relevance of debtor's conduct and of his fault, as seen from case law, is present in deliberations of courts and arbitrators although, due to applicable rules, not directly taken into account. Blatant breaches of the good faith principle, on the other hand, are frequently sanctioned, probably by implying that termination is justified in such cases. We argue that the presence of fault should play a role in establishing the fundamental character of the breach because fault is primarily removed from contractual liability in terms of its relevance for employing the legal remedies for breach and not in terms of ascertaining the fundamentality of a certain breach. Thus, even under the UPICC where fault is used as a factor for finding fundamental non-performance, the fact that the aggrieved party is deprived of what it was entitled to expect under the contract does not involve a subjective element, fault included (Tribunal Supremo, 15 June 2015, UNILEX). Debtor's fault hence plays and should play a role in determining whether a particular breach is fundamental or

not. Of course, fault cannot be the sole factor used; but it should be utilized. Developments in rules following the adoption on the CISG support such an approach. Morality and fault-based approaches do not play the exclusive role but they still play a role in contract law surroundings (Shiffrin, 2009; Shiffrin, 2009; Kraus, 2009; Katz, 2005).

Finally, the question of the manner of deciding on the relevance of fault remains to be answered. We offer four conclusions for this end, by also bearing in mind that fault has different meanings in civil law and common law jurisdictions (Basedow, 2005, pp. 496-498; Posner, 2009). The first relates to the maintenance of the basic concept of objectivity in ascertaining fundamental breach. The concept adopted by the CISG is conceived to be an objective one in terms that a breach may be fundamental if it results in such detriment to the creditor as substantially to deprive him of what he is entitled to expect under the contract, notwithstanding whether the debtor is at fault. If this condition is met, then fault does not play a decisive role. What we argue is that fault may be decisive in cases where, as mentioned by Treitel, 'the effect of the breach is less drastic' (Treitel, 2003, p. 809). The second hence relates to the degree of fault in such cases. We argue that debtor's fault is relevant due to its gravity, i.e. where the debtor has breached the contract intentionally or with gross negligence. Such a conduct should be considered in finding a case of fundamental breach, notwithstanding whether one would claim that the debtor's conduct, by itself, results in a fundamental breach or that termination is allowed in such cases even though the proper degree of seriousness of the breach is not met (Treitel, 1988, pp. 359-660, 370). In terms of clearness, we are inclined to accept the first option. The relevance of fault, in terms of the willfulness factor, has been stressed in literature by claiming that this will ultimately result in 'fostering a general feeling of trust and confidence in business dealings' (Marschall, 1982, p. 760), although the discussion has been focused on specific performance and the measure of damages. Intent or deliberateness, of course, is not always a clear-cut argument for the fundamentality of the breach. As said by Lord Wright in *Ross T Smyth & Co Ltd v. Bailey Son & Co* [1940] 3 All ER 60, the debtor may intend to perform the contract 'but may be determined to do so only in a manner substantially inconsistent with his obligations, and not in any other way'. His recklessness is hence also relevant. The third conclusion refers to the 'future performance' argument. Although debtor's fault would more easily amount to fundamental breach in instalment contracts, as provided for in Article 8:103(c) PECL, we propose that debtor's fault is relevant where his conduct compromises not only the creditor's reliance on the debtor's future performance but also on his proper performance. As for the fourth conclusion, creditor's fault is also relevant against the fault of the debtor. We do not dispute that bad faith behavior on the part of the creditor, when terminating the contract, may result in ineffectiveness of such a declaration (Friedmann, 1995, pp. 415-417).

We hence claim for the relevancy of debtor's fault on those suppositions. As stated in *Hershey Farms, Inc v. State of New York* 110 NYS2d 324 (Ct. Cl. 1952), although in terms of instalment contracts, the decision on whether a contract is properly terminated 'is not a matter of law but one of conscience'. On this and similar cases (*Aerial Advertising Co v. Batchelors Peas Ltd* [1938] 2 All ER 788, although not a sale of goods case), Treitel (1988, p. 359) has remarked

that ‘the breach is of a particularly dramatic character and in this way impresses the court with its “seriousness”’. We hold such findings to be appropriate, in terms that ‘the court’s instinctive reaction to the breaches was probably correct’, although ‘this method of decision-making has dangers … which can at least be reduced by the attempt … to analyze the factors which generally influence decisions concerned with the requirement of seriousness of default’ (Treitel, 1988, p. 360). Debtor’s fault and its gravity is one of those factors. To be clear, fault is only a factor that is relevant and needed to make abstract rules applicable in practice. In the words of Honnold (1965, p. 344) on Article 10 ULIS, it ‘calls for a lively imagination’ in ascertaining the prerequisites for fundamental breach imposed by it. Contract law, notwithstanding the legal traditions under which it was developed, has continuously endeavored to settle performance and breach issues in terms of the underlining principles of the contract itself. Such constructional approaches imply the relevance of fault as built into the contract by the moral structure of promising (Eisenberg, 2011, pp. 94-97). What we are left with, at the end of the day, is the reliance and its importance in contract law (Barnett, 1996).

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