

## **Once More Unto the Breach: A Comparative Analysis of the Meaning of Breach in Contract Law**

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### **Abstract**

*The comparative analysis of law has been used to flesh out the commonalities and divergences between different legal systems, legal families, and bodies of law. Legal systems are often grouped or categorized as parts of a given legal tradition. A popular division in legal traditions has been that of the civil versus common law traditions. But such a taxonomy is a bit simplistic since there are numerous and important differences across legal traditions. Most civil law countries can be divided into those of the Germanic and Franco-Romanistic families, whereas Anglo-American law suggests a more holistic view of the common law. In reality, there are significant differences between the English and American common laws of contracts. These differences have become more profound with the modernization of commercial law through the enactment of the American Uniform Commercial Code and its subsequent influence on the development of the American common law of contracts. Comparative contract law has been a longstanding subject of comparative law scholars. This Article continues that line of comparative law research by exploring the mostly unstudied area of the meaning of breach in breach of contract, and its consequences. The Authors come from different parts of the civil-common law divide and the intra-family divide within the civil law tradition, accompanied by a knowledge of the unique civil law system instituted in the People's Republic of China. Finally, since all five countries subject to this study have adopted the Convention on Contracts for the International Sale of Goods (CISG), a discussion of how these countries have applied the CISG's fundamental breach rule is undertaken.*

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**Once More Unto the Breach<sup>1</sup>:  
A Comparative Analysis of Legally Recognized Breach of Contract**

I. INTRODUCTION

Comparative law has been a longstanding methodology<sup>2</sup> and its application to contract law has a deep history.<sup>3</sup> In the era of free trade, international contracts between parties from different legal traditions are commonplace. One of the most important concepts in contract law is breach of contract, more specifically, what constitutes a breach and what are the consequences of breach. This construct is found in all national contract laws because this is not a perfect world where everyone precisely and fully performs their contractual obligations. In such a world there would be no such thing as breach, except for excused breach in cases of impossibility, frustration of purpose, and hardship.

In our world, a substantial portion of the docket of courts and commercial arbitration tribunals involves contract disputes. Breach is the linchpin that sends the parties down this path of costly dispute resolution. Surprisingly, there has been little comparative law research on the meaning of breach across legal systems.<sup>4</sup> The obvious importance of such a study is to see if what may be

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<sup>1</sup> The literal meaning of this phrase is “let us try one more time,” or “try again.” See WILLIAM SHAKESPEARE, *HENRY V* act 3, sc. 1, l. 1.

<sup>2</sup> See generally KONRAD ZWEIGERT & HEIN KÖTZ, *INTRODUCTION TO COMPARATIVE LAW* (Tony Weir trans., 3d ed. 1988) (discussing the nature of comparative law, its functions, aims, methods, and history); H. PATRICK GLENN, *LEGAL TRADITIONS OF THE WORLD* (5th ed. 2014) (discussing national laws placed in the context of major legal traditions); MATHIAS SIEMS, *COMPARATIVE LAW* (2d ed. 2018) (discussing the different approaches to comparative law study); *THE CAMBRIDGE COMPANION TO COMPARATIVE LAW* (Mauro Bussani & Ugo Mattei eds., 2012) (discussing major themes and developments in comparative law studies); ELGAR *ENCYCLOPEDIA OF COMPARATIVE LAW* (Jan M. Smits ed., 2d ed. 2013) (providing examples of comparative law study).

<sup>3</sup> See, e.g., *FORMATION OF CONTRACTS: A STUDY ON THE COMMON CORE OF LEGAL SYSTEMS* (Rudolf B. Schlesinger ed., 1968) (describing how the common core approach to contract law involves finding similarities or functional equivalents between different national contract laws).

<sup>4</sup> There have been numerous studies of remedies in response to a breach of contract, but no work was found on the comparative analysis of the meaning of breach. See, e.g., *REMEDIES FOR BREACH OF CONTRACT* (Mindy Chen-Wishart et al. eds., 2016); *COMPARATIVE REMEDIES FOR BREACH OF CONTRACT* (Nili Cohen & Ewan McKendrick eds., 2005); JOSEPH M. LOOKOFSKY, *CONSEQUENTIAL DAMAGES IN COMPARATIVE CONTEXT* (1989).

deemed breach in one national law is considered satisfactory performance in another? Ancillary questions include whether a breach places any additional duties on the non-breaching party and if different types of breaches lead to different remedial options. This Article will examine the law of contracts in China, Germany, France, Italy, and the United States to provide answers to these important questions. These countries were selected for study because they represent countries of the common and civil law tradition,<sup>5</sup> the Germanic and Franco-Romanistic families of the civil law,<sup>6</sup> and a unique civil law system represented by China.<sup>7</sup>

Contract law for all of its rules, principles, and nuance distills into four basic topical areas—contract formation, performance-breach, contract interpretation, and remedies. This Article will focus on the second and least studied of these areas of contract law. These different areas of contract law differ in the mixture of fixed rules, standards, and principles, and, thereby, the degree of judicial discretion which is allowed. Contract formation and remedies provide a lesser degree of judicial discretion. Contract formation consists of a thick body of fixed, formal rules that are intended to be applied in a formulaic way. There are still some matters for discretion, such as when an offer, acceptance, and the exact time of contract formation occur. But it is discretion at the fringes of fixed rules. The area of remedies is one of confined discretion with judicial discretion often focused in the area of whether to grant a non-damages remedy or not. In the common law, that discretion is skewed against granting a remedy of specific performance or injunction since they are considered extraordinary remedies.<sup>8</sup> In the civil law, such remedies are considered ordinary, and theoretically, the choice of remedy is given to the

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<sup>5</sup> Western law has long been characterized by a common law-civil law divide. The plausible genesis of the notion of a divide is that the two legal traditions evolved independently of one another—civil law evolving out of Roman law and common law evolving from case decisions of the early English courts. *See, e.g.*, THOMAS LUNDMARK, CHARTING THE DIVIDE BETWEEN COMMON AND CIVIL LAW (2012) (discussing the misconceptions about the civil-common law divide); William Tetley, *Mixed Jurisdictions: Common Law vs. Civil Law (Part I)*, 4 UNIF. L. REV. 591 (1999); William Tetley, *Mixed Jurisdictions: Common Law vs. Civil Law (Part II)*, 4 UNIF. L. REV. 877 (1999); REINHARD ZIMMERMANN & D.P. VISSER, SOUTHERN CROSS: CIVIL LAW AND COMMON LAW IN SOUTH AFRICA (1996).

<sup>6</sup> The first two major codifications of Roman law into general national civil codes were the French Napoleonic Code of 1804 and the Civil Code of Germany of 1900. Both have served as model codes for other countries throughout the world. GLENN, *supra* note 2, at 132–40. For a more thorough analysis of the two families of the civil law, see ZWEIGERT & KÖTZ, *supra* note 2, at 74–131 (Romanistic Legal Family), 132–79 (Germanic Legal Family).

<sup>7</sup> After a century or more of false starts, China enacted its first general civil code, which became effective on January 1, 2021. *See infra* Part V.

<sup>8</sup> RESTATEMENT (SECOND) OF CONTS. § 357 (AM. L. INST. 1981). *See also* RESTATEMENT (SECOND) OF CONTS. § 359(1) (AM. L. INST. 1981) (stating, “[s]pecific performance or an injunction will not be ordered if damages would be adequate to protect the expectation interest of the injured party.”).

claimant.<sup>9</sup> In practice, in most civil law systems damages is the preferred remedy.<sup>10</sup>

The area of contract where judicial discretion is at its peak is the area of contract interpretation. Judges are the gatekeepers of whether extrinsic evidence<sup>11</sup> is admissible in the interpretation of contracts and whether a contract term is clear or ambiguous. This discretion is most salient in the common law where the parole evidence rule<sup>12</sup> bars the use of extrinsic evidence to contradict a term of a contract. But, the preclusion of pertinent external evidence by the rule is more illusion than fact. Courts have used covert means to evade the application of the parole evidence rule by declaring an otherwise clear contract term as ambiguous, requiring the need to admit supplemental extrinsic evidence. With the persuasive promotion of contextual interpretation advanced by the Uniform Commercial Code,<sup>13</sup> beginning in the 1960s, the contextual school of interpretation has become the predominant approach in American common law.

The area of what constitutes a contractual breach is aligned with the contextual school of contract interpretation. Judicial discretion is also dominant in this area because the determination of breach is based upon standards and not fixed rules. The standards, such as fundamental, material, serious, perfect tender, and substantial performance, are applied through a

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<sup>9</sup> See Code Civil [C. civ.] [Civil Code] art. 1217 (Fr.) (the obligee can “ask for the specific performance of the contract” (author’s translation)); Bürgerliches Gesetzbuch [BGB] [Civil Code], § 241(1), translation at <https://perma.cc/3QUN-XDKH> (Ger.) (the obligee (promisee) “is entitled to claim performance from the obligor [promisor]”); Codice civile [C.c.] [Civil Code] art. 1453 (It.) (“the non-defaulting party can ask either for performance or for termination of the contract” (author’s translation)).

<sup>10</sup> See, e.g., Lei Chen & Larry A. DiMatteo, *Inefficiency of Specific Performance as a Contractual Remedy in Chinese Courts: An Empirical and Normative Analysis*, 40 NW. J. INT’L L. & BUS. 275 (2020) (although Chinese contract law recognizes specific performance as an ordinary remedy, Chinese courts’ preferred remedy is the awarding of damages).

<sup>11</sup> The traditional four-corners analysis approach argues that the answers to all questions may be in dispute. Extrinsic evidence is all evidence found outside of the contract, such as prior dealings, course of performance, and trade usage. See U.C.C. § 1-303 cmt. 1 (AM. L. INST. & UNIF. L. COMM’N 2001) (a contract shall be “read and interpreted in the light of commercial practices and other surrounding circumstances”). The broader use of such evidence is referred to as the “totality of the circumstances.” See *In re Westinghouse Elec. Corp. Uranium Conts. Litig.*, 517 F. Supp. 440, 456 (E.D. Va. 1981) (stating that a reasonable person is “determined by the totality of the circumstances”); *Kreis v. Venture Out in Am., Inc.*, 375 F. Supp. 482, 484 (E.D. Tenn. 1973) (“one rule of construction . . . is to give effect to the intention of the parties in light of all the surrounding circumstances”). In 1918, Justice Holmes provided the rationale for a contextual interpretation of contracts: “A word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used.” *Towne v. Eisner*, 245 U.S. 418, 425 (1918).

<sup>12</sup> RESTATEMENT (SECOND) OF CONTS. § 213 (AM. L. INST. 1981) (Effect of Integrated Agreement on Prior Agreements (Parol Evidence Rule)). Section 213(1) states, “[a] binding integrated agreement discharges prior agreements to the extent that it is inconsistent with them.” *Id.*

<sup>13</sup> See U.C.C. § 1-303 (AM. L. INST. & UNIF. L. COMM’N 2001) (concerning course of dealing and usage of trade). A key provision in § 1-303(e) states, “[t]he express terms of an agreement and any applicable course of performance, course of dealing, or usage of trade must be construed whenever reasonable as consistent with each other.” U.C.C. § 1-303(e) (AM. L. INST. & UNIF. L. COMM’N 2001).

case-by-case determination based on the degree of performance, transaction type, and the equities of the case.<sup>14</sup> It is important to note that breach and performance are the flip sides of the same coin. If there is sufficient performance, there can be no breach; if there has been a significant breach, there can be no sufficient performance. Thus, when a given standard or threshold of performance is not met there is a breach of contract. However, this begs the question of whether all breaches are created equal? The answer is found in the nuances of a contract law's remedial scheme. Different types of breaches may affect the menu of remedies available to the non-breaching party. Thus, the type of breach is the trigger to the non-breaching party's ultimate concern—the remedies available to rectify the breach.

This Article focuses on the meaning of breach across five legal systems—American, Chinese, French, German, and Italian contract laws. The first representing the common law and the other four representing various families of the civil law. The purpose of this comparative analysis is to assess the degrees of commonality across these various laws and, more importantly, the degree with which they diverge. In the end, the hope is that such a comparative analysis will lead to a better understanding of the breach standards of each legal system. The importance of nuance is at a premium in this analysis since the different contract laws often use similar terms but, in practice, they may have different functional meanings. Alternatively stated, divergent black letter standards, such as strict versus substantial performance, may be much more similar in application. Finally, since all five of the selected countries are members of the United Nations Convention on Contracts for the International Sale of Goods (CISG),<sup>15</sup> the national courts' application of the CISG's fundamental breach rule<sup>16</sup> will also be discussed.

Part II examines the meaning of breach under French law including discussing the distinction between *obligation de résultat* and *obligation de moyens*,<sup>17</sup> as well as the notion of “serious breach.” The meaning of breach in Italian law is reviewed in Part III, from the perspectives of the 1865 Civil Code,<sup>18</sup> 1942 Civil Code,<sup>19</sup> and the present. Part IV studies breach in German law by comparing the rules found in the original German Civil Code (*Bürgerliches Gesetzbuch* or BGB) of 1900 and the modernized revision of

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<sup>14</sup> Karl Llewellyn combined these factors in his concept of situation sense. The idea of transaction-type asserting how contract law applies to a case is highly dependent on the type of contract in dispute. KARL N. LLEWELLYN, *THE LAW OF SALES* 1073–77 (1930) (including Llewellyn's index of different types of sales based on different commodities). For Llewellyn, it is the task of the judge to be “constant[ly] reaching for a sound way to fit the facts into some significant pattern or type.” KARL N. LLEWELLYN, *THE COMMON LAW TRADITION* 125 (1960).

<sup>15</sup> U.N. Conference on Contracts for the International Sale of Goods, *Official Records*, U.N. Doc. A/CONF.97/19 (Mar. 10–Apr. 11, 1980), <https://perma.cc/L9GR-YCG7>.

<sup>16</sup> U.N. Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, 1489 U.N.T.S. 3, art. 25 [hereinafter CISG].

<sup>17</sup> See *infra* Part II.B.

<sup>18</sup> See *infra* Parts III.B–C.

<sup>19</sup> See *infra* Part III.D.

2002,<sup>20</sup> which reformulated the interface between breach and a new system of remedies. Regarding the CISG's fundamental breach rule, the German courts have been most active in interpreting its meaning. Part V examines breach in the evolution of Chinese contract law from a fragmented series of laws enacted in the 1980s to the unified Chinese Contract Law of 1999<sup>21</sup> and its transposition to the 2021 Chinese Civil Code.<sup>22</sup> Part VI analyzes the trilogy of American breach rules including perfect tender,<sup>23</sup> substantial performance,<sup>24</sup> and fundamental breach.<sup>25</sup> These rules cut across the spectrum from extremely pro-buyer to extremely pro-seller standards of performance and breach. Part VII reports the findings of the comparative analysis of the five national contract laws.

## II. BREACH IN FRENCH LAW

The French and German Codes have acted as models for laws in many countries throughout the world. Other civil law countries to be studied include China and Italy. This will allow a comparison between the Germanic and Franco-Roman families of the civil law tradition (Germany and France); between countries within the same civil law family (France and Italy); between the civil and common law traditions (United States); and between established systems and a new civil code (Chinese Civil Code 2021). This Article begins with an analysis of French law.

### A. Evolution of French Contract Law

The general rules on breach and its consequences are set out by the provisions in the French Civil Code (FCC), as interpreted and applied by national courts. The FCC, originally enacted in 1804, devoted very few rules to the matter. Over time, French courts have complemented the relatively thin statutory coverage of the FCC with a complex and thick set of principles aiming to fill the gaps in the FCC, clarifying and at times, manipulating existing

<sup>20</sup> See *infra* Part IV.B.

<sup>21</sup> Zhōnghuá Rén mín Gònghéguó Hétóng Fǎ (中华人民共和国合同法) [Contract Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 15, 1999, effective Oct. 1, 1999) ch. VII, 2021 P.R.C. L. 15, 15 (China) [hereinafter CCL]. See generally, CHINESE CONTRACT LAW (Larry A. DiMatteo & Lei Chen eds., 2018) (examining CCL from civil and common law perspectives).

<sup>22</sup> See Zhōnghuá Rénmín Gònghéguó Mínfǎ Diǎn (中华人民共和国民法典) [Civil Code of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., May 28, 2020, effective Jan. 1, 2021) Book III ch. VIII, 2021 P.R.C. L. (China) [hereinafter CCC]; See generally, Dessie Tilahun Ayalew, *China's Recent Civil Law Codification in the High Tech Era: History, Innovations, and Key Takeaways*, 13 TSINGHUA CHINA L. REV. 149, 155 (2020) (reviewing changes made in the new civil code).

<sup>23</sup> U.C.C. § 2-601 (AM. L. INST. & UNIF. L. COMM'N 1951) ("if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may: (a) reject the whole; or (b) accept the whole; or (c) accept any commercial unit or units and reject the rest."). See *infra* Part VI.B.

<sup>24</sup> RESTATEMENT (SECOND) OF CONTS. § 237 cmt. d (AM. L. INST. 1981); see *infra* Part VI.A.2.

<sup>25</sup> CISG, *supra* note 16, art. 25 (stating a breach is fundamental "if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract").

provisions to make them fit for real-world contracting. Many of these well-settled rules were codified and integrated into the new FCC of 2016, when a major reform of contract law was enacted.<sup>26</sup> Since one of the main goals pursued by the 2016 reform was to update the FCC's text in line with judicial developments of the previous decades, French rules on breach today show remarkable consistency between statutory formulas and judicial principles, with the latter having been largely inspired by the former. Given the significance of historical judicial developments in this area and considering that the newly reformed rules only apply to disputes arising out of contracts agreed upon after October 1, 2016,<sup>27</sup> the Authors will examine how the notion of breach was framed and applied before and after the 2016 reform.

### B. Obligation de Résultat *and* Obligation de Moyens

Neither the original nor the current version of the FCC specify the meaning of “breach” (which corresponds, in French, to the notion of *inexécution*, but is often called *faute contractuelle* (contractual fault)). Legal scholarship, however, defines the latter as the “non-compliance by the obligor (obligor) of an obligation originating from the contract (be it a non-performance, defective performance or a delayed performance) that triggers contractual liability.”<sup>28</sup> For a long time, a debate in French law was whether contractual liability was strict in nature or required fault on the part of the obligor (breaching party). The original version of the FCC contained conflicting provisions in this regard,<sup>29</sup> a conflict that remains in the current version of the FCC.<sup>30</sup> It is nowadays well-established that liability is strict whenever a party promised to procure a certain result (assumed an *obligation de résultat*), while it is fault-based where the contract implied a party's promise to use his best efforts in carrying out an activity (a party's *obligation de moyens*). While in the former case the failure to achieve the promised result makes the defaulting party liable, in the latter case liability can only be established if the non-defaulting party proves the defaulting one did not try as hard as a reasonable person

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<sup>26</sup> Ordonnance 2016-131 du 10 février 2016 portant réforme du droit des contrats, du régime général et de la preuve des obligations [Ordonnance 2016-131 of February 10, 2016 reforming contract law, the general regime and proof of obligations], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Feb. 10, 2016 (reforming contract law in the FCC).

<sup>27</sup> *Id.* art. 9.

<sup>28</sup> *Faute contractuelle*, VOCABULAIRE JURIDIQUE (13th ed. 2020).

<sup>29</sup> On the one hand, former Article 1137 of the Civil Code stated that the obligor had to perform their contractual obligations with “the diligence of a reasonable person”; on the other hand, former Articles 1147 and 1148 of the Civil Code provided that, in case of breach, an obligor was liable unless the breach was due to “*force majeure*” and “*cas fortuit*” (which were not defined by the Civil Code, but considered as synonyms of unpredictable and unavoidable external causes). RÉMY CABRILLAC, DROIT EUROPÉEN COMPARÉ DES CONTRATS 144–45 (2d ed. 2016) (author's translation).

<sup>30</sup> *Cf.* Code civil [C. civ.] [Civil Code] arts. 1197, 1231-1 (Fr.).

would have under the same circumstances.<sup>31</sup> Given the silence of the code, identifying whether a contractual obligation qualifies as an obligation of result or of means is a task for the courts.

### C. Consequences of a Failed Performance

Under both the original and the current versions of the FCC, any breach entitles the non-defaulting party to demand performance from the obligor;<sup>32</sup> the non-defaulting party can also claim damages in respect of all foreseeable losses caused by the breach.<sup>33</sup> Under the original version of the Civil Code, Article 1184 stated that the non-defaulting party to a bilateral contract was allowed to renounce performance.<sup>34</sup> The alternative is to ask a court to terminate the contract by judgment and assess damages against the defaulting party. Also, in cases of non-trivial but insufficiently serious breaches, French lower courts have the power, regardless of any request in this regard by the non-defaulting party, to set a *délai de grâce* (time extension) for the defaulting party to cure the breach; upon the expiry of that period without performance the contract is terminated.<sup>35</sup> By contrast, the FCC did not allow the obligee to

<sup>31</sup> CABRILLAC, *supra* note 29, at 163; BÉNÉDICTE FAUVARQUE-COSSON & DENIS MAZEAUD, EUROPEAN CONTRACT LAW: MATERIALS FOR A COMMON FRAME OF REFERENCE: TERMINOLOGY, GUIDING PRINCIPLES & MODEL RULES 214–26 (2008); ZWEIGERT & KÖTZ, *supra* note 2, at 501–02.

<sup>32</sup> The original version of the Civil Code did not provide the right to ask for specific performance. However, French case law slowly recognized the obligee's right to specific performance as a general remedy, which could not be resisted by the defaulting promisor on grounds of proportionality or reasonableness. For instance, an order for specific performance—in terms of demolition of what was built and its reconstruction—was granted to the non-defaulting party in cases in which a swimming pool had three rather than the contractually specified four steps, even though the missing fourth step did not impede access to the pool. Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Jan. 17, 1984, Bull. civ. III, No. 13 (Fr.); *see also* Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., May 11, 2005, Bull. civ. III, No. 103 (Fr.) (where the house was 13 inches beneath the height required in the contractual specifications); SOLÈNE ROWAN, REMEDIES FOR BREACH OF CONTRACT: A COMPARATIVE ANALYSIS OF THE PROTECTION OF PERFORMANCE 37–52 (2012); YVES-MARIE LAITHIER, ÉTUDE COMPARATIVE DES SANCTIONS DE L'INEXÉCUTION DU CONTRAT 37–58 (2004) (quoting further case law). The 2016 reform introduced specific performance as a general remedy in the Civil Code, specifying, however, that the remedy should not be ordered where there is a manifest disproportion between its cost to the promisor and the benefit to the promisee. Code civil [C. civ.] [Civil Code] art. 1121 (Fr.); Hélène Boucard, *Penalties for Contractual Non-Performance: The Art of Doing Something New with Something Old, and Vice Versa*, in THE REFORM OF FRENCH CONTRACT LAW 149, 156–67 (Bénédicte Fauvarque-Cosson & Guillaume Wicker eds., 2019).

<sup>33</sup> *Cf.* Code civil [C. civ.] [Civil Code] arts. 1142 (former), 1231-1 (current) (Fr.).

<sup>34</sup> *See* Code civil [C. civ.] [Civil Code] art. 1184 (Fr.) (former).

<sup>35</sup> *See* Cour de cassation [Cass.] [supreme court for judicial matters] com., June 16, 1987, Bull. civ. IV, No. 145 (Fr.) (holding that lower courts have the discretionary power to consider a party's failure to perform not serious enough to justify the termination of the contract); Code civil [C. civ.] [Civil Code] art. 1184 (Fr.) (former article; thought to be applicable even when the breach was not attributable to the non-performing party—that is, in cases of supervening impossibility); FAUVARQUE-COSSON & MAZEAUD, *supra* note 31, at 246–47; *see also* LAITHIER, *supra* note 32, at 319. Since Article 1184 of the Civil Code did not specify the consequences of termination, the gap was filled by courts, according to which termination obliged parties to the mutual restitution of the uncompleted performances as if the contract was never entered upon. Cour de cassation [Cass.]

suspend or refuse the performance of its own obligations. The *exceptio non adimpleti contractus* (literally, the “defense of a non-performed contract,” allowing the performance of an obligation to be withheld if the other party has failed to perform the same or a related obligation) was available only under specific contracts, such as that of the sale of goods.<sup>36</sup> After the enactment of the 1804 FCC, the statutory rules on the matter were substantially revised by the courts, developing requirements, rules, and remedies for termination that departed from the statutory text. Since such case law also concerned the notion of breach and constituted the basis for the 2016 reform, it is useful to trace these developments.

#### D. Concept of “Serious Breach”

Under the original version of Article 1184 of the Civil Code, the non-defaulting party was entitled to ask for termination in case of a breach by the other party of any of his contractual obligations, including ancillary or collateral duties under the contract.<sup>37</sup> French courts, however, were dissatisfied by a rule they deemed too harsh; they rapidly started to make termination conditional upon the proof that the breach was serious enough.<sup>38</sup> For instance, in 1845, the Court of Cassation held that a 24-hour delay in the delivery of the goods sold did not entitle the buyer to terminate the contract since the delayed delivery did not cause any monetary loss to the buyer.<sup>39</sup> Subsequent case law refused to allow the termination of contracts when the lessee of an enterprise sporadically violated a non-competition clause attached to the main lease contract,<sup>40</sup> when the lessor of a furniture warehouse did not deliver some of the agreed furniture on time,<sup>41</sup> or when, in the sale of a vehicle, its load capacity or horsepower was inferior to what was contractually agreed upon.<sup>42</sup> Courts, thus, allowed the termination of contracts only when the breach, considering all circumstances, was deemed to be sufficiently serious. For instance, termination was granted in cases where glassware delivered by

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[supreme court for judicial matters] com., Oct. 12, 1982, Bull. civ. IV, No. 309 (Fr.). In long term contracts, however, termination is prospective and past performances are unaffected. Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Apr. 30, 2003, Bull. civ. III, No. 87 (Fr.).

<sup>36</sup> See Code civil [C. civ.] [Civil Code] art. 1612 (Fr.) (former and current) (author’s translation). According to Article 1612, “the seller is not bound to deliver the thing, if the buyer does not pay the price and the seller has not agreed to give the buyer credit.” *Id.* (author’s translation).

<sup>37</sup> Cf. Code civil [C. civ.] [Civil Code] art. 1184 (Fr.) (former).

<sup>38</sup> LAITHIER, *supra* note 32, at 305–09; ZWEIGERT & KÖTZ, *supra* note 2, at 496.

<sup>39</sup> Cour de cassation [Cass.] [supreme court for judicial matters] 1e civ., Apr. 15, 1845, Bull. civ. (Fr.); see also Cour de cassation [Cass.] [supreme court for judicial matters] 1e civ., Oct. 20, 1887, Bull. civ. (Fr.).

<sup>40</sup> Cour de cassation [Cass.] [supreme court for judicial matters] req., May 26, 1868, Bull. civ. (Fr.).

<sup>41</sup> Cour de cassation [Cass.] [supreme court for judicial matters] req., Mar. 4, 1872, Bull. civ. (Fr.).

<sup>42</sup> See Cour de cassation [Cass.] [supreme court for judicial matters] com., June 4, 1980, Bull. civ. IV, No. 239 (Fr.) (concerning load capacity); Cour de cassation [Cass.] [supreme court for judicial matters] 1e civ., Feb. 20, 1996, Bull. civ. I, No. 103 (Fr.) (concerning horsepower).

a seller turned out to be made of glass rather than crystal;<sup>43</sup> where a buyer failed to pay part of a sum agreed under a contract of sale;<sup>44</sup> where landowners in a sharecropping contract held an “aggressive, insulting and threatening behavior against the tenants”;<sup>45</sup> and where a lessee of a garage regularly paid rent, but also recurrently sent their lessor letters of insults.<sup>46</sup>

In deciding whether a breach is serious enough to justify termination, French courts have balanced both objective and subjective factors. Among the objective factors, courts consider whether the breach involved a fundamental or accessory obligation of the contract, whether it was total or partial, non-curable or curable, and the degree of harm the innocent party had suffered or might suffer as a result of the breach. Subjective factors include the interests of the parties (primarily those of the innocent party, but also of the defaulting one), and whether the defaulting party was to blame for the non-performance.<sup>47</sup> The assessment of the above factors and the decision to grant immediate termination or to set a cure period are considered to be decisions dealing with the facts of a case, and therefore left to the discretion of lower courts and not reviewable by the Court of Cassation.<sup>48</sup>

### *E. Unilateral Termination and Suspension*

The judicial construction of the requirement of seriousness for granting termination was not the only aspect on which French courts deployed their creativity. In spite of the clear wording of Article 1184 FCC, which only allowed termination by court order, French courts recognized, especially in business (B2B) contracts, the right for the innocent party to declare the contract over by reason of the other party’s serious non-performance, provided that, under the same circumstances, a court would have ordered immediate rescission of the contract.<sup>49</sup> French case law also admitted that, in cases of serious non-

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<sup>43</sup> Cour de cassation [Cass.] [supreme court for judicial matters] req., Feb. 15, 1904, DALLOZ, 1904, I, 335 (Fr.).

<sup>44</sup> Cour de cassation [Cass.] [supreme court for judicial matters] req., Dec. 23, 1912, DALLOZ, 1913, I, 47 (Fr.).

<sup>45</sup> Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Apr. 29, 1987, Bull. civ. III, No. 93 (Fr.) (author’s translation).

<sup>46</sup> Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., June 3, 1992, Bull. civ. (Fr.).

<sup>47</sup> Fault is not a condition for terminating a contract, but it might be a reason for termination. For a detailed analysis of the factors that might justify a court’s decision to terminate a contract, see LAITHIER, *supra* note 32, at 305–09, 311–38; ZWEIGERT & KÖTZ, *supra* note 2, at 496.

<sup>48</sup> LAITHIER, *supra* note 32, at 305–09.

<sup>49</sup> See Cour de cassation [Cass.] [supreme court for judicial matters] req., Jan. 4, 1927, SIREY, 1927, I, 188 (Fr.). For instance, French courts recognized that the innocent party can declare the contract terminated, notwithstanding the absence of any contractual clause in this regard, where the other party installed an expensive alarm system so poorly that the system never functioned (Cour de cassation [Cass.] [supreme court for judicial matters] 1e civ., Apr. 28, 1987, DALLOZ, 1988 (Fr.)), where an employed anesthesiologist on several occasions refused to provide his services at the

performance, the non-defaulting party could refuse to perform his own part subject to the principle of good faith—that is, provided that the innocent party’s refusal to provide performance was reasonable and proportioned to the gravity of the breach.<sup>50</sup> Further, French courts enforced contractual clauses detailing the circumstances under which a party was entitled to declare the contract over by simple declaration to that effect.<sup>51</sup> The combined result of these rules and doctrines was that, especially in B2B contracts, the statutory principle that only a court could rescind a contract was effectively overthrown in daily legal practice.

The above judicially made rules and doctrines were largely codified in the FCC through the 2016 reform. Under current Article 1224, termination of a bilateral contract is possible whenever one party commits a breach covered by a termination clause<sup>52</sup> or commits a “sufficiently serious breach” (*inexécution*

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health clinic which employed him (Cour de cassation [Cass.] [supreme court for judicial matters] 1e civ., Oct. 13, 1998, DALLOZ, 1999, jur. 197 (Fr.)) or where a financial advisory firm did not abide by the obligation to provide counseling services to its counterparty for two months (Cour de cassation [Cass.] [supreme court for judicial matters] 1e civ., Oct. 28, 2003, Bull. civ., No. 211 (Fr.)). In such cases, the party who terminates the contract does it at their own risk, knowing that a court might later qualify their act as unjustified and therefore as a “wrongful termination of contract” (*rupture abusive du contrat*). For further decisions, see LAITHIER, *supra* note 32, at 257–96; Philippe Delebecque, *Le droit de rupture unilatérale du contrat: genèse et nature*, 126 DROIT ET PATRIMOINE 56, 56–63 (2004); Laurent Aynès, *Le droit de rompre unilatéralement: fondement et perspectives*, 126 DROIT ET PATRIMOINE 64, 64–68 (2004); Philippe Stoffel-Munck, *Le contrôle a posteriori de la résiliation unilatérale*, 126 DROIT ET PATRIMOINE 68, 68–77 (2004).

<sup>50</sup> See, e.g., Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Nov. 26, 1974, Bull. civ., No. 439 (Fr.) (stating that, in the lease of a farm, a tenant may refuse to perform their obligation to maintain the land if the lessor refuses to perform the contractually agreed maintenance on the buildings). Courts assessed ex post the reasonableness of the innocent party’s refusal to perform. See, e.g., Cour de cassation [Cass.] [supreme court for judicial matters] com., Jan. 30, 1979, Bull. civ. IV, No. 41 (Fr.) (holding that, in a contract for leasing hardware and software equipment, the party who received two allegedly defective magnetic disc units was not entitled to suspend the monthly payments due under the contract, providing that the two discs, although not brilliantly performing, were working and actually used by the party raising the *non adimpleti contractus* exception).

<sup>51</sup> ZWEIGERT & KÖTZ, *supra* note 2, at 498; HUGH BEALE ET AL., CASES, MATERIALS AND TEXT ON CONTRACT LAW 787 (3d ed. 2019). Of course, even when a contract contains a “*clause de résolution en plein droit*,” courts are empowered to review ex post facto whether a party’s use of a termination clause complied with the principle of good faith. See, e.g., Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Apr. 8, 1987, GAZETTE DU PALAIS, 1988, II, 21037 (Fr.) (noting that, in a contract between friends for the lease of a building, a lessor who did not ask for payment of the lease for twelve years cannot avail themselves of the termination clause in the contract after they unsuccessfully asked the lessee to pay at once all the arrears because such behavior is contrary to good faith).

<sup>52</sup> Code civil [C. civ.] [Civil Code] art. 1225(2) (Fr.) (stating that “termination may take place only after service of a notice to perform which has not been complied with, unless it was agreed that termination may arise from the mere act of non-performance. The notice to perform takes effect only if it refers expressly to the termination clause”) (translation by John Cartwright et al., <https://perma.cc/K35A-HFJQ>). For a comment on such clause, see Clotilde Jourdain-Fortier, *La résolution*, in ANALYSE COMPARÉE DU DROIT FRANÇAIS RÉFORMÉ DES CONTRATS ET DES RÈGLES MATÉRIELLES DU COMMERCE INTERNATIONAL 418, 422–43 (Clotilde Jourdain-Fortier & Marc Mignot eds., 2016) [hereinafter ANALYSE COMPARÉE DU DROIT FRANÇAISE RÉFORMÉ].

*suffisamment grave*).<sup>53</sup> In the latter case, termination is no longer a matter for courts only; whenever a party commits a sufficiently serious breach, the innocent party can unilaterally declare the contract terminated. According to current Article 1226 of the FCC, this can be done by giving notice to the other party of the non-breaching party's intent to terminate unless performance is rendered within a reasonable period of time. Upon the expiry of the time extension to perform, any non-performance results in the termination of the contract.

The party who unilaterally terminates the contract does it at its own risk. Article 1228 of the FCC expressly provides that, if the defaulting party challenges the termination, the court will assess *ex post* whether the termination was justified. If the court finds it was not justified, it can restore the contract or grant the defaulting party a further chance to perform before declaring the contract terminated.<sup>54</sup> The reform further codified the right of the non-defaulting party to refuse performance when the other party has not performed its obligations, provided that the latter's breach is sufficiently serious,<sup>55</sup> or if it becomes evident that the other party will not perform its obligations and the consequences or harm to the non-breaching party is likely to be sufficiently serious.<sup>56</sup> The reform, by contrast, left largely untouched the regulation of specific contracts (sale, rental, construction) contained in the original FCC. The new general remedies should therefore be coordinated with older rules relating to specific types of contracts. For instance, in case of sale of goods contracts (covered by Articles 1582 to 1701-1 of the FCC), special rules on warranty for defects that make the goods unsuitable for their intended use or considerably decrease the value of the goods, authorize the buyer to choose between an *actio redibitoria* and an *actio estimatoria*—that is, between termination or reduction of price.<sup>57</sup>

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<sup>53</sup> The notion of “sufficiently serious breach” is not further specified in the Civil Code; rather, it seems that it should be interpreted in line with the pre-reform case law. See Jourdain-Fortier, *supra* note 5252, at 448–53 (author's translation).

<sup>54</sup> For a comment to the new Articles 1226–1228 of the Civil Code, see Boucard, *supra* note 32, at 153, 158–60; Jourdain-Fortier, *supra* note 5252, at 444–67. The 2016 reform did not introduce a general right for a non-performing party to cure their non- or mis-performance; however, the fact that termination is not possible unless a deadline for performance is set operates as a time frame before which cure is possible.

<sup>55</sup> Code civil [C. civ.] [Civil Code] art. 1219 (Fr.).

<sup>56</sup> Code civil [C. civ.] [Civil Code] art. 1220 (Fr.). This is very close to the common law notion of anticipatory breach, with one difference being that, in such a case, a contract is not per se terminated and an innocent party has the right to suspend performance. See CABRILLAC, *supra* note 29, at 157; Grayot-Dix, *L'exception d'inexécution*, in ANALYSE COMPARÉE DU DROIT FRANÇAIS RÉFORMÉ, *supra* note 52, at 355, 363–66; Jourdain-Fortier, *supra* note 5252, at 460–67.

<sup>57</sup> Code civil [C. civ.] [Civil Code] art. 1644 (Fr.). According to French case law, a buyer does not have to provide reasons for their choice, and that cannot be contested by judges. Cour de cassation [Cass.] [supreme court for judicial matters] 1e civ., Nov. 22, 1988, Bull. civ. I, No. 334 (Fr.). Yet, there is also case law holding that a court may refuse to terminate a contract when the denounced defect is not sufficiently serious to justify the termination of the contract, for example only concerning the reduction of the price. Cour de cassation [Cass.] [supreme court for judicial matters]

### F. French Courts' Application of the CISG

In light of the above, it is clear that the 2016 reform made French statutory contract law more consonant with long-standing judicial practice and with international commercial principles and rules, including the CISG.<sup>58</sup> The FCC now embraces principles long developed by judicial practice—such as the standard of “sufficiently serious breach” and a party’s right to unilaterally declare the contract avoided and to suspend performance in case of the other party’s breach, which was previously found in the French courts’ application of CISG rules.

French courts have always assessed breaches in international disputes over sale contracts in line with the provisions of the CISG.<sup>59</sup> French courts have for instance defined as a fundamental breach under Article 25 of the CISG the buyer’s unjustified refusal to receive and pay for the goods previously ordered<sup>60</sup> or the buyer’s refusal to disclose to the seller the ultimate destination of the goods.<sup>61</sup> A seller’s failure to deliver the goods was deemed to be a fundamental breach where the seller’s faulty instructions to the carrier resulted in the loss of the goods<sup>62</sup> and when the seller’s refusal to deliver the goods was justified upon its frustration with the buyer’s uncooperative behavior.<sup>63</sup> As to non-conforming goods, French courts have found that sellers committed a fundamental breach of the contract when two grinding machines sold never properly functioned, notwithstanding the seller’s attempts to cure their defects;<sup>64</sup> when 13,800 of the 14,100 bra fillers sold proved to be unfit for their purpose, which was known to the seller;<sup>65</sup> when approximately one-third

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com., Mar. 6, 1990, Bull. civ. IV, No. 75 (Fr.). Further, under sales contracts, a specific right to refuse performance is granted to the seller by Article 1612 of the Civil Code, according to which a seller can retain goods if the buyer has not paid the price and the seller has not granted an extension of the deadline for payment. Code civil [C. civ.] [Civil Code] art. 1612 (Fr.).

<sup>58</sup> See Jourdain-Fortier, *supra* note 5252, at 330–54, 445–60. The author, however, claims that the notion of a “sufficiently serious breach” does not coincide with that of “breach of a fundamental obligation” mentioned by CISG Article 25 inasmuch as the latter is mainly defined in light of the non-defaulting party’s interest. See *id.* at 348, 445–60 (author’s translation).

<sup>59</sup> The CISG was ratified by France in 1982 but entered into force only in 1988. See U.N., *Status: United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) (CISG)*, [https://uncitral.un.org/en/texts/salegoods/conventions/sale\\_of\\_goods/cisg/status](https://uncitral.un.org/en/texts/salegoods/conventions/sale_of_goods/cisg/status).

<sup>60</sup> Cour d’appel [CA] [regional court of appeal] Bordeaux, 2e civ., Feb. 25, 2016, 14/06947 (Fr.); Cour d’appel [CA] [regional court of appeal] Aix-en-Provence, 2e civ., June 4, 2015, 2015/10 (Fr.); Tribunal de commerce [Trib. comm.] [commercial court] Versailles, Mar. 12, 2010, DALLOZ, 2007, 530 (Fr.) (concerning electronic medical equipment).

<sup>61</sup> Cour d’appel [CA] [regional court of appeal] Grenoble, com., Feb. 22, 1995, 11/01518 (Fr.).

<sup>62</sup> Cour de cassation [Cass.] [supreme court for judicial matters] 1e civ., May 20, 2003, Bull. civ. I, No. 237 (Fr.).

<sup>63</sup> Cour d’appel [CA] [regional court of appeal] Lyon, civ., Feb. 4, 2011, 11/01518 (Fr.). Similarly, a seller was found to have committed a fundamental breach when they first refused to deliver the goods ordered and then fraudulently denied that they received the orders. Cour d’appel [CA] [regional court of appeal] Grenoble, civ., Oct. 21, 1999, D. 2000 Somm. (Fr.).

<sup>64</sup> Cour d’appel [CA] [regional court of appeal] Versailles, civ., Jan. 29, 1998, 1222/95 (Fr.).

<sup>65</sup> Cour d’appel [CA] [regional court of appeal] Rennes, civ., May 27, 2008, 2010/921 (Fr.).

of 15,000 cookers sold to a buyer were seriously dangerous and not properly tagged, thus obliging the buyer to recall the entirety of the cookers from its customers;<sup>66</sup> and when a seller delivered 928 boxes of frozen lamb meat of which two reportedly had passed their expiration dates, thus causing the local authorities to declare all the meat unsuitable for human consumption.<sup>67</sup>

By contrast, French courts have denied that a buyer committed a fundamental breach when it did not take timely delivery of part of the goods, since the time for delivery was not of the essence<sup>68</sup> nor was the seller's delivery time unreasonably short.<sup>69</sup> Conversely, French courts have held that the seller's breach was not fundamental when the non-conformity concerned a minor and easily replaceable component of the goods sold;<sup>70</sup> or when, notwithstanding the alleged defects in the machines sold, the buyer did not accept the seller's offer to replace them, refused to participate in a technical analysis of the allegedly defective goods,<sup>71</sup> waited more than one year from the delivery before asking for termination,<sup>72</sup> or continued to use a machine for six years after delivery.<sup>73</sup> In another case, the seller's breach was deemed not to be fundamental when it could not be ascertained with certainty whether the malfunctioning of an industrial printer was due to the defectiveness of the machine or to the low-quality paper rolls used by the buyer.<sup>74</sup>

As the above cases demonstrate, French courts have shown little difficulty in administering the fundamental breach standard of the CISG since it has been equated with the domestic notion of "sufficiently serious breach." French courts have applied numerous factors not expressly stated in Article 25, which instruct that a fundamental breach determination shall take the obligee's interest and the foreseeability of the ensuing losses into account. French courts have applied additional subjective and objective criteria used in domestic law,

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<sup>66</sup> Cour d'appel [CA] [regional court of appeal] Paris, civ., June 4, 2004, 2005/2281 (Fr.).

<sup>67</sup> Cour de cassation [Cass.] [supreme court for judicial matters] com., Dec. 17, 2013, Bull. civ. IV, No. 12-23998 (Fr.).

<sup>68</sup> Cour d'appel [CA] [regional court of appeal] Grenoble, civ., Feb. 4, 1999, 98/02700, D. 1999 Somm. 363 (Fr.).

<sup>69</sup> Tribunal de grande instance [TGI] [ordinary court of original jurisdiction] Strasbourg, Dec. 22, 2006, 04/00925 (Fr.).

<sup>70</sup> Cour d'appel [CA] [regional court of appeal] Grenoble, civ., Apr. 26, 1995, 93/4879 (Fr.) (discussing the defects affecting a few metal beams that the steel hangar sold).

<sup>71</sup> Cour de cassation [Cass.] [supreme court for judicial matters] com., Mar. 26, 2013, Bull. civ. IV, No. 46 (Fr.).

<sup>72</sup> Cour d'appel [CA] [regional court of appeal] Paris, civ., June 14, 2001, 98/38724, D. 2005 Somm. 2281 (Fr.) (confirmed by Cour de cassation [Cass.] [supreme court for judicial matters] com., Sept. 24, 2003, Bull. civ. IV, No. 139 (Fr.)).

<sup>73</sup> Cour de cassation [Cass.] [supreme court of judicial matters] com., Mar. 22, 2016, Bull. civ. (Fr.); *see also* Cour d'appel [CA] [regional court of appeal] Bordeaux, June 27, 2011 (Fr.).

<sup>74</sup> *See* Cour de cassation [Cass.] [supreme court of judicial matters] com., July 9, 2019, Bull. civ. (Fr.).

such as the promptness of parties' reactions,<sup>75</sup> parties' fault in causing the breach or attempting to limit its consequences,<sup>76</sup> certainty of the evidence of a breach,<sup>77</sup> the availability of a technical examination of defects, and the parties' refusal to cooperate.<sup>78</sup>

### III. BREACH IN ITALIAN LAW

Italian developments in the area of breach of contract follow a pattern, albeit original, that closely resembles the French experience. The current legal framework can only be properly understood by examining the evolution of Italian contract law, beginning with the 1865 Italian Civil Code.

#### A. *Evolution of Breach in Italian Law*

The few rules on breach contained in the 1865 Italian Civil Code (ICC),<sup>79</sup> adopted after the unification of the Italian peninsula, were rapidly integrated and modified by court practice. The mismatch between written rules (law in books) and legal practice (law in action) was largely solved by the enactment of the Civil Code in 1942,<sup>80</sup> which is still in force.

Current statutory rules on breach, as interpreted and applied by Italian courts, are largely consonant with those established under the CISG for international sales contracts: any breach entitles the innocent party to ask for performance and sue for damages, but not every breach allows the wronged party to terminate the contract.

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<sup>75</sup> Cour de cassation [Cass.] [supreme court of judicial matters] com., Mar. 22, 2016, Bull. civ. (Fr.); Cour d'appel [CA] [regional court of appeal] Bordeaux, June 27, 2011 (Fr.); Cour d'appel [CA] [regional court of appeal] Paris, civ., June 14, 2001, 98/38724, D. 2005 Somm. 2281 (Fr.) (confirmed by Cour de cassation [Cass.] [supreme court for judicial matters] com., Sept. 24, 2003, Bull. civ. IV, No. 139 (Fr.)).

<sup>76</sup> See Cour de cassation [Cass.] [supreme court of judicial matters] com., July 9, 2019, Bull. civ. (Fr.); Cour de cassation [Cass.] [supreme court for judicial matters] com., Mar. 26, 2013, Bull. civ. IV, No. 46 (Fr.); Cour d'appel [CA] [regional court of appeal] Grenoble, civ., Oct. 21, 1999, D. 2000 Somm. (Fr.); Cour d'appel [CA] [regional court of appeal] Grenoble, com., Feb. 22, 1995, 11/01518 (Fr.); Tribunal de grande instance [TGI] [ordinary court of original jurisdiction] Strasbourg, Dec. 22, 2006, 04/00925 (Fr.).

<sup>77</sup> See Cour de cassation [Cass.] [supreme court of judicial matters] com., July 9, 2019, Bull. civ. (Fr.); Cour de cassation [Cass.] [supreme court for judicial matters] com., Mar. 26, 2013, Bull. civ. IV, No. 46 (Fr.); Cour d'appel [CA] [regional court of appeal] Versailles, civ., Jan. 29, 1998, 1222/95 (Fr.).

<sup>78</sup> Cour de cassation [Cass.] [supreme court for judicial matters] com., Mar. 26, 2013, Bull. civ. IV, No. 46 (Fr.); Cour d'appel [CA] [regional court of appeal] Lyon, civ., Feb. 4, 2011, 11/01518 (Fr.); Cour d'appel [CA] [regional court of appeal] Paris, civ., June 14, 2001, 98/38724, D. 2005 Somm. 2281 (Fr.); Cour d'appel [CA] [regional court of appeal] Versailles, civ., Jan. 29, 1998, 1222/95 (Fr.).

<sup>79</sup> The original text of the 1865 Italian Civil Code may be found at <https://perma.cc/YXX8-6EZN>.

<sup>80</sup> Unfortunately, there is not a freely available and updated official version of the Italian Civil Code of 1942 in English, the contents of which might be accessed at [dejure.it](http://dejure.it).

### B. Civil Code of 1865 (*Vive la France*)

The ICC of 1865 was French-inspired in both content and form.<sup>81</sup> Consequently, it did not define breach (*inadempimento*); contained ambiguous rules (Articles 1218 and 1224) as to whether contractual liability was strict or required fault on the part of the obligor;<sup>82</sup> convolutedly stated that remedies for breach included performance and termination, in addition to compensation for damages (Articles 1218 and 1165); allowed termination for any kind of breach, but only by court order (Article 1165);<sup>83</sup> and did not mention the possibility for the non-defaulting parties to avail themselves of the *exceptio non adimpleti contractus* (rule allowing the performance of an obligation to be withheld if the other party has failed to perform the same or a related obligation).

### C. Judicial Application of the 1865 Code

In the years following its enactment, Italian courts interpreted the ICC's text. Courts, for instance, specified that breach meant any deviation from what was contractually agreed upon by the parties and that contractual liability was a strict principle.<sup>84</sup> On the basis of the ambiguous provisions set forth in Articles 1218 and 1224 of the ICC, a distinction was drawn between obligations of result (*obbligazioni di risultato*) and obligations of means (*obbligazioni di mezzi*).<sup>85</sup> In the former case, the obligor's failure to achieve the promised result made it liable, while an obligor of an obligation of means was only required to render the agreed performance with the utmost care and could defend itself from liability by proving its diligence.<sup>86</sup> In case of breach, Italian courts conditioned the non-defaulting party's right to have the contract terminated under Article 1165 of the ICC upon the judicial assessment of the severity of the breach. They did so in spite of the fact that the ICC stated no requirement that the breach be serious. Whenever a breach was thought to be trivial, courts refused to terminate the contract but rather granted the non-performing party

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<sup>81</sup> Michele Graziadei, *Legal Culture and Legal Transplants*, in LEGAL CULTURE AND LEGAL TRANSPLANTS (Jorge A. Sánchez Cordero ed., 2012); John H. Merryman, *The Italian Style II: Law*, 18 STANFORD L. REV. 396, 413 (1966).

<sup>82</sup> Article 1218 of the Italian 1865 Civil Code provided that whoever does not perform a contract is liable for the consequences of their non-performance. Codice civile [C.c.] [Civil Code] art. 1218 (It.). Article 1224 of the same code added that obligors should act as a reasonable person in performing their contractual obligations. Codice civile [C.c.] [Civil Code] art. 1224 (It.).

<sup>83</sup> The third paragraph of Article 1165 also authorized the court to grant an obligor a grace period for performance before declaring a contract terminated. Codice civile [C.c.] [Civil Code] art. 1165 (It.).

<sup>84</sup> See, e.g., FRANCESCO RICCI, *INDOLE E FONTE DELLE OBBLIGAZIONI E DEI CONTRATTI* 57 (1892) (citing Cass. Palermo, 4 marzo 1875 (It.)).

<sup>85</sup> See Giuseppe Osti, *Revisione Critica della Teoria sull'impossibilità della Prestazione*, in RIVISTA DI DIRITTO CIVILE 209–59, 313–60, 417–71 (1918).

<sup>86</sup> In other words, obligations of result were governed by Article 1218 of the 1865 Civil Code, while obligations of means fell under Article 1224. Codice civile [C.c.] [Civil Code] arts. 1218, 1224 (It.). It was up to individual courts to decide whether a contractual obligation was of means or of result. Osti, *supra* note 85.

an extended deadline for performing its obligations, upon the expiry of which the contract was effectively terminated.<sup>87</sup> Yet, courts also acknowledged, through a generous interpretation of two provisions of the 1887 *Codice di commercio* (Code of Commerce) on commercial sales contracts,<sup>88</sup> that in some cases a tribunal could declare the contract terminated, regardless of the gravity of the breach.<sup>89</sup> In particular, this was allowed whenever the non-defaulting party had previously granted the defaulting party a last chance to perform within a reasonable time limit and that time limit had expired in vain, or if the defaulting party did not perform or delayed performance when time of performance was of essence.<sup>90</sup> Italian courts also recognized, in spite of the silence of the Civil and Commerce Codes in this regard, that the non-defaulting party could suspend his own performance when the defaulting party was in breach.<sup>91</sup>

#### D. Civil Code of 1942

The judicial and doctrinal developments generated around the ICC of 1865 were codified in the ICC of 1942. As far as breach is concerned, the 1942 ICC maintained substantial continuity with the past, but it also introduced new revised rules in an effort to systematize the law and make it more consonant with business needs. Continuity is demonstrated by the fact that the 1942 ICC still provides no definition of breach and contains contradictory provisions about the nature of contractual liability. Article 1218 of the ICC states that liability is strict,<sup>92</sup> while Article 1176 suggests that liability is fault-based.<sup>93</sup> The ICC also shows continuity because its rules concerning remedies for breach cover performance, termination, and damages,<sup>94</sup> and it provides that

<sup>87</sup> Cass. Turin, 17 ottobre 1894, Foro. it. 1895, I, 1175 (It.). According to Italian courts, a defaulting party could not cure their breach after the non-defaulting one started an action for termination except in cases where a court granted the obligor an additional period for performance under the third paragraph of Article 1165. Cass. Florence, 29 febbraio 1908, Giur. it., 1908, I, 423 (It.).

<sup>88</sup> Codice di commercio [C. comm.] [Commercial Code] art. 67 (It.) (allowing for termination following a notice with a last chance to perform and the expiry of the period granted); Codice di commercio [C. comm.] [Commercial Code] art. 69 (It.) (allowing termination when time of performance is of the essence).

<sup>89</sup> Cass. Rome, Plenary, 6 aprile 1922, Rivista di diritto commerciale, 1922, II, 539 (It.); Cass., 4 aprile 1927, Foro it., 1928, I, 793 (It.).

<sup>90</sup> Cass., 4 aprile 1927, *supra* note 89.

<sup>91</sup> Cass. Naples, 21 luglio 1902, Giur. it., 1902, I, 1, 1097 (It.).

<sup>92</sup> “The obligor who does not exactly render due performance is liable for damages unless he proves that the non-performance or delay was due to impossibility of performance not attributable to him.” Codice civile [C.c.] [Civil Code] art. 1218 (It.) (author’s translation).

<sup>93</sup> “In performing obligations, the obligor shall use the diligence of a reasonable man.” Codice civile [C.c.] [Civil Code] art. 1176 (It.) (author’s translation).

<sup>94</sup> Codice civile [C.c.] [Civil Code] arts. 1218–1229 (It.) (regarding compensation); Codice civile [C.c.] [Civil Code] arts. 1453–1462 (It.) (regarding termination for breach). Termination is also possible for supervening impossibility and hardship under Articles 1463–1465 and 1467–1469 of the Civil Code respectively. Codice civile [C.c.] [Civil Code] arts. 1463–1465, 1467–1469 (It.); Codice civile

termination is in principle possible only by court order.<sup>95</sup> But in many respects, the ICC of 1942 represents a clear rupture from its predecessor. First, Article 1455 of the ICC now enshrines the judicially developed principle that termination follows only after a serious breach—that is, termination cannot be granted “if the non-performance by one party is immaterial in view of the interests of the other party.”<sup>96</sup>

Second, the ICC tempered the rule that termination is only through court order by introducing three exceptional cases in which a party can unilaterally terminate a contract: (1) where the contract includes a termination clause specifying defaults in performance that allow for self-termination and the non-defaulting party declares that he intends to make use of the clause;<sup>97</sup> (2) three days from the expiration of the time expressly or impliedly set by the parties as time of the essence, unless the non-defaulting party declares an interest in obtaining performance notwithstanding the delay;<sup>98</sup> and (3) when, after the time for performance has expired, a party notifies the defaulting party in writing (notice called *diffida ad adempiere*) that performance should be rendered within a reasonable period, not shorter than fifteen days, and that, upon unsuccessful performance within the extended time period, the contract may be terminated.<sup>99</sup>

Third, the 1942 ICC codified the *exceptio non adimpleti contractus*, expressly authorizing the non-defaulting party’s right to refuse performance in case of breach by the other party, unless that refusal is contrary to good faith.<sup>100</sup>

Fourth, the ICC recognized anticipatory breach when a party, before performance is due, declares in writing its unwillingness to perform; in such a case, the contract is deemed to be breached at the time of the notice.<sup>101</sup>

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[C.c.] [Civil Code] arts. 2930–2933 (It.) (regarding specific performance). Article 1453 of the Civil Code specifies that the non-defaulting party has a choice between bringing a claim for performance and bringing an action to terminate the contract, and that any of such actions may be combined with a claim for damages with the only limitation being that, once a claim for performance has been raised, the plaintiff may switch to a claim for rescission and damages, but not vice versa. Codice civile [C.c.] [Civil Code] art. 1453 (It.).

<sup>95</sup> Codice civile [C.c.] [Civil Code] art. 1453 (It.). Termination for non-performance has a retroactive effect between the parties, except in the case of contracts for continuous or periodic performance, with respect to which the dissolution’s effect does not extend to performances already rendered. See Codice civile [C.c.] [Civil Code] art. 1467 (It.); PIETRO TRIMARCHI, IL CONTRATTO: INADEMPIMENTO E RIMEDI 74–80 (2010); Alberto M. Musy & Alberto Monti, *Contract Law*, in INTRODUCTION TO ITALIAN LAW 247, 278 (Jeffrey S. Lena & Ugo Mattei eds., 2002).

<sup>96</sup> Codice civile [C.c.] [Civil Code] art. 1455 (It.) (author’s translation).

<sup>97</sup> Codice civile [C.c.] [Civil Code] art. 1456 (It.).

<sup>98</sup> Codice civile [C.c.] [Civil Code] art. 1457 (It.).

<sup>99</sup> Codice civile [C.c.] [Civil Code] art. 1454 (It.).

<sup>100</sup> Codice civile [C.c.] [Civil Code] art. 1460 (It.).

<sup>101</sup> Codice civile [C.c.] [Civil Code] art. 1219 (It.).

These general rules are complemented by bodies of specialized rules governing particular types of contracts. For instance, for sale contracts, the ICC provides that, if there are defects in the goods that make the goods unsuitable for their intended use or considerably decrease the value of the goods, the buyer is entitled to choose between a reduction of the purchase price or the termination of the agreement<sup>102</sup> (to go along with compensation for damages under Article 1494).<sup>103</sup>

### *E. Subsequent Case Law*

Subsequent case law has elaborated upon the scope of application of the statutory rules. Courts, for instance, have resolved the contradiction between Articles 1218 and 1176 of the ICC by resorting to the well-rooted distinction between obligations of result (governed by strict liability) and obligations of means (subject to negligence-based liability).<sup>104</sup> Since the ICC is silent about the seller's right to cure, courts have recognized that the party in breach can cure its defective performance or non-performance before the other party brings a claim for termination.<sup>105</sup> In cases of non-judicial termination of the contract, courts have established that parties are free to agree that any kind of delay or defective performance, which is not "sufficiently serious," might allow the innocent party to terminate the contract under Articles 1456 or 1457 if the contract so provides.<sup>106</sup> In contrast, in the absence of a termination clause or a "time is of the essence" term, the non-defaulting party can rely on a *diffida ad adempiere* to terminate the contract under Article 1454 of the Italian Codice Civile only if the non-performance of the other party is material.<sup>107</sup> In other words, whenever the parties agree on certain breaches being fundamental,

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<sup>102</sup> Codice civile [C.c.] [Civil Code] art. 1492 (It.).

<sup>103</sup> Codice civile [C.c.] [Civil Code] art. 1494 (It.). Further rules on specific contracts modify the general principle embraced by Article 1455 of the Civil Code. *See, e.g.*, Codice civile [C.c.] [Civil Code] art. 1525 (It.) (concerning hire-purchase agreements, the buyer's failure to pay one single installment exceeding the eighth part of the total price allowed the seller to ask for termination of the contract, irrespective of any concrete evaluation of the materiality of the buyer's breach); Codice civile [C.c.] [Civil Code] art. 1564 (It.) (in supply contracts, the non-performance of a single installment by one of the parties does not allow the other party to terminate the contract unless the breach is significant such as to reduce confidence in the punctuality of subsequent performances).

<sup>104</sup> Luigi Mengoni, *Obbligazioni 'di risultato' e obbligazioni 'di mezzi'*, in I RIVISTA DI DIRITTO CIVILE 185–209 (1954); Valeria De Lorenzi, *Obbligazioni di mezzi e obbligazioni di risultato*, in XII DIGESTO DELLE DISCIPLINE PRIVATISTICHE, SEZIONE CIVILE 397–410 (1995).

<sup>105</sup> From the date in which a party raises a claim for termination, the other party cannot offer any more to perform their obligations. Cass., 14 febbraio 1994, n. 1460, Giust. civ. massimario, 1994, 156 (It.); Cass., 31 luglio 1987, n. 6643, Foro it., 1988, I, c. 138 (It.). *See also* TRIMARCHI, *supra* note 95, at 65.

<sup>106</sup> *See* Cass., 18 giugno 1980, n. 3866, Foro it., 1980, no. 276 (It.) (concerning termination clauses) (author's translation); Cass., 18 febbraio 2011, n. 3993, Responsabilità civ. e previdenza, 2011, 1651 (It.) (concerning "time is of the essence" clauses). *See also* LORENZO BERTINO, LE CLAUSOLE SULLA NON SCARSA IMPORTANZA DELL'INADEMPIMENTO 165–234 (2016).

<sup>107</sup> *See* Cass., 4 maggio 1994, n. 4275, Foro it., 1995, I, 2537 (It.); Cass., 17 maggio 1949, n. 1220, Foro it., 1949, I, 1176 (It.).

courts refrain from questioning the parties' choices, but, in the absence of such a choice, courts retain the power to verify *ex post* whether the termination was based on a material breach and therefore justified.<sup>108</sup>

Similarly, in sale contracts, courts have held—notwithstanding the wording of Article 1492 of the ICC—that if goods are defective the buyer can ask for termination of the contract only if the seller's breach is not immaterial under Article 1455 of the ICC.<sup>109</sup> As to the assessment of which breaches are material under Article 1455, courts take into account “all circumstances relevant to that particular contract concerning the alteration of the contractual balance, according to objective and subjective criteria,” such as “the weight and function of non-performance within the contractual relationship” and “the aggrieved party's interest in receiving performance.”<sup>110</sup> Courts further examine, *inter alia*, the duration of breach, to what extent the breach undermined the parties' relationship and their reciprocal trust, whether the breach could be easily cured, whether damages could represent an adequate remedy, and the consequences of the termination on both parties.<sup>111</sup> Courts have held that the buyer's failure to pay a part of the price might constitute a material breach justifying the termination of the contract;<sup>112</sup> the seller commits a material breach when it fails to deliver a painting's certificate of authenticity,<sup>113</sup> registration documents of a car,<sup>114</sup> or delivers a boat which is later declared by authorities unfit to navigate,<sup>115</sup> or installs a pharmacy electronic management system that fails to register numbers higher than three-digits or to print the data stored in the system.<sup>116</sup> Breach, by contrast, has been deemed to be immaterial when the seller of a vehicle delayed the delivery of the car registration documents<sup>117</sup> or sold two vans whose width was

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<sup>108</sup> The rationale behind the rule is that, since judicial termination is conditioned upon the materiality of a defaulting party's breach, the same requirement should apply to non-judicial termination in cases where no termination clause or “time is of the essence” term applies, because otherwise contractual parties would be entitled to obtain by notice a result that they could not obtain before courts. See TRIMARCHI, *supra* note 95, at 69–72; MAURO PALADINI, L'ATTO UNILATERALE DI RISOLUZIONE PER INADEMPIMENTO [THE UNILATERAL ACT OF TERMINATION FOR NON-FULFILLMENT] 44, 68, 75 (2013).

<sup>109</sup> See Cass., 25 settembre 2013, n. 21949 (It.); Cass., 29 novembre 2004, n. 22416 (It.); see also PALADINI, *supra* note 108, at 129–31.

<sup>110</sup> Luisa Antonioli, *Particular Remedies for Non-Performance*, in PRINCIPLES OF EUROPEAN CONTRACT LAW AND ITALIAN LAW: A COMMENTARY 408–09 (Luisa Antonioli & Anna Veneziano eds., 2005).

<sup>111</sup> TRIMARCHI, *supra* note 95, at 67–68; MARIA G. CUBEDDU, L'IMPORTANZA DELL'INADEMPIMENTO [THE IMPORTANCE OF BREACH] 91–187, 219–300 (1995).

<sup>112</sup> Cass., 27 maggio 2015, n. 10995 (It.); Cass., 15 giugno 1989, n. 2879, Giur. it. 1990, I, 634 (It.).

<sup>113</sup> Cass., 15 febbraio 1985, n. 1300 (It.).

<sup>114</sup> Cass., 22 febbraio 1999, n. 1472, Giust. civ. massimario 1999, 371 (It.).

<sup>115</sup> Cass., 30 marzo 2015, n. 6401 (It.).

<sup>116</sup> Cass., 22 marzo 1999, n. 2661, Giur. it. 2000, 47 (It.).

<sup>117</sup> Cass., sez. sec., 6 settembre 2017, n. 20843 (It.).

2.55 meters rather than the contractually agreed 2.60 meters.<sup>118</sup> As in France, the judicial assessment of the materiality of the breach is thought to be a decision by the lower courts and is not reviewable by the Court of Cassation or the Supreme Court.<sup>119</sup>

#### *F. Italian Law and the CISG*

According to Italian case law, the statutory requirement of a material breach for termination is functionally equivalent to the notion of fundamental breach found in Article 25 of the CISG.<sup>120</sup> In the words of one Italian court,

there is a correspondence of meaning between fundamental breach mentioned in Article 25 CISG and the non-immaterial breach found in Article 1455 of the ICC. Both standards emphasize the proportionality between the gravity of the breach and the remedies granted to the non-defaulting party in determining if a breach is grounds for termination. The termination of contract, which cancels the effects of the contract, is considered a remedy of last resort, which can be granted only for serious breaches.<sup>121</sup>

As an illustration, Italian courts have deemed the seller's breach to be fundamental under Article 25 CISG when the seller postponed the delivery of the goods for four months.<sup>122</sup> Other courts have found fundamental or serious breach in cases that included delivery of non-functioning goods,<sup>123</sup> goods of such low quality that they were unmarketable,<sup>124</sup> and where pure beef tallow was contaminated by traces of vegetable oils, making the tallow unsuitable for

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<sup>118</sup> Cass., sez. sec., 13 dicembre 2010, n. 25157, Giust. civ. 2010, 1596 (It.).

<sup>119</sup> Cass., sez. sec., 8 gennaio 2020, n. 134, 2020, 8, 101 (It.).

<sup>120</sup> Trib., Forlì, 12 novembre 2012 (It.); Trib., Forlì, 9 dicembre 2008 (It.); Trib., Padua (Este), 11 gennaio 2005 (It.). Italian legal scholarship agrees that the notion set forth by Article 1455 of the Italian Civil Code is equivalent to that employed by CISG Article 25. Luca Mastromatteo & Alessandro Bovio, *Obblighi del venditore e rimedi all'inadempimento del venditore*, in *LA VENDITA INTERNAZIONALE* 135, 177 (Luca Mastromatteo ed., 2013) (discussing seller's fundamental breach); Luca Mastromatteo & Alessandro Bovio, *Obblighi del compratore e rimedi all'inadempimento del compratore*, in *LA VENDITA INTERNAZIONALE* 201, 216 (Luca Mastromatteo ed., 2013) (discussing buyer's fundamental breach); CUBEDDU, *supra* note 111, at 73–75, 216–17 (explaining that the CISG entered into force in 1988 and Italy ratified it in 1985).

<sup>121</sup> Trib., Forlì, 12 novembre 2012 (It.) (author's translation).

<sup>122</sup> *Id.* (concerning goods that were never actually delivered to the buyer); *see also* App., Milan, 20 marzo 1998, n. 790 (It.) (concerning woven fabric goods that were never delivered); Pret., 24 novembre 1989, n. 77 (It.) (concerning a partial delivery of the plastic bags ordered that took place four months after the time-limit set out by the contract).

<sup>123</sup> Trib., Busto Arsizio, 12 dicembre 2001, Giur. it. 2001 (It.).

<sup>124</sup> Trib., Foggia, 3 luglio 2013, Giur. it. 2013 (It.) (declaring that the buyer's failure to send a sample of the wine to the seller prior to the delivery of the wine, in spite of his contractual obligation to do so, amounted to a fundamental breach); Trib., Forlì, 11 dicembre 2008, *supra* note 120 (regarding sale of shoes); Trib., Padua (Este), 11 gennaio 2005, *supra* note 120 (regarding the quality of rabbits).

the purpose (known to the seller) of producing soap.<sup>125</sup> In assessing the seriousness of the breach, besides the criteria provided by Article 25 CISG, Italian courts have placed particular emphasis on the good or bad faith conduct of both parties,<sup>126</sup> on both parties' willingness and availability to cure the non-performance,<sup>127</sup> and on the availability of an expert determination of the quality of the goods sold.<sup>128</sup>

#### IV. BREACH IN GERMAN LAW

Unlike the Romanesque civil codes (French and Italian),<sup>129</sup> the original version of the German civil code (*Bürgerliches Gesetzbuch*, or BGB) did not provide unitary rules for cases of breach of contract (*Leistungsstörungen* or irregularities of performance).<sup>130</sup> The BGB provisions on breach were discussed in the parts of the code devoted to specialized contracts.<sup>131</sup> General contract law rules on breach, by contrast, only focused on impossibility and delay of performance. Relying upon the code's architecture, scholarship and case law eventually classified breach into three types, namely: impossibility of performance, delay of performance, and defective performance.<sup>132</sup> However, this structure was largely reshaped by the 2002 German Act to Modernize the Law of Obligations (*Gesetz zur Modernisierung des Schuldrechts*),<sup>133</sup> which reformed and updated the contract law provisions in the BGB. Given the significance of this reform regarding breach, in the next section, the Authors will provide a brief overview on how the notion of breach was framed under the original BGB (1900), an analysis of subsequent case law, and then a review of reforms and case law stemming from the 2002 modernization.

<sup>125</sup> Trib., Modena, 19 febbraio 2014, *Giur. it.* 2014 (It.) (denying termination because the buyer used the otherwise defective goods).

<sup>126</sup> *Id.*; Trib., Foggia, 3 luglio 2013 (It.).

<sup>127</sup> Trib., Forlì, 9 dicembre 2008 (It.).

<sup>128</sup> Trib., Modena, 19 febbraio 2014 (It.); Trib., Foggia, 3 luglio 2013, (It.).

<sup>129</sup> *See supra* Parts II–III.

<sup>130</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 280 (Ger.). The new general clause on the right to damages in cases of breach of contract uses the word “*pfllichtverletzung*” (breach of duty), which covers not only contractual obligations, but also other legal obligations which are of non-tortious origins. *Id.*

<sup>131</sup> For instance, the regulation on the contract of sale did not provide just the requirements of conformity, but it also included a special and exclusive regime of remedies such as price reduction and a peculiar right to demand termination called “*wandelung*.” *See* BASIL MARKESINIS ET AL., *THE GERMAN LAW OF CONTRACT: A COMPARATIVE TREATISE* 379 (2d ed. 2006).

<sup>132</sup> REINHARD ZIMMERMANN, *THE NEW GERMAN LAW OF OBLIGATIONS: HISTORICAL AND COMPARATIVE PERSPECTIVES* 66–72 (2005).

<sup>133</sup> Gesetz zur Modernisierung des Schuldrechts [Law to Modernize the Law of Obligations], Nov. 26, 2001, *BGBI I* at 3138 (Ger.). The BGB, son of the Pandectistic doctrine, is divided into 5 books: (1) General Part, (2) Law of Obligations, (3) Property Law, (4) Family Law, and (5) Law of Succession. Contract law is a part of the second book. For the meaning of “contract” under German law, *see* MARKESINIS ET AL., *supra* note 131, at 25.

*A. Original Version of the BGB*

Adhering to the Pandectistic doctrine,<sup>134</sup> under the original version of the BGB the remedies for the obligee depended on the type of breach the obligor committed. The BGB did not elaborate on the rights of a party in case of breach of contract. The only general rules on breach concerned impossibility of performance and delay. Impossibility was regulated by Sections 275 and 276 BGB, the former dealing with the release of the obligor (breaching party) from his obligation in cases of impossibility for which he was not responsible (*Nicht zu vertretende Unmöglichkeit*), and the latter providing for liability of the obligor (breaching party) in cases of impossibility caused by the obligor's own intention or negligence (*Haftung für eigenes Verschulden*). As to delayed performance (*Verzug des Schuldners*), § 284 BGB limits obligors' liability to cases where there was a formal protest (*Mahnung*) by the obligee (non-breaching party). It is only after formal notice that the delay becomes relevant, unless the obligor proves that the default was due to a circumstance not attributable to the obligor. To complete this framework, the original version of § 306 BGB stated that a contract was void in all cases of original impossibility of performance (*Unmöglichke Leistung*).<sup>135</sup> If the party knew or should have known of the impossibility, the other party was entitled to compensation for having relied on the contract, unless he also knew or should have known of the impossibility.

Under this framework, many types of non-performance not related to delay or impossibility were left unregulated by the BGB.<sup>136</sup> The gaps in coverage were filled by German scholars and courts through the development of the concept of "positive breach of contract" (*positive Vertragsverletzung*), covering, among others, irregular performance and the infringement of ancillary obligations.<sup>137</sup>

Yet, notwithstanding scholarly and judicial innovation, German scholars and courts were deeply unsatisfied with the complexity of the regulation of breach in the BGB.<sup>138</sup> To give an example, in cases of defective or non-performance in sale contracts, the non-breaching party had a choice of seven possible remedies against the defaulting obligor, depending on the specific breach claimed.<sup>139</sup> Each type of breach had its own requirements and gave rise to remedies that were different in scope and substance. For instance, the right of the buyer to ask for a remedy in cases of defective performance was subject

<sup>134</sup> ZIMMERMANN, *supra* note 132, at 8–11, 66–72.

<sup>135</sup> For commentary on the original BGB, see ZWEIGERT & KÖTZ, *supra* note 2, at 488–96.

<sup>136</sup> This "gap" was first identified in HERMANN STAUB, *DIE POSITIVEN VERTRAGSVERLETZUNGEN* (1904).

<sup>137</sup> *Id.* (author's translation); MARKESINIS ET AL., *supra* note 131, at 439.

<sup>138</sup> ZWEIGERT & KÖTZ, *supra* note 2, at 495–96; 1 BASIL S. MARKESINIS ET AL., *THE GERMAN LAW OF OBLIGATIONS, VOL. I: THE LAW OF CONTRACTS AND RESTITUTION: A COMPARATIVE INTRODUCTION* 398 (1997).

<sup>139</sup> MARKESINIS ET AL., *supra* note 131, at 380; *see generally* HANS SCHULTE-NÖLKE, *THE NEW GERMAN LAW OF OBLIGATIONS: AN INTRODUCTION* (2002).

to a short limitation period (6 months from delivery) and generally did not include the possibility for compensation; by contrast, whenever the seller failed to perform, the buyer enjoyed a longer limitation period (2 years from delivery) and a greater chance of obtaining compensation.<sup>140</sup> Academics also criticized the principle that contracts in cases of preexisting impossibility were voidable under § 306 BGB<sup>141</sup> and the fault principle limiting the obligor's liability in cases of supervening impossibility under § 275 BGB.<sup>142</sup> Such criticism, combined with the growth of EU-driven legislation related to the law of obligations and soft law innovations promoting the harmonization of contract laws across Europe, accelerated the movement towards a revision of the BGB.<sup>143</sup>

### B. Reform of the German Law of Obligations

Two European soft law projects—the Principles of International Commercial Contracts by UNIDROIT (first published in 1994) and the Principles of European Contract Law (first published in 1995)—were the initial impetus for revising the BGB. The real event that advanced the reform movement was the enactment of the EU Consumer Sales Directive.<sup>144</sup> The implementation of the Directive in Germany offered an occasion to proceed with needed changes to the BGB, namely, harmonizing limitation periods and codifying rules and doctrines developed by the courts after the enactment of the original BGB, such as the principle of *culpa in contrahendo* (precontractual liability).<sup>145</sup> Also, Germany's adoption of the Convention on the International Sale of Goods (CISG) and, specifically, Article 45 CISG (remedies for breach of contract by the seller) influenced amendments to the BGB regarding the breach of contract.<sup>146</sup>

The old structure of multiple types of breach was superseded by a system based on a uniform concept of breach (*Pflichtverletzung*).<sup>147</sup> The starting point of the new set of rules is § 241 BGB (concerning duties arising from an obligation, or *Pflichten aus dem Schuldverhältnis*), which clarifies the duties

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<sup>140</sup> For example, see the difference between the delivery of defective goods and the delivery of an *aliud*, which gave rise to different limitation periods. See Bundesgerichtshof [BGH] [Federal Court of Justice] Nov. 20, 1967, NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 640 (1968) (Ger.).

<sup>141</sup> ZIMMERMANN, *supra* note 132, at 39.

<sup>142</sup> *Id.*

<sup>143</sup> SCHULTE-NÖLKE, *supra* note 139.

<sup>144</sup> Directive on certain aspects of the sale of consumer goods and associated guarantees 1999/44/EC, 1999 O.J. (L171) 12.

<sup>145</sup> MARKESINIS ET AL., *supra* note 131, at 383 (providing detailed analysis on the reform of the German law of obligations).

<sup>146</sup> ZIMMERMANN, *supra* note 132, at 40.

<sup>147</sup> Under German law, there is a distinction between the obligee's claim for specific performance (primary claim) from the rights of the obligee that may arise in case of non-performance or insufficient performance. SCHULTE-NÖLKE, *supra* note 139. Technically, remedies in a strict sense (damages, termination) are related only to secondary claims. *Id.*

arising from a contractual obligation. Under the first paragraph of § 241, the primary duty is obviously the performance of the obligations agreed upon; in cases of defective performance or non-performance, the obligee is entitled to claim specific performance from the obligor, unless performance is impossible.<sup>148</sup> The second paragraph of § 241 states that the concept of obligation may also require the obligor to perform collateral obligations (*Nebenpflichten*).<sup>149</sup>

Impossibility of performance is now regulated by § 275 BGB (concerning exclusion of duty to perform, or *Ausschluss der Leistungspflicht*). The impossibility that bars a claim for specific performance under § 275 can be either subjective (where an obligor is unable to perform) or objective (where performance is impossible for any obligor).<sup>150</sup> The second paragraph of § 275 BGB additionally allows the obligor to refuse a demand for performance in cases where “performance requires expense and effort which, taking into account the subject matter of the obligation and the requirements of good faith, is grossly disproportionate to the interest in performance of the obligee.”<sup>151</sup>

The obligor’s liability for breach is clarified in § 276(1) BGB (concerning responsibility of the obligor, or *Verantwortlichkeit des Schuldners*). It states that the obligor is responsible for any breach that was due to the obligor’s intentional or and negligent action or lack of action. If the obligor commits a § 276 breach, its liability is determined by Section 280, and Sections 283 through 285 BGB, which are discussed in the next section.

### C. New System of Remedies

After the 2002 revision of the BGB, German law recognized a unitary notion of “breach of duty” (*Pflichtverletzung*) for less than full performance.<sup>152</sup> Under the new system, in cases of breach, the obligee can demand performance under § 241 BGB, and additionally may make claims for damages (§ 280 BGB) and termination of contract (§ 323 BGB).

#### 1. Damages

Section 280 BGB (concerning damages for breach of duty, or *Schadenersatz wegen Pflichtverletzung*) states that the obligee may demand damages from the obligor in case of breach of duty arising from an obligation. The same provision specifies the two types of damages that the obligee can

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<sup>148</sup> WOLFGANG ERNST, MÜNCHENER KOMMENTAR ZUM BGB, § 275, Randnummer (Rn.) 1 (8th ed. 2019).

<sup>149</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 241, translation at <https://perma.cc/3QUN-XDKH> (Ger.) (stating that “an obligation may also, depending on its contents, oblige each party to take account of the rights, legal interests and other interests of the other party”). See ERNST, *supra* note 148, § 275, Rn. 6.

<sup>150</sup> ERNST, *supra* note 148, § 275, Rn. 6.

<sup>151</sup> *Id.* (author’s translation).

<sup>152</sup> MARKESINIS ET AL., *supra* note 131, at 379.

claim: damages in lieu of performance (*Schadenersatz statt der Leistung*, regulated by § 280(3) BGB) and damages for delay (*Schadenersatz wegen Verzögerung*, under § 280(2) BGB). It goes without saying—as stated in the second part of § 280(1) BGB—that neither of these damages is available “if the obligor is not responsible for the breach of duty.”<sup>153</sup> As to the damages in lieu of performance, they are meant to correspond to the economic value of the performance; when the obligee claims in lieu of performance damages, it loses the right to claim performance.<sup>154</sup>

According to § 281 BGB (concerning damages in lieu of performance for nonperformance or failure to render performance as owed, or *Schadenersatz statt der Leistung wegen nicht oder nicht wie geschuldet erbrachter Leistung*), the obligee can ask for damages in case of non-performance, only if he gives the obligor a second chance to perform or cure its performance within a reasonable period (*Nachfrist*) and performance or cure are not rendered by the end of that period.<sup>155</sup> In any case, there is no right to damages in lieu of performance when the breach is immaterial (*unerheblich*).<sup>156</sup>

A different rule applies when performance becomes impossible, which cancels the duty of performance.<sup>157</sup> According to § 283 BGB (concerning damages in lieu of performance where the duty of performance is excluded, or *Schadenersatz statt der Leistung bei Ausschluss der Leistungspflicht*), if the performance becomes impossible or the obligor refuses to perform, the obligee can immediately demand damages in lieu of performance, without the need to proceed with the *Nachfrist* procedure (granting a time extension).<sup>158</sup>

In sum, damages in lieu of performance can be claimed in cases where the obligee is no longer interested in performance or performance has become impossible, while damages for delay arise in cases in which the obligor has not (yet) performed but performance is still possible. Under § 286 BGB (concerning default of the obligor, or *Verzug des Schuldners*), the obligor is in default (*Verzug*) when, after performance was due, it receives a warning notice (*Mahnung*) from the obligor and, notwithstanding such notice, fails to

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<sup>153</sup> Bundesgerichtshof [BGH] [Federal Court of Justice] Dec. 18, 1952, Entscheidungen des Bundesgerichtshofes in Zivilrecht [BGHZ] 54/52 (Ger.) (author’s translation). According to legal scholarship, the burden of proof is on the obligor because of the negative formulation of § 280 BGB, which states: “This does not apply, if . . .” MARKESINIS ET AL., *supra* note 131, at 446.

<sup>154</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], §§ 281(4), 283 (Ger.) (wherein Sections 281 and 283 set forth the requirements for claiming such damages, while Section 282 concerns the claim of damages in lieu of performance for the violation of protective duties and will not be discussed here as it mostly applies to claims by persons who technically were not parties to the contract). See MARKESINIS ET AL., *supra* note 131, at 459.

<sup>155</sup> ERNST, *supra* note 148, § 281, Rn. 18. If performance is partial, an obligee is entitled to claim damages only if they has no interest in the part performance. Bürgerliches Gesetzbuch [BGB] [Civil Code], § 281, para. 1, sentence 2 (Ger.).

<sup>156</sup> ERNST, *supra* note 148, § 281, Rn. 6.

<sup>157</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 283 (Ger.).

<sup>158</sup> ERNST, *supra* note 148, § 283, Rn. 1.

perform.<sup>159</sup> This means that the obligee can claim damages for delay only once the obligor is in default following the expiration of the additional time granted to perform. An exception to the rule allowing an extension is that, when the time for performance is fixed with precision, with reference to a given calendar day, the obligor is automatically in default at the time of the contractual warning.<sup>160</sup>

## 2. Termination (*Rücktritt*)

The 2002 BGB allows an obligee to claim damages at the time of requesting a termination of the contract (§ 325 BGB, concerning damages and revocation, or *Schadensersatz und Rücktritt*).<sup>161</sup> The German rules on contract termination are found in Sections 323 and 324 of the BGB, which substantially mirror Sections 280 through 283 BGB analyzed above with regard to damages. Section 323 BGB (concerning termination of the contract for non-performance or for performance not in conformity with the contract, or *Rücktritt wegen nicht oder nicht vertragsgemäß erbrachter Leistung*) lays down the fundamental rule on termination for breach.<sup>162</sup> Section 323(1) of the BGB provides that, in bilateral contracts, “[i]f . . . the obligor does not render an act of performance which is due, or does not render it in conformity with the contract, then the obligee may revoke the contract, if he has specified, without result, an additional period for performance or cure” (*Nachfrist*).<sup>163</sup> This means that, after the expiration of the notice period, parties are automatically released from their obligations.<sup>164</sup> The notice and the passing of the time extension are not necessary in cases described in § 323(2) BGB, i.e., if (1) the obligor seriously and definitively refuses performance, (2) the obligor does not render performance by the date specified in the contract when the latter was of essential importance to the obligee, and (3) the obligor does not carry out its work in accordance with the contract, and special circumstances exist which, considering the interests of both parties, justify immediate termination.<sup>165</sup> The same rule of immediate termination without need of notice also applies,

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<sup>159</sup> ERNST, *supra* note 148, § 281, Rn. 52.

<sup>160</sup> ZIMMERMANN, *supra* note 132, at 56.

<sup>161</sup> Termination—which operates *ex nunc*—is defined as a power (*gestaltungsrecht*) of the non-defaulting party to change, by unilateral act, the content of the contractual obligations. MARKESINIS ET AL., *supra* note 131, at 419–20.

<sup>162</sup> BEALE ET AL., *supra* note 51, at 991–93, 1027.

<sup>163</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 323(1), translation at <https://perma.cc/3QUN-XDKH> (Ger.).

<sup>164</sup> See Bürgerliches Gesetzbuch [BGB] [Civil Code], § 323(5) (Ger.) (stating that, in the case of partial performance, a non-defaulting party may terminate the whole contract only if they have no interest in part performance).

<sup>165</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 323(2) (Ger.).

according to § 275 BGB, to cases of impossible performance,<sup>166</sup> in which the obligee may be entitled to immediate termination under § 326(5) BGB.<sup>167</sup>

Comparatively, an interesting point about these provisions is that the BGB does not *per se* provide any instruction regarding the assessment of the non-performance that allows the termination of the contract, nor does it make termination conditional upon the significance of the breach. Crucial for triggering the right to termination is not the notion of fundamental breach, but rather the granting of an extra period which has to have lapsed to no avail under § 323 BGB.<sup>168</sup> The seriousness of breach with regard to termination becomes relevant only under § 323(5) BGB, on termination in cases of partial performance.<sup>169</sup> According to such a rule, when the obligor partially performs and the performance is not in conformity with the contract (*Schlechtleistung*), the non-defaulting party may terminate the whole contract only if it has no interest in part performance and the obligor's breach is not trivial.

Outside the scope of termination, the seriousness of the defaulting party's breach also emerges as conditional upon a remedy under § 320 BGB.<sup>170</sup> The principle of *exceptio non adimpleti contractus* enshrined in § 320(1) BGB allows a party to refuse performance in case of breach, unless it was obliged to perform in advance. Paragraph 2 of § 320 BGB nevertheless specifies that, in cases in which the other party has partly performed, the non-breaching party cannot refuse to perform if, considering all the circumstances, including the triviality of the unperformed part, such a refusal would constitute bad faith.<sup>171</sup>

#### D. German Law and the CISG

As highlighted above, the 2002 revision of the BGB largely took inspiration from the CISG, which entered into force in Germany in 1991, especially with regard to the rules pertaining to breach of contract.<sup>172</sup> This is hardly surprising, considering the influence that German law played in the drafting of the Convention, as enshrined, for instance, by the adoption in Articles 47 and 63 of the CISG of the German idea of *Nachfrist*.<sup>173</sup>

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<sup>166</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 275 (Ger.).

<sup>167</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 326(5) (Ger.). Section 326 BGB is titled "*Befreiung von der Gegenleistung und Rücktritt beim Ausschluss der Leistungspflicht*" ("release from consideration and revocation where the duty of performance is excluded"). *Id.* (translation at <https://perma.cc/3QUN-XDKH>).

<sup>168</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 323 (Ger.).

<sup>169</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 323(5) (Ger.).

<sup>170</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 320, translation at <https://perma.cc/3QUN-XDKH> (Ger.) (Section 320 BGB is titled "*Einrede des nichterfüllten Vertrags*" ("Defence of unperformed contract").

<sup>171</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 320(2) (Ger.).

<sup>172</sup> See *supra* Part IV.B.

<sup>173</sup> Also, the requirement that a buyer must notify the seller if the goods are defective and do not conform to the contract of CISG Article 39 comes from the German commercial code.

The keen interest of German lawyers in the CISG is also demonstrated by the attention German academics have continuously paid to its interpretation<sup>174</sup> and by the impressive contribution of German courts to its interpretation. On the Case Law on UNCITRAL Texts (CLOUT) database of CISG decisions, as of January 10, 2021, Germany has the highest number (222) of reported decisions,<sup>175</sup> including numerous decisions of the Federal Supreme Court, many of which have been viewed as highly authoritative outside of Germany.<sup>176</sup>

The requirement of fundamental breach (*wesentlichen Vertragsverletzung*), found in CISG Article 25, is the cornerstone of the CISG's remedies scheme (*Angelpunkt des Sanktionensystems*).<sup>177</sup> For German commentators, the first criterion for identifying when a breach of contract is fundamental is an analysis of the parties' will as reflected in the terms of their contract that define which requirements shall be deemed fundamental to justify a termination.<sup>178</sup> Other additional criteria concern the seriousness of the breach in light of the contract's purpose, parties' interests, and the possibility that the breach might be cured.<sup>179</sup>

Looking directly at German case law, a seller's delivery of a shipment of pepper was deemed to be a fundamental breach as the goods were not fit to be sold in Germany due to their high amount of ethylene oxide.<sup>180</sup> The seller was deemed to have committed a fundamental breach also when a generator it sold only reached an output of 250 kilo volt-amperes (KVA), notwithstanding the fact that the seller had advertised that the product produced 300 KVA. An important fact in the case was that the output of 250 KVA was not a sufficient

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Handelsgesetzbuch [HGB] [Commercial Code], § 377 (Ger.); Ulrich Magnus, *The Vienna Sales Convention (CISG) Between Civil and Common Law – Best of All Worlds?*, 3 J. CIV. L. STUD. 87 (2010).

<sup>174</sup> Beate Gsell, *Article 25*, in KOMMENTAR ZUM UN-KAUFRECHT (CISG) Rn. 2 (Heinrich Honsell ed., 2010); Peter Huber, *Typically German? Two Contentious German Contributions to the CISG*, 3 BELGRADE L. REV. 150 (2011).

<sup>175</sup> See *Case Law on UNCITRAL Texts (CLOUT)*, UNCITRAL, <https://perma.cc/CWH2-LJ9F> (last visited Jan. 10, 2021).

<sup>176</sup> See the influence of the decision of NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 1955, 2099 (1995) (Ger.) on the U.S. case *Med. Mktg. Int'l v. Internazionale Medico Scientifica, S.R.L.*, No. 99-0380, 1999 WL 311945, at \*2 (E.D. La. May 17, 1999). See also Magnus, *supra* note 173, at 87.

<sup>177</sup> Huber, *supra* note 174, at 153; Ulrich G. Schroeter, *CISG Article 25: Wesentliche Vertragsverletzung*, in KOMMENTAR ZUM UN-KAUFRECHT 232, Rn. 1 (Peter Schlechtriem et al. eds., 7th ed. 2019); Michael Will, *Article 25*, in COMMENTARY ON THE INTERNATIONAL SALES LAW 205 (Carlo M. Bianca & Michael J. Bonell eds., 1987).

<sup>178</sup> Schroeter, *supra* note 177, Rn. 80; Bundesgerichtshof [BGH] [Federal Court of Justice] Apr. 3, 1996, VIII ZB 51/95 (Ger.) [hereinafter *Cobalt Sulphate Case*].

<sup>179</sup> Oberlandesgericht [OLG] [Higher Regional Court] Koblenz, Jan. 31, 1997, CISG-ONLINE No. 256 (Ger.) ("Even a serious defect is not a fundamental breach of contract if the seller is prepared to replace the goods without unacceptable burden to the buyer" (author's translation)). In the *Cobalt Sulphate Case*, the BGH used a fourth criteria: the "reasonable-use-test." *Cobalt Sulphate Case*, *supra* note 178 (author's translation). For a comment to the decision, see Huber, *supra* note 174.

<sup>180</sup> Landgericht [LG] [Regional Court] Aug. 21, 1995, 1 KAMMER FÜR HANDELSACHEN (KFH) O 32/95 (Ger.).

amount of power for the buyer's workshop.<sup>181</sup> In contrast, the delivery of syrup mixed with glucose syrup, which could not be referred to as "apple juice concentrate," was not considered a defect serious enough to trigger the buyer's right to terminate for fundamental breach.<sup>182</sup>

Similarly, delayed delivery is not generally considered a fundamental breach of contract<sup>183</sup> unless the parties have explicitly stated that time is of the essence.<sup>184</sup> For example, a one-day delay in the delivery of summer clothes has not qualified as a fundamental breach.<sup>185</sup> However, a seller's failure to supply iron-molybdenum before the expiration of an additional delivery period (*Nachfrist*) was considered fundamental.<sup>186</sup>

It should be noted that, although the CISG remedial system does not support an approach focusing on the gravity of the consequences as measured by the contract's overall value and the monetary loss suffered by the aggrieved party, some German courts have based their findings of fundamental breach on the gravity of the consequences of the breach.<sup>187</sup> Thus, the sale by a German seller of sportswear that shrank when washed was deemed a fundamental breach because the defect deprived the buyer of what it was entitled to expect under the contract since customers would surely complain about the shrinking.<sup>188</sup>

Much less frequent are the cases in which German courts have found that a buyer committed a fundamental breach. Courts have, for instance, denied that the buyer committed a fundamental breach by selling cobalt sulfate from

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<sup>181</sup> Oberlandesgericht [OLG] [Higher Regional Court] Dec. 19, 2012, CISG-ONLINE 2470, INTERNATIONALES HANDELSRECHT 2014, 64, 65 (Ger.).

<sup>182</sup> Oberlandesgericht [OLG] [Higher Regional Court] Mar. 12, 2001, CISG-ONLINE 841, OLG-REPORT STUTTGART 2002, 148 (Ger.) (author's translation). The court denied the fundamental breach because:

[I]f the breach of contract – as in the present case – consists of a lack of conformity of the goods, it will be decisive whether the Buyer was without unreasonable expenditure able to process the goods differently or sell them in the normal course of business, if only with a price discount, and if the Buyer could reasonably be expected to take such measures.

*Id.* (author's translation).

<sup>183</sup> Schroeter, *supra* note 177, Rn. 195; Gsell, *supra* note 174. See also Landgericht [LG] [Regional Court] Mar. 27, 1996, 12 O 2541/95 (Ger.); Amtsgericht [AG] [District Court] Dec. 21, 1990, 4 C 549/90 (Ger.). For a comment on the decision of the Amtsgericht Ludwigsburg, see Burghard Piltz, *Neue Entwicklungen im UN-Kaufrecht*, NEUE JURISTISCHE WOCHENSCHRIFT 1101 (1994).

<sup>184</sup> Oberlandesgericht [OLG] [Higher Regional Court] Feb. 15 2016, CISG-ONLINE 2740, INTERNATIONALES HANDELSRECHT 2016, 147 (149) (Ger.).

<sup>185</sup> [LG] Mar. 27, 1996, *supra* note 183.

<sup>186</sup> Oberlandesgericht [OLG] [Higher Regional Court] Feb. 28, 1997, 1 U 167/95 (Ger.) (where the court drew the special interest of the buyer from the reference to the Incoterm CIF in the contract).

<sup>187</sup> Robert Koch, *The Concept of Fundamental Breach of Contract Under the United Nations Convention on Contracts for the International Sale of Goods (CISG)* (Aug. 1998) (Master of Laws thesis, McGill University) (ProQuest).

<sup>188</sup> Landgericht [LG] [Regional Court] Apr. 5, 1995, 54 O 644/94 (Ger.).

South Africa when the contract specified that the cobalt sulfate would be of British origin.<sup>189</sup> Likewise, courts have denied a fundamental breach where the buyer failed to timely pay for a substantial order of shoes since the latter were neither perishable goods nor goods requiring special care during storing or transporting.<sup>190</sup>

## V. BREACH IN CHINESE LAW

Chinese contract law mostly follows the civil law tradition, but it also has been influenced by common law. This Part examines the definition of breach and limitations on declaring breach under Chinese law.

### A. Evolution of Chinese Contract Law

The general rules on breach and its consequences were originally set forth in multiple provisions of Chinese contract law. The first comprehensive codification of Chinese contract law was the Economic Contract Law (ECL) in 1981. Specialized contract laws were subsequently enacted, including, the Law on Economic Contracts involving Foreign Interests (LECFI) in 1985 and the Law on Technology Contracts (LTC) in 1987. At the same time, the 1986 General Principles of Civil Law (GPCL) were enacted. All four laws contained rules relating to breach of contract and its consequences.<sup>191</sup> In 1999, contract law modernization continued with the adoption of China's first uniform contract law—the Chinese Contract Law (CCL). The former inconsistency in breach of contract law was thus replaced by a uniform breach rule.<sup>192</sup> Following the promulgation of CCL, the Chinese Supreme People's Court issued several judicial interpretations of the new law in order to clarify the meaning of some

<sup>189</sup> *Cobalt Sulphate Case*, *supra* note 178; *see also* Oberlandesgericht [OLG] [Higher Regional Court] July 22, 2004, I-6 U 210/03 (Ger.) (in which delayed payment was not a fundamental breach); Schroeter, *supra* note 177, Rn. 201.

<sup>190</sup> [OLG] July 22, 2004, *supra* note 189; *see also* Schroeter, *supra* note 177, Rn. 201.

<sup>191</sup> Zhōnghuá Rénmín Gònghéguó Jīngjì Hétóng Fǎ (中华人民共和国经济合同法) [Economic Contract Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 13, 1981, effective July 1, 1982, amended Sept. 2, 1993) arts. 29–41 (China) [hereinafter ECL]; Zhōnghuá Rénmín Gònghéguó Duìwài Jīngjì Hétóng Fǎ (中华人民共和国对外经济合同法) [The Law on Economic Contracts involving Foreign Interests of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 21, 1985, effective July 1, 1985) arts. 16–25 (China) [hereinafter LECFI]; Zhōnghuá Rénmín Gònghéguó Jìshù Hétóng Fǎ (中华人民共和国技术合同法) [The Law on Technology Contract of the People's Republic of China] (promulgated jointly by the Ministry of Science and Technology, Ministry of Finance, and State Administration of Taxation, June 23, 1987, effective Nov. 1, 1987) arts. 17–20 (China) [hereinafter LTC]; Zhōnghuá Rénmín Gònghéguó Mǐnfǎ Tōngzé (中华人民共和国民事诉讼法通则) [General Principles of Civil Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 12, 1986, effective Jan. 1, 1987) arts. 106–116 (China) [hereinafter GPCL].

<sup>192</sup> ECL adopted a fault-liability principle, but LECFI, LTC, and GPCL all adopted a strict-liability principle. *See* HUIXING LIANG, 2 CIVIL LAW: THEORIES, CASES AND LEGISLATION 156–57 (1999). For a brief introduction to the history of Chinese contract law, *see* Lei Chen & Larry A. DiMatteo, *History of Chinese Contract Law*, in CHINESE CONTRACT LAW, *supra* note 21, at 3–6.

of its provisions.<sup>193</sup> In May 2020, a comprehensive Chinese Civil Code (CCC) was enacted, and it became effective on January 1, 2021. Just prior to the CCC coming into effect, the Supreme People's Court organized and clarified what had become an assortment of chaotic judicial interpretations by repealing some and revising others.<sup>194</sup> Today, Chinese contract law is more uniform and consistent than it has ever been.

### B. Definition of Breach in CCL and CCC

The CCL and CCC adopt concepts of non-performance and breach. CCL Chapter 7 (and CCC Book III Chapter 8) is entitled “Liability for Breach of Contract,” although the specific provisions use the term “non-performance of the obligation.”<sup>195</sup> The scope of non-performance is wider than that of breach—for example, some issues of non-performance concern tort and unjust enrichment law.<sup>196</sup>

Under the CCL and CCC, there is a breach whenever a party has failed to perform its obligations in any respect.<sup>197</sup> This is true even if the breach is only a violation of an accessory or ancillary obligation.<sup>198</sup> This is also true even if the breaching party is neither willful nor negligent in failing to perform.<sup>199</sup> Thus, unlike French and Italian law, breach is not generally fault-based in Chinese contract law;<sup>200</sup> although, under a few specific contracts where reasonable care and skill are required, the breaching party's liability is

<sup>193</sup> See, e.g., Guānyú Shiyòng “Zhōnghuá Rénmín Gònghéguó Hétóng Fǎ” Ruògān Wèntí de Jiěshì (关于适用《中华人民共和国合同法》若干问题的解释) [Interpretation on Certain Issues Concerning the Application of the Contract Law of the People's Republic of China (II), Judicial Interpretation No. 5 [2009]] (promulgated by the Judicial Comm. Sup. People's Ct., Apr. 24, 2009, effective May 13, 2009) (China) [hereinafter *Judicial Interpretation on Contracts II*]; Guānyú Shěnli Xiāoshòu Hétóng Jiūfēn Ànjiàn Shiyòng Fǎlù Wèntí de Jiěshì (关于审理销售合同纠纷案件适用法律问题的解释) [Interpretation on Issues Concerning the Application of Law in the Trial of Cases of Disputes Over Sales Contracts, Judicial Interpretation No. 7 [2012]] (promulgated by the Judicial Comm. Sup. People's Ct., May 10, 2012, effective July 1, 2012) (China) [hereinafter *Judicial Interpretation on Sales (2012)*].

<sup>194</sup> There are a total of 591 judicial interpretations and regulatory documents relating to civil law, among which 116 have been repealed, 111 have been revised, and the remaining 364 are unchanged. Notably, the *Judicial Interpretation on Contracts II* has been repealed, and the *Judicial Interpretation on Sales* was revised. See *Old Judicial Interpretations Sorted Out and New Judicial Interpretations Supporting Chinese Civil Code Promulgated by Chinese Supreme People's Court*, THE SUP. PEOPLE'S CT. PRESS & MEDIA AGENCY (Dec. 30, 2020, 11:55 PM), <https://perma.cc/6YXQ-GTPH>.

<sup>195</sup> See, e.g., CCL, *supra* note 21, arts. 107–108, 110 (author's translation); CCC, *supra* note 22, arts. 577–579.

<sup>196</sup> Lei Chen, *Damages & Specific Performance in Chinese Contract Law*, in CHINESE CONTRACT LAW, *supra* note 21, at 379.

<sup>197</sup> CCL, *supra* note 21, art. 107; CCC, *supra* note 22, art. 577.

<sup>198</sup> SHIYUAN HAN, THE LAW OF CONTRACT 476 (4th ed. 2018); COMMENTARY ON CCC CONTRACTS 264 (Wei Huang ed., 2020).

<sup>199</sup> See, e.g., CCL, *supra* note 21, art. 121 (discussing third party breach); CCC, *supra* note 22, art. 593 (discussing third party breach).

<sup>200</sup> HAN, *supra* note 198, at 477; COMMENTARY ON CCC CONTRACTS, *supra* note 198, at 266.

premised on the fault of the breaching party.<sup>201</sup> Furthermore, the CCL and CCC recognize two types of breach.<sup>202</sup> The first type is a failure “to perform,” which includes delay in performance, impossibility, and repudiation; the second type is the failure “to perform as contracted” or defective performance.<sup>203</sup>

### C. Fundamental Breach

The seriousness of a breach can be divided into fundamental (allowing for immediate termination of the contract) and non-fundamental. The CCL and CCC do not expressly use the phrase fundamental breach, but the Supreme People’s Court and scholarly commentary indicate that they implicitly adopted a system of fundamental breach, as is found in the CISG.<sup>204</sup> According to CCL Article 94 and CCC Article 563, a breach is fundamental if it makes the “realization of the contract purpose impossible.”<sup>205</sup> This contrasts with the CISG’s standard of “substantially to deprive [the non-breaching party] of what he is entitled to expect under the contract.”<sup>206</sup>

Under CCL Article 94 and CCC Article 563, the non-breaching party need only prove a causal link between the breach and the “impossibility of the realization of the contract purpose,”<sup>207</sup> whether or not the detriment was foreseeable. Importantly, the CCL and CCC abandon the foreseeability requirement, which clarifies the certainty of the breach and the non-breaching party’s right to terminate the contract. In this way, the breaching party is held strictly liable for damages it could not have foreseen.<sup>208</sup>

Despite the acceptance of the concept of *Nachfrist* (time extension for performance), Chinese law allows the parties to define the fundamental breach, which leads to a right of termination, in their contracts. Thus, late delivery in

<sup>201</sup> See, e.g., CCL, *supra* note 21, art. 222 (discussing lease contracts); CCC, *supra* note 22, art. 714 (discussing lease contracts); CCL, *supra* note 21, art. 265 (discussing work contracts); CCC, *supra* note 22, art. 784 (discussing work contracts); CCL, *supra* note 21, art. 303 (discussing carriage contracts); CCC, *supra* note 22, art. 824 (discussing carriage contracts); CCL, *supra* note 21, art. 374 (discussing storage contracts); CCC, *supra* note 22, art. 897 (discussing storage contracts). See also Chen, *supra* note 196, at 382.

<sup>202</sup> CCL, *supra* note 21, arts. 94(1), 117; CCC, *supra* note 22, arts. 563(1), 590. See also HAN, *supra* note 198, at 862; 2 GUANGXIN ZHU, STUDY ON GENERAL PRINCIPLES OF CONTRACT LAW 644–45 (2018).

<sup>203</sup> CCL, *supra* note 21, art. 107 (author’s translation); CCC, *supra* note 22, art. 577. See also HAN, *supra* note 198, at 522–66.

<sup>204</sup> See LIMING WANG, 2 STUDY ON CONTRACT LAW 337 (3d ed. 2015); ZHU, *supra* note 202, at 612; COMMENTARY ON CCC CONTRACTS, *supra* note 198, at 228. See also Qinghai Fangshen Constr. & Installation Eng’g Co. v. Qinghai Longhao Real Est. Co., MYZZD No. 69 (Sup. People’s Ct. 2014) (China); Lu Weigang v. Lu Guanli, ZGFMS No. 2161 (Sup. People’s Ct. 2020) (China).

<sup>205</sup> CCL, *supra* note 21, arts. 94(1), (4) (author’s translation); CCC, *supra* note 22, arts. 563(1), (4).

<sup>206</sup> See WANG, *supra* note 204, at 342.

<sup>207</sup> Changzhou Deshun Mech. & Elec. Equip. Co. et al. v. Broadenwin Mach. Jiangsu Co., SSZZD No. 0527 (Jiangsu High People’s Ct. 2014) (China) (author’s translation).

<sup>208</sup> See WANG, *supra* note 204, at 341.

a contract that makes time of the essence would be a fundamental breach.<sup>209</sup> In cases where the delivery date is not essential, *Nachfrist* notice can be used to fix a date certain for delivery.<sup>210</sup> The non-breaching party may give notice fixing an additional reasonable period of time for the breaching party to perform its obligations.<sup>211</sup> If the breaching party does not perform within the additional period, delivery after the expiration becomes a fundamental breach, allowing the non-breaching party to terminate the contract.<sup>212</sup> Finally, if the period given in the *Nachfrist* notice is unreasonably short or fails to fix any specific time period, the non-breaching party may still terminate the contract after a reasonable period of time has passed since the notice was given.<sup>213</sup>

Chinese contract law also recognizes the common law notion of anticipatory repudiation (breach). If the breaching party has repudiated its primary obligations so that the non-breaching party can no longer rely on the party's performance, the breach is considered fundamental.<sup>214</sup>

Whether defective performance constitutes a fundamental breach is the most difficult issue in the law of breach. Courts generally focus on whether the expected economic interests of the non-breaching party have been severely affected and whether the nonconformity can be remedied by reparation, replacement, or price reduction.<sup>215</sup> In specific cases, the Chinese courts have applied the resale-test,<sup>216</sup> expected-use-test,<sup>217</sup> or cure-cost-test<sup>218</sup> to decide whether the defective performance amounts to a fundamental breach.

Additionally, there are special breach rules in the CCL and CCC for certain long-term contracts. For example, in a lease contract, once the lessee fails to use the leased object in the manner as contracted or consistent with its nature,

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<sup>209</sup> See COMMENTARY ON CCC CONTRACTS, *supra* note 19898, at 227–28; Liu Xingpu v. Beijing Ihope Software Tech. Co., ZGFZMZ No. 335 (Sup. People's Ct. 2020) (China).

<sup>210</sup> CCL, *supra* note 21, art. 94(3); CCC, *supra* note 22, art. 563(3).

<sup>211</sup> The *Nachfrist* notice must state the obligation involved, a reasonable period of time for performance, and the consequences of non-performance during an additional time period. Wenjie Zhao, *A Commentary on CCL Article 94*, 4 JURIST 175, 185 (2019).

<sup>212</sup> See Lu Weigang, *supra* note 204.

<sup>213</sup> HAN, *supra* note 19898, at 661–62; COMMENTARY ON CCC CONTRACTS, *supra* note 19898, at 227. See also Chengdu Dacheng Real Est. Co. v. Huaxi Sec. Inc., ZGFMS No. 12 (Sup. People's Ct. 2020) (China).

<sup>214</sup> See CCL, *supra* note 21, arts. 94(1)–(2), 69, 108; CCC, *supra* note 22, arts. 563(1)–(2), 528, 578; ZHU, *supra* note 202, at 614–15; Fuxinhuatong Pipeline Co. v. Xinjiang Zhundong Tbea Energy Co., ZGFMS No. 5505 (Sup. People's Ct. 2019) (China).

<sup>215</sup> COMMENTARY ON CHINESE CONTRACT LAW 178 (Kangsheng Hu ed., 3d ed. 2013); Zhao, *supra* note 211, at 180; COMMENTARY ON CCC CONTRACTS, *supra* note 198, at 228.

<sup>216</sup> Yang Jun v. Dai Junwei, ZGFMS No. 2169 (Sup. People's Ct. 2016) (China).

<sup>217</sup> Ankang Zetai Huitong Motor Sales & Servs. Co. v. Shen Chuanping, E03MZ No. 1803 (Hubei Shiyuan Interim. People's Ct. 2017) (China); Zhang Chuanxin v. Henan Jiangtao Indus. Co., ZGFMS No. 234 (Sup. People's Ct. 2020) (China).

<sup>218</sup> Guangzhou Panyu Qiaoli Real Est. Dev. Co. v. Chen Bingchao, ZGFMS No. 1085 (Sup. People's Ct. 2020) (China).

causing damage to the leased object, such breach is considered fundamental and the lessor may terminate the contract.<sup>219</sup> Although, the CCL and CCC do explicitly provide special breach rules for certain long-term contracts,<sup>220</sup> courts have applied less strict rules to relational, long-term contracts. A breach that does not make the realization of the contract purpose impossible may be sufficient in cases where reliance on a party is no longer plausible.<sup>221</sup>

Similarly, in installment sales contracts, if an unpaid installment amounts to one-fifth of the total price, the seller may terminate the contract even if the buyer's failure to pay does not constitute a fundamental breach in the sense of CCL Article 94.<sup>222</sup> However, CCC Article 634 provides, even if the unpaid installment amounts to one-fifth of the total price, the seller may not terminate the contract unless the buyer has failed to pay the price within the additional period of time fixed by the seller.<sup>223</sup> Therefore the seller's right to terminate under the sales contract by installment payment is restricted by the seller's notice requirement.

#### *D. Limitation on Breach: Notice and Force Majeure*

Even if the breaching party has delivered the subject matters or services defectively, the non-breaching party must give a notice of non-conformity to the breaching party. If the non-breaching party fails to meet the notice obligation, it will lose the right to claim defective performance.<sup>224</sup> Notice

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<sup>219</sup> CCL, *supra* note 21, art. 219; CCC, *supra* note 22, art. 711. *See also* CCL, *supra* note 21, arts. 203, 224(2), 253; Guānyú Shěnlǐ Jiànshè Gōngchéng Chéngbāo Hétóng Jiūfēn Ānjiàn Shìyòng Fǎlù Wèntí de Jiěshì (关于审理建设工程承包合同纠纷案件适用法律问题的解释) [Interpretation on Issues Concerning the Application of Law for the Trial of Cases of Dispute over Contracts on Undertaking Construction Projects, Judicial Interpretation No. 14 [2004]] (promulgated by the Sup. People's Ct., Sep. 29, 2004, effective Jan. 1, 2005, and repealed on Jan. 1, 2021) arts. 8(3), 9(2) (China); CCC, *supra* note 22, art. 716(2) (explaining a lessor's ability to terminate lease contracts because of breach), art. 673 (explaining a lender's ability to terminate loan contracts because of breach), art. 772 (explaining an ordering party's ability to terminate work contracts because of breach); art. 806 (explaining a developer's ability to terminate construction project contracts because of breach). The CCC has more special fundamental breach rules for specific long-term contracts. *See, e.g.*, CCC, *supra* note 22, art. 753 (explaining a lessor's ability to terminate financial leasing contracts because of breach), art. 1022 (discussing contracts for use of likeness), art. 1023 (discussing the use of names in licensing contracts). *See also* Hainan Sanyou Real Est. Co. v. Haikou Yuerdao Ent. Co., ZGFMS 2248 (Sup. People's Ct. 2018) (China).

<sup>220</sup> Xiaozhe Zhu, *The Reconstruction of the System of Rules of the Statutory Rights to Terminate the Contracts in CCC*, 5 L. & ECON. 19, 25 (2020).

<sup>221</sup> COMMENTARY ON CHINESE CONTRACT LAW, *supra* note 215, at 412.

<sup>222</sup> CCL, *supra* note 21, art. 167; Judicial Interpretation on Sales (2012), *supra* note 193, art. 38; Zhao, *supra* note 211, at 191; *see also* Hubei Tianlin Real Est. Dev. Co. v. Hubei Shiyuan Wuyan Store Co., ZGFMS No. 94 (Sup. People's Ct. 2018) (China).

<sup>223</sup> CCC, *supra* note 22, art. 634.

<sup>224</sup> CCL, *supra* note 21, art. 158; CCC, *supra* note 22, arts. 621–622; *see also* Qinghai Qaidam Xinghua Lithium Salt Co. v. Rongcheng Whriyue Chem. Indus. Co., ZGFMS No. 527 (Sup. People's Ct. 2020) (China); PetroChina Qinghai Oil Field Co. v. Xi'an Fuxin Petrochemical Tech. Co., ZGFMS No. 2757 (Sup. People's Ct. 2019) (China).

obligations are found in CCL Article 158 and CCC Article 621.<sup>225</sup> They require the buyer to notify the seller of the nonconformity in the agreed period for inspection, or within a reasonable period of time after it discovers or ought to have discovered the nonconformity. If the buyer fails to notify the seller within the agreed period for inspection,<sup>226</sup> or within a reasonable period of time, the subject matter is deemed in conformity with the agreed quantity or quality.<sup>227</sup> In any event, notice must be given within two years after the date of delivery.<sup>228</sup> However, if the seller is aware or ought to have been aware of the nonconformity, it may not rely on the buyer's obligation to give notice.<sup>229</sup>

Although the CCL and CCC only refer to defects in quantity or quality for the purpose of the buyer's notice obligations,<sup>230</sup> the courts have applied the notice obligation to the nonconformity of packages, descriptions, and documents.<sup>231</sup> The courts have applied the notice obligation to a variety of contracts, such as technology development and land-use rights assignment contracts.<sup>232</sup> The CCL and CCC also require particularized notice,<sup>233</sup> stating the precise nature of all nonconformities. Most courts, however, have not required anything more than a general notice of nonconformity.<sup>234</sup> The interests of consumer buyers are protected by requiring only a general notice

<sup>225</sup> CCL, *supra* note 21, art. 158; CCC, *supra* note 22, art. 621.

<sup>226</sup> Judicial Interpretation on Sales (2012), *supra* note 193, art. 18; CCC, *supra* note 22, art. 622.

<sup>227</sup> Judicial Interpretation on Sales (2012), *supra* note 193, art. 17; Guānyú Shěnlǐ Xiāoshòu Hétóng Jiūfēn Anjiàn Shìyòng Fǎlù Wéntí de Jiěshì (Xiūdìng) (关于审理销售合同纠纷案件适用法律问题的解释 (修订)) [Revised Interpretation on Issues Concerning the Application of Law in the Trial of Cases of Disputes over Sales Contracts, Judicial Interpretation [2020]] (amended by the Judicial Comm. Sup. People's Ct., Dec. 23, 2020, effective Jan. 1, 2021) art. 12 (China) [hereinafter Revised Judicial Interpretation on Sales (2020)].

<sup>228</sup> If there is a quality guarantee period for the subject matter, that period shall prevail over the two-year limit. See *Dongfang Turbine Co. of Dongfang Elec. Corp. v. Daqing Nat'l High-Tech Indus. Dev. Zone Dafeng Constr. Decoration Co.*, ZGFMS No. 185 (Sup. People's Ct. 2019) (China).

<sup>229</sup> CCL, *supra* note 21, art. 158; CCC, *supra* note 22, arts. 621–622; Judicial Interpretation on Sales (2012), *supra* note 193, arts. 15–20; Revised Judicial Interpretation on Sales (2020), *supra* note 227, arts. 12–14.

<sup>230</sup> CCL, *supra* note 21, art. 158(1); CCC, *supra* note 22, art. 621(1).

<sup>231</sup> Jing Jin, *A Commentary on Article 158 of the Contract Law (Buyer's Obligation to Notify)*, 1 JURIST 173, 176 (2020).

<sup>232</sup> CCL, *supra* note 21, art. 174; CCC, *supra* note 22, art. 646; Judicial Interpretation on Sales (2012), *supra* note 193, art. 45; Revised Judicial Interpretation on Sales (2020), *supra* note 227, art. 32; *Chongqing Mas Sci. & Tech. Co. v. Sino BPO Digit. Co.*, ZGFMS No. 5300 (Sup. People's Ct. 2019) (China) (concerning a technology development contract); *Changning Bihu Chuntian Mod. Agric. Co. v. Yibing Hongchengda Led Lightning Co.*, CMS No. 1628 (Sichuan High People's Ct. 2020) (China) (concerning a work contract); *Dalian Changhai Constr. Inv. Co. v. Meishi (Dalian) Inv. Co.*, LMC No. 107 (Liaoning High People's Ct. 2017) (China) (concerning a land-use right assignment contract).

<sup>233</sup> Jin, *supra* note 231, at 178–79; COMMENTARY ON CHINESE CONTRACT LAW, *supra* note 215, at 266; COMMENTARY ON CCC CONTRACTS, *supra* note 198, at 368.

<sup>234</sup> See Larry A. DiMatteo & Jingen Wang, *CCL and CISG: A Comparative Analysis of Formation, Performance and Breach*, in CHINESE CONTRACT LAW, *supra* note 21, at 488.

since the CCL and CCC do not recognize an obligor's right to cure. Thus, the rationale for particularized notice is lacking.<sup>235</sup>

Breach may be excused due to a *force majeure* event.<sup>236</sup> CCL Article 117 and CCC Article 180 have strict requirements for *force majeure* relief—the event must have been unforeseeable, unavoidable, and unable to overcome.<sup>237</sup> The strictness of the language of CCL Article 117 does not plausibly support a claim of exemption due to hardship.<sup>238</sup> However, Chinese courts have recognized the concept of change of circumstances under the principles of fairness and good faith.<sup>239</sup> In 2009, the Supreme People's Court, in its Judicial Interpretation on Contracts II, recognized that a change of circumstances that does not render performance impossible, but causes undue hardship, may be grounds for giving an exemption to the breaching party.<sup>240</sup> Article 26 of the Interpretation distinguishes *force majeure* (impossibility of performance) from exemption due to a change of circumstances, although this distinction is not strictly applied by courts.<sup>241</sup> CCC Article 533 provides that change of circumstances could be caused by a *force majeure* event.<sup>242</sup> Therefore, if the change of circumstances is due to *force majeure*, a party may request to terminate the contract under CCC Article 533.<sup>243</sup>

### E. Remedies

The non-breaching party has numerous remedial options, such as claiming damages,<sup>244</sup> requiring specific performance,<sup>245</sup> price reduction,<sup>246</sup> and terminating the contract.<sup>247</sup> The price reduction remedy, where the buyer

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<sup>235</sup> *Id.*

<sup>236</sup> CCL, *supra* note 21, art. 117; CCC, *supra* note 22, arts. 180, 590.

<sup>237</sup> See Shiyuan Han, The CISG and Modernization of Chinese Contract Law 67–80 (2014) (unpublished manuscript) (on file with Comparative Law Journal of the Pacific).

<sup>238</sup> DiMatteo & Wang, *supra* note 234, at 498.

<sup>239</sup> Wuhan Gas Co. v. Chongoing Detector Factory, FH (1992) No. 27 (Sup. People's Ct. 1992) (China).

<sup>240</sup> Judicial Interpretation on Contracts II, *supra* note 193, art. 26. See also Qingdao New Town Establishment Real Est. Co. v. Jinan Yinfeng Hongfu Real Est. Co., ZGFMZ No. 283 (Sup. People's Ct. 2019) (China); Friends Union Inv. Co. v. Tianjing Binghai Panshan Inv. Co., ZGFMZ No. 1351 (Sup. People's Ct. 2018) (China).

<sup>241</sup> See, e.g., Jiangsu Zhengtong Hongtai Inc. v. Changzhou Xindong Chem. Dev. Co., MTZ No. 39 (Sup. People's Ct. 2015) (China).

<sup>242</sup> CCC, *supra* note 22, art. 533.

<sup>243</sup> COMMENTARY ON CCC CONTRACTS, *supra* note 198, at 225.

<sup>244</sup> CCL, *supra* note 21, art. 113; CCC, *supra* note 22, art. 584.

<sup>245</sup> CCL, *supra* note 21, art. 110; CCC, *supra* note 22, art. 580.

<sup>246</sup> CCL, *supra* note 21, art. 111; CCC, *supra* note 22, art. 582.

<sup>247</sup> See, e.g., CCL, *supra* note 21, arts. 94, 69; CCC, *supra* note 22, arts. 563, 528.

unilaterally reduces the contract price is often used in cases of defective performance.<sup>248</sup>

### F. Chinese Courts' Application of the CISG

The breach provisions in CCL and CCC are consistent with the breach rule in CISG Article 25, except for a slight difference in language. Instead of Chinese contract law's impossibility of fulfilling the contract purpose test, the CISG adopts a "substantial deprivation" of expectations standard. Specifically, a fundamental breach under the CISG "substantially deprives" a party of what it was "entitled to expect under the contract."<sup>249</sup> Chinese courts have consistently applied Article 25's fundamental breach rule. As an illustration, Chinese courts have deemed the seller's breach to be fundamental when a party failed to deliver the goods for a period of nine months after receiving the buyer's down payment;<sup>250</sup> delivered goods with little value;<sup>251</sup> delivered different goods than were ordered;<sup>252</sup> delivered goods that were seized by the customs authority due to infringement of a third party's intellectual property right;<sup>253</sup> and failed to deliver the goods within the additional time fixed by the buyer.<sup>254</sup>

Breach has been held to be non-fundamental in cases where the non-conformity of the goods delivered could be cured or the non-conforming goods could be resold.<sup>255</sup> For example, in the *Petroleum Coke* case, the contract provided for the sale of petroleum coke with an HGI value between 36 and 46.<sup>256</sup> The delivered coke had an HGI value of 32.<sup>257</sup> The Supreme People's Court ruled that the lower quality of coke supplied did not constitute a

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<sup>248</sup> ZHU, *supra* note 202, at 747; HAN, *supra* note 19898, at 862; *see also* Dalian Changhai Constr. Inv. Co., *supra* note 232.

<sup>249</sup> CISG, *supra* note 16, art. 25.

<sup>250</sup> Aldakkak Trading Co. v. Fujian Dingfeng Mach. & Elec. Mfr. Co., NMCZ No. 10 (Fujian Ningde Interm. People's Ct. 2015) (China).

<sup>251</sup> ZheJiang Zhongda Tech. Imp. Co. v. Specialty Fibres LLC, ZMZ No. 402 (Zhejiang High People's Ct. 2017) (China).

<sup>252</sup> Demilec Inc. v. Hangzhou Osking Im & Ex Trading Co., ZHSWCZ No. 145 (Zhejiang Hangzhou Interm. People's Ct. 2013) (China).

<sup>253</sup> Anson Distrib. LLC v. Shenzhen Kangerqi Biotechnology Co., Y0391MC No. 2049 (Guangdong Shenzhen Qianhai Coop. Zone People's Ct. 2016) (China).

<sup>254</sup> Tianjing Luye Steel Trade Co. v. Beta A., JMZ No. 90 (Tianjing High People's Ct. 2019) (China); T'S Network Co. v. Fujian Zhaoan Cnty. Lv Yuan Food Co., MMZ No. 578 (Fujian High People's Ct. 2019) (China).

<sup>255</sup> Hama GmbH & CoKG v. Yongkang Kanton Film & TV Equip. Co., Z07MZ No. 361 (Zhejiang Jinhua Interm. People's Ct. 2018) (China); St Cyber Link Corp. v. Dragonmen Grp. Co., Y0391MC No. 2728 (Guangdong Shenzhen Qianhai Coop. Zone People's Ct. 2018) (China).

<sup>256</sup> ThyssenKrupp Metallurgical v. Sinochem Int'l (Overseas) Pte., MSZZ No. 35 (Sup. People's Ct. 2013) (China).

<sup>257</sup> *Id.*

fundamental breach.<sup>258</sup> It noted that there are six criteria for determining the quality of coke, with HGI value being one of them.<sup>259</sup> Furthermore, coke with an HGI value of 32 can still be used, just in a more limited way. This was made evident when the buyer resold the coke to mitigate its losses.<sup>260</sup> The court also looked at decisions from other countries<sup>261</sup> and concluded that the general view was when the buyer can use or resell the goods through reasonable efforts, the non-conformity of quality does not constitute a fundamental breach.<sup>262</sup> However, in a few cases, Chinese courts, influenced by CCL, held that the breaching parties had committed fundamental breaches in the sense of CISG Article 25 because defective performance results in a party *not realizing the purpose of the contract*.<sup>263</sup> The next part will examine the meaning of breach in a common law system.

#### VI. BREACH IN AMERICAN LAW

First, a note of caution. The idea of identical or consistent rules in civil versus common law countries has always been a myth on numerous levels, whether between common law countries or across civil law countries. More specifically, the commonality between countries of the Germanic versus Franco-Roman systems is neither identical nor precise.<sup>264</sup> For this part, it is important to note that Anglo-American common law is also not fully aligned. For example, the English Sale of Goods Act of 1979 is merely a recapitulation of the English sales law existing at that time, while the main purpose of the American Uniform Commercial Code's Article 2 (sale of goods) (UCC) was the modernization and expansion of sales law.<sup>265</sup> It was the adoption of variant rules and new principles in the UCC that led to substantial divergences between the common law of contracts in the U.S. and the United Kingdom.<sup>266</sup>

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<sup>258</sup> *Id.*

<sup>259</sup> *Id.*

<sup>260</sup> *Id.*

<sup>261</sup> See *CISG-AC Opinion No. 5, The Buyer's Right to Avoid the Contract in Case of Non-Conforming Goods or Documents* (May 7, 2005).

<sup>262</sup> See [TGI] Strasbourg, Dec. 22, 2006, *supra* note 69, ¶¶ 63–66.

<sup>263</sup> See, e.g., CIETAC Arbitration Proceeding (PTA Powder Case), Apr. 18, 2008 (China); *ZheJiang Zhongda Tech. Imp. Co.*, *supra* note 251; *Aldakkak Trading Co.*, *supra* note 250.

<sup>264</sup> See Martin Schmidt-Kessel & Eva Silkens, *Breach of Contract*, in *EUROPEAN PERSPECTIVES ON THE COMMON EUROPEAN SALES LAW STUDIES IN EUROPEAN ECONOMIC LAW AND REGULATION* 111 (Javier Plaza Penadés & Luz M. Martínez Velencoso eds., 2015) (stating that, “[h]istorically, the notion of breach of contract was by no means clear and coherent within European Private Law and even less so in the field of sales law in Europe.”).

<sup>265</sup> The English Sale of Goods Act was intended to consolidate existing law stemming from the Sales of Goods Act 1893 and subsequent legislation. See generally MICHAEL G. BRIDGE, *THE SALE OF GOODS* (3d ed. 2014) (discussing the development of English sales law).

<sup>266</sup> As noted above, the purpose of the English Sales Act 1979 was simply to recapitulate or consolidate English sales law while the purpose of the UCC was much more ambitious, including: “(1) to simplify, clarify, and modernize the law governing commercial transactions; [and] (2) to permit the continued expansion of commercial practices through custom, usage, and agreement of the parties.” U.C.C. § 1-103(a) (AM. L. INST. & UNIF. L. COMM’N 2001).

Thus, the perfect tender breach rule, along with the doctrine of impracticability, principles of good faith and unconscionability, as well as a fuller embrace of contextual interpretation, introduced in the UCC, transformed American common law, separating itself in these areas from English common law.

In sum, there are four breach rules found in American contract law, consisting of strict performance (common law),<sup>267</sup> the “substantial performance doctrine” (common law),<sup>268</sup> the “perfect tender rule” in the sale of goods (UCC),<sup>269</sup> and fundamental breach (CISG).<sup>270</sup> These rules, taken together, form a spectrum from an extremely pro-buyer measure of breach (perfect tender) to an extremely pro-seller standard (fundamental breach), and a doctrine somewhere between the two extremes (substantial performance). Despite the simple taxonomy offered above, upon closer inspection, the rules often overlap. The common law of contracts generally requires performance to be close to complete performance. However, in certain categories of contracts, such as construction contracts, where a complete performance standard would work a hardship on the performing party, the substantial performance standard has been used.<sup>271</sup> The common law also recognizes the distinction between material and minor breach.<sup>272</sup> The pro-buyer perfect tender rule, which can be seen as similar to the strict performance standard, is limited by general principles of commercial reasonableness and the duty of good faith.<sup>273</sup>

#### A. Breach Under the Common Law of Contracts

There are numerous concepts of breach in American common law. Notably, the common law has alternating general principles—strict compliance and substantial performance. Under the strict compliance rule, anything short of full performance would constitute a breach.<sup>274</sup> The substantial performance

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<sup>267</sup> See *infra* Part VI.A.1.

<sup>268</sup> See *infra* Part VI.A.2.

<sup>269</sup> See *infra* Part VI.B.

<sup>270</sup> CISG, *supra* note 16, art. 25.

<sup>271</sup> *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889 (N.Y. 1921) (creating substantial performance doctrine in construction contracts). See also *infra* VI.A.2.

<sup>272</sup> See *infra* notes 276–77 and accompanying text.

<sup>273</sup> See U.C.C. § 1-304 (AM. L. INST. & UNIF. L. COMM’N 2001) (“Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.”); U.C.C. § 1-103(b) (AM. L. INST. & UNIF. L. COMM’N 2001) (“the principles of law and equity, including the law merchant” supplement the UCC); U.C.C. § 2-202(a) (AM. L. INST. & UNIF. L. COMM’N 1951) (“by course of performance, course of dealing, or usage of trade”); U.C.C. § 2-311(1) (AM. L. INST. & UNIF. L. COMM’N 1951) (“Any such specification must be made in good faith and within limits set by commercial reasonableness.”).

<sup>274</sup> The vestiges of the common law’s strict performance or strict liability for breach of contract persisted into the 20th Century. See, e.g., *Cutter v. Powell* (1795) 101 Eng. Rep. 573 (Eng.); RESTATEMENT (SECOND) OF CONTS. § 235 cmt. b (AM. L. INST. 1981) (“[w]hen performance is due, however, anything short of full performance is a breach”); *Sumpter v. Hedges* (1898) 1 QB 673

doctrine recognizes complete performance as something less than one hundred percent and is mostly applied to service contracts, such as those involving construction projects.<sup>275</sup> The practical difference between the two rules is that in the former the buyer may withhold final payment until full performance is reached, while in the latter the buyer is required to make the final payment and then seek a remedy, such as repair, replacement, or damages under warranty law.

Also, the strict compliance rule is not without nuance. Courts have recognized different types of breaches including *de minimis* or trivial, minor or partial, and material breach.<sup>276</sup> *De minimis* breach is one that has little or no impact on the value or functionality of the item or service being rendered. A minor or partial breach often involves some form of breach that does not affect the nature of the item or service.<sup>277</sup> For example, parties often state that delivery of performance is “time of the essence,” meaning the failure to meet the prescribed delivery date is a material breach. However, courts often disregard that contractual mandate, when the delay is reasonable, and the receiving party has not suffered serious harm related to the minor delay in delivery.<sup>278</sup> The non-breaching party can seek damages resulting from the breach but cannot withhold final payment. A material breach removes the duty of the non-breaching party to perform on the contract. With these different views of breach, the lines between material and minor, and between strict or full performance and substantial performance are blurry ones. In the end, the classification of breach is a factual determination based on the type or subject matter of the contract.

Other concepts in the common law that relate to breach include conditions, anticipatory repudiation (breach), and willful breach. Contracts are often made

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(Eng.) (“The law is that, where there is a contract to do work for a lump sum, until the work is completed the price of it cannot be recovered.”). Judge Benjamin Cardozo justified the acceptance of the substantial performance doctrine as follows, “[f]rom the conclusion that promises may not be treated as dependent to the extent of their uttermost minutiae without a sacrifice of justice . . .” *Jacob & Youngs, Inc.*, 129 N.E. at 891. Judge McLaughlin restated the case for a strict performance standard as, “[t]he [owner-buyer] had a right to contract for what he wanted.” *Id.* at 892.

<sup>275</sup> 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 8.12, at 489 (3d ed. 2004) (citing *Shaeffer v. Kelton*, 619 P.2d 1226 (N.M. 1980)).

<sup>276</sup> See Eric G. Andersen, *A New Look at Material Breach in the Law of Contracts*, 21 U.C. DAVIS L. REV. 1073 (1988).

<sup>277</sup> See, e.g., *Foundation Dev. Corp. v. Loehmanns*, 163 Ariz. 438, 445–46 (Ariz. 1990) (finding that “nearly all courts hold that, regardless of the language of the lease, to justify forfeiture, the breach must be ‘material,’ ‘serious,’ or ‘substantial,’” and that “we believe a material provision of a lease may be breached in such a trivial manner that to enforce a forfeiture would be unconscionable and inequitable.”).

<sup>278</sup> Time of the essence clauses must be considered along with other circumstances in determining the materiality of breach. RESTATEMENT (SECOND) OF CONTS. § 242 cmt. d (AM. L. INST. 1981). Even if the parties include a time of the essence provision, “[i]f the enforcement of such an express provision will have the effect of enforcing an excessive penalty or an unjust forfeiture, equity will prevent such enforcement.” 3 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 715 (1951).

conditional on a certain occurrence or non-occurrence.<sup>279</sup> If a landowner enters into a contract with a construction company to build an office building, the contractor's ability to get a building permit is considered a condition precedent, whether or not expressly stated in the contract. So, when the building application is rejected, because the land is not zoned for the type of building to be constructed, the failure to obtain the building permit would not be considered a breach. Contracts may also include conditions that must be met during the performance of the contract. A party's failure to meet a condition (no matter how trivial), known as a condition subsequent, allows the other party to terminate the contract.<sup>280</sup> In many ways, the failure to meet this type of condition is a form of breach. The difference is that one party that terminates, due to the other party's failure to meet a condition, may be able to obtain full value even in the case of partial performance. For example, a famous basketball coach is lured, by a contract offer paying \$5 million per year for five years, into coaching a lower level school on the condition that the school would build a new basketball arena by the end of the third year of the contract. If the school fails to meet this condition the coach will be able to terminate the contract and still receive the full \$25 million owed under the contract.

Anticipatory repudiation or breach<sup>281</sup> works much like a condition subsequent in that it may lead to early termination of the contract. The difference is the condition subsequent is a specific term that narrowly defines future events that allow for termination. An anticipatory breach is more general in nature, based upon objective evidence that shows that a party is likely not to be in performance in the future.<sup>282</sup> The easiest case is that of express repudiation where a party notifies the other party of its intent not to perform. An implied repudiation is more difficult to prove because it is based on extrinsic evidence, such as industry gossip or reporting of negative events involving the future of the performing party. Depending on the reliability and veracity of the sources, a party may send a notice of anticipatory repudiation

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<sup>279</sup> There are three general types of contractual conditions: (1) condition concurrent, which requires that parties perform at the same time, if possible; (2) condition precedent determines when a contract is effective or not effective at all; (3) condition subsequent determines if a contract will prematurely come to an end. See RESTATEMENT (SECOND) OF CONTS. § 224 (AM. L. INST. 1981). A condition precedent is "an event, not certain to occur, which must occur . . . before performance under a contract becomes due." *Id.* § 224. Comment *e* defines a condition subsequent as when "the failure of one of the [parties] to commence an action within a prescribed time, will extinguish a duty after performance has become due." *Id.* cmt. e. Section 234(1) provides for the common law's preference or presumption of concurrent conditions, stating that when performances can be rendered simultaneously, "they are to that extent due simultaneously, unless the language or the circumstances indicate the contrary." RESTATEMENT (SECOND) OF CONTS. § 234(1) (AM. L. INST. 1981).

<sup>280</sup> "A condition subsequent is an event or state of affairs that, if it occurs, will terminate one party's obligation to the other." *Condition Subsequent*, LEGAL INFO. INST. (May 2020), <https://perma.cc/RKC3-4PJP>.

<sup>281</sup> See RESTATEMENT (SECOND) OF CONTS. § 253 (AM. L. INST. 1981); U.C.C. § 2-610 (AM. L. INST. & UNIF. L. COMM'N 1951).

<sup>282</sup> See RESTATEMENT (SECOND) OF CONTS. § 253 (AM. L. INST. 1981); U.C.C. § 2-610 (AM. L. INST. & UNIF. L. COMM'N 1951).

to the other party. However, the other party can prevent the occurrence of premature breach and termination by providing adequate assurance<sup>283</sup> that they will indeed perform. The providing of adequate assurance results in the nullification of the repudiation.<sup>284</sup> The rationale for the principle of anticipatory repudiation is that common law, as a general rule, only provides remedies at the exact time of the breach. Anticipatory repudiation allows the non-breaching party to bring a future breach backward to the time of anticipation, allowing the party to terminate the contract in order to mitigate the harm that would be caused by the future breach.

The concept of willful breach is found in case law, but it is a controversial type of breach that is mostly the focus of theoretical debates. Willful breach is a form of maliciousness, where the party's breach is based on an intent to harm the other party. Other than ordinary contract or compensatory damages, the non-breaching party may seek exemplary damages. Exemplary damages are additional amounts of money above full compensation for the harm caused by the breach. Clearly, such damages are not intended to compensate the non-breaching party but are rendered to punish the breaching party for the maliciousness of its breach. Such types of damages are found in the domain of American tort law in the concept of punitive damages but are rarely given in contract law.<sup>285</sup>

### 1. Olde Common Law: Strict Performance

The *olde* or classical common law of contracts<sup>286</sup> held that anything short of full or one-hundred percent performance constituted a breach. This strict performance rule as applied held that even a minor flaw in performance meant the non-breaching party's reciprocal duty to perform (such as, to make a final

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<sup>283</sup> See RESTATEMENT (SECOND) OF CONTS. § 251 (AM. L. INST. 1981); U.C.C. § 2-609 (AM. L. INST. & UNIF. L. COMM'N 1951).

<sup>284</sup> U.C.C. § 2-609 (AM. L. INST. & UNIF. L. COMM'N 1951) (“[T]he other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonable suspend any performance for which he has not already received the agreed return.”).

<sup>285</sup> Punitive or exemplary damages are rarely given for breach of contract because contract damages are merely compensatory in nature. Susan M. Sutton, *Contracts—Breach of Disability Insurance Contract—Nonrecoverability of Mental Anguish Damages in “Commercial” Contracts*, 27 WAYNE L. REV. 1357, 1359 (1981). In some rare cases, egregious conduct warrants additional damages. *Id.* at 1359–60. The “general rule, excluding both emotional distress and ex-emplary damages for breach of a contract, is not without exceptions.” *Id.* at 1359. The exceptions relate to so-called “personal contracts,” such as contracts between inns and guests, common carriers and passengers, and insurance contracts. *Id.* at 1359–61. Exemplary or punitive damages have been awarded when insurance companies reject meritorious claims in violation of the duty of good faith. *Id.* at 1362.

<sup>286</sup> See Jack Beatson & Daniel Friedman, *Introduction: From ‘Classical’ to Modern Contract Law*, in GOOD FAITH AND FAULT IN CONTRACT LAW 7 (Jack Beatson & Daniel Friedman eds., 1995) (classical contract law developed during the 19th and early 20th Centuries focusing on the “centrality of the individual and a restricted role of intervention for ether court or state”); DUNCAN KENNEDY, THE RISE & FALL OF CLASSICAL LEGAL THOUGHT 242 (2006) (basing legal rules purely on private autonomy to be objectively determined by the courts).

payment) was suspended.<sup>287</sup> Thus, a defect valued at \$2,000 would defer a final payment owing of \$40,000 or so. This rule may have had its origins in the agrarian age and the barter system, which largely consisted of simple transactions where defects were waived upon acceptance by the buyer. In larger and more complex transactions, such a rule was inefficient, encouraged opportunism, and resulted in injustice. The modern law of contract still possesses the full or strict performance rule, but its more unjust applications are mollified by the substantial performance doctrine, the distinction between material versus minor breach, and the robust development of warranty law. The rule of strict or full performance remains the standard,<sup>288</sup> but modern common law is more flexible in applying the rule and more open to adjusting remedies based on the equities of the case. The next part explores developments meant to soften the harshness of the strict performance rule.

## 2. Brilliance of Benjamin Cardozo: Substantial Performance Doctrine

In the *olde* common law, courts exercised discretion by recognizing strict performance in cases where the performing party failed to fully perform, unless the failure was minor in nature, in which case the “[c]ourts occasionally ignore[d] trifling defects under the principle of *de minimis non curat lex* (‘the law does not concern itself with trifles’).”<sup>289</sup> This would be the case in which precise performance need not be considered an absolute, such as when a court determines that a degree of variance in performance is “within the range allowed by the [contract] specifications.”<sup>290</sup> The roots of the substantial performance doctrine have been traced to Lord Mansfield’s 1777 decision in *Boone v. Eyre* involving the sale of a plantation including slaves.<sup>291</sup> The purchaser argued that the seller did not fully perform because it did not legally own all of the slaves.<sup>292</sup> Mansfield held that the purchaser could not withhold payment (but could subsequently sue for damage) since “any one negro not being the property of the [seller] would bar the action [for payment].”<sup>293</sup> Farnsworth notes the rationale of the case is that “the purchaser should not be allowed to resist paying the price merely on the ground of an insubstantial breach.”<sup>294</sup> Mansfield was a master in modernizing the common law by looking at the consequences of the formulaic application of fixed rules and adjusting

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<sup>287</sup> Beatson & Friedman, *supra* note 286 (writing that the “mystic of individual autonomy and the morality of promise required strict performance”).

<sup>288</sup> “When performance of a duty under a contract is due any non-performance is a breach.” RESTATEMENT (SECOND) OF CONTS. § 235(2) (AM. L. INST. 1981).

<sup>289</sup> FARNSWORTH, *supra* note 275, § 8.8, at 552.

<sup>290</sup> *Id.* (citing *Intermeat v. Am. Poultry*, 575 F.2d 1017 (2d Cir. 1978) (in which the contract required delivery of meat marked “Richardson Production” and instead it was marked as “Tasmeats”; however, trade usage showed that both names referred to the same type of meat)).

<sup>291</sup> *Boone v. Eyre* (1777) 126 Eng. Rep. 160(a) (KB).

<sup>292</sup> *Id.*

<sup>293</sup> *Id.*

<sup>294</sup> FARNSWORTH, *supra* note 275, § 8.12, at 566.

them if their application led to ludicrous or unjust outcomes in certain types of fact patterns.<sup>295</sup>

The Mansfieldian approach to rewriting and modernizing contract law can be seen some one hundred and fifty years later in the work of American judge Benjamin N. Cardozo.<sup>296</sup> In the 1921 landmark case of *Jacob & Youngs, Inc. v. Kent*, Cardozo provided a full elaboration of the substantial performance doctrine.<sup>297</sup> The case involved the building of a home where the home specifications required the use of Reading-made plumbing pipe.<sup>298</sup> The builder used some Reading pipe, but mostly used another make of pipe of equal quality.<sup>299</sup> Under existing law, the homeowner argued that the final payment was not required until the builder corrected the breach.<sup>300</sup> Given that the pipe was embedded into the structure of the home, such a cure could only be performed at prohibitive costs.<sup>301</sup> Cardozo questioned whether the retention of the final payment under the strict performance rule should be the appropriate outcome.<sup>302</sup> He concluded that since the builder's performance did not reduce the functionality or habitability of the home, the homeowner was required to make the final payment.<sup>303</sup> However, the homeowner retained the right to sue under warranty law for damages caused by defective performance. In this case, there were no such damages since the pipe used was of equal or better quality.<sup>304</sup>

### 3. Modern Contract Law

The modern common law of contracts incorporates the remnants of the strict performance rule but limits its effect. A failure of full performance does not discharge a party's duty to perform unless the breach is material in

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<sup>295</sup> "Mansfield was the founder of modern commercial law. He enfolded into the ancient common law of England the customs and usages of the merchants and industrialists." NORMAN S. POSER, *LORD MANSFIELD: JUSTICE IN THE AGE OF REASON* 4 (2013).

<sup>296</sup> See ANDREW L. KAUFMAN, *CARDOZO* (1998); BENJAMIN NATHAN CARDOZO, *SELECTED WRITINGS* (Margaret E. Hall ed., 1947) (extrajudicial writings).

<sup>297</sup> *Jacob & Youngs, Inc.*, 129 N.E. at 890–92.

<sup>298</sup> *Id.*

<sup>299</sup> *Id.*

<sup>300</sup> *Id.*

<sup>301</sup> *Id.* at 890 (stating that the performance doctrine in this case "meant the demolition at great expense of substantial parts of the completed structure.").

<sup>302</sup> "[A]n omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture." *Jacob & Youngs, Inc.*, 129 N.E. at 890 (citing *Spence v. Ham*, 57 N.E. 412 (N.Y. 1900); *Woodward v. Fuller*, 80 N.Y. 312 (N.Y. 1880); *Glacius v. Black*, 67 N.Y. 563, 566 (N.Y. 1876); *Dodge v. Kimbell*, 89 N.E. 542, 543 (Mass. 1909)).

<sup>303</sup> *Jacob & Youngs, Inc.*, 129 N.E. at 890 (noting that the "omission of the prescribed brand of pipe was neither fraudulent nor willful" and there was a "basis for the inference that the defect was insignificant in its relation to the project.").

<sup>304</sup> *Id.* at 891 (stating "we think the measure of the allowance is not the cost of replacement, which would be great, but the difference in value, which would be either nominal or nothing.").

nature.<sup>305</sup> In short, a minor breach does not absolve the non-breaching party's duty to perform relative to the other party's performance. In cases of material breach, the breaching party is liable for damages.<sup>306</sup>

As discussed above, the substantial performance doctrine is a second-order rule, with full performance being the first-order rule, whose main purpose is not the assessment of damages for breach but rather a focus on the breach's effect on the duties of the non-breaching party.<sup>307</sup> In some cases, the withholding of payment due to a lack of full performance feels unjust. In such cases, a substantial performance by the performing party allows it to claim the unpaid balance, while the non-breaching party is limited to a separate claim for damages.<sup>308</sup>

Another principle used to prevent forfeiture of a right to payment due to the strict performance standard is the rule that treats part performances as agreed equivalents.<sup>309</sup> The general rule is that even if parts of a contract can be performed at different times, unless the contract expressly provides for installments, the whole of the performance must be made at a single time.<sup>310</sup> It is simply a contract that is performed in various parts. However, a court may seek to determine if a contract can be broken into equivalent parts (divisibility).<sup>311</sup> The court, at its discretion, may require payment or counter-performance related to the parts performed. This would be allowed only in cases where the contract can be interpreted as consisting of "parts of pairs of corresponding performances" or "agreed equivalents."<sup>312</sup>

Finally, some of the same factors used to determine if a breach is material for purposes of the full performance rule are also used when applying the substantial performance rule. Section 241 of the Restatement lists a number

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<sup>305</sup> RESTATEMENT (SECOND) OF CONTS. § 237 (AM. L. INST. 1981).

<sup>306</sup> A material breach has been held to mean "a breach of contract which is more than trivial . . . a breach which is substantial. The breach must be a serious matter, rather than a matter of little consequence." *Mid Essex Hosp. Serv. NHS Trust v. Compass Grp. U.K. and Ireland Ltd.* [2013] EWCA (Civ) 200, [126] (appeal taken from Eng.). See also *Material Breach*, BLACK'S LAW DICTIONARY (2d ed.) ("Material breaches of contract are also called fundamental breaches. They're the kind most people think of when they hear the term 'breach of contract.'").

<sup>307</sup> RESTATEMENT (SECOND) OF CONTS. § 237 (AM. L. INST. 1981).

<sup>308</sup> *Id.* cmt. d.

<sup>309</sup> RESTATEMENT (SECOND) OF CONTS. § 240 (AM. L. INST. 1981).

<sup>310</sup> RESTATEMENT (SECOND) OF CONTS. § 233 (AM. L. INST. 1981).

<sup>311</sup> Restatement (Second) of Confs. § 240 (Am. L. Inst. 1981). Section 240 states:

If the performances to be exchanged under an exchange of promises can be apportioned into corresponding pairs of part performances so that the parts of each pair are properly regarded as agreed equivalents, a party's performance of his part of such a pair has the same effect on the other's duties to render performance of the agreed equivalent as it would have if only that pair of performances had been promised.

*Id.*

<sup>312</sup> *Id.* cmt. b.

of factors for determining if a breach is material: the extent of harm to the non-breaching party's expected benefits; the extent that the non-breaching party can be "adequately compensated" for the partial non-performance; the extent of injury to the breaching party if the contract is terminated; the ability of the breaching party to cure the breach or give assurances; and whether the failure to perform meets the standards of good faith and fair dealing.<sup>313</sup> As to the latter factor, some courts have used the term willful breach in determining that the breach was not in good faith.<sup>314</sup>

Bad faith or willful breach, which has not yet been successfully defined, may also impact a party's use of the substantial performance doctrine. There is a split among the courts whether willful breach, such as intentionally varying from the specifications in the contract, should prevent the application of the substantial performance rule.<sup>315</sup> This is largely due to the fact that there is no widely accepted definition of willful breach,<sup>316</sup> and until it is adequately defined, the amount of damages awarded remains unclear.<sup>317</sup> The more established line of precedents holds that willful breach preempts the use of the substantial performance doctrine. Judge Cardozo in *Jacobs & Youngs v. Kent* stated that: "The willful transgressor must accept the penalty of his transgression."<sup>318</sup> However, Farnsworth notes a modern trend against such a prosaic rule.<sup>319</sup>

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<sup>313</sup> RESTATEMENT (SECOND) OF CONTS. §§ 241(a)–(e) (AM. L. INST. 1981).

<sup>314</sup> *Id.* cmt. f.

<sup>315</sup> RESTATEMENT (SECOND) OF CONTS. § 241(f) (AM. L. INST. 1981) (stating that "the extent to which the behavior of the party failing to perform . . . comports with the standards of good faith and fair dealing is, however, a significant circumstance in determining whether the failure is material . . . . In giving weight to this factor courts have often used the less precise terms as 'willful.'").

<sup>316</sup> 5 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 545 (1951). Corbin notes that:

The word most commonly used is "willful"; and it is seldom accompanied by any discussion of its meaning or classification of the cases that should fall within it. Its use indicates a childlike faith in the existence of a plain and obvious line between the good and the bad, between unfortunate virtue and unforgivable sin.

*Id.*

<sup>317</sup> "[C]ourts sometimes do award higher damages, under various legal doctrines, if the behavior of the breacher seems especially culpable." Richard Craswell, *When Is a Willful Breach "Willful"? The Link Between Definitions and Damages*, 107 MICH. L. REV. 1501, 1501 (2009) (citing Patricia H. Marshall, *Willfulness: A Crucial Factor in Choosing Remedies for Breach of Contract*, 24 ARIZ. L. REV. 733 (1982) (providing a survey of the relevant doctrines)).

<sup>318</sup> *Jacob & Youngs, Inc.*, 129 N.E. at 891.

<sup>319</sup> FARNSWORTH, *supra* note 275, § 8.12, at 493, (citing *Vincenzi v. Cerro*, 442 A.2d 1352 (Conn. 1982) (where the court stated that "[t]he contemporary view . . . is that . . . a conscious [or] intentional departure . . . will not necessarily defeat recovery, but may be considered as one of the several factors involved in deciding whether there has been full performance.")).

*B. Breach Under the Uniform Commercial Code*

The UCC adopted an extremely pro-buyer rule that allows the buyer to reject goods or delays in delivery for any type of breach no matter how minor.<sup>320</sup> This standard of breach, popularly known as the perfect tender rule, far predates the enactment of the UCC. Farnsworth dates the rule to the nineteenth century.<sup>321</sup> The severity of the injury caused to the seller, such as in cases of specialty or custom manufactured goods and perishable goods, is irrelevant to the buyer's right to reject.<sup>322</sup> Furthermore, the fact that the defect or breach caused little or no harm to the buyer is also immaterial.

The perfect tender rule does have a number of exceptions, including when the seller's right to cure non-conformities has not expired;<sup>323</sup> failure of the buyer to cooperate with the seller, such as by failing to provide specifications in a timely manner;<sup>324</sup> use of the substantial performance rule in the delivery of an installment;<sup>325</sup> and failure to comply with an agreed accommodation between the seller and the buyer.<sup>326</sup> The broadest limitation on the perfect tender rule is the duty of good faith.<sup>327</sup> In cases of bad faith rejection, the reason for the rejection is not due to any defect in the goods. The most common example is when a buyer rejects goods for a trivial defect in order to take advantage of a market change. If the market price of the contracted goods has decreased, the buyer may be incentivized to use the perfect tender rule to escape the higher-priced contract.

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<sup>320</sup> U.C.C. § 2-601 (AM. L. INST. & UNIF. L. COMM'N 1951) (stating that the buyer can reject "if the goods or the tender of delivery fail in any respect to conform to the contract").

<sup>321</sup> FARNSWORTH, *supra* note 275, § 8.12, at 494.

<sup>322</sup> *Id.*

<sup>323</sup> U.C.C. § 2-508(1) (AM. L. INST. & UNIF. L. COMM'N 1951) (stating if "the time for performance has not yet expired, the seller may seasonably notify the buyer of his intention to cure").

<sup>324</sup> U.C.C. § 2-311(1) (AM. L. INST. & UNIF. L. COMM'N 1951).

<sup>325</sup> U.C.C. § 2-612(2) (AM. L. INST. & UNIF. L. COMM'N 1951) (stating that a buyer can reject an installment only "if the non-conformity substantially impairs the value of that installment").

<sup>326</sup> A seller's right to cure is extended beyond the delivery date in the contract if the seller provides an accommodation (such as sending slightly non-conforming goods) "which the seller had reasonable grounds to believe would be acceptable" but are rejected, and thus "the seller may if he seasonably notifies the buyer have a further reasonable time to substitute a conforming tender." U.C.C. § 2-508(2) (AM. L. INST. & UNIF. L. COMM'N 1951).

<sup>327</sup> See U.C.C. § 1-203 (AM. L. INST. & UNIF. L. COMM'N 2001); U.C.C. § 2-103 (AM. L. INST. & UNIF. L. COMM'N 1951).

*C. Installment Contracts and Material Breach*

Installment contracts<sup>328</sup> pose a dilemma for determining breach.<sup>329</sup> Simply stated, in a long-term contract that involves numerous shipments, does a breach relating to one of the installments constitute a breach of the entire contract? U.C.C. Section 2-612(3) stipulates for installment contracts that when there is a defect or nonconformity of a shipment that “substantially impairs the value of the whole contract there is breach of the whole,” allowing the buyer to cancel all future deliveries and sue for total breach of contract.<sup>330</sup> One key factor in making this determination is whether the installment or shipments are independent or interdependent. If the contract is for the shipment of fungible goods, such as steel, cotton, microchips, and so forth, then a defect in one of the shipments should not rise to the level of a material breach of the contract as a whole.<sup>331</sup> However, if the shipments are of different component parts to be used in building something else, such as a national communications system, a defect in one of the more important installments would constitute a breach of the overall contract.<sup>332</sup> A turnkey project such as a communications system can only work if there is full performance of the contract, including each of its individual parts.

Another important issue in the area of breach is the order of performance. As noted above, the order of performance is affected if the contract contains an express or implied condition precedent or condition subsequent.<sup>333</sup> However, when neither type of condition exists the common law presumes concurrent or simultaneous performances. The rationale being that concurrent performance provides security against disappointment of the parties’ expectations of performance.<sup>334</sup> This prevents the parties from asserting that the other party breached the contract because it failed to perform first.

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<sup>328</sup> U.C.C. § 2-612(1) (AM. L. INST. & UNIF. L. COMM’N 1951) defines an “installment contract” as a contract “which requires or authorizes the delivery of goods in separate lots to be separately accepted, even though the contract contains a clause ‘each delivery is a separate contract’ or its equivalent.” See also RESTATEMENT (SECOND) OF CONTS. § 233 (AM. L. INST. 1981) (“performance at one time or in installments”).

<sup>329</sup> See Elizabeth Hayes Patterson, *UCC Section 2-612(3): Breach of an Installment Contract and a Hobson’s Choice for the Aggrieved Party*, 48 OHIO ST. L.J. 177 (1987).

<sup>330</sup> U.C.C. § 2-612(3) (AM. L. INST. & UNIF. L. COMM’N 1951); see U.C.C. § 2-711 (AM. L. INST. & UNIF. L. COMM’N 1951); FARNSWORTH, *supra* note 275, at 509–21.

<sup>331</sup> The “doctrine of material breach” states that “if one party breaches a . . . contract the other party cannot cancel the contract unless the breach is material.” IAN AYRES & RICHARD E. SPEIDEL, *STUDIES IN CONTRACT LAW* 935 (7th ed. 2008).

<sup>332</sup> See U.C.C. § 2-612(3) (AM. L. INST. & UNIF. L. COMM’N 1951) (“whenever non-conformity or default with respect to one or more installments substantially impairs the value of the whole contract there is a breach of the whole.”).

<sup>333</sup> See generally RESTATEMENT (SECOND) OF CONTS. (AM. L. INST. 1981).

<sup>334</sup> RESTATEMENT (SECOND) OF CONTS. § 234 cmt. a (AM. L. INST. 1981).

*D. Fundamental Breach Under the CISG*

The fundamental breach rule found in Article 25 of the CISG has no direct corollary in American contract law. It is a rejection of the perfect tender rule found in the UCC. The closest corollary in common law to fundamental breach is the notion of material breach.<sup>335</sup> The more appropriate comparison is between Article 25 and the perfect tender rule found in Article 2 of the UCC.<sup>336</sup> The rules are in diametric opposition. The perfect tender rule is lopsidedly pro-buyer allowing for the rejection of goods with only minor defects. The fundamental breach rule is incredibly pro-seller in that the buyer has a limited right of rejection of even highly defective goods as long as they have some intrinsic value. A strong argument can be made that each rule is economically efficient given the context of the application. The cost, under the perfect tender rule, of returning rejected goods or shipping them to another customer, is not cost-prohibitive given the efficiency of the American transport system. The highly developed secondary markets in the U.S. often allow for offloading of goods to another customer proximate to the party rejecting the goods. In turn, the efficiency of the fundamental breach rule is that it prevents waste. Goods that are shipped globally can often only be retrieved at substantial costs to the seller. The fundamental breach rule places the burden on the buyer to maximize the value obtainable from the defective goods in order to prevent waste and lower damages.<sup>337</sup>

The fundamental breach rule has little meaning based solely on American case law because there are only a few cases in which it has been recognized. *Delchi Carrier v. Rotorex*<sup>338</sup> involved the sale of compressors to a manufacturer of air conditioners. The compressors proved to be defective and were not useable. The court used the language of Article 25 stating, “there appears to be no question that [Delchi] did not substantially receive that which [it] was entitled to expect’ and that ‘any reasonable person could foresee that shipping non-conforming goods to a buyer would result in the buyer not receiving that which he expected and was entitled to receive.”<sup>339</sup> Therefore, the court concluded that Rotorex was liable for fundamental breach.

In *Valero Marketing v. Greeni Oy*,<sup>340</sup> the breach involved the failure to tender cargo of naphtha during either the original delivery date or the revised delivery dates. The buyer argued that due to a volatile market a delayed

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<sup>335</sup> CISG, *supra* note 16, art. 25 (“a breach of contract committed by one of the parties is fundamental if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract.”).

<sup>336</sup> U.C.C. § 2-601 (AM. L. INST. & UNIF. L. COMM’N 1951).

<sup>337</sup> Specific Fundamental Breach Situations, 2016 DIGEST OF CASE LAW ON THE UNITED NATIONS CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS, art. 25 ¶ 8 (“Non-conformity concerning quality remains a mere non-fundamental breach of contract as long as the buyer—without unreasonable inconvenience—can use the goods or resell them even at a discount.”).

<sup>338</sup> *Delchi Carrier v. Rotorex*, 71 F.3d 1024 (2d Cir. 1995).

<sup>339</sup> *Id.* at 1028–29.

<sup>340</sup> *Valero Mktg. v. Greeni Oy*, 373 F. Supp. 2d 475 (3d Cir. 2005).

delivery constituted a fundamental breach. In response, the seller noted that the buyer intended to use the goods solely for blending and that it already had a large supply of naphtha in reserve. Unfortunately, the Circuit Court did not render a decision on the substance but only stated that a fuller development of the CISG's applicable provisions and resolution of the facts were needed.<sup>341</sup> An example of fundamental breach is provided in *Magellan International v. Salzgitter Handel*, where the court held the buyer's demand that the seller waive the contract's requirement of a letter of credit rose to the level of fundamental breach.<sup>342</sup>

There is no consensus as to the factors that should be weighed in determining whether a fundamental breach occurred. However, factors that likely weigh in the determination include the type of contract (discrete versus long-term), the future performance, whether the breaching party offered to cure, terms of the contract, the type of goods, nature or size of breach, the remedy being sought, degree of reliance, and trade usage.<sup>343</sup> Finally, the allocation of the burden of proof to provide evidence that a breach was fundamental is a key issue. The court in *Chicago Prime Packers, Inc. v. Northam Food Trading Co.* held that the party arguing a fundamental breach (non-conformity of goods) occurred had the burden of proving that the non-conformity was fundamental in nature.<sup>344</sup>

### *E. Breach and Remedy*

The various types of breach standards can be explained in a number of ways. Clearly, new types of transactions have influenced the development of alternative meanings of breach. The injustice of strict performance led to the emergence of the substantial performance doctrine. The enactment of the UCC and the CISG introduced diametrically opposed standards for contracts for the sale of goods. The evolution of contract breach also resulted in the diversification of remedies related to different breach standards. Benjamin Cardozo recognized that substantial performance in construction contracts was satisfactory performance and did not constitute breach, thus, requiring the

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<sup>341</sup> The court held in favor of the seller that the CISG was applicable law, but did not decide on substance since additional evidence was needed to determine if there was a fundamental breach and whether the buyer's rejection was in good faith. *Id.* It concluded that, "[t]hese and other issues require a fuller development of the CISG's applicable provisions and the resolution of factual questions." *Id.* at 484. Subsequently, the District Court ruled in favor of the seller, holding that the buyer wrongfully rejected a late delivery under a second contract (modifying the first). *Valero Marketing v. Greeni Oy*, D.C. No. 01-cv-5254 (D.N.J. 2006). The court held that Article 47 of the CISG provided the seller with the right to a time extension. *Id.* It further held that the second contract was invalid because it interfered with the working of Article 47. *Id.* In a second appeal, the Second Circuit reversed the District Court holding that the contract modification or second contract was invalid. *Valero Mktg. v. Greeni Oy*, 242 Fed.App'x 840, 845 (3d Cir. 2007).

<sup>342</sup> *Magellan Int'l v. Salzgitter Handel*, 76 F. Supp. 2d 919 (N.D. Ill. 1999).

<sup>343</sup> Bashar H. Malkawi, *CISG: The Relation among Cure, Fundamental Breach, and Avoidance*, 93 J. L. POL'Y & GLOBALIZATION 24, 26-27 (2020).

<sup>344</sup> *Chi. Prime Packers, Inc. v. Northam Food Trading Co.*, 408 F.3d 894 (7th Cir. 2005).

non-breaching party to make final payment on the contract.<sup>345</sup> Despite the existence of satisfactory performance, the building owner retains a claim for damages.<sup>346</sup> The strict performance standard allowed the building owner to retain final payment until the breach was corrected through the remedy of repair or replacement.<sup>347</sup> This caused injustice when the costs of correction were catastrophic, while the gain or benefit to the non-breaching party was negligible.<sup>348</sup> Thus, Cardozo fashioned the alternative remedy of diminishment of value (difference between the value between full performance and less than full performance).<sup>349</sup> Courts now have the discretion to award damages based on required repair-replacement or diminishment in value. In cases where the costs to rectify the defect in performance are high relative to the benefits to be achieved, the court may award lesser damages based on diminishment of value.

#### VII. COMMONALITY AND DIVERGENCE

This Article aimed to explore a number of questions. Do countries have different requirements related to breach? Does the meaning of breach differ depending on the type of contract? What types of factors do courts use that are predictive of a finding of breach? What is the relationship between the types of breach and available remedies? How has the fundamental breach rule in the CISG been applied in different countries? How does the formal meaning of breach differ from how it is applied by the courts?

The answers, succinctly stated, are as follows: (1) countries do have different requirements related to breach, such as the civil law's notice requirement; (2) the type of contract impacts the nature of breach, such as the UCC's rule on breach in installment contracts and its "agreed equivalents" rule, as well as the civil law's variant treatment of breach in long-term contracts; (3) fault is a key factor in breach in the civil law, but has no place in the common law; (4) different types of breach effect the type of remedies or responses available to the non-breaching party, such as whether a party can or cannot withhold final payment due to a breach, as well as the civil law's broader use of the remedy of specific performance; (5) the application of the CISG's fundamental breach rule has been influenced by individual countries' national breach rules, such as fundamental breach being viewed as akin to French law's seriousness of breach standard; and (6) the formal breach rules have been applied differently in similar cases, such as the great deal of discretion given to American judges in applying the substantial performance standard. The rest of this part will provide a deeper discussion of these findings.

The notion of breach, its requirements and its consequences, differs from country to country. French law combines both a strict liability breach standard

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<sup>345</sup> See *supra* Part VI.A.2.

<sup>346</sup> See *supra* Part VI.A.2.

<sup>347</sup> See *supra* Part VI.A.2.

<sup>348</sup> See *supra* Part VI.A.2.

<sup>349</sup> See *supra* Part VI.A.2.

and a fault-based principle—an *obligation de résultat* is created whenever a party promises to procure a certain result, while an *obligation de moyens* is fault-based in that the contract implies that a party promises to use his best efforts in carrying out an activity. It is left to the discretion of the courts to determine if a contractual obligation qualifies as an obligation of result or of means. In French law, the courts distinguish between various forms of breach, such as in cases of trivial breach; non-trivial, but insufficiently serious breach; and serious breach.<sup>350</sup> Also, French courts have the power to unilaterally set a *délai de grâce* or time extension. Again, the power of the courts to set an extended time for performance is completely discretionary. The concept of fault is also found in Italian law. Unlike French and Italian law, American law does not recognize fault in contract law. In American law, fault is a concept primarily found in tort law.

A widely regarded difference between the civil and common laws is that the former is based on direct application of codified provisions and the latter is case-based. The law of breach proves this divergence to be too simplistic. The previous paragraph shows that the courts possess a great deal of discretion in applying statutory provisions. For example, Article 1184 of the early French Civil Code adopted a strict performance standard where the non-breaching party had the right to terminate for any breach. French courts saw the standard as draconian in nature and made termination conditional upon the seriousness of the breach. The new French Civil Code codifies the case law by recognizing the “sufficiently serious breach” standard.

Deeper differences between European civil law and American common law exist elsewhere. In most contract law systems, general rules on breach coexist with variant rules attached to specific types of contracts. In France, Italy, Germany, and China, civil codes deal with breach both in the general section on the law of obligations as well as in the subparts on special contracts, such as the rules pertaining to the sale of goods. While general rules remain applicable, special rules often provide additional requirements and remedies that replace or deviate from the general ones. In the U.S., the common law rule of substantial performance is replaced by the perfect tender rule enshrined by U.C.C. § 2-601 for domestic transactions concerning the sale of goods. Further, in all the countries under examination, the CISG fundamental breach rule comes into play when there is an international sale of goods. Yet, for a sale of goods, a buyer governed by the civil law would have the choice between remedying through termination or reduction of price. The reduction of price remedy allows the buyer to unilaterally reduce the contract price for any diminishment in the value of the goods. There is no equivalent type of remedy in the common law.

The three civil law European countries herein analyzed all have codified rules on breach (although no code offers a definition of contractual breach). French and Italian lawyers have embraced the idea that any breach matters for damages, but only a sufficiently serious or non-trivial violation of

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<sup>350</sup> See *supra* Part II.

contractual duties entitles the non-breaching party to terminate the contract.<sup>351</sup> When a sufficiently serious breach occurs, contracts might be terminated by a court or by the non-breaching party first giving notice to cure and an extended time for performance.<sup>352</sup> Under both French and Italian law, the assessment of the seriousness of a breach takes into account both objective and subjective factors, such as whether the breach was total or partial, non-curable or curable, how much harm was caused, and how much it affected the innocent party's interest in receiving performance.<sup>353</sup> American law does not recognize the requirement to give notice; instead, the non-breaching party has a right to unilaterally terminate the contract at the time of breach.

Quite different is the legal framework in Germany that has long emphasized the notice requirement. The well-known *Nachfrist* rule,<sup>354</sup> codified in Section 275 BGB, provides that breach by non-performance or defective performance entitles the non-breaching party to set a deadline for performance and then terminate the contract. This principle was incorporated in the CISG.<sup>355</sup> Regarding the meaning of breach, German law fails to provide a fixed standard, but German courts have proven adept in applying the CISG's fundamental breach rule. They have focused on a number of factors in determining whether a breach is fundamental, such as the parties' intent, the seriousness of the breach in light of the contract's purpose, and the possibility that the breach might be cured.<sup>356</sup>

The German BGB, like most civil law countries, makes clear that specific performance is a remedy for breach on equal footing with the remedy of damages.<sup>357</sup> Damages are paid "when the obligee claims in lieu of performance."<sup>358</sup> Also, in any case, there is no right to damages in lieu of performance when the breach is immaterial (*unerheblich*).<sup>359</sup> In American law, the right to damages, despite the type of breach, is sacrosanct.<sup>360</sup> In the area of delayed performance, German law allows for termination without regard to the significance of the breach. The crucial element needed for termination is not the seriousness of the breach, but rather the expiration of the extended period

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<sup>351</sup> Code civil [C. civ.] [Civil Code] art. 1224 (Fr.); Codice civile [C.c.] [Civil Code] art. 1455 (It.).

<sup>352</sup> Code civil [C. civ.] [Civil Code] art. 1226 (Fr.); Codice civile [C.c.] [Civil Code] art. 1454 (It.).

<sup>353</sup> See *supra* Parts II.D, III.D.

<sup>354</sup> Bürgerliches Gesetzbuch [BGB] [Civil Code], § 323 (Ger.).

<sup>355</sup> CISG, *supra* note 16, art. 47. For an analysis of such a rule, see CHENGWEI LIU, ADDITIONAL PERIOD (NACHFRIST) FOR LATE PERFORMANCE: PERSPECTIVES FROM THE CISG, UNIDROIT PRINCIPLES, PECL AND CASE LAW (2d ed. 2005).

<sup>356</sup> See *supra* Part IV.D.

<sup>357</sup> See Bürgerliches Gesetzbuch [BGB] [Civil Code], § 241(1) (Ger.); see also *supra* Part IV.B.

<sup>358</sup> See Bürgerliches Gesetzbuch [BGB] [Civil Code], § 281(4), translation at <https://perma.cc/3QUN-XDKH> (Ger.); see also *supra* Part IV.C.1.

<sup>359</sup> ERNST, *supra* note 148, § 281, at Rn. 6.

<sup>360</sup> Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897) (stating that "[t]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, — and nothing else.").

to perform.<sup>361</sup> The seriousness of the breach is only relevant in cases of partial or defective performance.<sup>362</sup> The non-breaching party may terminate the whole contract only if it has no interest in the part performance and the obligor's breach is not trivial.<sup>363</sup>

Unlike French and Italian law, breach is not fault-based in Chinese contract law. Chinese law has features in common with all of the other legal systems studied in this Article. Under the CCL and CCC, there is a breach whenever a party has failed to perform its obligations in any respect, but only a serious breach allows the non-defaulting party to terminate the contract. Specific fundamental breach rules apply to long-term contracts. The focus is on whether the grounds for reliance on the other party have deteriorated. In that case, the non-breaching party may terminate the contract, even if the breach makes the realization of the contract purpose impossible. For example, a series of minor breaches may lead to the deterioration of reliance and termination of the contract.

As in the other civil law countries, in Chinese sales contracts, even if the breaching party has delivered defective goods, the non-breaching party must give a notice of non-conformity to the breaching party, otherwise it will lose the right to rely on the non-conformity.<sup>364</sup> Chinese law is closely aligned to German law insofar as it distinguishes between delay and defective performance,<sup>365</sup> but it also aligns with French and Italian law insofar as it embraces the rule that only a serious breach allows termination.<sup>366</sup> As noted above, serious breach in Chinese contract law is either a breach that makes the "realization of the contract purpose impossible"<sup>367</sup> or a breach that is non-fundamental per se, but that has become fundamental through the *Nachfrist* notice mechanism, that is, because of the expiry of the deadline set in the performing party's request to cure.<sup>368</sup> Yet, different from their French and Italian counterparts, Chinese judges traditionally assess the seriousness of the breach through objective criteria only, focusing on the severity of harm to the economic interests of the non-breaching party and whether the nonconformity can be remedied by replacement or price reduction.<sup>369</sup> Interestingly, Chinese contract law also incorporates the common law's notion of anticipatory repudiation,

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<sup>361</sup> See *supra* Part IV.C.2. "Crucial for triggering the right to termination is not the notion of fundamental breach, but rather the granting of an extra period which has to have lapsed to no avail under § 323 BGB." *Id.*

<sup>362</sup> See Bürgerliches Gesetzbuch [BGB] [Civil Code], § 323(5) (Ger.).

<sup>363</sup> See *id.*; See also *supra* Part IV.C.2.

<sup>364</sup> See *supra* Part V.

<sup>365</sup> Minfa Dian (民法典) [Civil Code] (promulgated by the Standing Comm. Nat'l People's Cong., May 28, 2020, effective Jan. 1, 2021), art. 577, 2021 P.R.C. L. (China).

<sup>366</sup> *Id.* art. 563.

<sup>367</sup> *Id.* art. 563(4) (author's translation).

<sup>368</sup> *Id.* art. 563(3).

<sup>369</sup> See *supra* Part V.C.

underscoring the wide variety of legal sources used in drafting its law of contracts. Finally, the breach provisions in Chinese law are consonant with the CISG's fundamental breach rule. Chinese courts do not recognize a breach as fundamental if the non-conformity of the goods delivered can be easily cured or the non-conforming goods can be easily resold.<sup>370</sup>

Under U.S. common law, when the non-defaulting party's performance is still due, its right to suspend performance is dependent on whether there is a material breach, as well as whether the court decides to apply the strict performance rule or the substantial performance rule. In case of material breach, the non-breaching party has the right of termination and a claim for damages.<sup>371</sup> The idea of material breach is similar to the French notion of seriousness of breach. Courts assess whether a breach is material by considering: the extent to which the injured party will be deprived of its expected benefits; the extent to which the non-breaching party can be adequately compensated (if damages prove to be ineffective, then a party may claim specific performance); the extent to which the party failing to perform will suffer forfeiture; the likelihood that the failure can be cured; and the extent to which the behavior of the party failing to perform comports with standards of good faith and fair dealing.<sup>372</sup>

The American UCC is stricter in defining breach in the sale of goods than its civil law counterparts. In the case of domestic contracts for the sale of goods, the material breach rule is replaced by the "perfect tender" rule found in Section § 2-601 UCC, which allows the buyer to reject nonconforming goods or delivery delays no matter how minor. Although the perfect tender rule does have a number of limitations,<sup>373</sup> it remains remarkably distant both from the common law's material breach rule and the fundamental breach rule adopted by the CISG.<sup>374</sup>

## VIII. CONCLUSION

A concentrated study of the meaning of breach in different legal systems is long overdue. In the free trade era, the meaning of breach needs serious consideration. This Article offers an initial step in such an analysis. A party to a transborder transaction will find it disconcerting that what is considered to be a breach in a foreign country may be different than its meaning in the party's home country. Equally distressing is that the rights and duties of the non-breaching parties vary across legal systems; these differences may be heightened depending upon the type of breach. The consequences of divergent

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<sup>370</sup> See *supra* Part V.F.

<sup>371</sup> See RESTATEMENT (SECOND) OF CONTS. §§ 235–249 (AM. L. INST. 1981).

<sup>372</sup> RESTATEMENT (SECOND) OF CONTS. §§ 241(a)–(e) (AM. L. INST. 1981).

<sup>373</sup> See U.C.C. § 2-508 (AM. L. INST. & UNIF. L. COMM'N 1951) (explaining seller's right to cure); U.C.C. § 2-612(2) (AM. L. INST. & UNIF. L. COMM'N 1951) (discussing the substantial performance rule in the delivery of installments).

<sup>374</sup> See *supra* Part VI.D.

definitions of breach across countries can be profound. This Article shows that what may be considered a breach that allows the non-breaching party to terminate a contract, demand specific performance, or seek damages varies among the countries studied. Further, the term “breach rule” is a misnomer since breach rules are better described as standards, which give judges a great deal of discretion in their application. The analysis of case law presented here illustrates the various factors that courts have used in applying the different standards.

This Article analyzes the different meanings of breach in five national contract laws (China, Germany, France, Italy, and the United States) and one international contract law (Convention on Contracts for the International Sale of Goods or CISG). Given the similarity of transactions across legal systems, a great deal of commonality would be expected among national contract laws. Even though this is generally true, this Article shows a great deal of divergence and nuance exists in comparing common and civil law systems, as well as across civil law systems. The analysis shows that the type of breach and type of contract results in different meanings of breach. For example, national contract and sales law often incorporate different breach rules. The differentiation is significant and includes: Germany’s “any breach” rule; American common law’s strict and substantial performance rules, the Uniform Commercial Code’s (UCC) “perfect tender rule,” as well as the notion of material breach; France’s and China’s seriousness of breach standard; Italy’s non-immaterial breach standard; and France, Italy, China, and the CISG’s acceptance of various forms of the “fundamental breach rule.”

These different breach standards can be characterized as either pro-buyer or pro-seller. For example, in the law of the sale of goods, the UCC’s perfect tender rule is clearly pro-buyer and the CISG’s fundamental breach rule is pro-seller. Yet, the distinction between the numerous breach rules is in practice much more nuanced. All the contract law systems studied delegate a great deal of discretion to the courts in the application of the doctrines. This is the nature of standards versus fixed rules. Standards allow for greater flexibility in application—the meaning of undefined terms, such as substantial performance or fundamental breach, is determined by factors developed by the courts. Some of the important factors discerned by this study include the nature and uniqueness of the subject matter, the availability of alternative sources or supplies, reasons for the breach, degree of sunk costs (discrete versus long-term contracts), severity of the harm caused, and the availability of adequate remedies.

Finally, harmonization of the meaning of breach and its consequences remains elusive. The CISG adopted a single breach rule to be independently applied outside of the influences of national contract laws. In reality, this has not been the case as courts remain highly biased by national notions of breach when applying the CISG’s fundamental breach rule. In countries like France, Italy, and China, the courts have simply seen the CISG rule as an analog to the rules found in their domestic contract laws. Instead of constructing an independent meaning, they have used national rules to infuse meaning into

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the CISG's fundamental breach rule. In sum, what is considered a fundamental breach is different across CISG countries.<sup>375</sup>

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<sup>375</sup> Eduardo Grebler, *Fundamental Breach of Contract Under the CISG: A Controversial Rule*, 101 PROCEEDINGS OF THE ANNUAL MEETING OF THE AMERICAN SOCIETY OF INTERNATIONAL LAW 407–13 (2007); Leonardo Graffi, *Case Law on the Concept of 'Fundamental Breach' in the Vienna Sales Convention*, 3 INT'L BUS. L.J. 338, 338–49 (2003). For the drafting history of Article 25, see also Robert Koch, *The Concept of Fundamental Breach of Contract Under the United Nations Convention on Contracts for the International Sale of Goods (CISG)*, in REVIEW OF THE CONVENTION ON CONTRACTS FOR THE INTERNATIONAL SALE OF GOODS (CISG) 177–354 (Pace Int'l L. Rev. ed. 1999); Andrew Babiak, *Defining 'Fundamental Breach' Under the United Nations Convention on Contracts for the International Sale of Goods*, 6 TEMP. INT'L & COMP. L.J. 113–43 (1992).