Application of CISG in PRC Court Practice: Tips and Pitfalls

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1. Introduction

CISG entered into force in PRC China on 1 January 1988 with two reservations under Articles 95 and 96. Since then, any international sales contract between parties with places of business located in China and another CISG member state is governed by the CISG. To date, the success of CISG in China has been evidenced by a large number of CISG decisions rendered by PRC courts and arbitral tribunals.[2] Chinese parties are also generally willing to explicitly choose CISG or at least not exclude CISG from their international sales contracts. Furthermore, the current PRC Contract Law ("**PRC CL**") was also largely drafted with reference to CISG.[3] Today, the two sets of rules became even closer after the PRC government finally withdrew its Article 96 reservation to Article 11 CISG in 2013. The practice under the PRC domestic law and CISG in terms of forms of contracts is now unified and seamless.

Nevertheless, there have been always concerns of whether CISG is correctly applied by Chinese courts and consequently whether uniform interpretation and application of CISG is secured in China. A number of scholars and CISG commentators have investigated into this subject and made their individual assessments.[4] The author of this article however does not aim to add additional comments on the same topic but rather to focus on the reasons and logics behind the decisions so as to help practitioners to understand the tips and pitfalls for dealing with CISG contracts in China.

The author has thus reviewed around 90 CISG decisions rendered by different levels of Chinese courts between 2010 and 2014. On such basis, the following advice is given on a number of specific issues with regard to the sphere of application of CISG, formation and modification of CISG contracts, obligations of CISG parties (particularly "conformity of goods"), the breach of obligations (particularly the concept of "fundamental breach") and remedies for the breach.

2. Sphere of Application of CISG

Article 142 of GPCL

The sphere of application of CISG is defined by Articles 1 to 6 CISG. Since China has not withdrawn its Article 95 reservation, Article 1(1) (b) generally has no binding effect in China.

Under Chinese law, however, the application of CISG is regulated by Article 142 of the General Principles of PRC Civil Law (**GPCL**) which provides for the general rules on application of international treaties in China, which reads:

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[2] "PRC arbitral tribunals" refer to arbitral tribunals seated in PRC China.

[3] The currently applicable PRC Contract Law was enacted in 1999. As far as contractual matters are concerned, reference is also often made to the General Principles of the PRC Civil Law 1987. In order to enhance the uniform application of PRC Contract law as well as to clarify the meanings of certain legal texts, the PRC Supreme Court has to date issued three Judicial Interpretations on Contract Law in 1999, 2009 and 2012. The Judicial Interpretation 2012 exclusively focuses on sales contracts. Whereas the legal status of Supreme Court's judicial interpretations is heavily disputes, they are commonly regarded as having the same legal effect as statutes. However, it is not the aim of the author to give an in-depth discussion on the history of PRC Contract Law and the legal status of the judicial interpretations within this article.

[4] See e.g. Xiao Yongping, Long Weidi, *Selected Topics on The Application of the CISG in China*, Pace International law Review, Vol.20:61 (2008), pp. 61-103; Fan Yang, *The Application of CISG in the Current PRC Law & CIETAC Arbitration Practic*e, Nordic J. Com, L. Issue 2, at 2-28 (2006).

> "*If any international treaty concluded or acceded to by the PRC Contains provisions differing from those in the civil laws of the PRC, the provisions of the former shall apply, unless the PRC has announced reservations to these provisions*."

As a result, in practice Chinese courts seem to have based the application of CISG first on the Article 142 GPCL rather than on CISG. Nevertheless, Article 142 GPCL is regularly applied in the sense that CISG prevails over the domestic Chinese law unless the subject matter does not fall within the scope of CISG. Therefore, although the ground for applying CISG may allegedly be incorrect,[5] it generally does not lead to the unfortunate result of exclusion of CISG.

However, a different approach is taken infrequently by some lower Chinese courts: according to their interpretation of the Article 142 GPCL, CISG applies only when its provisions are in conflict with the Chinese law. Where the provisions of CISG are identical with the Chinese law, both CISG and Chinese law or only Chinese law is applicable.[6] However, this is clearly not the intention of the Article 142 GPCL. Notably, these decisions were mostly revised by the higher courts in the appealing proceedings by confirming the application of CISG.

Furthermore, with regard to Article 1 (1) (a) CISG, it is worth noting that Chinese courts seem to have considered the time of conclusion of the contract as the decisive point of time to determine whether parties are from different member states. For example, in a final decision rendered by the Beijing High Court, application of CISG was denied with regard to a contract between a Japanese company and a Chinese company based on the ground that Japan was not a member state of CISG when the contract was concluded.[7]

Exclusion of CISG

According to Article 6 CISG, parties may exclude the application of CISG by e.g. agreeing on a national law as the governing law of the contract. In practice, an explicit reference to e.g. PRC Contract Law would suffice for such purpose. When there is no such explicit choice, it is generally not possible to exclude CISG if the other conditions of application are met.

However, Chinese courts sometimes attempt to take a broader meaning of "choice of law" so that Chinese law could be applied as an "implied" choice of the parties. For example, a decision by the Shanghai High Court in 2007 concluded that where one of the parties objected to the application of CISG in the course of the proceedings, it should be regarded as the intention of the parties to exclude CISG.[8] This decision generated considerable criticism because it was an obvious misapplication of Article 6 CISG and violation of the fundamental principle of party autonomy.[9] Unfortunately, the same mistake was repeated more recently in a final decision by the Hebei High Court. In this case, whereas the court in the first instance correctly applied CISG to a sales contract between the Chinese and Egyptian parties, the Hebei High Court overturned this decision for the reason of "misapplication of law" in light of the fact that the parties disagreed on the application of CISG. The Hebei High Court said that "it was only possible in such situation to apply the law with the closest connection to the case, which was Chinese law." [10] However, since neither of

[5] *See* Xiao Yongping, Long Weidi, *Selected Topics on The Application of the CISG in China*, Pace International law Review, Vol.20:61 (2008), page. 71.
[6] See e.g. *Fengshan Stone Materials Co., Ltd. (China) vs. Fujian Nanan City Lianfengmei Stone Materials Co.,Ltd.(China) & Others (Korea)*, Fujian Intermediate Court (First Instance), Xiaminchu No.179 (2011).
[7] *Beijing Nuosi Trading Co., Ltd. (China) vs. GINO Co., Ltd. (Japan)*, Beijing High Court (Final Appeal), Gaominzhong No.1851 (2011).
[8] *Canada Watersports Co., Ltd. (Canada) vs. Donghui Plastics (Shanghai) Co., Ltd (China)*, Shanghai High Court (Final Appeal), hugaominsi(shang)zhong No.6 (2007).
[9] See Xuan Zengyi & Wang Yanyan, *Application of CISG by Chinese Courts*, Legal Journal No. 5 (2012).
[10] See *Gengqunyin (China) vs. Elborsh (Egypt)*, Hebei High Court (Final Appeal), yiminsanzhong No.59 (2010).

the above two cases seems to have been referred to the retrial before the Supreme Court, the position of the highest Chinese court remains unclear.

The effort to exclude CISG by the mechanism of "implied choice" seems to continue in other ways as well. In two recent cases, the parties appear to have made reference to Chinese contract law in the course of trial, although their main arguments seem to have been based on CISG. The courts in the first instance decided to apply the Chinese law on the ground that the parties had in such way agreed to apply the Chinese law and therefore CISG was excluded.[11] The higher courts however did not support such broad interpretation. The CISG was applied in the appealing proceedings under Article 1 (1) (a) CISG.[12] In one case, the higher court expressly ruled that CISG cannot be excluded if the contract itself does not make another choice of law.[13]

As a matter of principle, it is always suggested that reference to domestic law should be avoided as far as the matter is governed by CISG. However, in practice the lawyers sometimes may have to use the domestic law as a secondary legal source especially when the judge is not familiar with CISG. This approach could be less troublesome in China since the Chinese contract law system is to a certain extent modelled on CISG. Still, it is always useful to make a statement following any reference to Chinese law that such reference shall in any situation not be regarded as the intention of the parties to exclude CISG.

Application of CISG between mainland China and Hong Kong, Macau and Taiwan

Hong Kong and Macau used to be the colonies of UK and Portugal and now both became the special administrative regions within the territory of China after they returned to China in 1997 resps. 1999. This gave rise to a special question of whether CISG is applicable to sales contracts between the mainland Chinese and Hong Kong or Macau parties.

According to the view of the leading CISG authors, Hong Kong and Macau on one hand cannot accede to CISG as "contracting states" under the Articles 91(3) CISG but on the other hand should be bound by CISG as parts of the member state – China under Article 93 CISG. In detail, according to Article 93 (1), a state comprising of more than one territorial unit where different systems of law are applicable may at the time of signature, ratification, acceptance, approval or accession, declare that CISG is to extend to all of its territorial units or only to one or more of them. Furthermore, Article 93 (4) states that lack of such declaration means that CISG is to extend to all territorial units of that State. The previewing view therefore holds that in light of the spirit of CISG, China should have been given the opportunity to make an Article 93 declaration at the time when Hong Kong and Macau returned to China. China having made no such declaration leads to the result that CISG extends to Hong Kong and Macau due to the effect of Article 93 (4) CISG.[14]

Unfortunately, the above persuasive suggestion is still disregarded by Chinese courts. This is demonstrated in the recent decision by Zhejiang High Court to have excluded CISG from a sales contract between mainland and Hong Kong parties.[15] Zhejiang High Court reasoned that in virtue of the declaration requirement of the Article 93 (1) CISG, "CISG shall not apply

[11] See *Tianjin Zhonglianweitian Commercial and Trading Co., Ltd (China) vs. xxx (Russia),* Tianjin 2nd Intermediate Court (First Instance), erzhongminchu No.24 (2010)*; Zhejiang Taizilong Trading Co., Ltd. (China) vs. F.A.C.I.BDICORTESI & C.S.P.A (Unknown)*, Hangzhou Xiacheng District Court (First Instance), Hangxiashangwaichu No.12 (2013).

[12] See *xxx (Russia) vs. Tianjin Zhonglianweitian Commercial and Trading Co., Ltd (China),* Tianjin High Court (Final Appeal), jingaominzhong No.181 (2011)*; F.A.C.I.BDICORTESI & C.S.P.A (Unknown) vs. Zhejiang Taizilong Trading Co., Ltd.(China),* Hangzhou Intermediate Court (Final Appeal), zhehangshangwaizhong No.35 (2013).

[13] See supra note 8, the first one.

[14] See Ulrich G. Schroeter, *The Status of Hong Kong and Macau Under the United Nations Convention on Contracts for the International Sales of Goods*, Pace International Law Review, Volume XVI, fall 2004, Number II, pp.308-332.

[15] See *Yinshun Hong Kong Co., Ltd.(Hong Kong SAR, China) VS. Zhejiang Zhongda Technology Important and Export Co., ltd. (China)*, Zhejiang High Court (Final Appeal), zheshangwaizhong No.99 (2010).

to Hong Kong because the Chinese government till today has not made a declaration under Article 93 CISG". In this decision Zhejiang High Court did not mention Article 93 (4) CISG nor dealt with the issue of the timing of such declaration. Since this decision seems not have been referred to the retrial procedure of the PRC Supreme Court, the position of the Supreme Court is not yet known. Whether this decision would be followed by other Chinese courts also remains to be seen. Therefore, for contracts involving Hong Kong and Macau parties, it is suggested to include a choice of law clause selecting CISG as the governing law (if the parties agree so).

For contracts between mainland China and Taiwan parties, the situation seems even more complicated. This topic has rarely been addressed probably because of the high sensitivity with regard to the status of Taiwan. In light of the Chinese traditional "One China" principle, Taiwan will not be a member state of CISG in any case. Moreover, neither Article 91 nor 93 CISG seems to be relevant given the current situation of Taiwan.

A recent decision by Zhuhai Intermediate Court has affirmed the "One China" policy in the context of CISG. With reference to Article 1 (1) (a) CISG, it was ruled that since CISG only applies to contracts between parties from different member "States", CISG is not applicable to contracts involving the parties from the Taiwan region.[16] Therefore, the same advice for a "choice of CISG" clause as aforementioned also applies here in case of interest of the parties.

3. Formation and Modification of CISG Contracts

Formation of CISG Contracts

First of all, as aforesaid, China has officially withdrawn its reservation to Article 11 CISG. Whereas this undertaking has a significant implication for a positive relationship between China and CISG, it may have little importance in practice because the domestic Chinese contract law anyway does not require a contract to be in writing in general.[17]

In practice, Chinese courts generally will not frustrate formation of a non-written CISG contract inasmuch as it could be proved by a series of evidence for existence and/or performance of such an agreement. Said evidence often refer to, for example, receipts of orders, invoices, packing lists, letters of credit, bills of lading, transmission of documents, enquiries on the status of goods, customs declarations, payment vouchers etc. [18] This is also in line with the general practice under the Chinese domestic contract law.[19]

Nevertheless, contracting with Chinese parties may still be a risky and complex process for many foreign traders. For example, in a long-standing transaction it is not uncommon for the Chinese contracting party to enter into contracts under different company names (also under different letterheads). When disputes arise, the foreign counter-party may even be unable to determine the right person to sue. Chinese courts seem to have been non-permissive for such confusing conduct. In a recent decision by Hangzhou Intermediate Court, the ten contracts concluded by the Chinese party under different company names are held to bind

[16] See *Hongye Industry Co., Ltd (Taiwan, China). vs. Renshi (Zhuhai) Industry Co., Ltd (Zhuhai, China),* Zhuhai Intermediate Court (Guangdong Province) (Final Appeal), zhuzhongfaminzhong No. 10 (2013).

[17] Article 10 PRC CL: conclusion of contracts can take writing, oral and other forms. Where the law or administrative regulations require the writing form of the contract, the contract must be in writing. Where the parties agree on the writing requirement, the contract must be in writing.

[18] See e.g. *Company A (Gabon) vs. Company B (China)*, Shanghai 1st Intermediate Court (Final Appeal), huyizhongminsizhong No. S1400 (2012); *Cobra Europe (Unknown) vs. Galaxy Depp Sealing Tap Co., Ltd. (China)* (Final Appeal), Luminsizhongzi No.150 (2010).

[19] Article 1(1) PRC Supreme Court Judicial Interpretation on Sales Contract Law (2012): in the absence of a written contract, where one party alleges existence of the contract based on documents such as delivery orders, receipts of goods, bills or invoices, courts shall decide on the existence of the contract by giving due consideration to the conclusion of the transaction, business practices between the parties and any other evidence.

the signatory to the contracts. [20] This case demonstrates again why a signed and stamped contract may still make a huge difference in today's China.

Lastly, it is relevant to mention that, according to Article 11 of the Supreme Court Regulation on Evidence, documentary evidence generated outside China can only be admitted by Chinese courts after it has been proved by the "authority" in the relevant foreign country and certified by the Chinese embassy in that country (or in other manners as agreed between China and said country). Moreover, even if the approval and certification requirements are met, foreign evidence is often vulnerable to challenge in terms of credibility and legitimacy. Therefore, it is more likely than not that documentary evidence containing formal (e.g. original documents are missing) or substantial defects (e.g. the names of the parties referred to in the invoice and export declaration documents are not the same) may have little convincing value. [21]

Modification of CISG Contract

According to Article 29 CISG, modification of a CISG contract is generally not subject to formal requirements, unless the contract otherwise provides.

In Chinese court practice, the form of modification is rarely an issue in dispute. What is often in dispute is the existence of consent of the parties to modify the contract. What has happened is that where a written contract does not exist, one of the parties often argues that a contract is not only concluded but also modified by subsequently presenting a different set of invoices, letters of credits or customs declaration documents containing different prices or categories of the goods. Whereas Chinese courts in such case are likely to hold the contract to be formed, modification of the contract is rarely found. The reason for such ruling is that the above documents are mostly *ex parte* documents which are not sufficient to establish the consent in modifying the contract.[22] Notably, this approach seems to be in line with the practice under domestic Chinese law where modification of contract is nearly only possible in an express manner. [23]

4. Obligations of the Parties and Fundamental Breach

In general, under the CISG contract the seller is obliged to deliver goods and the buyer is obliged to take delivery and pay the price for the goods.

The cases where buyers fail to pay and are therefore requested to make payment are often straightforward and the application of the relevant CISG rules has caused little controversy. The focus of this part of the article is the Chinese court practice with regard to (1) the seller's obligation to deliver the goods which must conform with the contract and be free from any right or claim of a third party; and (2) the concept of "fundamental breach" under the CISG.

Conformity of Goods and Notice of Non-Conformity

Article 35 CISG is the default rule to determine whether goods are in conformity with the contract. In practice, sales contracts often contain explicit and detailed provisions on the

[20] See e.g. *Oriental Co., Ltd. (Japan) vs. Hangzhou Dongzhi Paper Co., Ltd (China)*, Hangzhou Intermediate Court (first instance), zhehangshangwaichu, No.293 (2012).
[21] See e.g. *XXX (Korea) vs. XXX (Dongguan, China)*, Dongguan 2nd Court (First Instance), dongerfaminsichu, No. 47 (2011).
[22] See e.g. *XXX (unknown) vs. XXX (China)*, Shanghai Pudong District Court (First Instance), puminer(shang)chu No.S1876 (2012); *CHOIWON (Korea) vs. Xuchun (China)* (First Instance), Dalian Intermediate Court (First Instance), daminsichu No.111 (2013).
[23] Article 78 PRC CL: if the parties have not reached an express agreement on modification of the contract, it should be assumed that the contract is not modified.

quantity, quality or package requirement of the goods. Article 35 CISG is normally applied by Chinese courts as a guideline and has rarely caused problems.

The examination requirement under Article 38 CISG is however often a matter in dispute. Firstly, Article 38 (1) CISG requires the buyer to examine the goods "within a short period of time as is practicable in the circumstances". In this regard, a higher standard seems to have been sometimes applied by Chinese courts: for example, "examination should be made as soon as the employees of the buyer acknowledge receipt of the goods".[24] In another case (a CIF contract), the buyer for certain reasons only examined the goods one month after the goods left the port of destination. The buyer claimed non-conformity of the goods based on the examination reports and the Chinese largely decided in favor of the buyer. However, the Chinese court also concluded that since the examinations were not made in time, the buyer should not be compensated for the loss incurred by the late examinations, which amounted to the transportation and storage fees as of the time the goods left the port of destination.[25] This case indicates that a late examination report may still be admitted and considered by Chinese courts whereas the seller is likely not to be fully compensated.

When the conformity of goods is in dispute, the parties often also disagree with the appointment of the inspector of the goods, especially when the sales contract itself is silent on the name or qualification of the inspector. In such case, the parties are likely to appoint their respective inspectors and the admissibility of their respective examination reports is to be decided by Chinese courts based on the procedural rules on evidence. Reports issued by foreign inspectors may be considered as foreign evidence and therefore subject to the complex process of authentication. Consequently, their examination results are more likely to be challenged for formality reasons[26] than those issued by Chinese organizations (such as China Certification & Inspection Group).[27]

Lastly, Article 39 CISG requests the buyer to dispatch a notice of non-conformity "within a reasonable time after he has discovered it or ought to have discovered it". What amounts to "a reasonable time" is a question within the discretion of the trial court. Decisions by Chinese courts on this issue are too few for the author to make a general comment. There is only one relevant decision where the buyer for the first time raised the issue of non-conformity of the goods in its defense against the seller during the trial, which was almost two years after

[24] See *Fengshan Stone Materials Co., Ltd. (China) vs. Fujian Nanan City Lianfengmei Stone Materials Co.,Ltd.(China) & Others (Korea)*, Fujian Intermediate Court (First Instance), Xiaminchu No.179 (2011).

[25] See *Tradeways S.A. (Italy) vs. Xuchang City International Trading Co., Ltd. (China)*, Guangzhou Intermediate Court (Final Appeal), Huizhongminsizhong No.71 (2011). In this case, the parties from Italy (buyer) and China (seller) entered into two "CIF Genoa" contracts for sales of oxalic acid. After the goods arrived at the port of destination and before the buyer had the opportunity to arrange for the import clearance, the Italian customs seized the goods for the reason of lack of the Certificate of Origin ("**COA**", which was not required under the sales contracts). Although the Italian customs were subsequently provided with the COA, the goods remained at their custody because the examination conducted by the customs revealed that the goods were not in conformity with the COA specification. After the goods were finally released by the customs, the seller arranged other examinations of the goods which also found that the goods were not in conformity. The Italian seller terminated the contract for the serious non-conformity of the goods whereas the buyer alleged that the seller was prevented from doing so because it did not exercise its right of examination until the goods finally left the port of destination. The Chinese courts in the first instance and final appeal both ruled that the seller was in breach whereas the buyer was liable for the extra loss incurred due to the late examination.

[26] See, e.g. *Royalbeach Spiel & Sportartikel Vertriebs GmbH (Germany) vs. Ningbo Import & Export Co., Ltd.(China)* (First Instance), zheyongshangwaichu No. 276 (2010), in which the German buyer submitted the *ex parte* test reports by LGA Nürnberg and SGS Saarland which were all dismissed by the Chinese court because *inter alia* "the resources of goods, the sampling criteria and the testing procedure were unclear". However, in another case where the parties jointly appointed SGS, the SGS test report seems to have been accepted without being questioned. See *Shanghai Jump Industry Ltd. (China) vs. Moraglis S.A. (Italy)*, Shanghai High Court (Final Appeal), hugaominer No.4 (2012).

[27] See e.g. *Nanjing Overseas Wood Co., Ltd. (China) vs. Trans-Pacific Trading Ltd. (Unknown)*, Nanjing Intermediate Court (First Instance), ningshangwaichu No.75 (2012); *Tradeways S.A. (Italy) vs. Xuchang City International Trading Co., Ltd. (China)*, Guangzhou Intermediate Court (Final Appeal), Huizhongminsizhong No.71 (2011).

delivery of the goods. The Chinese court rejected the buyer's defense in accordance with Article 39 CISG. [28]

Third Party's Rights or Claims

According to Article 42 CISG, the goods must also be free from any third party's intellectual property right or claim based on the law of the place where the goods will be resold or used or in any other case, under the law of the buyer's place of business.

China has been criticized for a long time for the weak protection of intellectual property rights. However, the situation seems to have been improved in the field of international sales law. In one case, the Japanese buyer of furnitures requested to terminate the sales contract for the reason that the Chinese seller failed to provide the letter of authority of the original designer, without which it would be impossible to sell the goods without violating the third party's IP right. The Chinese court concluded from the documentary evidence that the parties were both aware of the importance of such authority in relation to the value of the goods to the buyer and therefore the seller breached the contract under Article 42 CISG.[29] In another case, the Chinese court also decided in favor of the foreign buyer against the Chinese seller after the seller was in another prior patent infringement proceeding found liable for infringement of third party's patent for selling the buyer's products.[30]

In Chinese practice, Article 42 CISG may not only be relevant to determine the IP-related contractual claims but also to infringement matters. Recently this became a highly sensitive issue in the case where the Chinese court was asked to decide on the infringement of a Chinese original equipment manufacturer (**OEM**). OEM in the Chinese context refers to, *inter alia*, the manufacturer who produces the branded goods within the territory of China as per the order of the foreign brand owner but all the goods will be returned to the brand-owner to be sold exclusively outside China. During the production process, the foreign brand owner is to provide the logo or trademark and the Chinese OEM is to place the logo or trademark on the goods. In this case, a Chinese company sued a German company and its Chinese OEM partner for infringement of its trademark. The Chinese OEM objected to the claim pursuant to, *inter alia*, Article 42 CISG by stating that the Chinese company incorrectly based its claim on the law of China where the goods were produced but not on the law of the state where the goods were to be sold or used. It is unclear whether this argument was upheld by the Chinese court because the final decision did not refer to any provision of CISG. However, the Chinese court seemed to have indeed considered the fact that the goods were and would never be sold in China. The final decision was that the use of trademark by the Chinese OEM during the production process did not constitute infringement inasmuch as the Chinese OEM had fulfilled the duty of reasonable care and had been authorized to do so (so that there was no fault).[31]

It is arguable whether the same standard could be applied to sales contract disputes when a Chinese buyer tries to rely on Article 42 for a breach of contract by a foreign seller of products made by a Chinese OEM. The impact of the above decision on the Chinese practice with regard to Article 42 CISG indeed remains to be seen.

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[28] *Hangzhou Qiandaolake Tiantu Textile Co., Ltd (China) vs. US Huatai Group, Wenzhou Intermediate Court (USA)* (First Instance), zhewenshangwaichu No.73 (2011).

[29] See *XXX (China) vs. XXX (Japan)*, Shanghai 1st Intermediate Court (Final Appeal), Huyizhongminsi (shang) No. S1038 (2012).

[30] See *Sunbaojia, Zhanggongdao (Australia) vs. Shanghai Huili Group & Shanghai Huili Floorboard Co., Ltd. (China)* (Final Appeal), Shanghai High Court, hugaominer (shang) No. 81 (2011).

[31] See *Niannianhong Food Co., Ltd (China) vs. I. Schroder KG (GmbH & Co.) (Germany) & Xiamen Guomao Co., Ltd (China)*, Fujian High Court (Final Appeal), minminzhong No. 378 (2012).378 (2012).

Fundamental Breach

Both domestic Chinese contract law and CISG allow termination of the contract in case of a fundamental breach.[32] The CISG provides for a high threshold for meeting the preconditions for a fundamental breach so that termination of a contract could be used as the "last resort" remedy. In defining this threshold for each individual case, the decisive criterion is the parties' mutual preferences, either expressed in the contract or implied from the circumstances of the case.[33]

Chinese courts however seem to have adopted a different approach by exclusively focusing on the seller's opportunity to cure. In other words, there is no fundamental breach, if there is the possibility that the seller may cure the defects of the goods or in other means remedy the breach of the contract. In one case, for example, the buyer was previously authorized by the seller as its exclusive distributor in China whereas the seller later on withdrew such authority without giving a prior notice to the buyer. Since the buyer was no longer able to re-sell the goods without such authority, it requested the seller to take back all the goods in stock and return the payments. The Chinese court decided in favor of the buyer (which means that the contract was partly terminated) for the reason that the contract in such situation could not be saved by other means of remedies such as substitute delivery, repair or reduction of the price. More interestingly, as the seller actually had the contractual right to terminate the authority, the decision on the fundamental breach of the seller was essentially based on the breach of the principle of good faith.[34]

In another case, the Singapore buyer sued the German seller before the Chinese court for the fundamental breach of the contract when the Hardgrove Grindability Index (**HGI**) of the tar sold to the buyer was only 32 (far below the contractual standard of 36-46). The Chinese court in the first instance decided in favor of the buyer based on the serious non-conformity of the goods. In the appealing proceeding, the higher court however found that there was no fundamental breach since the buyer eventually resold the goods for a reasonable price without being unreasonably burdened.[35]

5. Remedies

The system of remedies under the CISG is too complex to be covered by this short article. The author intends to only address two minor issues where the Chinese practice is often asked.

Liquidated Damages

CISG provides for rules on damages in case of no otherwise agreement by the parties. In practice, the sales contracts often contain liquidated damages clauses on an agreed sum to be paid for a certain breach.

It is however important to note that Chinese courts may tend to subject liquidated damages clauses under a CISG contract to provisions of the domestic contract law.[36] This may make a significant difference in consequence because under the practice of the Chinese domestic

[32] Article 94 (4) of PRC CL: the party may terminate the contract when the other party delays in performance or in other breach of the contract which makes it impossible to achieve the purpose of the contract. It is commonly understood that this provision has the same effect as Article 25 CISG.

[33] See, e.g. Ingeborg Schwenzer (ed.) Schlechtriem & Schwenzer, Commentary on the UN Convention on the International Sale of Goods (CISG), 3rd English Version, Oxford University Press, pp.403-04.

[34] See *Comac Co., Ltd. (Unknown) vs Shanghai Xunwei Equipment Co., Ltd (China)*, Shanghai High Court (Final Appeal), hugaominer(shang) No.18 (2011).

[35] See *ThyssenKrupp Metallurgical Products GmbH (Germany) vs. Sinochem International (Overseas) Pte Ltd.* (Singapore), PRC Supreme Court (Final Appeal), minsizhong No.35 (2013).

[36] See *CSMN. V. (Unknown) vs. Shanghai Fulian Food Co., Ltd (Shanghai)*, Shanghai High Court (Final Appeal), hugaominer (shang) No. 37 (2011).

contract law, an agreed sum could be either increased or reduced when the sum is grossly disproportionate in relation to the actual loss. [37] In particular, the PRC Supreme clarified the threshold for the sum to be considered as "disproportionately high" – i.e. 30% higher than the actual loss.[38]

Interests

In the case of any momentary claims, lawyers should never forget to claim interests under Article 78 CISG because no interest will be granted otherwise.[39]

With regard to the interest rate, the Chinese court practice seems to apply the prima rate of the currency involved. Therefore, when the currency of the contract is RMB, the Chinese central bank (Bank of China)'s loan interest is likely to be applied.[40] When the currency is US dollars, for another example, Chinese courts often apply LIBOR (3% up), despite that the parties have already fixed the claimed sums in the Chinese currency.[41]

6. Conclusion

The foregoing discussion has cast light on at least the current practice of Chinese courts on a number of issues under the CISG. The author has observed a general "CISG-friendly" atmosphere and particularly appreciates to see the increasing efforts made by the Chinese courts on specifying the reasoning process for making their decisions under CISG. This article would otherwise be impossible without such a major development.

Nevertheless, one still often sees flaws in the Chinese courts' understanding and application of CISG. Besides the long-term solution by enhancing the CISG training and education, the Supreme Court is expected to play a more active role in timely correcting the various mistakes made by the lower courts. Perhaps, an intensive judicial interpretation on CISG is most urgently needed for the current practice.

[37] Article 114 PRC CL.
[38] Article 29 of PRC Supreme Court Judicial Interpretation on Contract Law (2).
[39] See e.g. *Jaiping Jiayu Co. Ltd (China) vs. Allapparel LLC (Unknown)*, Kaiping City Court (Guangdong) (First Appeal), jiangkaifaminchu No.17 (2013);
[40] See e.g. *Xiongsheng Cixi Electronics Co., ltd (China) vs. XXX (Japan)*, Nibong Intermediate Court (First Instance), zheyongshangwaichu No.5 (2013).
[41] See e.g. *Shanghai Yuqin Co., ltd (China) vs. Corporate Funding Partners (Unknown)*, Shanghai Pudong District Court (First Instance), puminer (shang)chu No.S2384 (2012).