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On the Normative Application of the Breaching Party's Right to Contract Termination

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ABSTRACT
In 2006, the Supreme People's Court Gazette published the case of Xinyu Company v. Feng Yumei, which for the first time recognized the right to terminate a contract by the breaching party. Although an increasing number of judicial decisions tend to support the breaching party's right to terminate the contract, some rulings still oppose it. The main reasons for this disagreement include unclear understanding of the nature of the right to terminate, lack of clear rules on the conditions for its exercise, and improper standards for determining the termination period and the amount of (penalty for breach). Regarding judicial perspectives on the breaching party's right to terminate, the arguments presented by different parties are inconsistent. This inconsistency is reflected not only in the specific timing of contract termination but also in differences regarding termination methods and the allocation of liability for breach. No consensus has been reached on these issues. Therefore, choosing the breaching party's right to terminate as the research topic has practical significance in resolving contractual deadlocks. Theoretically, it can further improve China's regulations on contract termination. Legally, it can help interpret and integrate relevant provisions in the Civil Code.

KEYWORDS
Right to terminate a contract; Termination by the breaching party

1 Theoretical basis of the breaching party's right to terminate a contract

Necessity of the Breaching Party's Right to Terminate.

Experts generally agree that the doctrine of changed circumstances cannot fully replace the contractual terms set by the breaching party in termination cases. They argue that when pursuing the core objective of terminating a breached contract, the specific content of the contract and the rights and interests of both parties must be comprehensively considered to ensure fairness and reasonableness. To resolve contractual deadlocks, experts suggest that the doctrine of changed circumstances could serve as an implementation strategy, balancing the interests of both parties through its application.

As stipulated in Article 533 of China's Civil Code, the doctrine of changed circumstances refers to significant, unforeseeable, and objective changes occurring during contract performance that are beyond the parties' control. If the contract is enforced unchanged under such circumstances, it would result in manifest unfairness to one party, making such enforcement unreasonable. In such cases, the affected party has the right to request a court to modify or terminate the contract to prevent further harm to their interests.

Changed circumstances, in this context, refer to a legal mechanism where one party, due to objective impediments, can no longer fulfill contractual obligations, allowing the other party to request termination or demand corresponding liability. Notably, the doctrine of changed circumstances and the breaching party's right to terminate differ significantly in their applicable conditions and legal consequences.

2 Current judicial practice regarding the breaching party's right to terminate contracts

General Prohibition of Contract Termination.

The case involving the dispute between Hunan Yucheng Investment Group Co., Ltd. and Hongming Metal Plaza Market Co., Ltd. over a commercial lease agreement illustrates this principle. The two parties had entered into a specific lease contract for supermarket operations, under which Hongming, as the lessor, had fulfilled its obligation to deliver the premises. However, due to shifting market conditions, Yucheng concluded that the commercial environment was no longer suitable for its supermarket business and sought to terminate the contract. Hongming refused, insisting on continued performance.

When negotiations failed, the dispute was brought before the Nantong Intermediate People's Court. The first-instance court ruled against termination, ordering the contract to remain in force. Dissatisfied, both parties appealed, arguing that the contract had become impracticable. However, the second-instance court upheld the original judgment, reaffirming that unilateral termination by the breaching party (Yucheng) was not permitted under general circumstances.

In the lease contract dispute between Hengxin Aote Investment Development Co., Ltd. (Plaintiff/Lessee) and Liu Xuechun (Defendant/Lessor), the parties had entered into a clear agreement specifying the permitted business scope for the leased property. During contract performance, Hengxin encountered operational difficulties that rendered it unable to fulfill rental payment obligations, making continued performance under the original terms impracticable. Consequently, Hengxin petitioned the court for contract termination, which was initially granted.

The first-instance court held that Article 94 of the Contract Law expressly limits termination rights to the non-breaching party, thereby excluding the breaching party (Hengxin) from such entitlement. This position was upheld by the appellate court, which ruled that Hengxin's termination request lacked legal basis. The judgment reaffirmed the principle that contractual stability cannot be undermined by a breaching party's self-created performance difficulties, absent statutory exceptions (e.g., force majeure or fundamental change of circumstances).

3 Judicial challenges in applying the breaching party's right to terminate contracts

The determination of contract deadlock currently lacks uniform standards, as evidenced by Article 62 of the "Interpretation of General Provisions for Contracts (Draft for Solicitation of Comments)" which provides two alternative approaches for establishing the effective time of contract termination: either the specific time when the copy of the statement of claim is served on the counterparty, or the time when the court renders its judgment after a party files and wins the lawsuit. However, both approaches present significant implementation challenges - the first may result in procedural deficiencies if service of process is delayed, potentially preventing proper adjudication of termination validity, while the second ties termination effectiveness to litigation completion, which may cause undue delays. In practice, courts typically determine the specific termination date by considering multiple factors including when the breaching party actually ceased performance, when both parties completed handover procedures, or when the non-breaching party regained actual control of the subject matter, reflecting the need for a more nuanced approach to this complex issue.In judicial practice, when specific circumstances permit the breaching party to terminate the contract and the non-breaching party does not actively claim damages, courts generally refrain from intervening in liability determination, preferring to let the parties resolve potential disputes through alternative means. This approach not only upholds judicial efficiency and procedural fairness but also preserves autonomy for contractual parties in dispute resolution. It should be noted that academic circles remain divided on whether the non-breaching party automatically acquires termination rights.

Within this legal framework, the non-breaching party retains the right to file lawsuits demanding monetary compensation or material restitution. The case of Xinyu Company v. Feng Yumei regarding a commercial property sales contract illustrates this principle well. As published in the Supreme People's Court Gazette, the ruling demonstrated the court's comprehensive and prudent evaluation of the non-breaching party's claims during contract performance.[1] This judgment not only ensured balanced protection of both parties' rights but also reinforced the authority of contract law and judicial impartiality.

Notably, while the court found no substantive breach in this case, it nevertheless rendered a complete adjudication on liability issues after terminating the contract. The ruling thoroughly considered multiple factors including refund of payments, compensation for property appreciation, contractual penalties, and compensation for other economic losses, reflecting the judicial commitment to comprehensive and equitable remedies.

4 Improvement of rules on the breaching party's right to terminate contracts

4.1 Refining the standards for identifying contract deadlock

Refining the Rules for the Breaching Party's Right to Terminate Contracts.

We should not adopt the respective performance interests of both parties as a comparative standard. Due to insufficient protection of a party's performance interest under China's contract law, many disputes cannot be properly resolved. In judicial practice, the "Xinyu Company v. Feng Yumei" case provided courts with a new perspective for comparing the interests of both parties. Inspired by this precedent case published in the Gazette, most courts now tend to use the respective benefits of both parties as the primary balancing factor when determining whether performance costs are excessive, thereby ensuring the fairness and reasonableness of judgments. Furthermore, the performance benefits obtained by the breaching party should not be regarded as comparable objects. At the contract formation stage, the breaching party's performance obligation constitutes its own benefit rather than the non-breaching party's performance interest.

When we compare the breaching party's performance costs with the benefits it obtains, we are essentially evaluating the unilateral interest of the debtor. Therefore, the determination of the breaching party's performance costs should consider its actual performance situation. Ultimately, the breaching party should compare its performance costs with the performance benefits that the creditor may obtain. Thus, from this perspective, the breaching party's performance costs acquire comparative legal significance. According to Article 275(2) of the German Civil Code, when assessing whether a debtor has the right to refuse further performance of the obligation, consideration should be given to one party's payment costs and the other party's payment benefits.

4.2 Defining the scope of performance costs

An interpretation of the statutory text reveals that the obligation of specific performance may only be waived when the required costs exceed a certain threshold. If this threshold is not met, the parties must continue performance as originally agreed. However, if the cost of continued performance surpasses what the obligor can reasonably bear, it should be deemed to have exceeded their assumed liability. This makes the determination of whether costs are excessive critically important.

In judicial practice, disputes over whether performance should continue primarily revolve around two issues: whether enforcement would impose an undue burden on the obligor, and how to properly calculate their assumed obligations. That said, mere unreasonable hardship to the obligor cannot, in itself, serve as sufficient grounds to deem performance excessively burdensome. If the obligor still fails to perform as required, courts may consider compulsory enforcement to resolve the dispute—though this approach often leads to prohibitively high execution costs and is therefore generally inadvisable.

Furthermore, the performance costs borne by the breaching party should be treated as their own execution expenses, which do not include the supervisory costs incurred by courts during enforcement. Even if enforcement oversight proves difficult, such expenses should not factor into the assessment of whether compulsory performance is appropriate. In this sense, performance costs must be viewed as strictly "reasonable" or "legitimate" considerations. Conversely, the absence of clear constraints on what constitutes excessive enforcement duration may further complicate cost determinations, creating practical challenges for judicial proceedings.

5 Conclusion

The recognition of the breaching party's right to terminate contracts represents a significant development in modern contract law, reflecting a balance between upholding the binding force of agreements and addressing practical commercial realities. As demonstrated through judicial precedents like the Xinyu Company case, China's legal system has gradually acknowledged that rigid enforcement of contracts may sometimes lead to manifestly unjust outcomes, particularly when performance becomes objectively impossible or commercially impracticable.

However, the current framework still requires clearer standards to determine when termination by the breaching party should be permitted. Key considerations should include: the fundamental change of circumstances, disproportionate performance costs, and the availability of alternative remedies. The non-breaching party's legitimate interests must be protected through appropriate compensation mechanisms, while preventing abusive exercise of termination rights.

Moving forward, legislative refinements and consistent judicial interpretation are needed to establish a more predictable and equitable approach. This evolution should draw from comparative law experiences while remaining grounded in China's unique legal tradition and commercial context. Ultimately, a well-calibrated system for contract termination can better serve the goals of justice, efficiency, and good faith in contractual relationships.

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