



Analysis of the Determination of Fundamental Breach of Article 25 of the United Nations Convention on Contracts for the International Sale of Goods-----Analysis of “Sinochem International (Singapore) Ltd. v. ThyssenKrupp Metallurgical Products Ltd. International Contract for Sale and Purchase of Goods”

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Abstract. “Sinochem International (Singapore) Ltd. v. ThyssenKrupp Metallurgical Products Ltd. International Contract for Sale and Purchase of Goods” is the guidance case No.107 of the 21st batch of guidance cases issued by the Supreme People's Court of China on February 25, 2019. In this article, the main controversial points and the judgment result of the case are taken into account to explain the determination and application of Article 25 of the United Nations Convention on Contracts for the International Sale of Goods (hereinafter referred to as "CISG") in relation to fundamental breach of contract, and to suggest the significance of the provisions on fundamental breach of contract in the Civil Code of China.

Keywords: CISG, fundamental breach of contract, international contracts of sale and purchase of goods

1 Introduction

In reality, when judges use the CISG to settle disagreements arising from the management of international sales contracts, the standards for defining whether a contract constitutes a fundamental breach are not consistent, leading to vastly different rulings in the same case that do not safeguard the legitimate obligations and interests of both buyers and sellers and do not promote the consistency of court rulings. In light of this, this paper analyzes the elements of a fundamental breach of contract based on Article 25 of the CISG Convention, discusses the main point of contention regarding whether the seller in this case committed a fundamental breach of contract, and suggests how the Convention's provisions might apply to the Chinese Civil Code when it comes to this topic. Starting from an important case published by the Supreme People's Court of China, this article draws on the views, doctrines and articles of previous authors and

combines its own views to provide an insightful analysis of the facts and controversies of the case and use the conclusions to make suggestions for the practice of the Chinese Civil Code. By refining the constitutive elements of fundamental breach of contract, the judges will be able to determine the fundamental breach of contract in a clear and homogeneous standard, avoiding the abuse of discretion by judges and the phenomenon of different judgments in the same case, thus safeguarding the legitimate rights and interests of both parties to the contract and making it possible to obtain a just and reasonable judgment.

2 Basic facts of the case

2.1 Case Introduction

After ordering a batch of fuel-grade petroleum coke from ThyssenKrupp Metallurgical Products Ltd. (Krupp Company), Sinochem International (Singapore) Ltd. (Singapore Company) engaged into a Sales Contract with the agreement that the State of New York, USA's laws would govern the transaction. The quality requirements of petroleum coke were clearly agreed in the contract, including seven aspects of petroleum coke: moisture content, sulfur content, ash content, volatile matter content, size, calorific value, and hardness. Among them, the typical value of petroleum coke hardness (HGI) agreed by both parties was 36-46. However, during the actual performance, after the Singapore Company paid the full amount of the goods, it was found that the HGI value of the petroleum coke delivered by Krupp Company was 32, which was not in line with the 36-46 agreed in the contract. After that, the buyer negotiated with the seller for several times, but failed. The petroleum coke was resold by Singapore Company to Weihai Golden Monkey In & Out Trading Co., Ltd. at a level that was equal to or greater than the market rate for the same period in order to stop the loss from growing, but it was discovered that this move still lost Singapore money. The competent Chinese court had jurisdiction because the site of the contract's execution was in the Chinese port chosen by the buyer. Due to a fundamental violation of contract, the Singapore Company has now filed a lawsuit against Krupp Company with the Jiangsu High People's Court. The Singapore Company is asking for the contract to be terminated, the full purchase amount to be returned, and damages to be paid. Subsequently Krupp Company sued to the Supreme People's Court against the verdict.

2.2 Judgment results

In this case, the first trial decision is very different from the second trial decision. First, the CISG served as the foundation for the parties' rights and obligations in both the first and second instances courts. Secondly, the court of first instance supported the plaintiff Singapore's view that the defendant Krupp Company constituted a fundamental breach of contract, and therefore ruled that the sale and purchase contract between the parties was null and void the seller returned the entire purchase price and compensated for damages of US\$520,339.77.

However, the second instance determined that although the petroleum coke delivered by the defendant did not comply with the terms of the contract, the buyer could have successfully resold the goods with its efforts and had already made a reasonable resale, and that therefore did not meet a fundamental contract violation. The second instance also determined that the Purchase Contract was valid and that the seller was given compensation for the loss of US\$160,581.74. The seller was awarded US\$160,581.74 in damages and interest and US\$98,442.79 in damages for storage fees.

The divergence between the first instance and the second instance regarding the criteria and determination of fundamental breach of contract in this case means that the criteria for determining fundamental breach of contract are not yet clear and unambiguous in practice, resulting in the first instance directly finding that Krupp Company constituted a fundamental breach of contract, but the second instance only finding that it constituted a general breach of contract. Therefore, this paper will analyze the circumstances and criteria of fundamental breach from Article 25 of CISG, and discuss whether the case constitutes a fundamental breach, as well as the significance of Article 25 of CISG and its criteria for China's Civil Code regarding fundamental breach.

3 Application of the CISG in this case

The CISG was used by the first instance and the second instance in this matter to establish the parties' rights and obligations, primarily for the following reasons:

First of all, according to the provisions of Article 1 of the CISG, the subjects of the application of the Convention mainly include the following two situations: (1) the places of business of the parties are in different countries, and these countries are Contracting States of the Convention; (2) the places of business of the parties are in different countries, regardless of whether one or both parties have their places of business as Contracting States, if the parties agree to use the law of a country whose law is, according to Private international law rules guide the application of the law of a State Party to the Convention, the same can be applied to the Convention [1]. This case complies with the above two circumstances.

On the one hand, the parties have their places of business in Singapore and Germany respectively, and they are both parties to CISG, so the Convention should be applied. In addition, the parties agreed in the contract to apply the relevant laws of New York State of the United States, and the case law of New York State indicates that cases under the jurisdiction of federal courts should apply the law at the federal level to resolve disputes. The parties in this matter consented to have the issue resolved in accordance with New York law, and CISG application is indicated by New York law. Therefore, the CISG should be used to determine the dispute in this case regardless of how the circumstances are interpreted.

On the other hand, the parties in this case might be assumed to have not rejected the adoption of CISG through autonomy as they mutually decided to employ it as their guiding law during the lawsuit. [2]. In conclusion, it is accurate that the court of first and second instance applied the Convention to resolve the dispute in this case.

3.1 Determination of fundamental breach and whether this case is a fundamental breach

Article 25 of the CISG provides for fundamental breach of contract. However, as can be seen from the contrasting judgments of the first and second instance in this case, there are no specific and clear criteria for determining fundamental breach of contract in practice. The following is therefore a discussion of the criteria for determining a fundamental breach, based on Article 25 CISG, in terms of what are elements of a fundamental breach [3].

Determination of breach of contractual obligations by a party. A breach of a contractual obligation is a prerequisite for a fundamental breach. A breach of contract can only constitute a fundamental breach if it occurs and reaches a certain level of seriousness, so to determine whether it constitutes a fundamental breach, it should first be determined whether a party has breached its contractual obligations. Obligations here include: statutory obligations, obligations agreed by the parties, and custom and practice between the parties. Among these, statutory obligations include the duty to aid the other party in the discharge of its obligations, the duty to stop damage from spreading, the duty to uphold the rule of good faith, and other legal requirements. In addition, due to the principle of contractual autonomy, special agreements between the parties based on elements such as the subject matter of the contract are also legally binding obligations that should be fully performed by the parties to the contract. Moreover, according to Article 9 of CISG unless otherwise stated, any usage express and implied between the parties and any established custom between them shall be binding on the parties [4]. There may be tacit trading customs between buyers and sellers with frequent trade dealings, as well as tacit practices generally known within the industry, which are automatically and tacitly part of the obligations to be observed by the parties at the time of the conclusion of the contract without specific specification. If the parties perform the above obligations in full, then there will be no breach of contract, let alone a fundamental breach of contract under Article 25 CISG.

In this case, the Purchase Contract signed between the two parties clearly agreed that the HGI range of petroleum coke was 36-46, while the seller, Krupp Company, provided petroleum coke with an HGI of 32, which clearly did not comply with the obligations that the seller should perform as agreed in the contract, and therefore constituted a breach of contract. Moreover, the buyer had already paid the full amount of the goods and fulfilled its main obligations, so that the seller, Krupp, did not enjoy the right of non-performance under article 71 of CISG [5]. It was therefore undisputed that the seller, Krupp, had breached the contract in this case.

Furthermore, a mere breach of a contractual obligation does not necessarily lead to a fundamental breach. A fundamental breach requires not only a breach, but also that the non-breaching party suffers a detrimental result and that there should be a causal link between the breach and the detrimental result. The CISG does not clearly define "damage". According to the official records of the Secretariat of the International Trade Commission, the term "damage" in Article 25 CISG includes all present and future adverse consequences of a breach of contract [6]. This includes not only present and

future loss of economic benefits, but also any other type of adverse consequences, such as damage to the subject matter, loss of business opportunities, etc. [7]. In this case, Singapore Company indicated that it used the Chinese port as the port of receipt in order to resell the petroleum coke in the Chinese market. However, the domestic market demand in China is generally for petroleum coke with an HGI of not less than 35, which means that the petroleum coke with an HGI of 32 offered by Krupp Company was not in demand by most companies in China. Because of the low demand, the petroleum coke supplied by Krupp Company was not easily sold within the Chinese market and its price was severely restricted, causing Singapore Company, as a commercial entity, not only to lose more commercial opportunities for resale, but also to lose its initiative in negotiating resale pricing with third parties, depriving Singapore Company of the opportunity to make higher profits through resale, and indeed Singapore Company did incur pecuniary losses as a result, so that Krupp Company's breach of contract should be found to have caused damage to Singapore Company. Furthermore, the loss was a direct result of the breach of contract, so a causal link did exist between the two.

Determination of actual deprivation of the non-breaching party's expected benefit. Under Article 25 CISG, the determination of actual deprivation of the non-breaching party's expected benefit is the key to distinguishing between a general breach and a fundamental breach. This element can be discussed in two parts: the definition of "expected benefit" and the definition of "actual deprivation".

Expected benefit. CISG refers to an expected benefit as something that the parties are entitled to expect to receive from the contractual agreement. It is also what the parties to the contract should receive or the status they should have at the time of correct performance [8]. The expected benefit can be determined from the perspective of the benefit that the non-breaching party would receive if the contract were to be performed normally, mainly from the nature of the contract, the type, quality, price and quantity of the subject matter of the contract and the purpose of the contract between the parties. In addition, when determining the expected benefit, the judge should also take into account the objective facts, such as the market price of the subject matter of the contract, the market reputation of the parties, the possibility of resale of the goods and other aspects of the comprehensive determination of the expected benefit, rather than relying solely on the one-sided words of the parties.

Actual deprivation. "Actual deprivation" is the extent of the fundamental breach, which indicates that the fundamental breach requires not only that one party has breached its contractual obligations and caused damage to the other party, but also that the damage is so severe that the non-breaching party can no longer be compensated for the loss incurred by the non-breaching party by way of repair, remaking, replacement, return, reduction of price, or remuneration and that the only available remedy is to declare the contract void for fundamental breach. In fact, the CISG does not establish a uniform standard for "actual deprivation", but is only slightly mentioned in the United Nations Trade Law Commission's commentary on the 1978 draft CISG, which is to be analysed on a case-by-case basis, in addition to several elements to measure the extent of the loss, such as the amount of the contract, the impact on the injured party, etc. [9].

In short, the determination of "actual deprivation" must be made in the context of various possible elements, such as the terms of the contract, the manner of breach and the damages suffered by the injured party, which gives the judge a certain degree of discretion and needs to be decided for each individual circumstance.

Combined with this case. From the perspective of the seriousness of the breach, the parties in this case agreed on seven requirements for the quality of petroleum coke, including sulphur content, hardness and other aspects, and the petroleum coke delivered by the seller only failed to comply with the contractual agreement on the index of hardness, but the other six items all complied with the contractual agreement, so in terms of seriousness, the breach may not be sufficient to reach the seriousness of fundamental breach, but this is not absolute.

Secondly, focusing on the purpose of the contract, Singapore Company's purpose at the time of entering into the Purchase Contract was to resell it within China, so its expected benefit was to receive the goods delivered by the seller in conformity with the contract and resell them within China at the highest possible price in order to make a profit. The petroleum coke delivered by Krupp Company in this case, HGI 32, although limited in the Chinese market, could be processed through the relevant technical equipment to make it meet the standards of the Chinese market. Therefore, as long as the costs are increased and the relevant equipment is replaced, it can still be bought and sold normally in the Chinese market, i.e. there is a feasible remedy, which is not so serious that it is difficult to make up for and need to find the contract void.

The cost of replacement equipment, labour costs, etc., incurred because of the re-processing should have been borne by Krupp Germany as a breach of contract. Singapore really was successful in reselling to a third party at a price that was competitive with the current market, and it can be said that the buyer's immediate purpose was achieved, albeit at a discount to the resale price, but this should be found to be a defective achievement of that purpose and not an actual deprivation of its expected benefits.

In summary, Krupp Company did not actually deprive Singapore Company of the benefit of expectation and therefore did not constitute a fundamental breach of contract.

Determination of the foreseeability of the outcome of the breach. Article 25 CISG makes it clear that in addition to these three objective elements, subjective foreseeability of the outcome of the breach is also required to constitute a fundamental breach. This indicates that a reasonable third party in similar situations may reasonably have predicted such an outcome and that the party in breach of contract should have foreseen or has foreseen.

The CISG establishes two requirements for foreseeability of the outcome of a breach, requiring that both the breaching party and a reasonable third party should have foreseen it in the same circumstances. In practice, the identification of a "reasonable third party" is very complex, requiring not only that it be engaged in the same specific industry as the defaulting party, but also that its own factors, such as economic strength, and environmental factors, such as the legal policies of the country in which it is located, meet the requirements of "equal qualifications and common sense".

The CISG does not provide for the time of foreseeability, an issue that has been the subject of two main theoretical opinions: scholars such as Peter Schlechtiem in Germany argue that the "foreseeability" of the outcome of the damage by the breaching party should be determined at the time of the conclusion of the contract [10]. And scholars represented by the American scholar Honnold believe that the foreseeability of fundamental breach should be counted from the time of breach [11]. In contrast, the author believes that the foreseeability of the consequences of fundamental breach should be determined at the time of contract formation for the following reasons.

Firstly, when the parties enter into an international contract for the sale and purchase of goods, they have clearly agreed on the rights and obligations of both parties and know that the contract is legally binding on both parties, and as commercial subjects, they will unavoidably evaluate the contract's performance as business subjects, forecast the potential loss of economic benefits to themselves in the event of partial performance, analyze the profit and loss, and take it into account while deciding whether or not to conclude the deal. The parties should therefore be considered to be obliged to foresee the possible adverse consequences of a fundamental breach at the time of the conclusion of the contract.

Secondly, the market environment, legal policies, etc. can have an impact on the market order and the market price of goods fluctuates up and down around their value, affecting the transactions and earnings of commercial parties. Therefore, if the defaulting party should have foreseen the consequences of a breach of contract only at the time of the breach, then when the market price of such goods rises significantly, the amount of damages will far exceed the amount estimated by the parties based on the market price at the time of the conclusion of the contract, for which the defaulting party may have to bear huge losses or may even face the crisis of bankruptcy because of a contract. This can lead to a reduction in transactions by commercial parties in order to avoid unforeseen risks, to the detriment of the flow of goods and economic development, while the non-breaching party may also benefit unduly from the difference in price from the amount of damages.

Thirdly, according to the provisions of Article 74 CISG regarding the limit of damages, it is clear that the damages of the breaching party shall not exceed the loss that it should have or had foreseen at the time of the conclusion of the contract [12]. As both Article 74 and Article 25 of the CISG are the legal basis for dealing with breaches of contract, the foreseeability provision in Article 25 of CISG should be aligned with it, namely "at the time of the conclusion of the contract".

First of all, it should be noted that in this instance both Krupp Company and a reasonable third party in a comparable circumstance should have been aware that the duties imposed by the parties at the time of the contract's conclusion should be adhered to or met, otherwise they would be liable for breach of contract, and in serious cases this could constitute a fundamental breach of contract and render the contract void. The parties had expressly agreed that the HGI range for petroleum coke was 36-46, so Krupp should have been aware when the contract was signed that the agreement was legally binding on it and had a duty to foresee that its failure to deliver petroleum coke with an HGI between 36 and 46 would entail liability for general or even fundamental

breach of contract, and that Krupp Company was able and obliged to carry out tests to confirm this prior to delivery.

In summary, Krupp Company satisfied the "breach of contractual obligations" and "foreseeability of the consequences of the breach" of the elements of fundamental breach, but since the contractual purpose of Singapore Company was basically fulfilled, i.e. it was not actually deprived of its expected benefits, Krupp Company in this case only constituted a general breach of contract and not a fundamental breach of contract.

4 The significance of Article 25 of the CISG for the Chinese Civil Code

In Article 563 of the Chinese Civil Code on the determination of fundamental breach of contract, only four material circumstances of force majeure, anticipatory breach, delay in performance resulting in the failure to achieve the purpose of the contract and a transparency provisions [13]. The author believes that the definition of fundamental breach in Article 25 of CISG can be used as a formal general provision, which on the one hand can solve the embarrassing situation of a party who has clearly constituted a fundamental breach of contract but cannot rescind the contract because it does not comply with the fundamental breach of contract as stipulated in Article 563 of Chinese Civil Code. On the other hand, it can help the judiciary to make a more legalistic interpretation of Article 563 of Chinese Civil Code in relation to "there exist any other circumstance as provided by law".

Chinese Civil Code also does not specify the standard of "the purpose of a contract cannot be achieved". CISG provides for the actual deprivation of the non-breaching party's expected benefit as a criterion for determining the seriousness of a breach of contract, which not only unifies the standard for determining the more general concept of "failure to achieve the purpose of the contract", but also effectively regulates the discretion of judges and prevents them from abusing the concept of "failure to achieve the purpose of the contract" and bending the law referee.

Finally, the concept and criterion of "foreseeability at the time of conclusion of the contract" could also be incorporated into Chinese Civil Code to prevent situations where the non-breaching party abuses its right to remedy by offering unreasonably high compensation to obtain unjustified benefits, in order to safeguard the legitimate interests of the breaching party and protect the trading environment.

5 Conclusion

The CISG, as a convention regulating international contracts for the sale of goods, has not only had a significant impact on international economic development, but has also been of great reference to the codification of the Chinese Civil Code's Contracts section. Clarifying the criteria for determining fundamental breach of contract is an inescapable issue in resolving contract disputes. Therefore, an in-depth investigation and

clear definition of fundamental breach will not only be of great significance in dealing with international sale and purchase contracts between parties from different countries, but will also provide practical implications for the Chinese Civil Code regarding the determination of fundamental breach, so as to better deal with similar cases involving fundamental breach.

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3. CISG Article6: The parties may exclude the application of this Convention or, subject to article 12, derogate from or vary the effect of any of its provisions.
4. CISG. Article25: 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, unless the party in breach did not foresee such a result.
5. CISG. Article9: (1) The parties are bound by any usage to which they have agreed and by any practices which they have established themselves. (2) The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which international trade is wisely known to, and regularly observed by, parties to contracts of the type involved in the particular trade concerned.
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which he then knew or ought to have known, as a possible consequence of the breach of contract.

14. Civil Code of the People's Republic of China. Article 563: The parties may rescind the contract under any of the following circumstances: (1) the purpose of a contract cannot be achieved due to force majeure; (2) prior to expiration of the period of performance, one of the parties explicitly expresses or indicates by act that it will not perform the principal obligation; (3) one of the parties delays performance of the principle obligation and still fails to perform it within a reasonable period of time after being demanded; (4) one of the parties delays performance of the obligation or has otherwise acted in breach of the contract, thus making it possible to achieve the purpose of the contract; or (5) there exist any other circumstance as provided by law. For a contract under which the debtor is required to continuously perform an obligation for an indefinite period of time, the parties to the contract may rescind the contract at any time, provided that the other party shall be notified reasonably in advance.

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