

Chapter IX

Dissolution and Termination of Contracts

As a general principle under the Contract Law, a contract, once legally formed, must be performed. The strict performance requirement is also underscored, at least in theory, by the traditional virtue of promise honoring. The performance, however, may be excused upon the occurrence of certain events prescribed by the law. The direct result of the excuse for the non-performance is the dissolution of the contract, under which the party's obligation to perform is discharged. Generally, the contract dissolution is defined in China to mean extinguishment of contractual relationship between the parties by the manifestation of the intent of one or both parties as a consequence of the occurrence of the legally prescribed events.

Scholars in China debate on the difference between dissolution of the contract and termination of the contract. One argument is that dissolution and termination are the same, and the dissolution in essence is referred to as advance termination of the contract by agreement of the parties or by operation of law. Therefore, if the contract is dissolved by the parties' agreement or pursuant to the provision of law, the contract is terminated. In the sense in which the contract is discharged, there is no difference between dissolution and termination.

The opposite opinion, however, regards the dissolution as one of the elements for termination of the contract. In this opinion, dissolution differs from termination in several aspects. First, the dissolution may be followed by restitution in order to avoid unjust enrichment, but the termination may end up with the discharge of the contract. Second, the dissolution may retroactively affect the past rights and obligations of the contract, while termination only

deals with the present and future effect of the contract – i.e. it simply extinguishes the contractual relationship. Third, dissolution is often used as a means to punish the party in breach (e.g. the aggrieved party is given the right to dissolve the contract). The termination, however, is mainly used in the situations where there may not be a breach of contract.¹

The Contract Law seemingly takes the stance to treat the dissolution as one of the circumstances under which a contract may be terminated. For example, in Article 91 of the Contract Law, there are seven situations that would cause to terminate a contract, one of which is dissolution. On the other hand, however, the Contract Law is not intended to make distinction between dissolution and termination. Loosely speaking, the dissolution mainly deals with the excuses for which a duty to perform a contract may be discharged without triggering to liability for breach of the contract. In China, there has been a suggestion that a buzzword “retroactive” be used to help tell dissolution from termination in general. If the discharge of the contractual obligations has a retroactive effect on the contract (e.g. restitution), the discharge is normally a dissolution. Otherwise, the discharge would mean a termination.

1. Dissolution

A contract may be dissolved under certain circumstances, and the occurrence of a circumstance that leads to dissolution of a contract would serve as an excuse for the party involved not to perform its contractual obligations. As indicated above, under the Contract Law, a contract may be dissolved either by an agreement or by provision of law. In either case, the dissolution will result in the discharge of the contract, and thus, none of the parties, upon the dissolution of a contract, may have the right to ask the other to continue performing the contract.

1.1. Dissolution by Agreement

Premised on the principle of freedom of contract, the parties to a contract may decide to dissolve the contract as they wish. The Contract Law not only recognizes the right to dissolve, but also allows the right to be exercised in two different ways: (a) dissolution agreement and (b) agreed conditions. Article 93 of the Contract Law provides that a contract may be dissolved upon a consensus of the parties through negotiations. Article 93 further provides that the parties to a contract may agree upon the conditions to dissolve the contract by

¹ See Wang Liming, *Study on Contract Law (Vol. II)*, 273 (People’s University Press, 2003).