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A SNAPSHOT OF CHINESE CONTRACT LAW FROM A HISTORICAL AND COMPARATIVE PERSPECTIVE

Abstract

China's 1999 Contract Law has a hybrid character due to its reception of foreign and international influences such as German civil law, the common law and the UN Convention on Contracts for the International Sale of Goods, among others. This chapter briefly introduces the history of Chinese contract law, followed by some comparative remarks on the Contract Law. The practice and new developments of Chinese contract law are also described. Finally, the relation between the codification of civil law and the Contract Law is analysed. One of the main points of the chapter is that, for a law with a hybrid-reception character, the corresponding theoretical interpretation is not helped enough merely by a mechanical reception of one or more foreign legal theories. A unified interpretation is necessary. Chinese scholars still have a long way to go to create a unified interpretation of the Contract Law.

Keywords: Reception of Law, Chinese Contract Law, Change of Circumstances, Penalty Clauses, Third-Party Beneficiary Contract

Generally speaking, contracts function to ensure "cooperation to achieve social purposes by the use of promises given in exchanges arrived at through bargain".[1] Such a social function of contracts has been statutorily regulated in almost every jurisdiction.[2] China is no exception. In fact, being part of the civil law legal family, contract law has been extensively studied and plays a leading role in every phase of contemporary Chinese legal development.

This chapter will briefly introduce the history of Chinese contract law (part I), followed by some comparative remarks on the Contract Law (part II). The practice and new developments of Chinese contract law will then be described (part III) and, finally, the relation between the codification of private law and the Contract Law will be analysed (part IV). The purpose of the chapter is rather modest as it provides only a general account of the historical development and current situation of

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1 Allan Farnsworth, "The Past of Promise - An Historical Introduction to Contract", Columbia Law Review 69, (1969): 576, 578.

2 See general survey in Arthur T. von Mehren, "A General View of Contract," in International Encyclopedia of Comparative Law, Volume III: Contracts in General, ed. A. von Mehren, Chapter 1 (Tübingen: Mohr Siebeck, 1982).

Chinese contract law. The chapter traces contract law back to the late Qing Dynasty when the first draft of a Chinese Civil Code was made. The topic of contracts in Chinese feudal societies is beyond the scope of the chapter and, therefore, is not discussed. As far as content is concerned, the chapter does not attempt to address each and every aspect of contract law for doing so would be unrealistic due to space limitations.

1. *A Brief Introduction to the History of Chinese Contract Law*

1.1. *Drafts of a Civil Code in the early Twentieth Century in China*

The crisis of ancient Chinese law in the nineteenth century was part of the broader crises of the Chinese nation at that time. A primary example was the issue of extraterritorial jurisdiction since 1842. Western countries such as Great Britain and France claimed the law of the Qing Dynasty was brutal and imperfect and, therefore, demanded, and subsequently acquired, extraterritorial jurisdiction in China. China took this as an insult to its sovereignty. In order to abolish the system of extraterritoriality, the old Chinese empire was obliged to proceed by means of legal modernization. It is for this reason that China prepared the first draft Civil Code (*Da Qing Min Lu Cao An*), which was accomplished by the end of the year 1911. It was in the *Pandekten* style and featured five books, namely, the General Part (§§ 1-323), Law of Obligations (§§ 324-977), Property Law (§§ 978-1316), Family Law (§§ 1317-1459) and Succession Law (§§ 1460-1569). Unfortunately, the draft miscarried due to the collapse of the Qing Dynasty. The Beijing Government of the Republic of China (1912-1928) assumed the role of creating the second draft Civil Code. This was based on the first draft and was finished in 1925. In the second draft some rules of the Swiss Law of Obligations were borrowed. However, in the end this draft was not enacted into law, again due to political turmoil.[3]

In April 1927, the Nanjing Government was set up. Only two years later, in January 1929, the legislature of the Nanjing Government organized a committee to prepare a draft of a Civil Code. This undertaking was completed on 26 December 1930 and became the first Civil Code in China. (This Civil Code is still applied in Taiwan despite numerous amendments.) The Code adopted the structure and concepts of the German Civil Code (*Bürgerliches Gesetzbuch* – BGB) and has five books and 1,225 articles in total. Furthermore, this Code was also influ-

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3 Huixing Liang, Studies on Civil Law Theories, Cases and Legislation (Beijing: China University of Political Science and Law Press, 1993), 62.

enced by the Japanese Civil Code, the Swiss Civil Code, the Russian Civil Code and, to a lesser extent, the Civil Code of Thailand.

China's reception of foreign laws, especially German private law, was a result of the influence of Japan. The reason China did not follow the common law is purely accidental and technical and is not because of the content of the law.[4] In this respect, it cannot be said that civil law and common law are different in quality. However, common law includes case law and is, therefore, unsuitable for reception in the form of legislation or statute. China chose German private law instead of French private law because the German BGB of 1900 was a latecomer, and was thought better both in legislative technique and in content than the French Civil Code of 1804.[5]

1.2. *Laws on Contract in the PRC*

1950s

After the People's Republic of China (PRC) came into existence, its economy was to be renewed after decades of wars. Domestic trade was encouraged by the new PRC Government. Against this background, contracts and related institutions were put on the government's agenda. On 27 September 1950, the Finance and Economy Commission of the Government Council (i.e. the central government, the predecessor of the present State Council) published *Provisional Measures for the Conclusion of Contracts by Official Organs, State-owned Enterprises and Cooperatives*.[6] It was the first of the formal regulations on contracts of the PRC as applied within a Socialist sector of the economy.[7]

The PRC started drafting a new Civil Code in 1954 (the First Draft), which was finished two years later (in December 1956). It was composed of four parts with 525 articles in total. These parts consisted of the General Part, Ownership, Obligations and Succession. Chapter 4 of the General Part included the civil juridical act (*minshi xingwei* 民事行为), and the part on Obligations encompassed 'Contract in General' and 'Special Obligations' including sales, work contracts, leases and so on. Arguably, the draft followed the Soviet Civil Code of 1922, and it was a sign

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4 Lei Chen, "The Historical Development of the Civil Law Tradition in China: a Private Law Perspective," The Legal History Review, 78, nos. 1-2 (2010): 162-164.

5 Zejian Wang, Studies on Civil Law Theories and Cases, Vol. 5 (Taipei: Sanmin Bookstore Press, 1991), 4-5.

6 Renmin ribao, Peoples Daily (人民日报), 4 October 1950.

7 Huaishi Xie, "The Contract Law of Modern China," in International Encyclopedia of Comparative Law, ed. Arthur T. von Mehren (Tübingen: Mohr Siebeck, 1991).

of China's reception of Soviet private law.[8] However, the reception of Soviet law was eventually negated by criticism from the Communist Party of China (CPC) of the revisionism of the Communist Party of the Soviet Union in 1959.

1960s and 1970s

The PRC began preparing the Second Draft of the Civil Code in 1962. The draft was finished in 1964 and reflected a planned economy. This draft was affected both by international and national political conflict. The drafters wanted to break away from the Soviet private law model and create a clear distinction between the PRC code and the private law practised in capitalist countries. Progress on the Second Draft was interrupted by the so-called *siqing* (四清) Socialist Education Movement in 1964. The lesson learned from this experience is that it is not advisable for private law drafters to refuse to consider foreign private laws or to blindly pursue so-called Chinese characteristics.[9]

At the beginning of the Cultural Revolution, the commercial production and exchange of commodities was abolished. The Government managed social and economic activities through a variety of economic plans, which were carried out by administrative orders. This scheme lasted until the end of the 1970s. From the first regulations on contracts in the 1950s, there were no other formal laws or administrative regulations on contracts for thirty years.

On the other hand, there were still contract practices in China, albeit under different names, such as 'plan contract' and 'economic contract'. Accordingly, the question how people could ensure the performance or effects of a contract arises naturally from this situation. In the first thirty years of the PRC, even though there were courts and civil trials, civil cases mainly concerned divorce, succession and tort liability. It is uncertain whether contractual disputes would have been accepted and taken to trial by the people's courts during that period. During the ten years of the Cultural Revolution, contractual disputes were mainly mediated by administrative organs. In addition, there were other approaches to solving contractual disputes, such as public shaming. For example, one party would publish a 'reader's letter' in the newspaper People's Daily and expose a contractual dispute. Several days later, another letter would be published by the non-performing party to express apologies and to show

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8 Huixing Liang, Comments on China's Civil Legislation (Beijing: Law Press China, 2010).

9 Liang, Comments on China's Civil Legislation, 6-7.

how the matter was being resolved. This led to the following observation in 1978:

> Some enterprises either repudiated a contract casually, or did not conform with the agreed quality requirement, and thus caused a lot of loss in production. Nobody bothered about it, and the conflict between producer and user became severe. Even though the newly published *Thirty Articles on Industry* by the CPC has instructed economic commissions of all levels to be in charge of solving contractual disputes, the problem is not finally solved yet. What is called for urgently is enhancing economic legislation and trying to set up economic courts, so as to hold those who breach contracts financially and legally liable, and to ensure the legal effects of the contracts.[10]

1980s

Signing the CISG

On 30 September 1981, the Chinese Government signed the United Nations Convention on Contracts for the International Sale of Goods (CISG). The signing by China of the CISG shows the resolution of the Chinese people to open up and to follow an international standard of rules for a market economy.[11]

Law on Economic Contracts 1981

On 13 December 1981, the National People's Congress (NPC) enacted the Law on Economic Contracts. The law was the first Contract Law in the PRC. It provided rules to be followed for economic transactions and it applied mainly to contracts concluded between legal persons (economic contract). The law had fifty-seven articles and seven chapters. The content of the Law on Economic Contracts of 1981 was as follows:

Chapter 1 General Provisions
Chapter 2 The Conclusion and Performance of Economic Contracts
Chapter 3 Modification and Rescission of Economic Contracts
Chapter 4 Liability for Breach of Contract
Chapter 5 Mediation and Arbitration of Economic Contract Disputes
Chapter 6 Administration of Economic Contracts
Chapter 7 Supplementary Provisions

In this legislation, ten types of special contracts were regulated. Thereafter, substantial and complementary administrative regulations were

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10 See Cangbi Zhao, "Paper delivered at the Symposium on Establishing a Legal System," People's Daily, 29 October 29 1978.

11 See Shiyuan Han, "China," in The CISG and its Impact on National Legal Systems, ed. Franco Ferrari (Munich: Sellier. European Law Publisher, 2008), 91.

promulgated. However, the law was subsequently repealed on 1 October 1999 (along with the related administrative regulations).

The Law of the PRC on Economic Contracts Involving Foreign Interests 1985

The PRC Law on Economic Contracts Involving Foreign Interests was enacted on 21 March 1985 and became effective on 1 July 1985. It had seven chapters and forty-three articles. The content of the law was as follows:

Chapter 1 General Provisions
Chapter 2 The Conclusion of Contracts
Chapter 3 The Performance of Contracts and Liability for Breach of Contract
Chapter 4 The Assignment of Contracts
Chapter 5 The Modification, Rescission and Termination of Contracts
Chapter 6 The Settlement of Contractual Disputes
Chapter 7 Supplementary Provisions

This law was applicable to economic contracts concluded between economic organizations of the PRC and foreign enterprises, other economic organizations or individuals. However, this law did not apply to international transport contracts (Article 2). It provided general rules for economic contracts involving foreign interests. This legislation was influenced to some degree by the CISG, which can be seen in its adoption of the foreseeability rule on damages. The law was annulled on 1 October 1999.

General Principles of Civil Law 1986

On 12 April 1986, China enacted the General Principles of Civil Law (GPCL), which included rules on contracts. The GPCL used, for the first time, the general term 'contract' and not the term 'economic contract', which had been the custom in China for thirty years. The GPCL expressly states that 'a contract is an agreement on the establishment, change and termination of civil relations between the parties' (Article 85). Accordingly, the contract has no necessary link with planning at all. The formulation marked a turning point for Chinese contract law.[12]

The Law of the PRC on Technological Contracts 1987

In 1987, China promulgated another important piece of contract legislation, the Law on Technological Contracts. This law provided legal rules for the transformation of technology into a commodity in China. It in-

12 See Xie, 67.

cluded rules for contracts on the development of technology, contracts on the transfer of technology, and contracts on technological consultations and technological services. Unlike the Law on Economic Contracts, this law was not in principle applicable to contracts between legal entities; rather, it was based on the recognition of the 'freedom of contract' by including technological contracts concluded between individuals (Article 2).[13]

Since 1990

Amendment of the Law on Economic Contracts in 1993

With the disintegration of the Soviet Union in the early 1990s, great changes occurred in Eastern Europe. These changes called for a rethinking of basic questions among Socialist states. Questions concerning world economic trends, the destiny of Socialism and the future of China began to gain traction. In the Spring of 1992, Deng Xiaoping, while on an inspection tour of several southern Chinese cities, addressed these issues. Deng advocated for China to pursue a Socialist market economy. Thereafter, China followed this aspiration. However, the Law on Economic Contracts was enacted in the days of a planned economy and some of its provisions were outdated. Accordingly, in 1993 the law was amended and updated to meet the needs of a market economy. However, China still had three separate Contract Laws in effect at that time. The enactment of a unified contract law was warranted.

The 1999 Contract Law

On 15 March 1999, China promulgated the Contract Law, which was the first unified contract law of the PRC. The Contract Law has three parts, the General Provisions, Special Provisions and Supplementary Provisions with 428 articles. The contents of the law are:

General Provisions
- Chapter 1 General Provisions
- Chapter 2 Conclusion of Contracts
- Chapter 3 Validity of Contracts
- Chapter 4 Performance of Contracts
- Chapter 5 Modification and Assignment of Contracts
- Chapter 6 Termination of Contractual Rights and Obligations
- Chapter 7 Liabilities for Breach of Contract
- Chapter 8 Other Provisions

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13 Xie, 68.

Specific Provisions
Chapter 9 Sales Contracts
Chapter 10 Contracts for Supply of Power, Water, Gas, or Heat
Chapter 11 Contracts of Donation
Chapter 12 Contracts for Loan of Money
Chapter 13 Lease Contracts
Chapter 14 Financial Lease Contracts
Chapter 15 Contracts for Work
Chapter 16 Contracts for Construction Projects
Chapter 17 Transportation Contracts
Chapter 18 Technology Contracts
Chapter 19 Storage Contracts
Chapter 20 Warehousing Contracts
Chapter 21 Commission Contracts
Chapter 22 Contracts of Commission Agency
Chapter 23 Intermediation Contracts

Supplementary Provisions
The legislators guide to the Contract Law (PRC) states that

> considering the real needs of the reform and opening-up of China and the development of a Socialist market economy, the set-up of a nationally unified market and access to the international market, we shall sum up the experiences of legislators and judges and the results of theoretical research concerning contracts in China, draw broadly on successful experiences of other countries and regions on laws and cases, adopt to the best of our abilities common rules reflecting objective laws of a modern market economy, and harmonize rules of Chinese law with those of international conventions and international customs.[14]

In this context 'international conventions' essentially means the CISG. In this respect, the unification and perfection of contract law is perceived as a real need in the development of a market economy in China. Adherence to the CISG was an independent decision of the Chinese people. The reasonableness of this decision may turn on the reasonableness of the CISG itself, as it is the product of the work of many scholars and experts.

The Law on Labour Contracts 2007

Finally, it is noteworthy that China enacted the Law on Labour Contracts on 29 June 2007. This provision has eight chapters and ninety-eight articles.

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14 See Huixing Liang, Studies on Civil Law Theories, Cases and Legislation, Volume 2 (Beijing: National School of Administration Press, 1999), 121.

Summary

There are three important points in the development of the PRC contract law. Firstly, Chinese contract law developed from the position of having no law to follow to one of having a unified contract law; secondly, the extent of what is meant by 'contract' has expanded from economic contract only to contract generally; and thirdly, there has been a conceptual evolution from the administration of contracts by public authorities to contractual litigation between private individuals.

The history of Chinese contract law reflects the history of Chinese society itself. The last sixty-three years of China's development has run the gamut from state-planned economy to market economy and in the process has experienced changes to the law as it went from 'counting for little' to 'occupying a pivotal position'. Contract law changed from being a tool for carrying out the state-run economic plan to being a tool for private market subjects to pursue their own interests. Thus, the State changed its role from contract administrator to judge of market rules, and this reflects the greater changes taking place in Chinese society.

2. *Chinese Contract Law and Comparative Law*

This section will primarily focus on an analysis of the Contract Law of 1999. Preparations to draft a unified contract law in China began in 1993, after the amendment of the Law on Economic Contracts. Because the Contract Law of 1999 was a latecomer, there were many models for it to follow including both national laws (such as the BGB, the Civil Code of Japan and the Civil Code of France) and international conventions or model laws (such as the CISG, the Principles of International Commercial Contracts (PICC) and the Principles of European Contract Law (PECL)). Thus, it is a product of comparative law. However, there is little systematic comparative study on the Contract Law of 1999. This chapter will make a preliminary comparative analysis of the Contract Law of 1999 to show how comparative law affects it.

2.1. *Autonomous Legislation and References to Foreign Laws*

The Effects of Ideology

Domestic legislation is a matter which falls solely under the auspices of state sovereignty. In this regard, the PRC has exhibited a strong tendency toward independence and self-determination since its establishment. One example of this independence is the abolition of all Kuomintang legislation as fraudulently constituted authority (*weifatong* 伪法统). In China,

scholars usually use the term 'reception' instead of 'transplant' to express the lawmaker's adoption of a foreign legal rule as the former emphasizes the self-determination of the lawmaker.[15]

Private law legislation in China has a hundred years of history. At the beginning, the objects of reception were German, Japanese and Swiss private law, and the resulting legislation was the Civil Law which is still applied in Taiwan. For obvious political and ideological reasons, the second jurisprudence that influenced Chinese private law came from the former Soviet Union. In the third period of law reception during the 1980s, the civil laws of the Soviet Union and the Socialist countries of Eastern Europe became even more ingrained in Chinese law. However, since the 1990s Chinese law has been influenced by and developed out of exposure to multiple jurisprudential systems.[16] Ideology no longer seems to play a role for Chinese lawmakers in formulating law or in choosing foreign models to emulate. Indeed, even in the 1980s lawmakers followed two guidelines: consciousness of self-determination (*zizhu yishi* 自主意识) and selective borrowing (*nalai zhuyi* 拿来主义). Just as Mr. Peng Zhen, the former president of the Standing Committee of the NPC, said in May 1981:

> Our civil law is the PRC's civil law. It is neither the civil law of the Soviet Union or that of Eastern Europe, nor the private law of the UK, the USA, continental Europe or Japan. Where should our civil law come from? It should come from the practice and reality of China … As to foreign private laws, including civil laws of capitalism, civil laws of Socialism adopted in the Soviet Union and Eastern European countries, they are good models to be studied. They may provide many good experiences for us. We should borrow from them when good and useful.[17]

Four and a half years later, Mr. Peng Zhen emphasized again that

> foreign experiences, no matter from Socialist or capitalist countries, from Common Law or Civil Law countries, together with our history, should be referred to and borrowed by us. However, the borrowing work should not depart from the actual situation of our country … and the principle of 'discarding the dross and selecting the essence', so as to better serve our contemporary legislative work should be observed.[18]

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15 See Liang, Comments on China's Civil Legislation, 29.

16 Liang, Comments on China's Civil Legislation, 13-14.

17 See Zhen Peng, "Main Points of a Paper delivered at a Civil Law Symposium (27 May 1981)," People's Daily, 15 May 1986.

18 Zhen Peng, "Main Points of a Paper delivered at a Symposium on the Draft of General Principles of Civil Law (4 December 1984)," People's Daily, 15 May 1986.

Indirect Manifestation

Drafting legislation is different from academic work. In legislation pinpointing the origins of the various articles is not the habit. This also holds true for the PRC legislature. In order to bridge this gap, I will discuss some of the comparative law sources of the Contract Law of 1999 in the next part of this chapter.

2.2. *Roles of Civil Law, Common Law and International Conventions*

Civil Law as Structure (*ti* 体)

Legislative Technique

The Chinese Contract Law adopts a 'general-special' structure. As a legislative technique, the 'general-special' structure is very popular in civil law countries (such as Germany and Japan). The Contract Law also chooses 'contract' as its name, which contains strong generality. The Contract Law neither distinguishes civil contracts and commercial contracts (it regulates contracts of commission agency in Chapter 22) nor differentiates ordinary contracts and consumer contracts (it does not limit the application of rules on standard form contracts to consumer contracts). Although many scholars assume that in law the word 'contract' normally means a contract giving rise to obligations (*zaiquan hetong* 债权合同), the legislature, indeed, does not follow the German theory of *sachenrechtliche Rechtsgeschaefte*, which treats a transaction as involving three contracts. The transaction in the Contract Law is regarded as one contract; nonetheless, Chinese scholars have different views on this point.

The Contract Law not only stipulates a set of rules, but also provides some basic principles, such as equality of legal status (Article 3), freedom of contract (Article 4), the principle of fairness (Article 5), the principle of good faith (Article 6), public order and good morals (Article 7) and *pacta sunt servanda* (Article 8).[19] When no particular rule is applicable for a case, judges may make a judgment according to an appropriate principle. It is noteworthy that the principle of good faith plays an important role both in the law and in legal practice. Cases ruled in accordance with the principle of good faith can be found in the *Supreme*

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19 For a further analysis, see Wang and Xu, "Fundamental Principles of China's Contract Law," Columbia Journal of Asian Law 13 (1999): 1.

People's Court Gazette. They are divided into different types, for instance, a change of circumstances[20] and waiver.[21]

Rules and Institutions

Many civil law rules or institutions can be found in the Contract Law. These rules or institutions include *exceptio non adimpleti contractus* (Articles 66-69),[22] the creditor's right of subrogation (Article 73),[23] the creditor's right of revocation (*actio pauliana*, Articles 74-75),[24] pre-contractual obligations and *culpa in contrahendo* (Articles 42-43, 58),[25] ancillary obligations (*Nebenpflichten*, Article 60),[26] and post-contractual obligations (*nachvertragliche Nebenpflichten*, Article 92).

Common Law, the CISG and Model Laws as Substance (*yong* 用)

Common Law Influence: Why?

Firstly, it is true that the United States, as the most powerful common law jurisdiction, has a huge influence on the Chinese judicial system. In addition, compared with German, French, Japanese or Italian, the English language is much more popular in China and, thus, common law materials are easily accessible in law schools.

Examples of Common Law's Influence

Generally speaking, common law has a relatively weaker influence than civil law has in China. Nevertheless, one still can find rules in the Contract Law that are derived from common law systems, such as the rules on anticipatory breach of contract (Article 94(2) and Article 108,

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20 *Wuhan Gas Ltd v. Chongqing Checking Instrument Ltd* (*Wuhan shi mei qi gong si su Chongqing jian ce yi biao chang*) 1996 (2) Supreme People's Court Gazette 63-65; *Xinyu co. v. Feng Yumei* (*Xinyu gong si su Feng Yumei*) 2006 (6) Supreme People's Court Gazette 37-41.

21 *He Lihong v. China Life Insurance Company Ltd etc.* (*He Lihong su Zhongguo ren shou bao xian gu fen you xian gong si*) 2008 (8) Supreme People's Court Gazette 40-48.

22 Cf. BGB §§ 320-322; Japanese Civil Code Art. 533; Italian Civil Code Arts. 1460-1461; Taiwanese Civil Code Arts. 264-265; CISG Art. 71; PICC Art. 7.1.3.

23 Cf. Civil Code Art. 1166; Japanese Civil Code Art. 423; Taiwanese Civil Code Arts. 242-243.

24 Cf. Civil Code Art. 1167; Japanese Civil Code Arts. 424-425; Taiwanese Civil Code Art. 244.

25 Cf. Taiwanese Civil Code Art. 247; Italian Civil Code Arts. 1337-1338; PICC Art. 2.15.

26 Cf. BGB § 242; Italian Civil Code Arts 1176, 1374; PICC Art. 1.8, Arts. 5.2 and 5.5.

fundamental breach of contract (Article 94(4)), foreseeability of damages (Article 113(1)) and mitigation (Article 119).

Impact of the CISG, PICC and PECL

The impact of the CISG on the Contract Law can be found in aspects of the conclusion of the contract, termination, liabilities for breach (damages and price reduction), exemption and sales contracts (remedies for nonconformity, rules on risk).

Model laws such as PICC and PECL also influenced the Contract Law to some extent. Examples are liability for negotiations (*culpa in contrahendo*, Articles 42-43; PICC Article 2.15 and Article 2.16; PECL Article 2:301) and indirect agency (Articles 402 and 403; PECL Article 3:301).[27]

2.3. *Contract and Third Parties: Chinese Law and Comparative Law*

Following this overview of the Contract Law and its comparative laws, 'contract and third parties' will now be taken up as an example to further develop an analysis of the Contract Law.

The Contract Law follows the doctrine of privity of contract which can be inferred from Article 121. Nevertheless, sometimes a third party may be involved in contractual relationships. In this respect, Article 64 regulates a contract to be performed for the benefit of a third party,[28] while Article 65 addresses contracts that need to be performed by a third party.[29] If one looks at the words of the two articles, they are not in conflict with the doctrine of privity.

As far as Article 64 is concerned, one of the questions is whether the third party has a right to claim performance from the obligor. The question had been positively dealt with in the civil law draft of the 1950s where the drafters followed Article 140 of the Russian Civil Code of 1922. Similar provisions can also be found in some contract law drafts. However, in its final version the law is silent as to this question, thus making it a point of argument among scholars.[30] Giving fuel to the fire,

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27 For a further analysis, see Shiyuan Han, "European Contract Law, Chinese Contract Law and East Asian Contract Law," East Asian Law Journal 1, (2010): 146-147.

28 Cf. BGB §§ 328-335; Japanese Civil Code Arts. 537-539; UK The Contracts (Rights of Third Parties) Act 1999.

29 Cf. Swiss Law of Obligations Art. 111; Taiwanese Civil Code Art. 268.

30 Scholars may be divided into two groups. One group advocates that there is a gap in the law in Article 64 for not providing the third party with a right to performance. The second group takes the opposite position, insisting that Art. 64 gives the third party a right to performance even if this is not expressed explicitly in this article.

the Supreme People's Court in a judicial interpretation in 2009 made it clear that,

> [t]he People's Court may, as the case may be, list a third party as described in Articles 64 and 65 of the Contract Law as a third party without an independent right of claim, but shall not, ex officio, list such a third party as a defendant or a third party with an independent right of claim to the action.[31]

From foreign laws cited earlier in this chapter it is clear that the third party's right to performance is sustained.[32] Nonetheless, the Contract Law is not perfect as far as a third-party beneficiary contract is concerned.

2.4. *Summary: Hybrid Reception and Unified Interpretation*

From the above introduction, one can conclude that the Contract Law has the character of a hybrid, taking into consideration the civil law and the common law. Although the legislature has fulfilled its law-making mission, far more work is left to judges and scholars to deal with. They are asked to interpret the Contract Law in order to make it workable in practice. When there is only one foreign legal system from which rules have been adopted, the corresponding legal theories of that system may help the interpretation and application of the law. When there is a number of legal systems that have been used like in the drafting of the Contract Law, the use of the corresponding foreign doctrinal theories may be more difficult. Due to the uniqueness of the Chinese legal system, Chinese scholars still have a long way to go to create a unified interpretation of the Contract Law.

3. *Practice and New Developments of Chinese Contract Law*

To have a complete picture of Chinese contract law, it is necessary to discuss sources of law other than the Contract Law of 1999. Apart from the Contract Law, judicial interpretations made by the Supreme People's Court of the PRC are an important source of law in China.

3.1. *Judicial Interpretation I of the Contract Law*

On 1 December 1999, the Judicial Committee of the Supreme People's Court adopted and promulgated Interpretation I of the Supreme People's

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31 Art. 16 of Interpretation II of the Supreme People's Court on Several Issues concerning the Application of the Law of Contract of the People's Republic of China.

32 See *supra* note 28.

Court on Several Issues concerning the Application of the Contract Law of the People's Republic of China (hereafter 'Judicial Interpretation I'), which mainly focuses on the General Provisions of the Contract Law. The content of Judicial Interpretation I is as follows:

I. Scope of the Law (Articles 1-5)
II. Limitation of Actions (Articles 6-8)
III. Validity of Contracts (Articles 9-10)
IV. Right of Subrogation (Articles 11-22)
V. Right of Revocation (Articles 23-26)
VI. Third Party to the Transfer of Contract (Articles 27-29)
VII. Concurrence of Claims (Article 30)

The aim of Judicial Interpretation I is to better serve the application of the Contract Law. In the Contract Law, there are some newly established rules or institutions which are not covered by previous laws or administrative regulations. The creditor's right of subrogation and the right of revocation are two examples. The rule on the creditor's right of subrogation (Article 73 of the Contract Law) is aimed at coping with the 'triangular debts' (*sanjiaozhai* 三角债) problem in China. In addition, the rule concerning the creditor's right of revocation (Articles 74-75) is to provide a remedy against fraudulent conveyance. As most judges were not familiar with these rules, it was necessary for the Supreme People's Court to issue practical guidelines for them.

3.2. *Judicial Interpretation II of the Contract Law*

Ten years later, on 9 February 2009, the Judicial Committee of the Supreme People's Court adopted and promulgated Interpretation II of the Supreme People's Court on Several Issues concerning the Application of the Contract Law of the People's Republic of China (hereafter 'Judicial Interpretation II'). Similar to Judicial Interpretation I, Judicial Interpretation II mainly focuses on the General Provisions of the Contract Law and is composed of thirty articles. The content of Judicial Interpretation II is listed below:

I Conclusion of Contracts (Articles 1-8)
II. Validity of Contracts (Articles 9-15)
III. Performance of Contracts (Articles 16-21)
IV. Termination of Contractual Rights and Obligations (Articles 22-26)
V. Liability for Breach of Contract (Articles 27-29)
VI. Supplementary Provisions (Article 30)

It is noteworthy that in Judicial Interpretation II the Supreme People's Court not only made the rules of the law clear, but also gave a positive response to the requirements of reality as well as audaciously providing new rules for judges. One example is Article 26 of Judicial Interpretation II[33] in relation to a change of circumstances (*Wegfall der Geschaefts-grundlage*),[34] which is a positive response to the global financial crises of 2008. Other examples include Articles 20 and 21, which are concerned with the sequence of offset, and Article 15 relating to the effects of several sales contracts pertaining to the same subject matter. It is also worth noting that Article 15 should be a specific provision on contracts of sale; however, the way in which the Supreme People's Court issued Judicial Interpretation II, which concerns the General Provisions of the Contract Law, shows an intention to have the new rule made widely applicable, i.e. not limited to contracts of sale.

In many aspects, Judicial Interpretation II makes the provisions of the Contract Law clearer and more concrete. For instance, Article 14 provides the new phraseology 'mandatory provisions on effectiveness' concerning the effects of the illegality of a contract. Clearly, the draftsmen tried to divide the term 'mandatory provisions' as mentioned in subparagraph 5 of Article 52 of the Contract Law into two types, namely, 'provisions with an administrative aim' (*guanlixing guiding* 管理性规定) and 'provisions on effectiveness' (*xiaolixing guiding* 效力性规定).[35] Only the violation of the mandatory provision on effectiveness leads to the contract becoming void. Otherwise, the parties may still be responsible for the violation of a mandatory provision − but the contract will remain effective.

Another example is the interpretation of payments stipulated by the contract or penalty clauses (*weiyuejin* 违约金). With respect to the terminology, it should be noted that in this chapter expressions such as 'penalty clause' are used in the civil law sense (of a valid provision). However, in common law there is a distinction between penalty clause and

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33 Art. 26. When after the conclusion of a contract there is a serious change of objective circumstances, which was not foreseeable by the parties at the time of the conclusion of the contract, and which was not caused by *force majeure* and which should not be classified as a commercial risk, to continue to perform the contract will obviously be unfair for one party or will not achieve the purposes of the contract, and therefore that party may request the People's Court to modify or terminate the contract. The People's Court shall determine whether to modify or terminate the contract or not, according to the principle of fairness, and taking the circumstances of the case into consideration.

34 Cf. BGB § 313.

35 Deyong Shen and Xiaoming Xi (eds.), Understanding and Applying the Supreme People's Court's Judicial Interpretation II (Beijing: The People's Court Press, 2009), 110.

liquidated damages clause, it being that the former is normally invalid and the latter is *prima facie* valid.[36] This difference in terminology gave rise to some awkwardness in the preparation of this chapter. In China, the rule on penalty clauses is laid down in Article 114 of the Contract Law. In Chinese private law theories, penalty is divided into two categories, namely, 'compensatory penalty' and 'punitive penalty'. The former penalty aims at fixing in advance the damages payable in the event of default. The latter can be claimed together with performance or damages. Article 114 of the Contract Law puts the focus on compensatory penalties, but from the principle of freedom of contract follows that punitive penalties are also permitted by the Contract Law.[37] With respect to Article 114, Judicial Interpretation II provides three articles (Articles 27-29) which may be used for interpreting the Law of Contract. The most noteworthy is Article 29, which mainly deals with the reduction of the amount of the penalty. Article 29 makes two points clear, first, 'the losses caused by the breach', as mentioned in Article 114 of the Contract Law, refers to 'actual losses', which is the basis for judges to weigh a party's request. However, it is not the only factor that judges should take into account. When making a judgment, the judge shall also consider "the performance of contract, the seriousness of the fault of the party, the expected benefits and other important factors" as well as the principles of fairness and good faith (Article 29(1) of Judicial Interpretation II). Second, it provides a practicable and generally applicable standard for judges to determine whether to reduce the agreed amount of the penalty. The standard is the originally agreed amount of the penalty exceeding the losses incurred by 30 per cent (Article 29(2) of Judicial Interpretation II).

3.3. *Judicial Interpretations on the Special Part of the Contract Law*

Apart from the above-mentioned Judicial Interpretations, the Supreme People's Court has also promulgated Judicial Interpretations on the Special Part of the Contract Law. The most important ones are the *Interpretation of the Supreme People's Court on the Relevant Issues concerning the Application of Law for Trial of Cases concerning Disputes regarding Contracts for the Sale of Commodity Houses* (Interpretation 7 (2003)), *Interpretation of the Supreme People's Court on Issues concerning the Application of the Law for the Trial of Cases regarding*

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36 See Günter H. Treitel, Remedies for Breach of Contract (New York: Clarendon Press Oxford, 1988), 208.

37 Shiyuan Han, "Liabilities in the Contract Law of China: Their Mechanism and Points in Dispute," Frontiers of Law in China 1, (2006): 137-138.

Disputes concerning Contracts on Undertaking Construction Projects (Interpretation no. 14 (2004)) and *Interpretation of the Supreme People's Court on Several Issues concerning the Application of the Law for the Trial of Cases concerning Disputes Over Lease Contracts regarding Urban Buildings* (Interpretation No. 11 (2009)). It is said that, in addition to these, a Judicial Interpretation on sales contracts is in the process of being drafted.

4. *The Codification of Civil Law and Chinese Contract Law*

According to the legislation plan by the Chinese legislature, a legal system under a Socialist market economy should have been introduced by the end of 2010. This aim has been achieved. Since 1980, the legislature has followed a step-by-step approach in building up the civil law system. In the past thirty years, the law-making body promulgated the Marriage Law (1980, amended in 2001), the Succession Law (1985), the General Principles of Civil Law (1986), the Adoption Law (1991), the Guaranty Law (1995), the Contract Law (1999), Property Law (2007), Tort Liability Law (2009) and the Application of Laws to Civil Relations with Foreign Aspects (2010). The time has now come to draft a Civil Code for the PRC.

Today, the purpose, or purposes, of having a Civil Code in China is much different from that in France, Germany or Japan. In today's China, there is no need to draft a Civil Code to preserve the results of a revolution like that at the end of the eighteenth century in France. There is also no need to employ a Civil Code to realize *Ein Volk. Ein Reich. Ein Recht* (One People. One Empire. One Law),[38] as in Germany at the beginning of the twentieth century, nor is there a need to adopt a Civil Code to abolish the system of extraterritoriality as in Japan at the end of the nineteenth century. The main function of a Civil Code in China, as it seems to this author, is to perfect civil legislation, i.e. to rationalize, both outside and inside, Chinese civil law.

The rationalization of Chinese civil law requires an integration of the existing Chinese civil laws, including administrative regulations and judicial interpretations, into a systematic unity, and to eliminate conflicts between articles, rules and laws. As stated earlier, the existing civil laws were promulgated in a step-by-step approach over the past thirty-two years, during which the Chinese economy and society changed

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38 See Reinhard Zimmermann, "An Introduction to German Legal Culture (with special reference to private law)," in Introduction to German Law, ed. Werner F. Ebke and Matthew W. Finkin (The Hague: Kluwer Law International, 1996), 7.

dramatically. The Chinese people's knowledge and understanding of and desire for law have also changed. Legislation introduced in different periods may result in inconsistencies between one legislative act and another. One example is the Law on Property of 2007 which amended some provisions of the Guaranty Law of 1995; nevertheless, the latter has not yet been fully repealed. Besides, many rules in judicial interpretations, which are proved by practice to be suitable for China, need to be absorbed into legislation. As a result, a unified Civil Code will better serve China as a cornerstone of civil society and a market economy.

On the other hand, the aim of the rationalization of Chinese civil law is to improve the quality of civil legislation in the codification process. Undoubtedly, whether a piece of legislation is good or not has only a limited and relative meaning. For the Chinese people or Chinese society, upgrading the quality of civil legislation is a desirable aim. Here, one may use the Contract Law as an example. It should be noted that at present, the Contract Law is one of the best pieces of legislation among existing Chinese private laws. At the same time, one has to admit that, compared with the General Part of the Contract Law, the Special Part of the Law is weak and poorly drafted. One of the reasons may be that model laws for the Special Part were very limited in the 1990s. Currently, new model laws are becoming available in Europe, such as the DCFR[39] or the Principles of European Insurance Contract Law.[40] All these new progressive steps undoubtedly provide important references for China in preparing a Civil Code in the near future. This codification process is a golden chance and a critical method to raise the quality of Chinese contract law, especially the Special Part of it.

As mentioned above, one aim of the codification of Chinese civil laws is to realize the rationalization of these laws. Therefore, it is not necessary to preserve the Contract Law as a comparatively independent part inside the Civil Code. If logically needed, the Contract Law can be taken apart and introduced in the Civil Code. Nevertheless, a question arising here is whether a General Part of the Law of Obligations should be introduced in the Civil Code. This issue has already attracted hot discussion. A further question is, as it seems to this author, whether Chinese draftsmen are capable of preparing a satisfactory General Part of

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39 See Christian Von Bar, Eric Clive and Hans Schulte-Noelke, Draft Common Frame of Reference (DCFR), Outline Edition (Munich: Sellier. European Law Publisher, 2009).

40 Project Group 'Restatement of European Insurance Contract Law' (ed.), Principles of European Insurance Contract Law (PEICL) (Munich: Sellier. European Law Publisher, 2009).

the Law of Obligations in the Civil Code. At present, the studies on general theories of the law of obligations, especially on the plurality of parties, are far behind. Part III of PECL has provided model rules on this issue, and it may be used by Chinese draftsmen. Still, Chinese scholars are obliged to study this topic further, especially from a comparative perspective. Without sufficient preparation on legal theory, it will be unrealistic to expect there to be a satisfactory General Part of the Law of Obligations in the Civil Code of China.

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