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# Chinese Contract Law



香港公開大學  
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# Misc Information



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# LAW B844W

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# Chapter 1 General principles of contract law



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## Introduction

Welcome to *LAW B844W Chinese Contract Law*. It is a compulsory five-credit course in the Master of Laws in Chinese Business Law (LLM (Chinese Business Law)) programme. It gives you a thorough overview of the principles and practices of Chinese contract law, as well as its implications in business law.

In this course, we will discuss the basic structure of Chinese contract law, including the legislation known as the Contract Law of the People's Republic of China, and other related laws and regulations. Throughout the course, when we refer to 'the Contract Law' with an upper case 'C' and 'L' we mean the Contract Law of the People's Republic of China. The 'contract law' in small letters refers to the law relating to contracts in China generally. Through this course, you will gain a good grasp of the key concepts and principles of contract law from the perspective of business practice. Upon completion of this course, you should have developed the necessary analytical skills for resolving contract law issues in real life cases.

The hallmark of contract law in capitalist economies is the concept of **freedom of contract**. In this course, we will examine the interplay between this concept and the socialist market economy with Chinese characteristics.

In this first unit, we will examine the key concepts of the Chinese contract law together with some background information, including the characteristics of the system and its historical development and application. We will look at the legal concept of a contract and various approaches for defining a contract under law. We will also take a brief look at the scope of application of contract law in China.

There are a number of fundamental doctrines underlying Chinese contract law. These include principles such as equality, freedom of contract and good faith, and we will examine these in detail later in the unit. Following that, we will look at various ways of categorizing contracts, and the principles of interpretation of contractual terms.

Finally, we will discuss the two main policy considerations underlying the contract law. These are the policy to encourage transactions, and privity of contract.

In short, this unit:

- describes the historical development of Chinese contract law;
- analyses the general principle of contract law;
- illustrates the relationship between contract law and other related branches of law;
- assesses the scope of contract law;
- categorizes different forms of contract; and

- describes how to implement the principles of interpretation of terms of a contract.

## 1.1 Contract law: some background



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Before we launch into the main body of the unit, we will begin by thinking about contract law and its role in the market economy.

Contracts are at the core of the market economy. The reason for this is clear: business transactions are premised upon contractual relationships. The enforceability of contracts is a key to economic development. The market economy mechanism relies on the combined usage of capital and credit. The implementation of credit sales is effected by the contract law system. The fact that contracts are enforceable in a court of law makes credit sales possible. This unit will examine the background of the contract law system. One aspect we will not cover, however, is how different kinds of contractual arrangements affect transaction costs. This is a topic for the economists, and is out of the scope of this course.

As we think about the significance of contract law, it may be useful to consult the work of some well-known scholars. The first of these is the sociologist Max Weber.



**Figure 1.1 Max Weber**

According to Weber, one of the major characteristics of modern society is the process of rationalization. In other words, a task is achieved through a process broken down into a number of distinct and highly specialized rules. These rules are measured in terms of precise figures. Abstract adjectives such as 'basic' or 'good' are not helpful to rationalization.

To take an example, in modern accounting there is a process of breaking down accounts into balance sheets as well as profit and loss accounts. As a result of this process, the financial status of an enterprise can be expressed in terms of its assets and liabilities as well as profitability. This process is analogous to the use of contracts. Contracts are a rational means for managing future events. The breaking down of information into detailed clauses in a contract enables large-scale transactions to be made.

This explains why contracts occupy a prominent role as the infrastructure for the development of modern market economy. Some economists (for example, Cheung 1983) view the institution of 'company' or 'corporation' as a series of contractual arrangements.

By now, you may be under the impression that in modern society, commercial transactions are all based on contracts. Have contractual arrangements replaced the system of relationships based on personal connections and trust?

To answer this question, let's turn to another scholar, Stewart Macaulay. Macaulay, an American jurist, reminds us that the reality may be more complicated. In his essay, 'Non-contractual relations in business: a preliminary study', he reveals that in the 1950s, many business activities carried out in the US were non-contractually based. At that time, 75% of commercial disputes in the US were resolved through arbitration settlements (Bruce 1989, 644–61).

Later, Macneil, another American jurist, also pointed out in his work *The New Social Contract* (1981) that a majority of US commercial transactions were not transacted through discrete contracts between strangers, but rather through established relationships. He referred to these relationships as 'relational contracts.'

Avner Greif, an economist, made a historical study of the pre-modern European economy. He found that in the absence of a contract enforcement system, there was inter-community, impersonal exchange from as early as the 12th century in Europe, under an institution called the [Community Responsibility System](http://www.econ.stanford.edu/faculty/workp/swp97016.html) (<http://www.econ.stanford.edu/faculty/workp/swp97016.html>). Under this system, traders would belong to particular groups based on their social affiliation. Within these groups, contracts were often made and signed in the presence of witnesses. These groups also had the ability to impose sanctions on individual members. This guaranteed the fulfilment of the contractual obligations and promoted the economic development of credit transactions.

As we examine the findings of the scholars mentioned above, one thing is clear. In any society, interpersonal relationships are an important factor in commercial practice. In a long-term cooperative relationship between two commercial entities, if one party commits a breach, the other party may not hastily opt to resolve the dispute through litigation. The use of contracts is premised on the assumption that the other side is not completely reliable, for otherwise the contract becomes irrelevant in the commercial transaction.

## Activity 1.1

Imagine that you own a company and so does John, your friend. Your company has a long business relationship with John's company and both companies just carry out their respective obligations without entering into any contract. This time, you intend to make a transaction with John's company involving a large sum of money, and you wish to make a contract. In response, John says that it is a waste of time to draft any contract, as all along the parties have been dealing with each other based on personal trust and relationship. How would you respond to John's proposal?

Let's now take a brief look through history at the strategies used for resolving business disputes in the past. This can help us understand the evolution of contract

law. We will have a more thorough study of the historical development of contract law in the next section.

In the early stages of Western legal history, business disputes were resolved through specialized tribunals for merchants, and there was a time when courts of law competed with these tribunals. In England, the historical origin of many legal principles applicable to the sale of goods and negotiable instruments was 'the law merchant' (or *lex mercatoria*, to give it its Latin name). Towards the end of the Middle Ages, Italian merchants were influential, and the rules based on mercantile usage were better developed than those in England, which was relatively backward in terms of developing the legal framework for regulating commercial activities. The primary objective of the merchant rules developed in continental Europe was to ensure commercial disputes could be resolved expeditiously. In the early days of English trade, only smaller local commercial disputes were submitted to local courts in England, which dealt with them largely within the framework of the common law (Goode 2004, 5). Disputes involving transactions of a larger scale were submitted to the central courts, which were prepared to give decisions in accordance with the law merchant. In the early 17th century, common law judges gradually borrowed rules developed in the law merchant and integrated them into the common law as they became more experienced in handling such cases. By the 19th century, the law merchant was almost fully absorbed into the common law.

In the US, merchants had tried to avoid the time-consuming court procedures for resolving commercial disputes until the end of the 18th century. Similar to the situation in England, the outcome of the competition between courts of law and merchants' tribunals was that the customs of merchants were absorbed by judges and integrated into the common law.

The experience in Western jurisdictions shows that merchants' concern about their goodwill and long-term reputation, rather than the effectiveness of the court system, is probably the biggest driving force behind the enforceability of contracts. In China, however, business ethics have yet to be cultivated. The deterrent force of peer pressure on contract breakers remains to be seen. Coupled with the immature system of the enforcement of court judgments, it is hardly surprising that many commercial disputes in China are resolved by non-legal means.

In the next section of the unit, you will find out more about the key milestones in the historical development of Chinese contract law.

## 1.2 Historical development of Chinese contract law



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In this section, we will very briefly mention a few key milestones in the historical development of contract law in other jurisdictions before we discuss the history of contract law in China.



## 1.2.1 Historical developments in other jurisdictions



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The Code of Hammurabi, promulgated in about 1792 BC, contained a total of 282 articles, out of which 150 (representing more than 53%) provided for contractual relationships, including sales, leases, adoption and marriage. The Code of Hammurabi adopted the principle of fault liability, with a wide scope of application, through the implementation of strict formalism and a harsh enforcement mechanism.

### *Supplementary Information*

#### **Code of Hammurabi**

The Code of Hammurabi is one of the earliest written laws in human history. The Code was carved in black basalt columns, 2.25 meters in height, illustrating the exquisite scene of Apollo granting royalty to Hammurabi in the upper part and the Code carved in cuneiform writing in the lower part. At the beginning of the Code, Hammurabi cited his own merits, such as the construction of cities, palaces, canals, Temple land, pasture, offerings, and so on. Hammurabi also claimed in the preamble that enactment of the Code was to “*bring about the rule of righteousness in the land, to destroy the wicked and the evil-doers.*” The main body of code comes after the preamble.

Contract law was well developed in Roman Law. In *Ludwig Feuerbach and the End of German Classical Philosophy*, written in 1886, Frederick Engels commented that, “*Roman Law, the first world law of a commodity-producing society, with its unsurpassably fine elaboration of all the essential legal relations of simple commodity owners (of buyers and sellers, debtors and creditors, contracts, obligations, etc.), can be taken as the foundation.*”

Roman law for the first time distinguished breaches of contract from tortious acts. Prior to that, as in ancient Greece, non-performance was simply regarded as infringement. Various provisions of the Roman law have become the origin of modern contract law in Continental Europe, based on which the French Civil Code (*Code Civil des Français* 1804) and the German Civil Code (*Bürgerliches Gesetzbuch*) were drafted. The French Civil Code established for the first time the principle of *freedom of contract*, which has become the core principle of modern contract law.

In England, the principles of modern contract law were well developed in common law courts in the early 19th century. The first important treatise expounding the English law of contract was arguably John Powell's *Essay upon the Law of Contracts and Agreements*. The concept of freedom of contract, originating in the work of Adam Smith, was well summed up in the words of a judge in 1875 in the case of *Printing and Numerical Registering Co. v. Sampson* (1875) LR 19 Eq 462:

*If there is one thing more than another which public policy requires, it is that men of full age and competent understanding shall have the utmost liberty in contracting, and that their contracts, when entered into freely and voluntarily, shall be held sacred and shall be enforced by Courts of Justice. ”*

Legal recognition of the parties' freewill marked a significant milestone in the development of modern contract law. In the Middle Ages, the validity of a contract was premised on the notion of 'fair price,' meaning that the parties were required to enter into a contract at a 'reasonable price' as consideration, failing which the contract would be void. In the 19th century, the doctrine of freedom of contract was firmly established, and the courts no longer looked into the adequacy of the consideration when adjudicating the validity of a contract.

Contract law in the 19th century was developed against the backdrop of the rise of the free economy, while the contemporary trend is the emergence of the welfare state. Freedom of contract is now regulated for various reasons, such as the pursuit of social welfare, consumer safety and environmental protection. The interplay of these social factors and contractual freedom is unavoidably the subject of political and jurisprudential controversy.

Another contemporary trend is the internationalisation of contract law. As early as 1930, the International Institute for Unification of Private Law (UNIDROIT) embarked on the work of unifying the laws regarding the international sale of goods. In 1964, at the Hague Conference, the Uniform Law on International Sale of Goods and the Uniform Law on the Formation of Contract for International Sale of Goods were adopted. However, since these two conventions failed to achieve the objective of establishing a unified code on the international sale of goods, the United Nations International Trade Law Committee (UNCITRAL), on the basis of these two conventions, formulated in 1978 [the United Nations Convention on Contract for the International Sale of Goods \(CISG\)](http://www.cisg.law.pace.edu/cisg/biblio/bonell96.html) (<http://www.cisg.law.pace.edu/cisg/biblio/bonell96.html>), adopted in 1980 and effective from 1 January 1988. In May 1994, the Governing Council of the International Institute for the Unification of Private Law (UNIDROIT) gave its imprimatur to the publication of the Principles of International Commercial Contracts (hereinafter the UNIDROIT Principles). Meanwhile, the European Union has been actively formulating the uniform principles of European contract law. The Commission on European Contract Law made up of legal experts and academics from European Union member states has developed the Principles of European Contract Law (PECL).

### 1.2.2 Historical developments in China



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The existence of civil law in Imperial China (pre-1911) is debatable. Scholars such as Liang Chichao (梁啟超) and Wang Boqi (王伯琦) advocate that civil law, as opposed to criminal law, simply did not exist in Imperial China, whilst others such as Yang Honglie

(楊鴻烈) hold the opposite view. It is beyond dispute that no civil code ever existed in the history of Imperial China, but there was separate legislation on marriage and debt.

Towards the end of the history of Imperial China, in 1902, Emperor Guang Xu formed a team to draft a civil code modelled on the codes found in Continental Europe. The drafting process started in 1908 and was completed in 1910. It was known as the Draft Civil Law of Great Qing (《大清民律草案》). It was the first civil code in China's history, although in draft form. It was never enacted because the Qing Dynasty was overthrown shortly thereafter.

In April 1927 the National Government was established and in December 1928 the legislature (Legislative Yuan) was put in charge of the work of drafting the civil code. In January 1929, the Legislative Yuan set up the Drafting Committee of the Civil Code, and in February of the same year, it embarked on the compilation of the Civil Code. On 26 December 1930, the first civil code in China's history, entitled the Civil Law of the Republic of China (《中華民國民法》), was promulgated. It contained detailed provisions of the contract law.

After the establishment of the People's Republic of China in 1949, the Communist Party of China embarked on the drafting of a new civil code in 1954. The drafters completed the draft code in December 1956, but it was not enacted due to the anti-rightist movements and the Cultural Revolution. The political unrest halted in 1978. Instead of revisiting the old draft, China started all over again by enacting three pieces of legislation on contract law, that is, the Economic Contract Law in 1981, the Foreign Economic Contract Law in 1985 and the Technology Contract Law in 1987. You should note that the General Principles of Civil Law ('GPCL'), enacted in 1985, is not a civil code. It simply contains the 'general principles', as the title suggests. It is more like the introductory chapter of a civil code that is still in the drafting stage. The English version of GPCL can be found at [http://www.npc.gov.cn/englishnpc/Law/2007-12/12/content\\_1383941.htm](http://www.npc.gov.cn/englishnpc/Law/2007-12/12/content_1383941.htm)

The three pieces of legislation on contract law were not intended to be a comprehensive set. They were enacted piecemeal to solve the immediate needs of the economic reform starting from 1979. They contained contradictory provisions, and the scope of each of them overlapped. In 1993, the drafting process of a new Contract Law started, which was intended to replace the three pieces of legislation. It is believed that the drafters of the new Contract Law, consisting of many legal academics this time, had made extensive reference to various sources, such as the UNIDROIT Principles of International Commercial Contracts (PICC) (<http://www.unidroit.org/english/principles/contracts/main.htm>), the United Nations Convention on Contracts for International Sale of Goods (CISG) ([http://www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods.html)), the Principles of European Contract Law (PECL) ([http://frontpage.cbs.dk/law/commission\\_on\\_european\\_contract\\_law/](http://frontpage.cbs.dk/law/commission_on_european_contract_law/)), the civil codes of France and Germany, and the English common law. It was passed on 15 March 1999, effective 1 October 1999, and was supplemented by the Interpretation on Several Issues Regarding the Application of the Contract Law (1) (<http://www.sjzmbc.gov.cn/en/public/englishshow.jsp?id=20060904158511>) issued by the Supreme People's Court and some other judicial interpretations on technology contract and construction contract.

In this course, 'the Contract Law' refers to the Contract Law of the PRC promulgated in 1999. It has not been revised since then.

In this unit, we will refer to [the official English translation of the Contract Law \(http://tradeinservices.mofcom.gov.cn/en/b/1999-03-15/8371.shtml\)](http://tradeinservices.mofcom.gov.cn/en/b/1999-03-15/8371.shtml).

## Online discussion 1.1

At the drafting stage of the new Contract Law, it was proposed that the Technology Contract Law 1987 should be retained. Eventually it was superseded by the new Contract Law. Why do you think such a proposal was made? Why do you think it was finally rejected? Go to the course Discussion Board and discuss your response to this question with other students in this course.

## 1.3 Features of Chinese contract law



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In this section, we will discuss the features of Chinese contract law with reference to the legal concept of contracts in other jurisdictions.

### 1.3.1 The concept of a contract



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In traditional Continental civil law system, the two essential elements of a contract are the parties' intent and the expression of such intent by the parties. Article 1101 of the French Civil Code (*Code Civil des Français*) states: "A contract is an agreement by which one or several persons bind themselves, towards one or several others, to transfer, to do or not to do something". This reveals that the traditional civil law approaches the contract law from the perspective of the law of obligations.

The common law jurisdictions, on the other hand, view contract from a different perspective. According to the *Encyclopaedia Britannica*, a contract is "a promise enforceable by law." "The making of a contract requires the mutual assent of two or more persons ... If one of the parties fails to keep the promise, the other is entitled to legal recourse."

When the common law and Continental civil law definitions of contract are compared, the definition of contract in Continental civil law is more abstract. It is based on expression of the parties' intent (or translated as "expression of will"). The common law, on the other hand, defines it from the perspective of enforceability in a court of law. This reflects the pragmatic approach of the common law, a tradition that can also be seen in the common law of tort and other subjects.

The Chinese contract law follows the Continental civil law tradition. According to Article 2 of the Contract Law, a contract is "an agreement among natural persons, legal

*persons or other organizations as equal parties for the establishment, modification of a relationship involving the civil rights and obligations of such entities.”*

Apart from the term ‘contract,’ you may come across other related terms in Chinese contract law. We explore these briefly below.

### 1.3.1.1 Covenant



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In the past, a ‘covenant’ (契約) was an agreement under which the content of the expression of intent of the parties was antagonistic, whereas a ‘contract’ was an agreement under which the content of the expression of intent of the parties were consistent. Modern usage does not draw such a distinction. An agreement under which the content of the expression of intent of the parties is antagonistic is now also called a contract.

### 1.3.1.2 Multi-lateral act



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A ‘multi-lateral act’ is now an obsolete term. It simply means a multi party contract.

### 1.3.1.3 Unilateral act



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A unilateral act refers to an act that can be established by the expression of intent of a single party, without the assent of the other party, or without the existence of a counterpart. A contract is typically a bilateral act, which can only be established with the assent of two parties. We will discuss this further under ‘Advertisements of rewards’ below.

## 1.3.2 Advertisements of rewards



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Advertisements of rewards for the return of lost or stolen property are commonly regarded as offers at common law. This should be distinguished from advertisements intended to lead to the making of bilateral contracts (e.g. an advertisement of a supermarket offering to sell biscuits at a discount), which are not offers. What is the position of Chinese contract law? Please go through the following Case Study.

## Case Study 1.1

John asks Peter to take delivery of certain goods on his behalf, and gives Peter the cargo receipt. Peter takes away the cargo receipt and puts it in a bag, but he forgets the bag when he goes to his office by bus. Mary sees the bag being left on a seat of the bus and takes it away.

Peter later places a reward advertisement in the newspaper: 'Anyone who returns the bag will be awarded \$15,000.' Mary reads the advertisement and returns the bag to Peter. Do you think the advertisement constitutes a valid offer in Chinese law?

In Chinese law, a reward advertisement is a unilateral juristic act. [Article 57 of the General Principles of Civil Law](http://www.npc.gov.cn/englishnpc/Law/2007-12/12/content_1383941.htm) ([http://www.npc.gov.cn/englishnpc/Law/2007-12/12/content\\_1383941.htm](http://www.npc.gov.cn/englishnpc/Law/2007-12/12/content_1383941.htm)) provides: *"A civil justice act shall be legally binding once it is instituted. The actor shall not alter or rescind his act except in accordance with the law or with the other party's consent."* In the above example, the offer is valid, and Peter is bound to pay the reward of \$15,000.

Article 112 of the Property Law (also translated as the 'Real Right Law' (<http://tradeinsecurities.mofcom.gov.cn/en/b/2007-03-16/8379.shtml>)) confirms the validity of advertisements of rewards: The right holder of the object, when obtaining a lost-and-found object, shall pay the person who finds the object or the related department such necessary expenses as the cost for safekeeping the object. Where a right holder promises to offer a reward for finding the object, he shall, when claiming the object, perform the obligation of granting the reward. Where the person who finds the object misappropriates the lost object, he/she shall be deprived of the right to ask for paying the expenses he/she has paid for safekeeping the object or require the holder to perform the obligation as promised.

It is important to know whether an advertisement of rewards constitutes a unilateral juristic act or a contract in Chinese law for the following reasons:

- In the above example, assuming that Mary is not aware of the advertisement, will she be entitled to the reward? If the advertisement constitutes a contract, Mary will be entitled to the reward only if she reads the newspaper before she returns the lost property. On the other hand, if it is a unilateral juristic act, she will be entitled to the reward regardless of her knowledge of the advertisement.
- If Mary is of limited civil capacity, say a child of 6, will she be entitled to the reward? If the advertisement constitutes a contract, she will not be entitled to it, because she has no sufficient civil capacity to enter into a contract. However, if it is a unilateral juristic act, she is arguably entitled to the reward.

An advertisement of rewards is generally regarded as a unilateral juristic act in China.

## Self-test 1.1

A notice is placed at the entrance of a shopping mall:

Lucky draw:

Any single purchase of every \$1,000 is entitled to one lucky draw ticket.

First prize: \$30,000.

Second prize: \$20,000.

Ann does not see the notice before she buys a notebook computer for \$10,000 at the shopping mall. When she is about to leave the shop, she is given 10 lucky draw tickets. She opens one of the tickets and finds that she has won first prize. The shopping mall refuses to give the prize to her, alleging that there is no valid contract between the shopping mall and Ann. Please discuss.

### 1.3.3 Approaches for defining contracts



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A contract requires the consensual expression of intent by the parties. However, not all consensual acts constitute contracts. Please go through the following Case Study.

## Case Study 1.2

### The 'kow-tow' case

Judgment of the people's court in Bishan County Chongqing Municipality dated 8 November 2000

(Published [here](http://vip.chinalawinfo.com/Case/displaycontent.asp?Gid=117466384) (<http://vip.chinalawinfo.com/Case/displaycontent.asp?Gid=117466384>))

The defendant built a pile of sand in front of the claimant's restaurant, causing prejudice to the claimant's business. The claimant complained about the defendant's conduct. The defendant went to the claimant's restaurant in a luxurious car. The claimant asked the defendant to remove the pile of sand. The defendant refused, making rude comments. The claimant said, 'You own a luxurious car, so what?' The defendant took over the conversation, 'If you greet me as gandie and kow-tow, I will give you the car.' Hearing this, the claimant immediately performed a kow-tow and called him gandie. The defendant refused to give the car to him as promised. The claimant commenced legal proceedings against the defendant.

Do you think that the defendant's promise constitutes a valid contract of gift?



It was held that by asking the claimant to greet him as gandie and kowtow, the defendant's intent was just to embarrass the claimant. However, the claimant's conduct was also in lack of good faith. As the defendant did not deliver possession of the car to the claimant, nor did he register the transfer, the alleged contract of gift between the parties was invalid. In accordance with article 55 of the General Principles of Civil Law, and articles 5, 186 and 187 of the Contract Law, the claimant's claim was dismissed. Obviously the parties did not intend to create any contract in such circumstances.

There are two essential elements of a contract under Chinese law: (1) an expression of intent; (2) the expression of intent having legal significance. A simple test is whether the act is embodied with civil rights and obligations. At common law, the equivalent question is whether there is any intention to create legal relations.

At common law, consideration is an essential element of a contract, but there is no equivalent concept in Chinese law. In Case Study above, assuming that common law applied, the court would have held that the promise did not constitute a contract due to the lack of consideration. In Chinese law, on the contrary, the court has to rely on the ground of lack of expression of intent with legal significance.

## Activity 1.2

Five persons enter into an agreement that each of them will buy a lottery ticket every day by rotation with a fixed set of numbers. One day, it is Peter's turn to buy the lottery ticket, but he forgets. It turns out that the winning numbers are those they have chosen. The other four sue Peter for compensation.

Is Peter liable to compensate the other lottery group members?

## Self-test 1.2

David invites Mary to watch a movie together. Mary accepts, but does not turn up. David feels sad, and goes to a pub to drink. When he returns home, he is so drunk that he drives in the wrong lane and is seriously injured. He sues Mary for damages, including medical expenses and damage to his car. Do you think his claim will be upheld? Please explain.

## 1.4 Application of contract law



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In comparison with the old laws, the Contract Law enacted in 1999 has a wide scope of application.



## Activity 1.3

Is the Contract Law applicable to the following circumstances?

1. an agreement for marriage
2. the county government promises to award \$100,000 to a company as a gift if it agrees to pay business tax of \$1 million
3. an agreement to mortgage a property
4. tender
5. the state enters into an agreement for disposal of certain assets for public interest.

### 1.4.1 Marriage and other personal relationships



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Article 2 of the Contract Law provides, “A contract in this Law refers to an agreement among natural persons, legal persons or other organizations as equal parties for the establishment, modification of a relationship involving the civil rights and obligations of such entities.” It further provides that “agreements concerning personal relationships such as marriage, adoption, guardianship, etc. shall be governed by the provisions in other laws.” Hence, the Contract Law only regulates contractual relationship relating to personal property as opposed to personal relationships.

### 1.4.2 Contracts between state and business



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Are contracts between the state and the business sectors subject to the Contract Law? We must look at the transaction in question. As a general rule, if the state enters into a transaction with an enterprise on an equal basis, that means the state does not exercise its sovereignty as a state, but rather as an entity in the private law regime, the Contract Law applies. Hence, the example in item (5) of the above Activity is governed by the Contract Law. However, item (2) is an administrative act of the government, which is not governed by the Contract Law. As to why the Chinese government is allowed to make a ‘gift’ on condition of a certain amount of tax payment is outside the scope of this course.

In China, there is also a broad range of administrative contracts, such as contracts awarded through tender for government procurement, and other special procedures, such as state-owned land use right transfer contracts, contracts for public works, executive employment contracts, and so on. The state-owned land use right transfer contracts, for example, are granted in order to achieve the national land policy; the performance of such contracts is subject to the command and supervision of the land administrative authorities with respect to the land use, duration of the grant and so on, any breach of which would be susceptible to penalties imposed by the authorities.

With respect to this type of contract, where there is a specific law or regulation, the special law prevails, but in the absence of any specific law or regulation governing such contracts, the Contract Law applies. Examples of such specific laws and administrative regulations are, among others, the Law on Administration of the Urban Real Estate (《中華人民共和國城市地產管理法》), Interim Regulations Concerning the Assignment and Transfer of the Rights to the Use of the State-owned Land in the Urban Areas (《城鎮國有土地使用權出讓和轉讓暫行條例》), Provisions on the Assignment of State-owned Construction Land Use Right through Bid Invitation, Auction and Quotation (《招標拍賣掛牌出讓國有建設用地使用權規定》).

### 1.4.3 Contract law and property law



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The newly enacted Property Law refers to various types of contracts, such as contracted management of land, contracts on transfer of the right to use construction land, easement contracts, security contracts, mortgage contracts, contracts on pledge rights, etc. These contracts are in principle governed by the Contract Law, save for the contracts relating to state-owned land, which are subject to the specific laws mentioned in the previous section. In practice, business entities often deal with collective and rural enterprises and we will give a brief account of these issues below.

Article 19 of the Law on Land Contract in Rural Areas ([http://www.gov.cn/english/laws/2005-10/09/content\\_75300.htm](http://www.gov.cn/english/laws/2005-10/09/content_75300.htm)) provides that land shall be contracted out in accordance with the following procedures:

1. a contract-working team shall be elected by the villagers assembly of the collective economic organization concerned;
2. the contract-working team shall, in accordance with the provisions of laws and administrative rules and regulations, draw up and announce its contracting plan;
3. convening, according to law, the villagers assembly of the collective economic organization concerned to adopt the contracting plan through discussion;
4. making known to the public arrangements for the implementation of the contracting plan; and
5. concluding the contract.

The contractor of a household contract shall be the peasant household of the collective economic organization concerned. Article 48 of the Law provides that, where the party giving out contracts gives out the contracts for rural land to units or individuals other than the ones of the collective economic organization concerned, the matter shall first be subject to consent by not less than two-thirds of the members of the villagers assembly, or of the villagers' representatives, of the collective economic organization concerned and it shall be submitted to the township (town) people's government for approval.

In case of dispute, article 56 provides that, where a party fails to perform the obligations in a contract or the obligations it performs are at variance with the ones agreed upon, it shall, in accordance with the Contract Law, bear responsibility for breach of the contract.

### 1.4.4 Contracts awarded through bidding



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In China, the three competitive ways to procure a contract are: (1) bid invitation (tender); (2) auction; and (3) quotation.

Bid invitation refers to the bidding process which involves the release of the bid invitation notice, inviting specific or non-specific natural persons, legal persons and other organizations to participate in the bidding and determines the award of contracts according to the bidding results.

Auction refers to the bidding process involving the issue of the auction notice, pursuant to which the competitive buyers conduct open price competition at a designated time and place, and the contracts will be awarded according to the results of price competition.

In China, there is another bidding process for “*assignment of state-owned construction land use right through quotation*,” pursuant to which the assignor releases the quotation notice, lists and announces the trading terms about the land for assignment at a designated land exchange within the term specified in the notice, accepts the quotations of competitive buyers and updates the quotation, and determines the holder of state-owned construction land use rights according to the quotation results at the expiry time for quotation or the onsite quotation results.

This bidding process by ‘quotation’ is devised by reference to competitive contracting for securities transactions that embodies the advantages of bidding by invitation or auction: firstly, the listing for specific times is conducive to rational decision-making of investors; secondly, it is a user-friendly method that is easy to carry out; thirdly, the method is conducive to the formation and operation of the land market.

#### ***Link to Supplementary Information***

Provisions on the Assignment of State-owned Construction Land Use Right through Bid Invitation, Auction and Quotation (Published [here \(http://faolex.fao.org/docs/texts/chn74998E.doc\)](http://faolex.fao.org/docs/texts/chn74998E.doc)):

Article 18. The quotation term shall be no less than ten working days. The margin of price rise may be adjusted according to the prices offered by competitive buyers during the period of quotation.

Article 19. The termination of quotation shall be decided by the quotation presider. Upon expiry of the quotation term, the quotation presider shall announce the highest quotation and the quoter on the scene, and inquire about whether the competitive buyers would like to continue the price competition. Where there is any competitive buyer who shows any intent to continue the price competition, the assignment through quotation shall be turned into the onsite price competition, and the winner shall be determined through onsite price competition. If the quotation presider calls out a highest price for consecutive three times, and there is no buyer willing to continue the price competition, whether the transaction has been stricken shall be determined according to the following provisions:

If there is only one buyer for quotation within the quotation term, its quotation is not lower than the base price and it complies with other requirements, the quotation transaction is stricken;

If there are two or more competitive buyers for quotation within the quotation term, the quoter offering the highest price shall be the winner; and if their prices are the same, the quoter offering the quotation at first shall be the winner, unless its quotation is less than the base price; and

If there is no respondent within the quotation term, the price offered by competitive buyers is lower than the base price, or no quoter complies with other requirements, the quotation transaction is not stricken.

Contracts awarded through the process of bid invitation, auction or quotation are subject to regulation by the Contract Law, save for the procedures for awarding the contracts. [Article 43 of the Government Procurement Law \(http://www.gov.cn/english/laws/2005-10/08/content\\_75023.htm\)](http://www.gov.cn/english/laws/2005-10/08/content_75023.htm) provides that the Contract Law is applicable to government procurement contracts. The rights and obligations of the procuring entity and the supplier respectively shall, “*on the principle of equality and voluntariness,*” be agreed on in a contract.

### Case Study 1.3

Source: [http://www.zjyl120.com/ac\\_huangye/qt/2007/5/2007051622291379726.html](http://www.zjyl120.com/ac_huangye/qt/2007/5/2007051622291379726.html)

At 5 am on 30 October 2004, Mr Yang called the emergency hotline, 120, asking for ambulance service for his wife. He waited for an ambulance for 15 minutes, but in vain. He took his wife to the hospital by taxi, but she was certified dead on arrival. It was later found that the ambulance had not departed at all. Mr Yang’s home was only 1.3 km away from the hospital (where the ambulance was).

The hospital’s position was that there is no law or regulation requiring that the ambulance should depart or arrive within a specified time. The patient died as a result of her own physical condition, for which the hospital should not be liable. On the other hand, Mr Yang’s position was that a contract existed at the time the hotline accepted Mr Yang’s request. If the ambulance did not arrive within a reasonable time, the contract would have been breached and the hospital should be liable for compensation.

Which view do you think is correct?

At common law, the above dispute would fall within the scope of the law of tort. Under Chinese law, however, the hospital is liable for breach of contract. According to the State Medical Service Regulation, emergency hotline 120 is established by the government to undertake the obligation of providing public medical services. A legal obligation thus arises when the hospital receives the phone call. Hence, a contract was created at the time when the hospital replied to Mr Yang that ‘the ambulance will arrive soon.’

As the hospital is subject to the State Medical Service Regulation, it would be liable even if it simply rejected the request.

### Self-test 1.3

Shaw and three of his friends, all laid-off workers in Beijing, decided to contract a piece of rural land in Liaoning Province to cultivate organic vegetables. When they expressed their proposal to the local township government, the government officials, who showed support to their project, warmly received them. In view of the land being vacant, the officer in charge of the village committee and the secretary decided to contract out 20 acres of land to them for cultivation. The officer in charge of the village committee represented the village committee to sign the contract giving out the rural land to Shaw and his three friends to plant vegetables. A year later, many migrant workers returned to the village to start their own businesses. When they learnt that the rural land was contracted out to outsiders, they felt aggrieved and damaged Shaw's crop, and requested the village committee to discharge the contract with Shaw and others.

Do you think that the villagers' claim of discharging the contract has merit? Why or why not?

## 1.5 Sources of contract law



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At common law, contract law is mainly case law. In most jurisdictions, contract law is not codified, with the notable exception of India. In the realm of sale of goods, the laws in many common law jurisdictions are codified, e.g. the Sale of Goods Act in the UK and the Uniform Commercial Code in the US, but their application is restricted to contracts for sale of goods, rather than contracts generally.

In Continental civil law jurisdictions such as Germany, Japan, France, Switzerland and Italy, the contract law is found within the civil code or the code of obligations. Contract law, tort law and the law of unjust enrichment are all regarded as part of the law of obligations.

At the time of writing, China's civil code is still in the drafting stage. The General Principles of Civil Law and the Contract Law remain the sources of Chinese contract law. In addition, the Sino-foreign Equity Joint Venture Law and the Sino-Foreign Cooperative Joint Venture Law contain specific provisions on Sino-foreign joint venture contracts.

Administrative rules and regulations also constitute sources of the Chinese contract law. Furthermore, according to article 125 of the Contract Law, 'transaction practices' may also be the sources of contract law.

## 1.6 Doctrines of contract law



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The fundamental doctrines of Chinese contract law are set out in articles 3 to 7 of the Contract Law. They serve as the guidance for legislation and judicial interpretation of the relevant legislative provisions. They are the principles of equality, freedom of contract, good faith, *pacta sunt servanda* (Latin, meaning ‘agreements must be kept’), public policy and so on. We will discuss these doctrines in this section.

### 1.6.1 Freedom of contract



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Freedom of contract is a borrowed concept. China did not accept it in the planned economy era. In the light of such historical background, it is not difficult to understand why the draftsmen sought to declare it expressly in the Contract Law. Legal textbooks on contract law published in China often devote a substantive part of the introductory chapter to discussing the justification for this concept.

#### ***Link to Supplementary Information***

#### **Freedom of contract**

It is interesting to see the way in which Chinese academics explain the concept of freedom of contract to students. The following is a typical one.

Freedom of contract is the core principle of the modern civil law and contract law. Contractual obligations are self-imposed. People are free to make any promise they wish, or refrain from making any promise they do not wish. Hence, individuals should be free to prescribe the scope and content of the contracts they make. This is the underlying justification for the doctrine of freedom of contract. Intrinsic in the doctrine of freedom of contract is that, so long as it does not violate the law and is not against the public interest, a contract reached by the parties is legally binding and has the force of law and it should be recognized by law and be enforceable in court. The doctrine is entirely consistent with the classical essence of a free economy, as Adam Smith advocated that, “Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way, and to bring both his industry and capital into competition with those of any other man, or order of men.” (Source: [http://www.archive.org/stream/adamsmithmoderns00smaluoft/adamsmithmoderns00smaluoft\\_djvu.txt](http://www.archive.org/stream/adamsmithmoderns00smaluoft/adamsmithmoderns00smaluoft_djvu.txt))

The doctrine can be found in article 1134 of the French Civil Code: “*Agreements lawfully entered into take the place of the law for those who have made them. They may be revoked only by mutual consent, or for causes authorized by law. They must be performed in good faith.*”

The classic exposition of the dichotomy between private and public rights is that for private persons, they may do anything they choose which the law does not prohibit,

while for public bodies the rule is the opposite, such that any action to be taken must be justified or authorized by positive law. The doctrine of freedom of contract as expressed in terms of the freedom to enter into contract, freedom to choose contractual parties and freedom to decide the content and the form of contract is exactly an application of the principle of private law autonomy.

The doctrine of freedom of contract presumes that an individual is the 'legislator' of his own interests. Respecting the contract means respecting the laws. Based on this principle, an individual can establish rights and obligations in the realm of civil law according to his own will. This concept is premised on dividing a human society into three spheres, namely, the state, the society and the individual. The individual sphere is free from interference by the state or the society. Within this sphere, an individual has absolute freedom to act, for otherwise, a society could not exist. Freedom is a birthright of the individual; unless expressly restricted by law, an individual's freedom should not be restricted.

The essential elements of the doctrine of freedom of contract under Chinese law include: (1) the freedom to make a contract or not to make any contract; (2) the freedom to choose with whom one should contract; (3) the freedom to decide the contents of the contract; (4) the freedom to decide the mode in which the contract is to be made; and (5) the freedom to decide the dispute resolution mechanism to be stipulated into the contract.

The freedom of contract is often subject to various restrictions, for example:

- **Mandatory obligations:** In order to safeguard the legal interests and social and public interests of vulnerable groups, the contracting parties are sometimes required to observe certain mandatory obligations. For example, public utilities in China, such as water supply, electricity, gas, public transport, are prohibited from refusing consumers' offers.
- **Standard form contracts:** The use of standard form contracts by business operators greatly restricts the choice of customers, who are in the weaker bargaining position. Most service providers such as banks, telecommunications operators and insurance companies insist on adopting pre-printed standard form contracts. The inequality in bargaining power is adjusted by legislation.
- **Protection of vulnerable groups generally:** The typical example is consumers and employees (see, for example, the Consumer Protection Law, the Labour Law and the Labour Contract Law).

## Online discussion 1.2

### Freedom of contract

Modern contract law was created in the 19th century as an affirmation of the concept of freedom of contract. In recent years, legislators have been creating laws to restrict freedom, particularly in the areas of consumer protection and labour law. Where should we draw the line? Please express your view.



## 1.6.2 Pacta sunt servanda



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Once a contract is formed, the parties must strictly observe and comply with the contract. This doctrine is known as *pacta sunt servanda* (Latin) meaning that 'agreements must be kept'. Article 8(1) of the Contract Law provides that a lawfully established contract shall be legally binding on the parties thereto, who shall each perform its own obligations in accordance with the terms of the contract, and no party shall unilaterally modify or terminate the contract.

The doctrine of *pacta sunt servanda* is linked together with the doctrine of freedom of contract. In ancient times, contracts were enforced in a harsh manner. When a debtor failed to perform his contractual obligations, he would become a slave of creditors, or would even be killed. In the Middle Ages, breach of contract was regarded as a religious offence that signified a major issue of conscience.

In modern times, a person will not assume liabilities that affect his personal liberty for failing to perform a contract; for example, a debtor is not imprisoned for default in repaying a debt. The consequence for nonpayment is limited to monetary compensation. The basis for *pacta sunt servanda* is the social contract theory. The three natural laws advocated by David Hume are: stability of private property; transfer of property only by consent; and *pacta sunt servanda*. Thomas Hobbes also believes "that every man, ought to endeavour Peace, as far as he has hope in obtaining it; and when he cannot obtain it, that he may seek, and use, all helps, and advantages of Warre." A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences.

In modern contract law, one significant principle that erodes the doctrine of *pacta sunt servanda* is the so-called *clausula rebus sic stantibus*, i.e. the doctrine of fundamental change of circumstances. The doctrine of fundamental change of circumstances refers to the situation where a contract, once validly established, is rendered incapable of performance by a party due to a unforeseen fundamental change in circumstances beyond his control that upsets the common basis for the transaction envisaged by the contract such that it becomes obviously unfair for that party to continue the contract. The party adversely affected by the fundamental change in circumstances may then apply to court or an arbitral body to vary or discharge the contract. The doctrine has gained international recognition. Article 79(1) of the [United Nations Convention on Contracts for the International Sale of Goods \(CISG\)](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html) ([http://www.uncitral.org/uncitral/en/uncitral\\_texts/sale\\_goods/1980CISG.html](http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html)) states:



*A party is not liable for a failure to perform any of his obligations if he proves that the failure was due to an impediment beyond his control and that he could not reasonably be expected to have taken the impediment into account at the time of the conclusion of the contract or to have avoided or overcome it or its consequences. ”*

At common law, this is known as ‘frustration.’

The crucial rule for applying this doctrine is to judge the change of circumstances, including changes in political, economic or other circumstances. These may include changes in law, government policy, currency exchange, market conditions and so on. Only extraordinary and unforeseeable changes beyond the control of the parties are included. For example, when we refer to the issue of currency, normal fluctuation of the currency exchange rate is not regarded as changes of circumstances for such purposes.

The rationale for this doctrine is to avoid unfairness resulting from events beyond the parties’ control. The legal may include: (1) modification or renegotiation, also known as the ‘obligation to renegotiate,’ where the affected party has the right to request the other party to renegotiate the terms of the contract; and (2) discharge of contract. The former is the preferred option, because the law tries to maintain the parties’ existing legal relationship if possible.

At present, the Contract Law of the PRC does not incorporate the doctrine of fundamental change. Article 27(1) of the Economic Contract Law (1981, now repealed) included this doctrine, but it was repealed in the 1993 version. During the drafting stage of the Contract Law in the 1990s, the doctrine of fundamental change of circumstances was included in the first four versions of the bill, but was deleted from the final draft, on the ground that the ‘legal system’ (probably referring to the quality of the judiciary) was not mature enough to distinguish change of circumstances and commercial risk. However, there are cases where the people’s courts adopted the concept in judicial practice. See, for example, articles 4 and 7 of the Interpretations of the Supreme People’s Court on Some Issues Trial of Disputes Relating to Rural Household Contracts (《關於審理農村承包合同糾紛案件若干問題的意見》), where the concept was for the first time applied in China.

## Example 1.1

### Application of the Doctrine of Fundamental Change of Circumstances

Supreme People's Court's Reply on Some Issues concerning the Application of Laws for the Trial of Disputes Arising the Gas Meter Assembly Line Detection Technology Transfer Contract and the Sale and Purchase of Gas Meter Parts Contract between Wuhan City Gas Company and Chongqing Gas Meter Factory (《最高人民法院關於武漢市煤氣公司訴重慶檢測儀錶廠煤氣表裝配線技術轉讓合同購銷煤氣表散件合同糾紛一案適用法律問題的函》) (March 1992)

This case involved two separate contracts. The Gas Meter Assembly Line Detection Technology Transfer Contract was entered into between Wuhan City Gas Company and Chongqing Gas Meter Factory. The unforeseeable event in this case was the unexpected rise of the state-set price (the price ranged stipulated by the government) of aluminium ingot (the major raw material production of gas metre parts) from 4400-4600 yuan per ton, to 6600 yuan per ton, and the corresponding price of aluminium shell from 23.085 yuan per set to 41 yuan per set. Under item (4) of article 27(1) of the Economic Contract Law (now repealed), it was held by the court that if Chongqing Factory were required to supply the contracted gas meter parts at the original contract price, it would result in 'obvious unfairness.' Hence, the Supreme People's Court directed the lower court hearing the subject case that the trial judge should exercise discretionary power to alter the terms of the contract in a fair and reasonable manner.

### 1.6.3 Doctrine of good faith



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'Good faith,' or *bona fide*, is the highest principle in Continental civil law system. Article 6 of the Chinese Contract Law provides that 'the parties shall observe the principle of honesty and good faith in exercising their rights and performing their obligations.'

The doctrine of good faith is applicable in a wide range of transactions, such as gifts, leasing and letting. It is considered crucial in enhancing business ethics. Its two basic functions are: (1) to guide the parties to act honestly in commercial transactions; and (2) to give the necessary discretionary power to the judges.

This doctrine aims to balance the interests between the parties, as well as interests of the parties and the society at large. When applied between the parties, it requires them to respect each other. As regards the society at large, it prevents the parties from prejudicing public interest. It not only balances the interest between the parties, but also safeguards the social interest, such that the market can operate in an orderly

manner. The doctrine of good faith is considered in line with the highest ideals of human society.

The following points should be noted from a Chinese law perspective:

- The doctrine of good faith is used to justify 'pre-contractual obligations', i.e. the obligations accrued during the negotiation stage even though the contract is not made eventually, on the ground that the parties should act in good faith at that stage. Article 42 of the Contract Law provides that the party shall be liable for damages if it is under one of the following circumstances in negotiating a contract that causes damage to the other party: *"(1) pretending to conclude a contract, and negotiating in bad faith; (2) deliberately concealing important facts relating to the conclusion of the contract or providing false information; (3) performing other acts which violate the principle of good faith."* Article 43 of the Contract Law prohibits the disclosure or use of any trade secret learned during negotiation.
- The doctrine of good faith imposes collateral obligations on the parties, i.e. the obligations that are not explicitly stated in the contract or otherwise agreed by the parties, and are undertaken by the parties, on the basis of the doctrine of good faith in accordance with the nature and purpose of the contract and the transaction practice, for advancing the objectives of the contract and protecting the legitimate interest of the parties. Article 60 of the Contract Law provides: *"Each party shall fully perform its own obligations as agreed upon. The parties shall abide by the principle of good faith, and perform obligations of notification, assistance, and confidentiality, etc. in accordance with the nature and purpose of the contract and the transaction practice."* These are known as 'collateral' obligations. They are not contractual obligations, but are collateral to the principal obligations, such as the duty of confidence, the duty of notification, etc. For example, A sells a mobile phone set to B, but they do not expressly talk about the user's manual. However, based on the principle of good faith, it is arguable that A has the obligation to provide the user's manual to B.
- The doctrine imposes post-contractual obligations: Article 92 of the Contract Law provides that after the termination of the rights and obligations under the contract, the parties shall observe the principle of honesty and good faith and perform the obligations of notification, assistance and confidentiality in accordance with relevant transaction practices. It refers to the obligations undertaken by the parties after expiry of the contract to protect the legitimate interests of the other party, such as the covenant of confidentiality, non-competition clause, and so on.

The doctrine of good faith is also embodied in the rules governing breach of contract and interpretation of contract.

## Case Study 1.4

### Application of the doctrine of good faith to a leasing contract

A as lessor rents a shop to B as lessee. They agree that A shall provide the 'necessary approval' for B to apply to the government authorities for the licence for renovation and business operation. A fails to provide a permit issued by the government, and simply writes a letter purportedly permitting B to start the renovation work and the business operation, arguing that 'necessary approval' can mean the lessor's approval.

Do you think A's argument is justified?

Under Chinese contract law, the purposive interpretation of the contract, based on the principle of good faith, requires that the term 'necessary approval' be interpreted to mean the necessary government's approval. A's argument would not be accepted by the court.

### 1.6.4 Public policy



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This doctrine denotes good customs and public order, meaning that juristic acts must conform to the mainstream moral and ethical standard of the society. Obviously, this refers to the moral and ethical standards generally accepted by, and according with the basic values of, the society. Article 6 of the French Civil Code provides: "*Statutes relating to public policy and morals may not be derogated from by private agreements.*" Germany, Japan, and Taiwan also adopt this doctrine in their civil codes. Due to the past influence of the jurisprudence of the former Soviet Union, the term 'public policy' is not used in the Chinese Contract Law. Instead, expressions such as 'public interest' and 'social morality' are used.

In modern society, with the rise of democratic politics, the market economy and individualism, ethics has, to a large extent, become a relative concept. Against this background, the doctrine of public policy incorporates the mainstream of social ethics and moral values into the law enforcement provisions. The doctrine of public policy embodies ethics and moral values that change as the society evolves, as a concrete manifestation of the legal standards of the social ethics and moral values that the citizens are expected to attain.

Against the backdrop of the contemporary separation between morality and law and between natural and positive law, the doctrine of public policy is equivalent to the institutionalisation of moral law into the legal system that plugs the loophole of 'customs' as a source of law. It has the drawback of becoming outdated as the society evolves. From the legal perspective, the doctrine of public policy restricts the personal autonomy of achieving personal interest at the expense of social ethics; in the area of tort law, this doctrine expands the scope of protection such that an individual may not be harmed by moral hazard.

Civil acts that are contrary to the doctrine of public policy are legally void. In the field of juristic acts, it restricts the autonomous space of individuals and prohibits any attempt to attain individual achievement by sacrificing social morality. Like the doctrine of good faith, judges use the legal principle of public policy as the social yardstick for adjudicating cases to determine the parties' rights and obligations. Effectively, this principle introduces extra-legal standards for preservation of social morality and safeguarding public interests.

## Case Study 1.5

### Judicial application of the doctrine of public policy

In 1963, Mr Huang of Sichuan married Ms Jiang. Huang and Jiang did not have any children and separated for a long time after their marriage. In 1990, their matrimonial house was demolished, and they were assigned another house as compensation. In 1996, Huang cohabited with another woman, Zhang, in a rented apartment. Zhang later gave birth to a son. In early 2000, Huang was diagnosed with cancer. He made a will, bequeathing his housing allowance, provident fund, pension and his 50% interest in the matrimonial home, in the total sum of 60,000 yuan, to Zhang. The will was notarised. Two days later, Huang died. Zhang claimed her interests in the property bequeathed to her under Huang's will, but in vain. She brought the case to court. It was held that Huang's will was invalid on the ground of infringing public policy, in that Zhang was a 'mistress.' The court ruled that Jiang was entitled to the entire estate of Huang.

Do you think this case was correctly decided?

The core value of this doctrine is to defend the moral and ethical standards of a society. The judge in the above case probably thought that the doctrine of public policy would require him to disallow extramarital sex, and to defeat Zhang's claim. However, the court's decision is wrong in that the motive of Huang's bequest was not to maintain the extramarital affair, but to express gratitude to Zhang for taking care of him. It is submitted that such bequest does not infringe any public policy and should have been upheld. In contrast, the court should have revisited this doctrine in a case where, for example, a married man gives another woman certain property for the purpose of maintaining their extramarital affair.

## Self-test 1.4

Chen and Guo are good friends. Recently, Chen has been in financial difficulty. He asks Guo to lend him 50,000 yuan. Guo agrees to see him in a pub. When they met, Guo gives Chen 50,000 yuan, and he signs an IOU, acknowledging the debt. They leave the pub and meet a robber, who asks them to surrender all property. At that moment, Chen says to Guo, 'I now repay 50,000 yuan to you.' Seeing this, of course, the robber takes the money right away.

Guo sues Chen for repayment of the loan of 50,000 yuan. In defence, Chen contends that the IOU does not specify the time for repayment of the loan. According to article 62 of the Contract Law, a debtor is obliged to repay at any time upon request by the creditor if the contract does not prescribe the time for repayment. Chen claims that he has already repaid 50,000 yuan to Guo.

Do you think Chen's defence is meritorious? Why or why not?