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Wang Lliming

Keith Hand

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AN INQUIRY INTO SEVERAL DIFFICULT PROBLEMS IN ENACTING CHINA'S UNIFORM CONTRACT LAW

Wang Liming[†]

Translation by Keith Hand[‡]

Translator's Forward: In March of 1999, China's Ninth National People's Congress ("NPC") passed the Contract Law of People's Republic of China.¹ The new law is the product of nearly six years of drafting work by China's Legislative Affairs Commission and contains over 400 articles, including 129 general contract provisions and 299 articles dealing with specific types of contracts.² When the law takes effect on October 1, 1999, it will unify China's contract law by replacing the three principal contract statutes currently in force, the Economic Contract Law, the Foreign-related Economic Contract Law, and the Technology Contract Law.³ The passage of this statute is thus a significant milestone in the development of China's contract regime.

The article translated here was originally published in the Chinese law journal *Zhengfa Luntan* in 1996.⁴ The author, Professor Wang Liming of the People's University of China, has written numerous articles on contracts and was intimately involved in the drafting of the Contract Law as an NPC deputy. He is thus well qualified to provide insight into the drafting process. For those seeking to understand the new statute, this article provides an introduction to Chinese contract theory as well as a comprehensive analysis of the policy considerations and practical problems that influenced the drafters of the Contract Law. Some minor revisions to the original text have been made with the cooperation of Professor Wang. In addition, translator's notes have been included to clarify aspects of Chinese law that may be unfamiliar to Western readers and to direct the reader to supplementary source material.

[†] Professor and Assistant Dean, Law Department, People's University of China; Deputy of the Ninth National People's Congress of the People's Republic of China; Member of the NPC Finance and Economic Committee; Fulbright Scholar, Harvard Law School.

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[‡] J.D. candidate, University of Washington School of Law, M.A. in International Studies (China), University of Washington, Jackson School of International Studies, 1997.

¹ Zhonghua Renmin Gongheguo Hetongfa [The Contract Law of the People's Republic of China] (visited May 17, 1999) <http://www.snweb.com/gb/people_daily/1999/03/22/i0322001.htm> [hereinafter Contract Law]. For an English translation of the Contract Law, see Zhonghua Renmin Gongheguo Hetongfa [The Contract Law of the People's Republic of China], translated in *Chinese Contract Law Forum* (visited April 24, 1999) <<http://www.cclaw.net>>.

² Contract Law.

³ Contract Law, art. 428.

⁴ See Wang Liming, *Tongyi Hetongfa Zhidingzhong de Ruogan Yanan Wenti de Tantaoyao, Shang* [An Inquiry in Several Difficult Problems in Enacting the Uniform Contract Law, Part I], ZHENGFA LUNTAN [TRIB. POL. SCI. & L.], No. 4, 1996, at 49-56; Wang Liming, *Tongyi Hetongfa Zhidingzhong de Ruogan Wenti de Tantaoyao, Xia* [An Inquiry in Several Difficult Problems in Enacting the Uniform Contract Law, Part II] ZHENGFA LUNTAN [TRIB. POL. SCI. & L.], No. 5, 1996, at 52-60.

I. INTRODUCTION

The most fundamental legal rule of a market economy is that contract law regulates transactional relationships and upholds transactional order. Following the promulgation of the Economic Contract Law in 1981, China's legislature enacted the Foreign Economic Contract Law and then the Technology Contract Law, thus creating the "three pillars" of contract law. As these laws were passed, the State Council and many ministerial committees passed a large body of contract rules corresponding to each of them. In 1986, the legislature enacted the General Principles of the Civil Law ("GPCL"). The passage of the State Council rules and the GPCL represented major steps in the process of improving China's obligation and contract laws. The three pillars, however, suffer from duplicative, inconsistent, and even contradictory provisions and lack some of the most fundamental rules and institutions of standard contract relations. As such, China's contract legislation has not yet adapted to the needs of its market economic development and legal construction. In consideration of this problem and in order to unify and improve upon the three pillars of contract law, China's legislature has decided to enact a Uniform Contract Law.⁵ While participating in this great legislative process that has been watched around the world, I have worked to combine the relevant doctrine and judicial practice and have grappled with some of the difficult problems encountered in enacting the Uniform Contract Law. The following paper contains some of my evolving ideas on these problems.

II. THE CONCEPT OF CONTRACT

The first task in enacting a Uniform Contract Law is to inquire into the concept of contract. The concept of contract should not be discussed merely for some academic or logical end, but more importantly to clarify the normative scope and content of the contract law. Put another way, given the wide use of contracts in all areas of life and society, China must first consider the following question: what concept of contract should be adopted

⁵ For problems concerning the enactment of the Uniform Contract Law, see Zhang Guangxing, *Zhonghua Renmin Gongheguo Hetongfa de Qicao* [The Draft Contract Law of the People's Republic of China], FAXUE YANJIU [STUD. L.], No. 5, 1995, at 3-14; Liang Huixing, *Zhongguo Hetongfa Qicao Guocheng Zhong de Zhengyidian* [Disagreements in the Process of Drafting China's Contract Law], FAXUE [L. SCI.], No. 2, 1996, at 13-15; Translator's Note: During the drafting process, the Contract Law was referred to as the Uniform Contract Law.

in the Uniform Contract Law? What contracts should it cover and what contractual relationships should it regulate?

Presently, three different concepts of contract exist in China's theory and practice circles. The first is the broad concept of contract. According to this view, contracts are agreements that determine rights and duties. In other words, the parties only need to reach an agreement that determines rights and duties for a contract to exist, regardless of what area of the law or type of legal relationship is involved. Therefore, contracts include administrative law, labor law, and international law contracts in addition to civil law contracts.

The second is the narrow concept of contract. According to this view, a contract is specifically a civil law contract. "A contract (agreement) is the juristic act⁶ of expressing a uniform intent to establish, modify, or rescind a civil rights-duty relationship between the parties."⁷ Therefore, only agreements that determine civil rights and duties can be called contracts. While administrative law, labor law, and international law contracts are also called contracts, they should be strictly distinguished from civil law contracts.

The third is the narrowest concept of contract. Under Article 85 of the General Principles of the Civil Law ("GPCL"), "A contract is an agreement between the parties to establish, modify, or rescind their civil relations."⁸ Under the narrowest concept of contract, Article 85 does not refer to all civil law contracts. Instead, "civil relations," refers only to obligation rights and duties.⁹ Contracts are clearly established as a source of obligation in the GPCL (Article 84) because the GPCL provisions on contracts are contained in the part of the law dealing with obligations. Moreover, Chinese civil law does not recognize what are called juristic acts involving real rights.¹⁰ Finally, under Chinese law, a consensus not involving an obligation rights-

⁶ Translator's Note: A juristic act is an act "designed to have a legal effect, and capable thereof," or "an act of a private individual directed to the origin, rescission, or alteration of a right." BLACK'S LAW DICTIONARY 853 (6th ed. 1990).

⁷ MINFA YUANLI [PRINCIPLES OF CIVIL LAW] 259 (Tong Rou ed., 1986).

⁸ Translator's Note: For an English translation of this statute, see Zhonghua Renmin Gongheguo Minfa Tongze [The General Principles of the Civil Law of the People's Republic of China], translated in JEROME A. COHEN ET AL., CONTRACT LAWS OF THE PEOPLE'S REPUBLIC OF CHINA 29-48 (1988).

⁹ Translator's Note: The parties to an obligation rights contract (*zhaiquan hetong*) create specific rights and duties between them, the performance of which can be demanded by the other contracting party. See Ling Bing, *Civil Law*, in INTRODUCTION TO CHINESE LAW 211 (Wang Chenguang & Zhang Xiachu eds., 1997).

¹⁰ Translator's Note: Unlike the civil codes of most countries, China's GPCL does not contain a separate section on rights over things. The GPCL does contain provisions on ownership and property rights related to ownership in its section on civil rights. See Ling Bing, *supra* note 9, at 199.

duty relationship (such as marriage or divorce) cannot be called a contract.¹¹ Therefore, contracts can only be obligation rights contracts.¹²

I think that in discussing the concept of contract, it should be clarified that a contract is most importantly the legal form of a transaction.¹³ As Marx pointed out, "This specific relationship, created by means of an exchange and in an exchange, came to take the legal form of contract."¹⁴ Transactions are exchanges of property and interest among independent and equal market actors. Transactions include transfers of commodities, trades of goods, and exchanges of interests. The legal form of these transactions is the contract. If contracts are viewed primarily as reflections of transactional relationships created between civil entities, then administrative contracts that reflect administrative relations and labor contracts that reflect labor relations do not belong in the category of what I call contracts. The reason is that these contracts do not reflect transactional relationships. From this perspective, I do not advocate the adoption of the broad concept of contract. In particular, if the broad concept of contract is adopted in the Uniform Contract Law, it would simply not be possible to determine the law's specific normative object and content. Under such a broad concept of contract, the Uniform Contract Law would include everything, its content would be unwieldy and complex, and its structure would be confusing. This is simply not desirable.

The narrowest concept of contract regards contract as a category of civil law, which is undoubtedly correct. However, this view limits contracts to only obligation rights contracts; it holds that only a consensus creating an obligation rights-duty relationship is a contract. This concept of contract is clearly too narrow. If it is adopted, then the normative scope of the Uniform Contract Law would be severely restricted and it would be difficult to regulate many civil contractual relationships.

In particular, under China's present legislative and judicial practice, many contracts like mortgages, pledges, state land-use contracts, and contractor agreements¹⁵ are not considered obligation rights contracts. In German law, these contracts are called property rights contracts because they

¹¹ LIANG HUIXING, MINFA XUESHUO PANLI YU LIFA YANJIU [CIVIL LAW THEORY, PRECEDENT AND LEGISLATIVE RESEARCH] 244 (1993).

¹² *Id.*

¹³ In French, the word for contract is *contract* or *pacte*. In German, it is *vertrag* or *kontrakt*. These are all derived from the Roman law term *contractus*, which means mutual exchange.

¹⁴ MAKESI, ENGESI QUANJI [COLLECTED WORKS OF MARX AND ENGELS] 422-23.

¹⁵ Translator's Note: The Chinese term translated here is *chengbao hetong*. In this context, it is probably used to describe a contract like an agricultural production contract. It can also refer to a contract signed by a general contractor.

establish, modify, or transfer property rights. Although the concept of a property rights contract is not recognized in China's civil legislation and judicial practice, many scholars believe that the contracts listed above differ from obligation rights contracts in some respects.¹⁶ However, it is inappropriate to conclude that because these contracts are not obligation rights contracts they should not be treated as contracts nor regulated by the Uniform Contract Law. These contracts, by their essential nature, still reflect transactional relationships and should naturally be regulated by contract law.

In civil law, some joint acts like partnership contracts and joint venture contracts are not simple obligation rights contracts.¹⁷ As early as 1892, the German scholar Kunze proposed that acts of agreement (*qiyue xingwei*) and acts of contract (*hetong xingwei*) should be distinguished. According to Kunze, bilateral juristic acts should be called agreements, while joint acts (such as partnership contracts) should be called contracts. Some older scholars in China have noted that contractual acts differ from ordinary acts of agreement.¹⁸ I think that partnership contracts and joint operation contracts are not the same as ordinary obligation rights contracts. The purpose of the parties in concluding these contracts is not to create obligation rights or duties but to establish relationships for joint investment, operation, or risk allocation. However, the contract law should regulate these contracts because in essence they still reflect transactional relationships.

Finally, with the development of society and the economy, many new contractual relations will emerge as conditions require. In order to bring each new contract within the contract law's scope of regulation, the applicable scope of the contract law and the meaning of a civil contract must be broadened; contracts cannot be limited to only obligation rights contracts. China's judicial practice of applying contract rules to agricultural supply contracts (which has proven both possible and necessary in practice) is enough to illustrate this point.

¹⁶ Sun Jingzhong, *Budong Chanwuquan Qude Yanjiu* [Research on the Acquisition of Real Property Rights], MINSHANGFA LUNCONG [J. CIV. & COM. L.], No. 3, at 63.

¹⁷ Translator's Note: For example, partnership contracts differ from ordinary obligation rights contracts because in a partnership contract, the parties contribute capital jointly, manage the partnership jointly, and have common objectives and interests. In an ordinary obligation rights contract such as a sales contract, the goals of each party are different. One party is interested in money and the other party is interested in goods. There is no joint objective, only a bilateral obligation. For this point and a more detailed discussion of the special characteristics of partnerships and joint venture contracts, see BASIC PRINCIPLES OF CIVIL LAW IN CHINA 79, 306 (William C. Jones trans., M.E. Sharpe 1989).

¹⁸ FALU DA CIDIAN [LEGAL DICTIONARY] (Wang Hanzhang ed., 1934).

In all, I think that in practice, Article 85 of the GPCL, which provides, "A contract is an agreement by the parties to establish, modify, or rescind civil relations," adopts the narrow concept of contract. The Uniform Contract Law should follow the GPCL by adopting this concept and should place within its regulatory scope any agreement that establishes civil rights and obligations between equal parties.

III. THE PRINCIPLE OF FREEDOM OF CONTRACT

Freedom of contract is the freedom enjoyed by parties to conclude a contract according to the law, to choose a partner in contract and the terms of the contract, to modify or rescind a contract, and to establish the form of a contract. Freedom of contract is the most fundamental principle of contract law in Western nations. Scholars have various views on the issue of whether or not China's current contract legislation has adopted this principle.

Since the founding of its centralized economy, China has consistently emphasized the importance of the state plan in its contract law. The 1981 Economic Contract Law ("1981 ECL") stressed that in forming contracts, the parties should adhere to the principles of voluntariness, equality, and mutual benefit through consultation.¹⁹ However, this law also stressed that the state plan must be respected and that the intervention of state organs in all aspects of contracting must be accepted. In this respect, the principle of freedom of contract was not embodied in the law. Consequently, many Chinese legal textbooks recognized only the principles of voluntariness and unanimity through consultation and did not recognize the principle of freedom of contract.²⁰

I, think that the Uniform Contract Law should clearly affirm the principle of freedom of contract and that this principle should be fully manifested in all aspects of contract law. The spirit of contract freedom is embodied in the principles of equality, consultation, and equivalency of value. However, it is not completely encompassed within these principles. Freedom of contract should be manifested not only in the decision to

¹⁹ Translator's Note: For an English translation of the 1981 Economic Contract Law, see Zhonghua Renmin Gongheguo Jingji Hetongfa [The Economic Contract Law of the People's Republic of China], translated in COHEN, *supra* note 8, at 49-61. The provision of the 1981 ECL referred to in the text is Article 5, which states, "In concluding an economic contract, the parties must implement the principles of equality and mutual benefit, achieving agreement through consultation and making compensation for equal value. No party may impose its will on the other party (or parties) and no unit or individual may illegally interfere." *Id.*

²⁰ HETONGFA TONGLUN [A GENERAL SURVEY OF CONTRACT LAW] 38 (Liu Ruifu ed.); ZHONGGUO DANGDAI HETONGFA LUN [ON CONTEMPORARY CHINESE CONTRACT LAW] 34 (Su Huiyang ed.).

conclude a contract but also in the establishment of a contract's form, the terms of a contract, contract modification and rescission, and even the remedies for breach of contract.

Why should China's Uniform Contract Law adopt freedom of contract as a fundamental principle? I think that establishing the principle of freedom of contract is essential for stable reform and the development of a market economy. With the narrowing scope of the state plan and the expansion of enterprise autonomy, parties enjoy greater freedom of contract with each passing day. In 1993, China's legislature amended the 1981 ECL. One of the important objectives of China's legislature in amending the law was to confirm the expansion of contract freedom that has occurred as a result of China's economic reform. All but two of the 1981 ECL's ten clauses containing references to the state plan were removed in the amended version of the law. In particular, Article 4, which read, "the conclusion of economic contracts must comply with state law and accord with the demands of the state plan and policy," was changed to "the conclusion of economic contracts must comply with state law and administrative regulations."²¹ Article 7, which stated, "contracts that violate the law and the state policy and plan" are void, was changed to "contracts that violate the law and administrative regulations" are void. These changes imply that the principle of state planning is no longer a fundamental principle of China's contract law.

To the greatest extent possible, the amended ECL ("1993 ECL") has also reduced the power of the government to intervene unnecessarily in contractual relationships. One of the basic aims of amending the 1981 ECL was to enhance the freedom of contract enjoyed by contracting parties. This is clearly essential to reform and to the development of a market economy. Respect for the contract freedom of market actors is a precondition of market economic development. As the freedom enjoyed by contracting parties broadens, the flexibility and self-governing nature of the market will be strengthened. Transactions will be promoted and, with the development of the market, society's wealth will be increased. Therefore, freedom of contract is a basic and necessary condition for the development of transactional relationships under market economic conditions. Any contract law that regulates transactional relationships should adopt freedom of contract as its fundamental principle. Whether the Uniform Contract Law

²¹ Translator's Note: For an English translation of the 1993 Economic Contract Law, see *Zhonghua Renmin Gongheguo Jingji Hetongfa* [The Economic Contract Law of the People's Republic of China], translated in 1 *China L. Foreign Bus. (CCH Austl. Ltd.)*, ¶ 5-500 (2) (1993).

confirms the principle of freedom of contract is thus an important symbol of whether the law reflects the needs of China's market economy.

Respect for freedom of contract should be manifested in all aspects of the contract law. In particular, the emphasis of the Uniform Contract Law in implementing the principle should be to resolve the following issues. First, on the issues of contract formation and validity, government and administrative intervention should be reduced to the greatest extent possible. For example, government administrative bodies should not enjoy the power to confirm the validity of contracts under the law. Such power to supervise and examine contracts should be tightly restricted. Moreover, the law should prevent administrative bodies from arbitrarily restricting or interfering with the contract freedom of parties. Second, the law should fully respect the free will of contract parties with regards to the terms of the contract. Contracts should not be declared void simply because they do not contain a certain clause (such as a clause setting liability for breach) unless the clause must be present according to the law or by virtue of the nature of the contract. Third, on the form of a contract, the validity of oral contracts should not be denied unless the law requires that the contract be approved and registered. Oral contracts should be recognized as valid if one of the parties proves the existence and specific terms of the contract according to the evidence or if both sides acknowledge the contract and its terms. Fourth, on the issue of contract rescission, the parties should be permitted to establish a right of rescission when they conclude the contract. After the contract has become effective, the party with the right of rescission should be permitted to exercise this right and to rescind the contract if the conditions for rescission arise. Fifth, with regards to liability for breach, the validity of clauses setting liquidated damages and compensation for losses should be fully respected. Unless the liquidated damages are excessively large or small, the clause should be regarded as valid even the damages it sets do not conform to those set by law.

IV. CONTRACT RELATIVITY

Related to the concept of contract and to the principle of contract freedom is the rule of contract relativity. A contract, as an agreement by the parties to establish, modify, or rescind a civil law rights-duty relationship,

can only come about between two parties that have voluntarily concluded a contract. This is the rule of contract relativity.²²

In continental law, contract relatively is commonly referred to as the relativity of an obligation. According to the rule of relativity, contractual relations can only come about between the respective parties to a contract. Only a contracting party has the ability to make requests to and bring suits against the other party on the basis of the contract in question. Third persons who do not have a rights-duty relationship with the parties can neither make requests nor bring suits on the basis of the contract and thus should not assume contractual obligations or liabilities. Moreover, a third party cannot assert a contractual right unless such a third party right is provided for by law or in the contract.

Whether the Uniform Contract Law should emphasize the rule of contract relativity is a significant issue. Many scholars harbor suspicions about the importance of this rule because it has already been limited a great deal. In one respect, the establishment of the obligation preservation system²³ gives external validity to contractual relationships and can cause contract obligation rights to be legally binding on third parties. In another respect, with the development of modern product liability, many countries' statutes and case law have expanded the protection of the contractual relationship to third persons in order to protect the interests of consumers. Under the law of these countries, product manufacturers and sellers assume warranty obligations and liabilities with regards to third persons (such as users or possessors of the product). For example, the "agreement adding protection to third persons" in German law, the "right of direct suit" in French law, and "warranty liability" in American law are all violations of the rule of contract relativity.

²² Translator's Note: In other words, a "relative" right (*xiangduiquan*) is an in personam right. For a more detailed discussion of the concept of relativity, see BIJIAO MINFAXUE [COMPARATIVE STUDY OF CIVIL LAW] 78-79 (Li Shuangyuan & Wen Shiyang eds., 1998).

²³ Translator's Note: According to Professor Wang, two articles in the final draft of the Contract Law relate to the obligation preservation system. The first, Article 73, states, "If an obligor harms an obligee by failing to exercise its obligation rights, the obligee may, in its own name, petition a people's court to exercise the obligation rights of the obligor by way of subrogation, unless such rights are the exclusive rights of the obligor." Contract Law art. 73 *supra* note 1. Article 74 states:

If an obligor waives its rights or transfers its assets without consideration, the obligee may petition a people's court to void the obligor's acts. If the obligor transfers any of its assets at a manifestly and unreasonably low price, resulting in harm to its obligee, and the transferor is aware of this situation, the obligee may also petition a people's court to void the obligor's acts. Cancellation rights exercised by the obligee shall be limited to the extent of the obligee's right to performance. The necessary expenses for the obligee's exercise of its cancellation right shall be borne by the obligor.

See Contract Law art. 74. *supra* note 1.

I think that the relativity of contract is determined by the essential characteristics of contracts as well as by the principle of freedom of contract. Contract relativity is a type of civil legal relation. In fact, the principal difference between a contract obligation right and a property right is that contract obligation rights are relative while property rights are absolute in nature. Both of these characteristics are important in their respective areas of the law. For example, in the law of obligations, the rule of relativity applies to the establishment, modification, and transfer of relevant obligations. In the law of property rights, the registration system and the system for claiming rights in property are based on the absolute nature of property rights. Thus, in order to understand the distinct characteristics of obligation rights and property rights, one must first understand the relativity of obligation rights.

The fundamental difference between the law of delicts²⁴ and the law of contracts lies in the absolute nature of property rights and the relativity of obligation rights. Contract obligation rights are not rights of a public or societal nature (*sozialoypisch offenkundig keig*) because they are relative rights that only come about between specific persons. The realization of such rights depends upon the performance of the obligor's duty. Thus, only contract law can protect contract rights. However, property rights are absolute rights that must be enforced under the law of delicts. Thus, the law of delicts has its own structure based on its guarantee of property rights and other absolute rights. Denying the relativity of contract constitutes a threat to the internal structure of the civil law.

In China's judicial practice, the need to emphasize the rule of contract relativity is apparent. Presently, the rule of contract relativity is not strictly observed in many contracts cases. For example, some local courts have ordered people to perform the duties of an obligor or to assume liability for breach of a contract even when these people have had no obligation to a contracting party or direct connection to the dispute. The courts have done this in order to protect local interests. Thus, in judicial practice, relativity must be emphasized in order to determine liability properly and to handle disputes according to the law.

The rule of contract relativity should be recognized as an important element of the law and should be manifested throughout the Uniform Contract

²⁴ The term delict is a civil law term similar in meaning to "tort" but with a wider application. See BLACK'S LAW DICTIONARY, *supra* note 6, at 427. In Chinese law, delictual liability "refers to a subject of civil law infringing on the property or personal rights of another or on his intellectual property rights." For this point and a further discussion of the differences between contractual liability and delictual liability in the civil law of China, see BASIC PRINCIPLES OF CIVIL LAW IN CHINA, *supra* note 17, at 46-49.

Law. In this respect, relativity of contract is still an important contract principle. However, because contract relativity is not an abstract standard but is a concrete rule of behavior that regulates transactions, it differs from a principle. The question is, which substantive rules of contract relativity should be established in the Uniform Contract Law? I think that at a minimum, the Uniform Contract Law should include the following rules. First, except as otherwise provided in the law, a contracting party, on the basis of a contract, may only make requests to and bring suit against the other contracting party. The contracting party may not make requests to or sue a third person if they do not have a contractual relationship with this person. Second, except as otherwise provided for in the law or the contract, a third person who is not a contracting party may not assert a right under the contract. Third, no contracting party may obligate a third person by contract without their permission. Fourth, the contract obligor should be responsible for the mistakes of her legal representative or other persons who assist her in performing the contract obligations. Fifth, if the acts of a third person prevent the contract from being performed completely, the obligor should be liable to the obligee for breach of contract and afterwards may seek compensation from the third person. Sixth, the obligor should only be liable to the obligee, and not to the state or to a third person, for breach of the contract. Finally, except as otherwise provided by law or in the contract, if a third person takes the place of the obligor in performing an obligation and, through the person's own fault, does not perform or does not perform appropriately, the obligor should still be liable to the obligee for breach of contract.

V. THE PRINCIPLE OF CONTRACT JUSTICE

A twenty-first century Uniform Contract Law should do more than just meet the needs of the market economy and confirm the principle of freedom of contract. According to the trend in contract law and drawing on the legislative experience and case law of developed countries, the Uniform Contract Law should also confirm the principle of contract justice. According to Mr. Wang Zejian, so-called contract justice, (also known as the justice of an agreement), is a species of egalitarianism. Contract justice applies to bilateral contracts and stresses that what the parties give each other should be of equal value.²⁵ In practice, this view equates contract justice with the concepts of equal value or consideration. Although there is

²⁵ WANG ZEJIAN, *MINFA XUESHUO YU PANLI YANJIU* [CIVIL LAW THEORY AND CASE RESEARCH] 23 (1993).

a basis for this view, the understanding of contract justice it represents is too narrow. Since contract justice is the collective embodiment of the ethical and moral concepts of fairness, equality, and justice, the concept should not be limited to equality of economic value but should have other aspects as well. As the famous American philosopher Rawls pointed out, the principles of justice are the outcome of a type of fair agreement or contract.²⁶ According to the principle of contract justice, the parties should conclude and perform the contract on the basis of fairness and voluntariness, the terms of the contract should embody the principles of fairness and honesty, and the contracting parties should not abuse their economic power or strength and harm the interests of the other party.

Contract fairness is a restriction on contract freedom. According to the rationalist philosophy of the 18th and 19th centuries, contract freedom itself implies justice or fairness. In other words, free will naturally leads to justice. In the present century, however, the principle of contract freedom has not fully embodied the requirements of contract justice in practice. Contract freedom requires that the will of the parties be fully respected. However, contract freedom does not contemplate the problems of economic coercion that arise from disparities in the strength and position of the parties and that result in unfairness. Monopolies and large companies, for example, use form contracts to take advantage of consumers in a weaker position. Similarly, enterprise managers often make use of their position to force employees to accept poor conditions. Contract freedom must thus be limited by the principle of contract justice before its proper function can be realized.

Preserving contract justice is, in its essential nature, a legal reflection of the basic needs of the transactional relationship. An exchange of goods is an exchange of equal amounts of labor. Thus, under the law of value, an exchange of commodities between civil entities should be equal and mutually beneficial. When the financial interest of an entity is harmed, the entity should obtain compensation equivalent to the harm. In confirming the principle of contract justice, China's Uniform Contract Law must ensure that contracts adhere to the principles of fairness, equivalency of value, and honesty. Another goal in preserving contract justice is to uphold the normal transactional order by harmonizing the conflicting interests of different transactional entities, individuals and the state or society, and producers and consumers.

²⁶ JOHN RAWLS, ZHENG YI LUN [A THEORY OF JUSTICE] 10 (1988). Translator's Note: The author is citing a Chinese translation of Rawls' work which was published by the Chinese Social Science Press.

I think that the Uniform Contract Law, in confirming and upholding the principle of contract justice, should contain several features. First, the law should regulate form contracts by providing clear rules related to the formation, effectuation, and interpretation of such contracts. By so doing, the law will prevent economically stronger or monopolistic parties from harming economically weaker consumers or customers through the use of such contracts. The legislation of many countries provides that the drafter of standard contract clauses should call the attention of other parties to the terms of the contract and that standardized contracts should be construed against the drafter. These rules are worth borrowing.

Second, the law should set standards for the use of exemption clauses. It is clear that in practice, parties with stronger bargaining positions at the time of contract formation use exemption clauses as a tool to unfairly avoid liability. This harms the interests of their counterparts. The Uniform Contract Law should guarantee the fairness of liability clauses by providing clear rules on the interpretation of such clauses and the conditions under which they are valid.

Third, the law should prohibit abuse of interest. Honesty requires rules prohibiting abuse of interest to be applied not only in the realm of property law but also in contract law. Such rules will prevent one party from abusing contract freedom by taking advantage of the economic desperation or dire needs of another party.

Fourth, the law should uphold the principles of equality of value and fairness. To accomplish this, the Uniform Contract Law should confirm the rule that manifestly unfair contracts are voidable. Of course, to prevent the arbitrary interpretation of this rule, the law should clearly stipulate the required elements of and standards for judging manifest unfairness. This relates to the issue of whether or not the Uniform Contract Law should include a rule of consideration. I think that in principle, the Uniform Contract Law should require the parties to adhere to the principle of equivalency of value but should not require the obligations assumed by the two sides to be of identical economic value. On an objective level, the duties performed by each of the parties will never be of identical value. Thus, the issue of consideration should to a large degree be decided according to the will of the parties. Consideration should be found objectively equal if the rights enjoyed and the obligations assumed by the parties under the contract, as well as the respective performances of the two sides, are of roughly equivalent economic value. At the same time, although the amount paid by a party may be low, there is a kind of consideration on a subjective level if the price is voluntarily accepted. Thus, the parties

themselves can determine the standard for consideration in most situations. Of course, in order to avoid manifest unfairness, the Uniform Contract Law should still require that the parties observe the rules of fairness and equality of value.

VI. CONTRACT FORMATION AND EFFECTUATION²⁷

To say that a contract has been formed (*cheng li*) means that the parties have reached agreement on the principal terms of a contract. To say that this contract has become effective (*sheng xiao*) means that the contract has become legally binding on the parties and has legal validity. Article 9 of the 1993 ECL states, "An economic contract is formed when the two parties achieve unanimity on the principal clauses of the economic contract through consultation according to the law." On the surface, this article provides a separate rule for contract formation and thus distinguishes contract formation from contract effectuation. However, Article 6 of the 1993 ECL provides, "when an economic contract is formed according to the law, it is legally binding." This implies that in reality the two are not distinguishable. From the perspective of judicial practice in China, there is no distinction between contract formation and contract effectuation. The issue of whether the two should be distinguished in the Uniform Contract Law should thus be explored.

Formation is often closely connected to effectuation. By forming a contract, the parties intend to realize rights and benefits created under the contract. This requires that the contract be binding. If a contract does not become effective, it is no better than a blank piece of paper and the purpose of the parties in forming the contract is unfulfilled. Thus, the purpose of the parties' consensus is to make the contract valid and effective. Naturally, a contract will become legally binding if it is formed according to the law and meets the legal requirements for becoming effective. In such cases, it is not necessary to distinguish formation from effectuation. This statement does not imply, however, that formation and effectuation are identical concepts.

I do not think that contract formation and contract effectuation are the same. Formation implies that the process of concluding a contract has been completed and that the parties have reached agreement on its principal terms. However, the issue of formation only resolves the issue of whether a contract exists and not whether the contract has become effective. Contracts

²⁷ Translator's Note: For purposes of readability, the Chinese term *sheng xiao*, which means "to become effective," "to come into force," or "to become valid" will be translated in some places as "effectuation."

that have been formed but do not meet the legally stipulated requirements for becoming effective do not yet have legal validity. In other words, the state's appraisal of the parties' agreement is manifested in contract effectuation. Thus, formation is primarily an expression of the will of the parties and embodies the principle of freedom of contract. In contrast, effectuation embodies the state's confirmation or negation of the contractual relationship and reflects the intervention of the state in this relationship.²⁸

The distinction between contract formation and effectuation is significant in four respects. First, it relates to the application of contract interpretation techniques. Contract formation is primarily a manifestation of the will of the parties. Thus, when contract terms are ambiguous or unclear but the parties do not deny the existence of a contract, a court should be permitted to inquire into the true intent of the parties and to set the specific terms of the contract through techniques of contract interpretation. Interpretation does not mean that a court can take the place of the parties and create a contract. Instead, it means that the court, taking the need to encourage transactions and to respect the will of the parties as its starting point, can assist the parties in expressing their true intent by means of interpretation. In contrast, the system of contract effectuation is a manifestation of the state's appraisal of and intervention into the terms of the contract. Thus, the failure of the contract terms to conform to the legal requirements for contract effectuation implies that the will of the parties does not conform to the will of the state. In such a situation, the court may not use interpretation in order to make the contract valid and effective. On the contrary, it may only make a determination that the contract is void. Contract interpretation is thus used primarily to remedy defects in contracts that have been formed and not to remedy deficiencies in the validity of the contract.

Second, the legal consequences of non-formation and lack of validity are different. According to the system of liability for negligence in contract formation, if a court declares that a contract has not been formed the party at fault should compensate the other party for damage to its reliance interest. If the parties have already performed, then they should each return the benefits of the performance that they have accepted. Because contract formation relates primarily to the agreement of the parties, the failure of a contract to be formed creates civil liability but not other kinds of legal liability. However, void contracts fundamentally violate the will of the state. They

²⁸ SHEWAI HETONGFA DE LILUN YU SHIWU [THEORY AND PRACTICE OF THE FOREIGN ECONOMIC CONTRACT LAW] 103 (Chen An ed., 1994).

can thus create not only civil liability (such as liability for negligence in concluding a contract and responsibility for returning improper benefits) but also administrative and even criminal liability. For these reasons, I believe that the common Chinese judicial practice of treating contracts that have not been formed as void is inappropriate.

Third, with respect to the required form of contracts, it is very important to differentiate between contract formation and effectuation. Many Chinese laws establish rules regarding the form of contracts. For example, Article 3 of the 1993 ECL provides, "Except where a contract is fulfilled immediately, it shall be in written form." Article 7 of the Foreign Economic Contract Law ("FECL") provides, "A contract is formed when the clauses of the contract are agreed upon in written form and the parties have signed their names."²⁹ In academia, there are various opinions on whether these are legal requirements for contract formation or effectuation. I think that this problem should be analyzed concretely. If, by its nature and according to the law, a contract cannot be formed until it is in writing, then if the written form is not adopted, the contract cannot be formed. If the form of a contract only relates to the issue of whether or not it becomes effective, then the failure of the contract to conform to the legal requirements means that the contract has been formed but cannot become effective.

Fourth, on the issue of the state intervening in contracts on its own initiative, the distinction between formation and effectuation is significant. The terms of many void contracts are illegal by nature and violate either firm provisions of the law or public order and morality. Thus, the state should intervene in such contractual relationships on its own initiative, even if the parties do not assert that the contract is void. In contrast, contract formation primarily relates to the issue of the parties' consensus and not completely to the legality or authenticity of the contract terms. Even if the terms of a contract are imperfect or unclear, the parties have voluntarily accepted the contractual relationship. Consequently, such a contract should be considered formed and the state should not and need not take the initiative to intervene in it.

VII. SETTING THE BASIC RULES OF CONTRACT FORMATION

The system of contract formation includes many rules that directly regulate the transactional process. Among these rules, the most important is

²⁹ Translator's Note: For an English translation of the Foreign Economic Contract Law, see Zhonghua Renmin Gongheguo Shewai Jingji Hetongfa [The Law of the People's Republic of China on Economic Contracts Involving Foreign Interests], *translated in* COHEN, *supra* note 8, at 165-69.

the rule setting the time that an acceptance becomes effective. The two major legal traditions adopt different positions on this issue.

According to continental law, an expression of intent to accept becomes effective when it comes within the sphere of control of the offeror, and a contract is formed at this time. This is called the delivery doctrine.³⁰ As Article 130 of the German Civil Code provides, when an expression of intent is made to another party in non-conversational form, it becomes effective at the time that the party is notified.³¹ Under Anglo-American law,³² however, an expression of acceptance sent by mail or telegram becomes effective when the offeree places it in the mailbox or leaves it at the telegraph office, unless otherwise provided by the offeror and offeree. This rule is called the sending doctrine, or, as it is commonly referred to in the United States, the mailbox rule.³³

The primary distinction between the two rules is that each sets the time of contract formation according to a different standard. Under the delivery rule, an acceptance is not effective until the offeror has received notice of it. Until this moment, the offeree assumes the relevant consequences for the loss or delay of the acceptance by the post office, telegraph office, or other dispatcher. In addition, if an acceptance letter is lost or delayed, the acceptance does not become effective. In contrast, under the common law rule an acceptance is binding on the offeree as soon as it is placed in a mailbox or sent by telegraph.³⁴ The offeror is responsible for the loss or delay of the notification of acceptance by the post office or the telegraph office. Due to this difference, the rules regarding the withdrawal of an acceptance in the two traditions are also different. In the continental law system, an offeree can withdraw an acceptance after notice of the acceptance has been sent if the withdrawal is received by the offeror before or at the same time as the acceptance. Under the common law, a notice of acceptance is effective once it is sent and cannot be revoked by the offeree.³⁵

In comparing the rules of these two major legal traditions, it is evident that both have advantages. According to the common law rule, as soon as

³⁰ Translator's Note: The delivery doctrine, or *daodazhuyi*, is hereinafter referred to as the delivery rule.

³¹ Translator's Note: For an English translation of the German Civil Code see BÜRGERLICHES GESETZBUCH [BGB], translated in THE GERMAN CIVIL CODE (Simon L. Goren trans., 1994). Goren's translation of Article 130 (1) reads, "A declaration of intention required to be made by another, if made in his absence, becomes effective at the moment when it reaches him. It does not become effective if a revocation reaches him previously or simultaneously." *Id.* art. 130 (1).

³² Translator's Note: Anglo-American law is hereinafter referred to as "the common law."

³³ Translator's Note: The sending doctrine, or *songxinzhuyi*, is hereinafter referred to as the mailbox rule.

³⁴ XU BING, MAIMAI FA [BUSINESS LAW] 105-06 (1991).

³⁵ *Id.*

the offeree places the acceptance letter in the mailbox or leaves it at the telegraph office, a contract is formed. Under this rule, contracts are formed earlier than they are under the delivery rule. The rule thus quickens transactions. In addition, this rule can prevent an offeree from trying to take advantage of changes in the market that occur in the time between the issuance of the acceptance and its revocation at the last minute, which can harm the offeror. Under the common law rule, however, the offeror is bound even when she does not have knowledge of the acceptance. Particularly with regards to the assumption of liability in the case of a lost or delayed acceptance, this rule is too harsh on the offeror and is not beneficial in upholding transactional security. The continental law rule overcomes this defect. However, under the continental law rule the offeree can exploit changes in market conditions and commodity prices and engage in speculative behavior after an acceptance letter has been sent. For example, if market prices rise after the dispatch of an acceptance, the offeree can send a telegram that revokes the acceptance. Thus, the continental law rule can be abused as well. Setting a standard for the time that a contract becomes effective is closely connected with the basic concept and nature of offer and acceptance. Thus, choosing between these two rules is the first issue that must be resolved in establishing the basic content and structure of the contract formation system.

I think that the Uniform Contract Law should adopt the continental law rule. There are several reasons for this conclusion. First, after unification, China was a part of the continental law system and adopted traditional continental law rules on the concept and basic theory of offer and acceptance. In contrast, the experience of the common law was not drawn upon. For example, the mailbox rule is related to the common law concept that ordinary offers are not firm offers. That is to say, under the common law, the offeror can revoke the offer at any time before acceptance. This is not much of a restraint on the offeror. Thus, to balance the relationship and interests of the offeror and offeree, the common law adopts the mailbox rule for determining the time that an acceptance becomes effective.³⁶ Judicial practice in China, however, supports the notion that an offer has binding force and prohibits the offeror from violating the provisions of the offer by revoking it at will. This is obviously an adoption of the continental law concept of an offer. Thus, the delivery rule and not the mailbox rule must be adopted in order to balance the interests of the offeror and offeree.

³⁶ MINFA ZHAIQUAN [CIVIL LAW OBLIGATION RIGHTS] 301 (Wang Jiafu ed., 1991).

Second, although China's domestic contract legislation has not explicitly provided for the delivery rule, it can be found in many provisions. For example, Article 42 of the 1984 Regulations on Industrial Mineral Supply Contracts states,

Except where otherwise clearly specified, the date referred to in these regulations with respect to anything delivered directly is the date on which the receiver signs for receipt. With respect to anything sent by mail, the date referred to is the date stamped by the post office on the counterslip to indicate that the goods have been received.

Third, Article 18, Clause 2 of the United Nations Convention on the Sale of Goods states that an expression of intent to accept an offer becomes effective when it reaches the offeror. An acceptance is not effective if the expression of intent does not reach the offeror within the time the offeror has provided or, if a time is not provided, within a reasonable time. Since China has already ratified this treaty, the adoption of the delivery rule in the Uniform Contract Law is a great necessity.

After the delivery rule has been established, offer and acceptance rules that are closely tied to the delivery rule should also be adopted. These include, among others, the rule that an offeror cannot arbitrarily revoke an offer. As for some rules that are not closely tied to the delivery rule, these can be borrowed for the Uniform Contract Law where appropriate, even if they are used in the common law. For example, if the acceptance changes non-material terms of the offer and the offeror does not immediately object, then the acceptance should be considered effective. Although this principle is applied in American law,³⁷ it does not directly relate to the time of formation and can thus be borrowed for China's legislation.

VIII. VOID³⁸ CONTRACTS

A void contract is the opposite of a valid contract and refers to a contract that has been formed but lacks the legally required elements for validity. In this situation, the expression of the will of the parties cannot create a contract that has the validity of a juristic act. Article 58 of China's GPCL identifies several kinds of void contracts:

³⁷ See U.C.C. § 2-207 (U.S.).

³⁸ Translator's Note: The term *wuxiao*, translated here as "void," may also be translated as "invalid."

1. Contracts concluded by a person who lacks the capacity to perform civil acts;
2. Contracts concluded by a person with limited capacity to perform civil acts that, according to the law, cannot be concluded by such a person;
3. Contracts formed as the result of fraud or duress, or when one party takes advantage of a person;
4. Contracts related to a malicious conspiracy of the parties;
5. Contracts that violate the law or the social or public interest;
6. Contracts that violate mandatory state plans; and
7. Contracts that employ a legal form to conceal an illegal purpose.

According to Article 7, Clause 3 of China's 1993 ECL, contracts signed by agents who have exceeded their authority or contracts signed by agents on behalf of a principal with themselves or with other people they represent are void. With respect to this provision, current Chinese law differs from the traditional civil law of the continent in that it has expanded the range of void contracts. Specifically, Chinese law provides that some contracts that are voidable under continental law, (such as contracts that are not true expressions of intent because of fraud or duress), are void. Under Chinese law, some contracts of pending validity³⁹ (such as contracts concluded without permission by a person with a limited capacity for civil acts), are void as well. China's current legislation thus provides for a broad range of void contracts.

Whether the Uniform Contract Law should adopt the current provisions on void contracts or should establish a new range of void contracts is an important issue. China's current contract legislation, by expanding the range of void contracts, emphasizes state intervention in contracts and the punishment of those who engage in illegal acts such as defrauding or coercing another person. Because the rules on the range of void contracts are too broad, many valid contracts have been improperly

³⁹ Translator's Note: The Chinese term translated here is *xiaoli daiding de hetong*. See *infra* note 42 and accompanying text for a more detailed discussion of contracts of pending validity.

treated as void. In practice, courts have expanded the range of void contracts inappropriately. This has caused the number of void contracts in China to reach a surprising level. According to scholarly studies, ten to fifteen percent of all contracts are void.⁴⁰ This state of affairs has had some negative effects. First, it has brought about the unnecessary waste and loss of property. Once it is established that a contract is void, liability for the compensation of losses and for the mutual return of property that has been discharged arises under the principle of restitution. The mutual return of property means that the costs incurred by the parties in performing the contract will not be compensated and that the purpose of the contract will not be realized. It also means that property will be lost or wasted because the return of property itself adds unnecessary costs.

Second, voiding contracts excessively is detrimental to the preservation of and respect for the will and interests of the parties. Although contracts concluded as the result of fraud or coercion are illegal to a certain extent, the primary problem with these contracts is that they are not real expressions of the intent of the parties. To respect the interests of the victims of such contracts and to protect transactional security, this kind of contract should be treated as voidable if the victim so requests. However, if the victim is unwilling to demand that the contract be voided, such wishes should be respected and the state should not intervene.

Third, the excessive voiding of contracts does not encourage transactions. An important goal of contract law is to facilitate transactions to the greatest extent possible, not to extinguish transactions. Only if the law facilitates transactions can it promote economic development and the growth of social wealth. Thus, the excessive voiding of contracts, which causes some transactions to be improperly extinguished, is not in accord with the principle of encouraging transactions. For these reasons, the present legislative provisions related to void contracts should be amended. The goal of the amendments should be to clearly define void contracts, to narrow the range of void contracts appropriately, and thus to eliminate the negative effects of the present system.

I think that in principle, the range of void contracts should be limited to contracts that are illegal or that violate the public interest. A violation of the law is a violation of a prohibitory provision in a current statute or in a regulation issued by the State Council. Contracts that violate non-prohibitive provisions and administrative rules issued by ministries under the

⁴⁰ SUI PENGSHENG, WUXIAO JINGJI HETONG LILUN YU SHIWU [VOID ECONOMIC CONTRACTS, THEORY AND PRACTICE] (1992).

State Council should not be declared void. In practice, it is quite inappropriate to treat contracts that violate any official document (*hongtuo wenjian*) as a void contract. The treatment of every document from every locale as a law or a rule that confirms the validity of contracts is "bound to lead to a maze of transactional prohibitions, pitfalls everywhere in civil activities, and administrative intervention with unlimited legal force that will prevent the parties from taking a single step."⁴¹

Contracts that violate the public interest are contracts that violate public order and morality. Examples of these types of contracts are contracts that violate public moral or ethical concepts, contracts that restrict personal freedom, and contracts that injure the moral character of people. Ordinarily, contracts concluded as part of a malicious conspiracy by the parties to evade the law and to harm the interests of other people are also illegal and void contracts.

If the range of void contracts is limited to contracts that violate the law and public interest, then a contract of pending validity should be a special type of contract that is distinguished from a void contract. If a contract has already been formed but its validity has not yet been determined, then it is a contract of pending validity. A person with rights must recognize such a contract before it can become effective.⁴² There are three principal types of contracts of pending validity. One type is a contract that, according to the law, may not be established independently by a person with limited capacity to act. A legal representative of the person with limited capacity must recognize this contract before it can become effective. A second type is a contract that is formed in the name of others by an agent without the authority to form such a contract. The person represented by the agent must retroactively recognize such a contract before it can become effective. The third type is a contract through which a person arbitrarily dispenses with the rights or property of another without the right to do so. The person whose right or property is disposed of must approve the contract in order for it to become effective. Although a contract of pending validity lacks the elements required for it become effective, it can become effective if a person with rights recognizes it retroactively. Before this retroactive recognition, however, the validity of the contract is only potential. Pending validity not only protects the interest of the person with rights but also takes account of the interest of their counterpart. In contrast, void contracts violate the law and thus are never valid. Such a contract cannot become

⁴¹ Wang Weiguo, *Lun Hetong Wuxiao Zhidu* [On the System of Void Contracts], FAXUE YANJIU [STUD. L.], No. 3, 1995, at 16.

⁴² BIJIAO HETONGFA [COMPARATIVE CONTRACT LAW] 410 (Zhou Linbin ed., 1989).

legally valid through the retroactive recognition of any person. This is the basic difference between a contract of pending validity and a void contract.

IX. VOIDABLE⁴³ CONTRACTS

Voidable contracts are contracts that can be voided at the request of an interested party because the expression of intent at the time the parties concluded the contract was not genuine. A majority of continental law countries classifies contracts that are not genuine expressions of intent as voidable contracts. According to the provisions of Article 59 of the GPCL, if a person seriously misunderstands the content of an act or an act is manifestly unfair, the act can be voided upon the request of the interested party. When such an act is voided, its legal validity is extinguished. China's civil law provides that only two types of acts involving false expressions of intent are voidable acts of contract. Other contractual agreements that are not genuine expressions of intent (such as those involving fraud or duress) are treated as void agreements.

In the drafting of the Uniform Contract Law, there are two different views on whether contracts involving fraud or duress should be considered voidable. The first view holds that contracts involving fraud or duress are voidable because in such situations the expression of intent is not real or is defective. According to this view, a defective expression of intent implies that the person expressing the intent has not done so freely. To fully preserve the free will of these parties and to prevent parties engaging in fraud or duress, the law should give the victims of fraud or duress the right to void the contract. The coerced party should have the right to determine the validity of the defective expression of intent and, after careful consideration of the contract's advantages and disadvantages, to decide whether or not to void it.⁴⁴

The second view holds that contracts involving fraud or duress are void. According to this view, the invalidity of such contracts is provided for in Article 58 of the GPCL and these provisions should be adopted in the Uniform Contract Law. The primary justification for this view is that acts of fraud or duress not only harm the interests of the parties but also threaten the social economic order. Thus, to safeguard the social economic order, the relevant administrative and judicial organs should intervene in cases of fraud or duress regardless of whether the defrauded or coerced party requests that

⁴³ Translator's Note: The Chinese term translated here is *kechexiao*. The verb *chexiao* can be translated as "to revoke," "to cancel," "to rescind" or "to void."

⁴⁴ *Id.* at 430.

the contract be voided. Moreover, merely forcing the perpetrator of fraud or duress to assume liability for returning property and compensating the victim is not a punitive sanction. Without punitive sanctions, acts of fraud and duress are difficult to prevent. Treating these contracts as void provides a basis for not only civil liability but also administrative liability on the part of the perpetrator of the unlawful act.

For several reasons, my opinion is that the first view is the most appropriate. First, under this view the autonomy and the choice of the victim is fully respected. In practice, contracts involving fraud or duress are very complex. Not every act of fraud or duress will cause the victim serious loss, however. In some situations, a victim of fraud or duress may still be willing to be bound by a contract because the harm resulting from the contract is not serious and because the victim is in need of the performance of the other party. If contracts involving fraud or duress are treated as void, however, they must all be declared void regardless of the opinion of the victim. Thus, the wishes of the victim may not be fully respected.

Second, treating such contracts as voidable is a manifestation of state intervention in the contractual relationship but also gives consideration to the interests of the victim. Victims themselves decide whether to void the contract and a court or arbitration organ ultimately decides whether the contract is voidable. Specifically, contracts involving fraud or duress are valid until voided. Up to this time, the parties are still bound by the contractual relationship. This prevents one party from using fraud or duress as a pretext for refusing to perform.

Third, treating these contracts as voidable protects the interests of third parties acting in good faith. When a party acquires property through fraud or duress and transfers it to a third person acting in good faith, the voiding of the contract is not effective against this third party. Thus, the voiding of a contract cannot serve as a basis for action against such third parties.

Fourth, the voidability of a contract is often related to contract modification. Article 59 of China's GPCL states that voidable contracts may be voided or modified and thus permits a party to pursue either course. When a contract is modified, its validity is preserved. Thus, contract modification involves only the amendment or supplementation of a contract and does not lead to the extinguishing of the contract. By permitting a party to either void or modify voidable contracts, the law gives the party a right to choose whether or not to preserve the contractual relationship. In cases where the party chooses to modify and not to void the contract, such a rule is beneficial to the stability of contract relations and promotes transactions. If a contract is void, then a party cannot choose to modify it.

In the interest of encouraging transactions and reducing the waste caused by voiding contracts, I think that a court or arbitration tribunal should not void a contract if a party only requests that it be modified. Moreover, when a person requests that a contract be voided but modification of the contract would be sufficient to preserve this person's interests, and does not violate the law or public interest, a court or arbitration tribunal should be able to merely modify the terms of the contract instead of voiding it. In all, I think that while contracts involving fraud or duress are not true expressions of intent, the Uniform Contract Law should treat them as voidable.

X. MANIFESTLY UNFAIR CONTRACTS

Manifestly unfair contracts are contracts that have been concluded by an inexperienced or pressured party and that are clearly detrimental to that party. Article 59 of China's GPCL provides that parties have the right to apply to a court or arbitration organ to modify or void civil acts that are manifestly unfair. This provision has become very flexible over the years because in practice there are no reasonable required elements defining manifest unfairness. In practice, many contracts that are not manifestly unfair have unreasonably been treated as voidable. As such, many scholars think that the provision does more harm than good and that it should be abolished. There are several principal reasons for this view.

First, the standard for manifest unfairness is too abstract and too difficult for judges to grasp and apply. This has led to inconsistency and even abuse in the implementation of the law. Second, the system of manifest unfairness is detrimental to efforts to preserve transactional security and the transactional order. Many parties have demanded that contracts be voided on the basis of unfairness because they have not been successful in their transactions. This encourages people to conclude contracts carelessly and is detrimental to transactional security. Third, it is impossible to require that the results of all transactions be fair to the parties. The law cannot guarantee that the result of a transaction is fair. It can only provide conditions for manifest unfairness.⁴⁵ Many scholars thus think that in drafting the Uniform Contract Law, the concept of manifest unfairness should not be adopted.

It is still important for the Uniform Contract Law to provide for a system of manifest unfairness. In practice, many problems have arisen in

⁴⁵ Shen Qingzhong, *Xianshi Gongping Minshi Xingwei de Guiding Bida Lixiao* [Provisions on Manifestly Unfair Civil Acts: More Harm than Good], FAXUE [L. SCI.], No. 8, 1993, at 28-30.

the application of the system of manifest unfairness. For example, the standard has been too abstract and too difficult to grasp and apply. The applicable scope of manifest unfairness has also been too broad. The problem with manifest unfairness is not that such contracts should not be voided. Instead, the problems have all arisen because specific and effective standards for manifest unfairness have not been established in the law. Thus, I think the view that Article 59 of the GPCL should be abolished is inappropriate. In fact, legal confirmation that manifestly unfair contracts should be voided has great significance for guaranteeing transactional justice, protecting the interests of consumers, and preventing one party from exploiting its dominant position or the inexperience of another party. (Of course, for these functions of the system of manifest unfairness to be realized, the legally required elements for manifest unfairness must be perfected.)

In academic circles, there are several different views on what the required elements for manifest unfairness should be. Presently, most scholars maintain that the one required element for manifest unfairness is the existence of an objective imbalance of interest between the parties and that manifest unfairness takes only this kind of objective imbalance into account. These scholars affirm that manifest unfairness should only be concerned with this kind of objective imbalance. The injured party thus avoids the burden of introducing evidence on the reasons for the manifest unfairness. This method also guarantees civil equality and the implementation of the fundamental principle of equivalency of value.⁴⁶

I believe that this view is worthy of deliberation. First, in considering whether a contract is manifestly unfair and should be voided, the law should not only consider whether the result is manifestly unfair but should also look at the cause of the manifest unfairness. If the manifest unfairness is the result of fraud or exploitation, then the resulting contract belongs in the category of fraudulent or exploitative contracts. Therefore, manifestly unfair contracts are different from contracts involving fraud or exploitation. If the cause of the manifest unfairness is not considered, it is very difficult to distinguish between acts of manifest unfairness and other acts because fraud, exploitation, and serious mistake can all give rise to a result that is manifestly unfair.

Second, only considering whether the resulting contract is unfair is inappropriate given the character and requirements of transactions. In a

⁴⁶ Zhou Yuwen, *Jingji Hetong de Xianshi Gongping Chusuo* [A Preliminary Investigation into Manifest Unfairness in Economic Contracts], FAXUE YU SHIJIAN [LEGAL STUDY & PRAC.], No. 5, 1991.

market economy, any party engaged in commerce should assume the risks of transactions. Transactional failure is common, and the law certainly cannot and should not guarantee that every party to a transaction realizes a profit. Transactions would not be possible otherwise. Permitting anyone who engages in an unsuccessful transaction to demand that their contract be voided because it is not profitable, and thus manifestly unfair, would force the other party to assume the transactional risk of the unsuccessful party. Inevitably, this would cause chaos in the economy.

Third, only considering whether the result is manifestly unfair will result in a large number of contracts being handled as manifestly unfair contracts. Under such conditions, many contracts will be voided inappropriately and the purpose of establishing a system of manifest unfairness will be defeated.

I think that there should be two required elements for manifest unfairness. The first is an objective element. Specifically, there should be an objective imbalance of interest between the parties. The second is a subjective element. Namely, one side must intentionally exploit its superior position or the weakness or inexperience of another party and conclude a contract that is manifestly unfair. Only when both the objective and subjective elements are present can one truly claim that there is manifest unfairness.

The relationship between manifest unfairness and change of circumstance is also a significant issue. Change of circumstance refers to a situation in which the parties have formed a valid contract but, because of a change of circumstance for which neither party is to blame, performance of the contract becomes manifestly unfair. In such a situation, the party can request the modification or rescission of the contract according to the principles of honesty and trustworthiness. From a legal perspective, change of circumstance and manifest unfairness are closely connected. A change in circumstance often causes the interests of the parties to become unbalanced. If performance of the original contract becomes manifestly unfair, then the contract needs to be modified or rescinded. In applying this rule, however, some local courts have handled transactional risks that should be assumed by the parties, such as fluctuations in market prices or changes in sales, as changes of circumstance. This can be attributed to the fact that China's current legislation lacks provisions, and especially limitations, on the change of circumstance doctrine. Thus, I think that it is absolutely necessary for the Uniform Contract Law to contain provisions on change of circumstance. Until such provisions are made, the problems in current practice that have been created by the lack of provisions on change of circumstance can be dealt with by expanding the applicable scope of manifest unfairness.

XI. CONTRACT MODIFICATION AND RESCISSION

From a broad perspective, contract modification refers to a change that takes place in the terms of or parties to a contract. From a narrow perspective, modification only refers to a change in the terms of a contract. In China's legislation and theory of civil law, changes in the parties to a contract are generally referred to as contract transfers. Modification is limited to changes in content. As such, contract modification refers to a situation in which the parties agree to amend or to supplement the contract after it has been formed but before it has been performed completely.

Rescission generally refers to an expression of intent by one or both of the parties that causes the contractual relationship to be extinguished from its inception or at a later time. Contract rescission can only occur after the contract has been validly formed and the conditions for rescission have arisen. The two acts are often closely tied together and there are many similarities between them. First, most modifications require bilateral consultation. This is also a method of rescinding a contract. Second, if an event of force majeure takes place and one party commits a serious breach of contract, either of the parties will enjoy the rights of modification or rescission. According to one view, in this situation there is not only an issue of the legal right to rescission, but also an issue of the legal right to modification. The right to modification refers to the right of a party to modify a contract when one of the conditions for legal modification arises and an expression of intent to modify the contract is delivered to the other party. Thus, according to this view, when force majeure precludes performance, one or both parties have the right to modify the contract. I think that while this view is certainly reasonable, it should be analyzed carefully. Undoubtedly, force majeure can create a right to modification. However, breach of contract only gives one party the right to a remedy and does not create a right to modification. Therefore, one cannot say generally that Article 26 of the 1993 ECL provides the parties with a right to modification.

Third, there are similarities between the procedures for handling modification and rescission. Modification and rescission must both be in writing. In the case of rescission through consultation, both parties must reach agreement. Before such an agreement is reached, the contract remains valid.⁴⁷ Because of these similarities, Article 26 of the 1993 ECL provides for both modification and rescission. Providing for modification and rescission in the

⁴⁷ Translator's Note: This is also true of contract modifications made through consultation.

same article is intended to simplify the law, but easily leads to misunderstandings such as the notion that contract modification and rescission are the same and thus interchangeable. Another such misunderstanding is that rescission is a form of modification and is nothing more than a change in the original contract that results in the complete termination of an unperformed obligation.

I think that contract modification and rescission are two different concepts that should be distinguished in legal theory. The important distinctions are as follows. First, contract modification involves the amendment or supplementation of non-material clauses of the contract and not fundamental changes in the material content of the contract. Also, modification does not require that the original contractual relationship be extinguished but only involves changes to some of the terms of the original contract. Of course, the modification of a contract creates a new contractual relationship, but the new contract must include the material content of the original contract. If the new contract does not assimilate the material content of the original contract, then it is not a modification of the original contract. It is a new contract that is formed after the old contract has been extinguished.

For example, the object of the contract is a material term of the contract. To change the object is to alter the fundamental rights and obligations under the contract. Therefore, in practice, the original contractual relationship ends if the object of the contract is changed. Rescission extinguishes the original contractual relationship but does not involve the establishment of a new contractual relationship. After rescission, performance of the contract is not possible, even if a party wants to perform.⁴⁸ Thus, rescission implies that some kind of transaction has been extinguished.

Second, contract modification primarily comes about as a result of unanimity through consultation. Because the terms of every contract are arrived at through consultation, the two parties must reach agreement through consultation in order to modify them. Modification of the contract without the agreement of the other party or a without a just reason cannot bind the other party. Moreover, such an act constitutes a breach of contract. In contrast, rescission can come about in many ways, only one of which is consultation. Even on the issue of consultation itself, modification and rescission are different. Article 28 of the FECL provides that "After the parties agree through consultations, a contract can be modified." The implication of this provision is that there must be a consultation for the contract to be modified,

⁴⁸ Translator's Note: Here, the author means that after rescission, the parties can perform unilaterally, but the performance will not be governed by the terms of the contract.

but that consultation is not necessarily required for the contract to be rescinded.

Third, contract rescission is one type of remedy for contract breach. After a breach by one party, the other party enjoys the right of rescission. However, there is no connection between contract modification and remedies; a breach of contract by one party does not give the other party a right to modify the contract. Instead, the injured party must often apply for other remedial measures such as rescission. Article 29 of the FECL links breach with rescission, but not with modification.

Fourth, in terms of legal consequences, no issue of retroactivity arises in contract modification because modification does not extinguish the original contractual relationship. The modification is usually only valid with respect to a part of the contract that has not been performed. That is, the party only performs according to the terms of the modified contract. Portions of the contract that were performed before modification are not changed. In contrast, contract rescission extinguishes the contractual relationship and is thus valid retroactively. In addition, if one party breaches a contract, the other party not only has a right to rescind the contract but also has a right to damages. Contract modification usually does not involve the issue of damages because it is not related to breach.

From the analysis above, it is apparent that the differences between contract modification and rescission outnumber their similarities. Thus, China's Uniform Contract Law cannot provide for them together on the basis of their similarities. Instead, the individual characteristics of modification and rescission should be fully contemplated in the law, and separate provisions should be made for each. This will help to both improve the systems of modification and rescission and ensure that contracting parties correctly modify and rescind contracts. In addition, separating the two practices is essential for encouraging transactions. If the parties can resolve their disputes through modification, then they need not rescind their contract and should be encouraged to modify it. Rescission is a relatively extreme practice because it extinguishes the contractual relationship. Applying this method too often is not beneficial to commerce and results in the unnecessary loss of property.

XII. CONSENT OF THE OBLIGOR TO THE ASSIGNMENT OF CONTRACT RIGHTS

An assignment of contract rights refers the obligor's act of assigning, by means of an agreement, all or a portion of the obligation rights under a contract to a third person. In practice, contract obligation rights are the object of a transaction in an assignment. Such transactions are a

consequence of the development of a market economy. Contract assignment will also promote the free transfer and flow of investment and accelerate the development of market transactions in China.

Generally speaking, contract assignment involves two kinds of relationships. The first is the original contractual relationship between the obligor and the obligee. The second is the relationship of assignment between the obligee and a third person (the assignor and the assignee). Although in assigning obligation rights the obligee disposes of them according to his own will and interests, this disposition generally affects the interests of the obligor as well. This situation creates a legal conflict of interest. From the perspective of protecting and respecting the rights of the obligee and encouraging transactions, the party with rights should be permitted to assign them freely if such an assignment does not violate the law, the social or public interest, or the contract. However, from the perspective of preserving the interests of the obligor and the stability of contractual relationships, the assignment of rights should be restricted appropriately. Namely, the agreement of the obligor should be obtained.

Scholars have three views regarding how the Uniform Contract Law should harmonize the interests of the assignor, the assignee, and the obligor in the system of contract assignment. One view holds that an obligor must agree to the assignment of contract rights for it to become effective. As provided in Article 91 of the GPCL, "A contracting party that assigns all or a portion of its contract rights to a third party shall obtain the consent of the other party and may not profit from it." Thus, according to this view, the Uniform Contract Law should continue to apply the provisions of the GPCL. A second view holds that the assignment of contract rights is simply a disposition of rights by the obligee. Thus, the consent of the obligor is not necessary for an assignment. The third view is that although an obligee does not need to obtain the consent of the obligor to assign obligation rights, the obligee must notify the obligor of the assignment. Such notification prevents the obligor from suffering damages stemming from a lack of awareness about the assignment.

In China's legal practice, there are some rules that embody the third view. For example, Article 21 of Several Opinions Concerning the Trial of Loan Cases by the Peoples Court, issued by the Supreme People's Court on August 13, 1991, states,

"[i]f a person against whom judgment is being executed lacks the funds to pay an obligation and requests to pay the obligation with bonds, stocks or other securities of value, approval should

be given if the party executing the judgment agrees. Requests to satisfy the obligation with another obligation right must be agreed to by the executing party, and the obligor of the person against whom the judgment is being executed must be informed. Such a payment should be handled according to the relevant procedures for the transfer of obligations."⁴⁹

In comparing the three views above, it is apparent that although there are some differences between the second and third views, neither asserts that that obligors must consent to assignments. In contrast, the first view asserts that obligors must consent to assignments. I think that the differences in these views are related to a conflict of values in contract law, namely the contradiction between efficiency and security. The view that the assignment of obligation rights by obligees does not require the consent of the obligor encourages the transfer of rights and considers such transfers to be a kind of transaction. Thus, encouraging the transfer of rights is significant for facilitating transactions, developing a market economy, and improving economic efficiency.

However, while the view that obligors must consent to an assignment of contract rights by the obligee restricts the free assignment of contract rights to a certain degree, it does help to stabilize contractual relationships, preserve the transactional order, and protect the interests of obligors. Suppose, for example, that A and B conclude a contract for the purchase of cement. If the buyer can assign his contract right to a third party without the consent of the seller, the seller cannot guarantee her interest because even if the seller is notified, she cannot know whether the third person has good credit or the ability to pay. If the third party does not have good credit or the ability to pay, it may be difficult for the seller to obtain performance after delivery. Conversely, if the seller can assign her contract right to a third person without the consent of the buyer, it is still possible that the goods produced or handled by the third party may not conform to the quality requirements set in the contract or that the third party may not have a good reputation. Thus, even if the buyer is notified of the assignment, it is still difficult for him to fully protect his interest. Of course, the law can protect the interests of obligors through simultaneous performance or the adversarial system, but even with such protections it is still difficult to avoid and reduce the number unnecessary disputes.

⁴⁹ Translator's Note: For the Chinese text of this opinion, see ZHONGHUA RENMIN GONGHEGUO FALU QUANSHU [COLLECTION OF THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA] 272-74 (Wang Huaian et al. eds., 1993)

When there is a contradiction or conflict between two legal values, it is necessary to decide which value to lean towards. I think that while efficiency is important, it is more important to preserve transactional order and security in China's initial period of market economic development. Because the current contract laws and their legal enforcement have yet to be perfected, many contracting parties lack a concept of contract and the necessary restraint that this concept imposes. As such, contracts have not been adhered to and a serious debt crisis exists in China; a transactional order has not yet truly formed. In such a situation, it is necessary to stabilize transactional relationships and preserve transactional security and order.

Transactional security and order are also fundamental preconditions for economic efficiency. Without order, even if transactions benefit the parties, they are inefficient from the point of view of the entire society. For these reasons, I think that it is necessary and reasonable to regulate the assignment of obligation rights by obligees appropriately and to require the consent of the obligor to assignments.

In requiring the obligee to obtain the consent of the obligor to assign contract rights, the meaning of consent should be appropriately understood. If the obligor does not indicate his consent after he is notified of the assignment by the obligee, then the assignment is not effective with regards to the obligor. However, after the obligee notifies the obligor, if the obligor does not give a clear answer within a reasonable time, then consent will be implied and the assignment will become effective. The obligee must also have a just reason for objecting to an assignment. If the obligor does not have a just reason for her objection, then the obligee can apply to the court to confirm the validity of the assignment.

XIII. ASSUMPTION OF OBLIGATIONS AND THIRD PARTY SUBSTITUTE PERFORMANCE

Assumption of an obligation is a form of contract transfer and refers to the assumption of an obligation by a third party on the basis of an agreement reached between the obligor, the obligee, and the third party. This occurs, for example, if the obligor and obligee agree that a third party will take the place of the obligor, become a contracting party, and thus perform the obligation for the obligee. The transfer of obligations can be a complete or a partial transfer. In the case of a complete transfer, the obligor breaks the original contract relationship; the third party takes the place of the original obligor and assumes the contract obligation. Scholars generally call such complete transfers of liability "assumptions of obligation that exempt

the transferor." In the case of partial transfers, the original obligor does not break the obligation relationship. The third party joins the obligation relationship and assumes the obligation to one obligee jointly with the obligor. This arrangement is called a simultaneous assumption of obligation.

So-called third party substitute performance ("third party performance") refers to a situation in which a third party has not concluded an agreement with the obligee or the obligor on the assignment of obligations and does not become a contracting party, but voluntarily takes the place of the obligor in performing the obligation. In most cases, the obligor himself performs the contract. According to the principle of freedom of contract, or from the perspective of protecting the interest of the obligee, substitute performance of the obligation by a third party should be legally valid as long as it does not violate the law or the contract, result in losses for the obligee, or raise the costs of the obligee. This is so because in essence, such a substitute performance conforms to the will and interests of the obligee. Of course, obligations performed by third parties are duties that, according to the nature of the law or the contract, do not have to be performed by the obligor herself and for which the effect of performance by the third party is the same as performance by the obligor.

There are superficial similarities between the assumption of an obligation and third party performance. A third party performing is like a substitute obligor assuming an obligation. Thus, some people think that if a system of contract assignment is provided for in the Uniform Contract Law, then it is not necessary to provide for a system of third party substitute performance. This view is inappropriate, because there are obvious differences between the assumption of obligations and third party substitute performance of an obligation.

First, in the assumption of an obligation, both the obligor and obligee reach agreement with the third party on the transfer of the obligation. Regardless of whether the obligor or obligee reaches agreement with a third party on the transfer of an obligation, the consent of the other party must be obtained or the transfer cannot become effective. However, in the case of third party performance, the third party unilaterally declares that he is satisfying the obligation in place of the obligor or concludes an agreement with the obligor to take his place in satisfying the obligation. The validity of the expression of substitute performance is not effective against the obligee, and the obligor does not need to request performance of the obligation

directly from the third party. In this sense, the assumption of payment can be called an "internal assumption of obligation."⁵⁰

Second, in an assumption of obligation, the obligor has already become a party to the contract. If the entire obligation is assigned, then the third party completely takes the place of the obligor, the obligor is free of the contractual relationship, and the original contractual relationship is extinguished. However, in the case of substitute performance by a third party, the third party is only the performing party and is not an obligor. The obligor can treat the third party only as a person assisting with performance of the obligation and not as a contracting party. A person assisting with performance is a person that, from the perspective of the obligor, assists the obligor in performing the obligation. There are two principal types of assisting persons. The first is an agent of the obligor and the second is person who is not an agent but who performs the obligation according to the intent of the obligor. There is generally some kind of employment contract or relationship of trust between a person assisting with performance and the obligor, but there is no contractual relationship between this person and the obligee. Therefore, the obligor is responsible to the obligee for the acts of the person assisting with performance.

Third, in the case of an assumption of obligation, if the third party does not perform the contract obligation, the obligee can directly request that the third party perform the contract or assume liability for breach of contract because this person has become a party to the contract. If the third party has completely taken the place of the obligor, then the obligee cannot demand that the obligor perform the obligation or assume liability for breach. In the case of third party substitute performance, the obligor should assume civil liability for the nonperformance of the obligation if the performance by the third party is not appropriate. In addition, the obligee can only request that the obligor, and not the third party, assume liability. As Article 329 of the German Civil Code provides: "If one party contracts to assume the duty to satisfy the obligee of the other party but does not assume the obligation, if doubt arises, the obligee cannot be regarded to have obtained the right to demand satisfaction from this party."

I think that because there are obvious differences between the assumption of an obligation and third party substitute performance, the two are not interchangeable. As such, the law must make clear provisions for both the transfer of contractual obligations and for third party substitute performance.

⁵⁰ COMPARATIVE CONTRACT LAW, *supra* note 42, at 299.

A related issue is the relationship between contract modification and contract assignment. Many scholars think that contract transfer and modification cannot be separated. In their view, modifications include changes to the contracting parties (such as in an assignment of the contract) as well as changes in the content of the contract. Thus, the Uniform Contract Law should not separate the two. I think that there are some substantive differences between the two concepts because contract assignment ordinarily leads to a change in the contracting parties. In the case of assignment, a third party takes the place of the original obligor or obligee or joins the obligee as a party to the contractual relationship. Changing the contracting parties often leads to the dissolution of the original contract or creates a new contract. However, in the case of contract modification, the parties are only amending the content of the original contract. The contractual relationship thus remains valid. Also, modification only involves two people and does not involve third parties. Thus, I think that contract modification and assignment should be regarded as distinct in the Uniform Contract Law.

XIV. SUBROGATION RIGHTS

Subrogation rights are an important part of the system of contract preservation. There are two basic forms of contract preservation, namely the obligee's right to void a contract⁵¹ and the right of subrogation. Subrogation rights arise when an obligor does not exercise the rights she enjoys against a third party to the detriment of her obligee's rights. In such a situation, the obligee, in order to insure his own rights, can exercise the obligation right of the obligor in his own behalf. This is called the right of subrogation.⁵² Because the right of subrogation is a right given to obligors under the law, both parties to a contract enjoy the right regardless of whether they have agreed to it.

Current civil legislation in China does not yet provide for a system of subrogation rights. Whether the Uniform Contract Law should provide for

⁵¹ Translator's Note: Here, the author is referring to the right of an obligee to petition a people's court to void an obligor's transfer of assets to a third party when such a transfer is made for little or no consideration. See *supra* note 23 and accompanying text.

⁵² Translator's Note: The Chinese word *daiweiquan* is commonly translated into English as a "subrogation right." YINGHAN FALU CIDIAN [AN ENGLISH CHINESE DICTIONARY OF LAW] 1064 (1985). However, the reader should note that the definition of the term subrogation in this Article differs from that commonly used in American law. In the United States, subrogation refers to "the exchange of a third person who has paid a debt in the place of the creditor to whom he has paid it, so that he may exercise against the debtor all the rights which the creditor, if unpaid, might have done." See BLACK'S LAW DICTIONARY, *supra* note 6, at 1427.

subrogation is an issue worthy of inquiry. For the following reasons, it is essential that the Uniform Contract Law contain provisions on subrogation. First, with the development of a market economy, the number of debt disputes is increasingly rapidly. For many reasons, however, the difficulty of trying debt cases is growing. This shows that many obligors, in order to conceal property or avoid debts, are intentionally refraining from asserting their own rights to the point of even dispensing with their obligation rights. This not only makes it difficult to enforce judgments in debt cases but also constitutes a threat to transactional morality and the social economic order. Second, without a system of subrogation rights, it will be difficult to ensure the interests of obligees when obligors intentionally refrain from exercising their obligation rights. An obligee can request that an obligor be declared bankrupt, but the obligor may not yet meet the conditions for bankruptcy or bankruptcy may be too extreme. In such cases, it may not be possible to resolve the problems of the obligee as quickly as possible through a declaration of bankruptcy. Thus, establishing a system of subrogation and permitting obligees to exercise obligation rights in the place of their obligors is essential.

With regards to the system of subrogation rights, several difficult issues must be explored. The first is the scope within which subrogation rights may be exercised. It is generally believed that subrogation rights should only be exercised to the extent necessary to protect an obligation right. This is to say that subrogation rights can only be exercised when there is a danger that obligation rights will not be realized. If the property of the obligor is sufficient to satisfy an obligation, then the obligor need only petition a court to forcefully execute on the property of the obligor. In such cases, the obligation right can be realized and it is unnecessary for the obligee to exercise the right of subrogation. If an obligee exercises a right of the obligor through subrogation and the exercise of this right is sufficient to protect the obligee's own obligation right, then the obligee should not exercise additional rights of the obligor through subrogation. It should be observed that a subrogated obligee should exercise the rights of the obligor in the obligee's own name and not in the name of the obligor. Finally, the obligee may not dispose of the rights of the obligor. (For example, the obligation right exercised through subrogation may not be assigned or extinguished.) Finally, in the process of exercising subrogation rights, the obligee must act as a fiduciary of the obligor. If the obligation is not handled properly and the obligor suffers injury, then the obligee should assume liability for damages. The Uniform Contract Law must clearly provide the form in which subrogation rights may be exercised. It must also provide that such rights may only be exercised in order to protect

obligation rights and must prevent obligees exercising such rights from harming obligors and third persons.

The second issue is the relationship between subrogation rights and contract relativity.⁵³ It is generally believed that the exercise of subrogation rights is a manifestation of the external validity of contracts. This is to say, when subrogation rights are exercised, the obligation right of the obligee is not only valid with respect to the obligor but also with respect to third persons indebted to the obligor ("a third party obligor"). I think that in reality, the exercise of subrogation rights is valid with respect to third persons. This is a special kind of validity provided for by law. It is not based on the agreement of the parties and does not fundamentally change the rule of contract relativity. Instead, the obligor must still adhere to the rule of contract relativity in exercising the right of subrogation. Any interests obtained by the obligee in exercising the rights of his obligor belong to the obligor. The obligee may not request that the third party obligor perform the obligation for him directly. Because there is no relationship of obligation between the obligee and the third party obligor, the third party obligor does not pay the obligee and the obligor has the duty to accept satisfaction of the obligation. Direct performance for the obligee not only breaks the rule of contract relativity, but also harms the interests of other obligors who have not exercised subrogation rights (i.e. when the obligee is obligated to other parties).

Several related issues are whether an obligee, after exercising subrogation rights, has first priority to be compensated from payments obtained through the exercise of the subrogation right and whether such an obligee has this priority if the third party obligor voluntarily performs for him. I think that the purpose of exercising subrogation rights is to preserve the property of an obligor. Thus, the property of the obligor jointly guarantees the rights of all obligees. It does not matter whether every obligee exercises subrogation rights; under the principle of the equality of obligation rights, all obligees should have the right to be compensated equally from the property of the obligor. Giving priority to an obligee that exercises subrogation rights is not in accord with the nature of obligation rights and will harm the interests of other obligees.

The third issue is whether subrogation rights should be exercised through litigation. Two methods of exercising subrogation rights have been adopted in the laws of foreign countries. These are the litigation method and self-help method. Obligees may use either method to exercise their subrogation rights. In China, some scholars advocate permitting obligees to

⁵³ See *supra*, Part III.

adopt the self-help method.⁵⁴ Presently in China, however, many parties to transactions still lack a deep consciousness of the law, the concept of contract, and the extreme threat that the debt crisis poses to the transactional order. Given this situation, I think that permitting obligees to exercise their subrogation rights through self-help would result in property disputes, arbitrary dispositions of obligors' property to fulfill the obligation rights of obligees, and other problems. If the litigation method is adopted, these problems can be effectively avoided and unnecessary disputes that stem from the exercise of subrogation rights can be effectively prevented. In particular, the litigation method guarantees that subrogation rights are exercised only to protect obligation rights and that other interests outside of obligation rights are not protected. Therefore, obligees should follow the procedures for forceful execution of judgments before they are permitted to satisfy their obligations with interests obtained through the exercise of subrogation rights.

XV. IMPOSSIBILITY OF PERFORMANCE

The concept of impossibility of performance ("impossibility") occupies a very important place in German contract law and in the contract regimes of civil law countries influenced by German law. This concept can generally be divided into initial impossibility and subsequent impossibility. Initial impossibility is a problem of obligation formation, while subsequent impossibility is a problem of obligation performance. These two problems are the two basic problems of contract. As the Taiwanese scholar Wang Zejian has noted, "Impossibility of performance is one of core problems of contract law."⁵⁵ However, scholars have two sharply divergent views on whether or not the system of impossibility should be adopted in China's Uniform Contract Law. My basic view is that China's Uniform Contract Law should not borrow this system. The two components of the system of impossibility are analyzed below.

A. *Initial Impossibility and the Invalidity of Contracts*

The concept of initial impossibility first arose in Roman law when the Roman legal scholar Celsus advanced the proposition, "obligations that are impossible to perform are void" (*impossibilium nulla obligatio est*). This

⁵⁴ Yang Lixin, *Lun Zhaiquanren de Daiweiquan* [Discussion of the Subrogation Rights of Obligees], *FALU KEXUE* [LEGAL SCI.], No. 4, 1990.

⁵⁵ WANG, *supra* note 25, at 415.

view greatly influenced German law. In 1853, the German legal scholar Mommsen, in related writings, stressed that if a contract is impossible to perform when it is formed, then the contract should be declared void. This view was fully adopted in Article 306 of the German Civil Code. According to this Article, "a contract for an impossible performance is void." This German provision was copied in Article 246 of the Civil Code of Chinese Taiwan, which states, "a contract for an impossible performance is void."⁵⁶

On the surface, it is logical that initially impossible contracts should be considered void contracts. If a contract cannot be performed when it is concluded, then it is unnecessary to maintain the validity of the contract and the contract should be declared void. In reality, however, this is not the case. Article 306 of the German Civil Code overlooks two things. First, this provision does not consider the reasons for the invalidity of the contract. Declaring contracts void in all cases of initial impossibility expands the scope of invalidity too far. Doing so could force contracting parties who are not at fault to bear the unfavorable consequences of a void contract. Because such parties do not know that the performance of the other party is not possible, they may incur certain costs in performing the agreed upon contract because they believe that the contract is valid. A void contract will not only damage the reliance interest of this party but will also damage its expectation interest. It may not be possible to restore all of these interests. If some contracts are not simply declared void, then parties not at fault can bring actions for breach based on the valid contract. This method may be of greater benefit to such parties.

Second, situations involving initial impossibility are extremely complex. In some situations, performing the contract is not absolutely impossible. This is true, for example, when a party is unable to pay or encounters some other economic difficulty with performance. In addition, if the obligor cannot perform because of illness, then it still may be possible for the contract to be performed. However, it may be inappropriate for the law to compel performance by this party. If initially impossible contracts are all declared void, then the parties in some contractual relationships will exploit the provisions on invalidity and, using initial impossibility as an excuse, turn contracts that can and should be performed into void contracts. Thus, simply declaring contracts void in all such situations may not be beneficial to transactional security and may not conform to the interests of the contracting parties, particularly those of the obligee.

⁵⁶ Translator's Note: For an English translation of the Civil Code of Chinese Taiwan, see MINFA [CIVIL CODE], *translated in MAJOR LAWS OF THE REPUBLIC OF CHINA ON TAIWAN* (James C. Liu et al. eds., 1991).

The problems of initial impossibility have been resolved relatively effectively in China's legislation and judicial practice. According to Articles 59 and 61 of the GPCL, when there is a serious misunderstanding regarding a civil act, the act can be voided. In such cases, the party at fault should assume liability for the voiding of the contract. Cases in which two parties mistakenly believe that the object of a contract exists when in fact it does not, or that some object exists when in fact that type of object does not, can be handled as serious mistakes. After the serious mistake occurs, the party with the right to void the contract should decide whether to void it and thus make it void from its inception. This can solve some problems with impossibility that arise from mistake. In China's judicial practice, situations in which one party (the seller) clearly knows that she does not have the ability to perform, and intentionally signs a contract, are handled as fraud.⁵⁷ A situation in which a party, through its own fault, loses the object of the contract before concluding the contract is not a situation involving force majeure and can be handled as a breach of contract. In all, since the problems of initial impossibility have already been resolved relatively well in China's present legislation and judicial practice, it is not necessary to import the German concept of initial impossibility. Doing so would only cause unnecessary irrationality in the law.

B. Subsequent Impossibility and Breach of Contract.

Another important kind of impossibility is subsequent impossibility. This concept relates to the problems of performance and breach of contract. According to German law, an obligor should be responsible if the impossibility of performance can be attributed to him. In German law, impossibility of performance and delay of performance are the two forms of contract breach. Every other more sophisticated type of breach is encompassed within these two forms. Thus, German law creates a system for "dichotomizing" the forms of contract breach.

I think that impossibility of performance cannot be an independent form of breach and can only be an objective factual state. Any form of contract breach can give rise to the problem of impossibility. In particular, impossibility can occur for many reasons in the process of performing a contract. If impossibility is treated as an independent form of breach, then it will be difficult to distinguish between impossibility and other forms of

⁵⁷ Supreme People's Court, Response on Several Problems Concerning the Specific Application of Economic Contract Law in Adjudicating Economic Contract Disputes (1987).

breach. Of course, the occurrence of impossibility will influence the form of remedy used. In a situation involving impossibility, the contract cannot be performed. Consequently, compensation for damages is substituted for actual performance. This is not because impossibility is an independent form of contract breach, however.

Because impossibility is only a state of fact, it cannot be taken to cover other forms of contract breach. As such, China's contract law cannot recognize this term as covering forms of breach. Contract law should start from Chinese reality in constructing a system for acts of breach. It should fix different constituent elements and remedies in accordance with different types of contract breach. By so doing, the law will give play the utility of the system of contract liability in maintaining the legal interests of the parties and the transactional order.