

‘Rule of Law’ in China: The Confrontation of Formal Law with Cultural Norms

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‘Rule of Law’ in China: The Confrontation of Formal Law with Cultural Norms

Larry A. DiMatteo[†]

This Article will be one of the first to fully examine the adoption of the first part of China’s long-term quest to enact a grand civil code. It is primarily an examination of the interaction between law and culture—this interaction is most visible when law is transplanted from one legal tradition (Western) into a country of a different legal tradition (Eastern). The *General Rules of the Civil Law of the People’s Republic of China* took effect on October 1, 2017. This enactment of general principles is the first step in what is expected to take up to five years to create a European-style civil code. There are multiple, interlocking themes to this Article. First it focuses on the general principles of contract law, comparing the current Chinese Contract Law of 1999 with the General Rules of 2017. This analysis of general principles is not merely confined to contract law but reflects the values and goals of Chinese society. A second theme explores the effectiveness and inherent problems of legal transplantation from one legal system to another. China is a unique example given the great mass of laws adopted in its transition to a socialist-market economy.

The review of general principles and analysis of the effectiveness of China’s transplantation of Western-style laws provides the basis for examination of the status of the “rule of law” in present day China. The rule of law is generally associated with public law, such as criminal and constitutional law, and concepts such as due process. This Article demonstrates the importance of the rule of law in the more mundane area of private law, in this case, the law of contracts. The examination of the rule of law in Chinese private law also has different dimensions. First, the Article examines the pivotal role that Chinese cultural norms—Confucian and socialist principles—has had in diminishing the rule of law in China. Second, the continued influence of government agencies and the low quality of the Chinese judiciary has also held back the implementation of a rule of law system in the private law realm. The Article concludes with the use of a hard-soft law paradigm to best understand the interaction of formal law and cultural norms in modern China.

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Introduction

[T]he political and civil laws of each nation must be proper for the people for whom they are made, so much so that it is a very great accident if those of one nation can fit another. . . . [The laws] must agree . . . with the customs [of the people].

- Montesquieu¹

This Article examines two divergences in the evolution of modern, market-oriented law in the People's Republic of China (China). The first divergence pertains to the difference between the intended meanings of transplanted law in the country of origin and the borrowing country. The second divergence relates to the rule of law—the difference between the

1. Eric W. Orts, *The Rule of Law in China*, 34 VAND. J. TRANSNAT'L L. 43, 44 (2001) (quoting 1 CHARLES DE SECONDAT, BARON DE MONTESQUIEU, *THE SPIRIT OF LAWS* 7 (Thomas Nugent trans., Fred B. Rotham & Co. 1991) (1751)).

objectivity of law as enacted and partiality of law as applied.² The first divergence relates to China's massive transplanting of Western-style law into an Eastern cultural and legal tradition. This transplantation was broad in scale and implemented with lightning speed given the broad sweep of legal evolution. Not surprisingly, there was a large divergence between implementation and understanding, leading to wholesale confusion and contradiction in the laws' interpretation. This divergence did not come as a surprise given China's Confucianist-Communist-Socialistic history. There was another divergence relating to the difference between the law on the books and the law in interpretation. If we assume uniformity of interpretation as an intended goal, other divergences have appeared between the meaning of the borrowed law in the country of origin and the meaning appropriated through the lens of Chinese cultural and socialistic norms. This divergence has been problematic in the application of individual legal rules and concepts as part of a body of holistic law. However, such culturally tainted meanings should not be considered as a failure of transplantation, but as the necessary intermixing of formal law with cultural, social, and legal norms of the accepting country.

At one level, the mass transplantation of Western-style law can be measured as a major success given the rapid expansion of China's market-export economy. However, this shrouds the weakness of the Chinese court system and its inability to comply with the rule of law. This has been a result of partiality and bias in the application of private law and the general lack of objective legal reasoning due to the low quality of the Chinese judiciary. The movement of the law of the person, based on the omnipotence of the Communist party and the hierarchical nature of roles in Confucianism, to the rule of law still need further development. With regard to the low quality of the judiciary, the Chinese government—mostly through the work of the Supreme People's Court (SPC)—has taken steps to improve the qualifications of judges and to obtain a more uniform application of law throughout the Chinese court system.

This Article focuses on the importance of the rule of law and the application of concepts such as fairness, justice, and due process in areas of private law, such as contract law, as opposed to the areas where these concepts receive more attention, such as constitutional, criminal, and human rights law. Chinese contract law provides an excellent case study of a country trying to adopt the rule of law in private law while limiting its application in the public sphere controlled by a Communist dictatorship. This schizophrenic split of the rule of law is unique and perplexing.

A. China as a Civil Law Country

China's gradualism in introducing formal (Western) law and recognizing contract and private property rights was best equipped to handle its

2. See William C. Jones, *Trying to Understand the Current Chinese Legal System*, in UNDERSTANDING CHINA'S LEGAL SYSTEM 7, 35–36 (C. Stephen Hsu ed., 2003) (discussing the dichotomy between the law in theory and the law in practice in China's contemporary legal system).

dramatic shift from a socialist-relational perspective of law's role in society to a private rights and formal law approach to managing legal relationships.³ After the destruction unleashed by the Cultural Revolution, it is understandable that the legal reforms begun by the Deng Xiaoping's government in the late 1970's and those that followed have been "so cautious and gradual."⁴

Just as the Chinese economy has accelerated in unprecedented fashion over the last thirty-five years, the Chinese government has implemented a massive expansion of Chinese law, most of which relates to the creation of a market economy. Almost the entire Chinese legal system has been created over this period, whereas for western countries it took centuries.⁵ A major part of this legal revolution is yet to be created—a grand or general Chinese Civil Code. This Article will examine the recently-promulgated first part of the Code project.

On March 15, 2015, the Twelfth National People's Congress of the People's Republic of China promulgated the first part of what is intended to become China's first comprehensive General Civil Code,⁶ entitled *General Rules of the Civil Law of the People's Republic of China (General Rules)*.⁷ The law went into effect on October 1, 2017. The idea of a comprehensive Chinese Civil Code is not a new one, as tentative steps towards its creation can be seen in various eras of modern China, including the late Qing Dynasty's (1902- 1911) production of a Draft Civil Code, the enactment of the first Chinese Civil Code in 1930 by the Kuomintang (Republican Government), and again in the early 1950s when a civil code was contemplated by the new Chinese communist government.⁸ The Kuomintang Civil Code was highly influenced by Chinese natural law theory, which focused on social

3. See Gil Lan, *American Legal Realism Goes to China: The China Puzzle and Law Reform*, 51 AM. BUS. L.J. 365, 425 (2014) ("China's emphasis on gradualism allowed the emergence of sociopolitical alignments of interests, which, at the time, better suited China's context.").

4. *Id.* at 396.

5. It is important to understand the difference between substance and praxis as it relates to Chinese law. The massive amount of legislative activity was set in the context of a Chinese judicial system ill equipped to understand and apply Western-style law. For example, it was not until 2002 that judges were required to pass a national bar exam. See Stanley Lubman, *Looking for Law in China*, 20 COLUM. J. ASIAN L. 1, 29 (2006). Thus, a divergence remains between the substantive law and its functional use, as well as uncertainty in its application. The independence and quality of the Chinese courts still remains an issue and until that issue is solved the legal system will remain less than fully functional. See *id.*

6. The Chinese government has committed itself to the adoption of a comprehensive Civil Code over the next four years. See Communiqué of the 4th Plenary Session of the 18th Central Committee of CPC, CHINA.ORG.CN (Dec. 2, 2014), available at http://www.china.org.cn/china/fourth_plenary_session/2014-12/02/content_34208801.htm [<https://perma.cc/3ZE7-DVBU>].

7. General Rules of the Civil Law of the People's Republic of China (promulgated by Nat'l People's Cong., Mar. 15 2017, effective from October 1, 2017), available at <https://www.dimt.it/images/pdf/GeneralRules.pdf> [<https://perma.cc/3GEJ-FSGT>] [hereinafter "General Rules"].

8. See Lei Chen, *The Historical Development of the Civil Law Tradition in China: A Private Law Perspective*, 78 TIJDSCHRIFT VOOR RECHTSGENSCHIEDENIS 159, 168-69 (2010).

harmony—the “we” over the “I” that favored conciliation and compromise in social (contractual) relationships. Thus, the Kuomintang Code is “characterised by a concern for social order rather than unbridled individual interests.”⁹ This same communitarian theme persists in current Chinese contract law and in the *General Rules*, which will be reviewed in this Article.

Chinese leaders selected a civil law system, as opposed to a common law system, because it was a better fit given the civil law’s reliance on general principles or general clauses, which can be found in the code-like precepts of Confucius, “while the individualistic common law approach did not fit into a Chinese communitarian society.”¹⁰ The Chinese government resurrected the idea of a civil code in the early 1980s, but this effort was ultimately rejected. In 1986, however, the National People’s Congress adopted a short instrument of a mere 156 Articles entitled the General Principles of the Civil Law (GPCL).¹¹ The GPCL was a milestone in a sense since it moved China toward a market economy, but it was not a great leap forward in crafting a civil code because it retained the ideas of public ownership of property and a “planned socialist commodity economy.”¹²

Oddly, there is strong evidence of a common-law style of legal system, based upon *panwen* (written legal documents) judgments or decisions, dating back to at least before the pre-Qin dynasty (before 221 B.C.).¹³ In this context we see that although Chinese law subsequently evolved through the use of civil-like codes,¹⁴ elements of the common law’s principle of precedent or *stare decisis* had been firmly entrenched. This is important in that it shows that the Chinese legal tradition moved beyond the “law of persons” or status based on Confucian principles, with *panwen* recognizing the importance of the rule of law that similar decisions and punishments should be prescribed for similar fact situations (also based upon Con-

9. *Id.* at 169 (citing CHEN JIANFU, FROM ADMINISTRATIVE AUTHORIZATION TO PRIVATE LAW 14 (1994)).

10. Chen, *supra* note 8, at 165. See also Roscoe Pound, *The Chinese Civil Code in Action*, 29 TUL. L. REV. 277, 289 (1955).

11. General Principles of Civil Law of the People’s Republic of China, (promulgated by the Nat’l People’s Cong., Apr. 12, 1986, effective January 1, 1987).

12. Chen, *supra* note 8, at 176–77.

13. See Norman P. Ho, *Confucian Jurisprudence in Practice: Pre-Tang Dynasty Panwen (Written Legal Judgments)*, 22 PAC. RIM L. & POL’Y J. 49, 55–56 (2013). See also Jialue Charles Li, Note, *China, A Sui Generis Case for the Western Rule-of-Law Model*, 41 GEO. J. INT’L L. 711, 737–38 (2010) (discussing precedent in the Han and subsequent dynasties and noting that Western scholars often ignore the role of precedent in ancient China). However, it is important to note that the ancient Chinese legal system pre-dated Western common and civil law systems. See JOHN W. HEAD & YANPING WANG, LAW CODES IN DYNASTIC CHINA 3–4 (2005) (noting that Chinese law predates and is distinguishable from the civil and common law traditions); *id.* at 135 (discussing the role of codification in civil and common law jurisdictions and distinguishing imperial China from both).

14. Chen, *supra* note 8. See also R. Randle Edwards, *The Role of Case Precedent in the Qing Judicial Process as Reflected in Appellate Rulings*, in UNDERSTANDING CHINA’S LEGAL SYSTEM 180, 180–81 (C. Stephen Hsu ed., 2003) (describing the ancient system in which rarely-changed “statutes” were adopted verbatim by subsequent dynasties, but “sub-statutes” evolved “in response to changing social needs”).

fucian principles).¹⁵ Later, in the early nineteenth century, predictability in the case law was demonstrated in partnership law, where the ability of partnerships to contract and the survivorship of the partnership after the death of a partner were universally accepted in some areas of China.¹⁶

The *panwen* system, which came into full force during the Han dynasty (206 B.C.–208 A.D.), was based on the application of principles to factual scenarios; analysis of context; and analogical reasoning from previously espoused *panwen* judgments. During the Han dynasty different types of *panwen* were developed using various types of reasoning. Dong Zhongshu was a key figure in developing the *panwen* system during the Han Dynasty. He used the Confucian text known as the *Spring and Autumn Annals* to derive general principles to be used in legal decisions.¹⁷ Dong also created hypothetical or model *panwen*, which can be seen as the precursor to the Chinese SPC's current practice of issuing *Guiding Opinions*.¹⁸ The principles derived from the *Spring and Autumn Annals* and the model *panwen*, known as the *Chunqiu Jueyu* practice,¹⁹ were applied to decide real cases. This was a way of bringing more consistency and objectivity to the legal system, which differs from the current Chinese court's

15. It was in the second century B.C. that the Emperor Wu officially adopted Confucianism as the guiding principles of government and society. It remained official state doctrine until 1911. See Mo Zhang, *The Socialist Legal System with Chinese Characteristics: China's Discourse for the Rule of Law and a Bitter Experience*, 24 TEMP. INT'L COMP. L.J. 1, 33 (2010).

16. Mark Allee found that in at least one Chinese locality in the early 1800s, courts treated *partnerships* as being capable of retaining or alienating contractual rights that survived the individual natural persons constituting the partnership. This arrangement almost certainly "had important implications for the rationality and predictability of economic transactions." See Mark A. Allee, *The Status of Contracts in Nineteenth-Century Chinese Courts*, in CONTRACT AND PROPERTY IN EARLY MODERN CHINA 159, 167 (Madeleine Zelin et al. eds., 2004). Interestingly, the development of these contract principles predated the transplantation (or imposition) of any Western legal concepts beginning with the Opium War era in the early 1840s. The role of judicial precedent, Allee concludes, was central to these contractual principles: "[These] cases suggest that, although the statutes of codified law may appear indifferent at best, precedents established through the findings of local courts were far from inimical to economic growth." *Id.*

17. See Ho, *supra* note 13, at 81.

18. The Guiding Case or Opinions System was announced by the SPC on November 26, 2010; Provisions of the Supreme People's Court Concerning Work on Case Guidance. The first Guiding Case was issued on May 2, 2012 in *Shanghai Centaline Property Consultants Ltd. v. TAO Dehua*, an intermediation contract dispute. See OU ZELIN, CHINA GUIDING CASES PROJECT, DISCUSSING THE GUIDING CASE SYSTEM WITH CHINESE CHARACTERISTICS BY FIRST COMBINING GUIDING CASE NO. 1 WITH ADJUDICATION PRACTICES 1, 2 (2012), available at <http://cgc.law.stanford.edu/wp-content/uploads/2012/11/CGCP-English-Commentary-4-Judge-Ou.pdf> [<https://perma.cc/ME5V-2S5T>]. The SPC's Guiding Cases deal with specific issues taken from real cases, presented in a concise format. See generally, NANPING LIU, OPINIONS OF THE SUPREME PEOPLE'S COURT: JUDICIAL INTERPRETATION IN CHINA (1997) (background on the Guiding Cases in modern PRC jurisprudence); Mo Zhang, *Pushing the Envelope: Application of Guiding Cases in Chinese Courts and Development of Case Law in China*, 26 PAC. RIM L. & POL'Y J. 269 (2017) (analysis of the Guiding Case system in place); Nanping Liu, *Legal Precedents with Chinese Characteristics: Published Cases in the Gazette of the Supreme People's Court*, 5 J. CHINESE L. 107 (1991) (examining the less formal, less authoritative prior practice of publication of SPC cases).

19. Ho, *supra* note 13, at 78–79.

inconsistent application of modern, Western-style laws. In sum, like other legal traditions, the legal traditions during the Han dynasty did not linearly progress from a status-based law to a rule of law (freedom of contract), but shows various mixtures of the two principles, with one type being more dominant than the other at given times.

B. Modern Chinese Contract Law

The evolution and codification of a general contract code culminated in the 1999 enactment of the Contract Law of the People's Republic of China, referred to as the Chinese Contract Law (CCL),²⁰ and led to subsequent "interpretations" of the SPC.²¹ The CCL and SPC interpretations can be seen as the first steps toward a general, uniform civil law of contracts. The new civil code, if completed as anticipated within the next five years, will hopefully include a new and improved law of contracts.

The movement towards a grand Chinese civil code is the culmination of the evolution of Western-style law in China following its shift to a partially free-market, capitalistic economy in the early 1980s and before the opening of the Chinese economy to international trade and investment. The first generation of modern Chinese contract law evolved as a piecemeal approach through the enactment of specialized bodies of contract law, including a domestic Economic Contract Law,²² Foreign Economic Contract Law,²³ Technology Contract Law,²⁴ and a Joint Venture Contract Law,²⁵ among others. A major event that led the Chinese government to embrace a more harmonized approach was its adoption of the United Nations Convention on Contracts for the International Sale of Goods

20. Zhonghua Renmin Gongheguo Hetong Fa [The Contract Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 15, 1999, effective Oct. 1, 1999), WIPO, available at <http://www.wipo.int/edocs/lexdocs/laws/en/cn/cn137en.pdf> [<https://perma.cc/8MHT-B8GK>] [hereinafter CCL].

21. The Supreme People's Court supervises the work of the local people's courts by issuing "Interpretations" on various areas of law. See, e.g., Ashley M. Howlett, *China's Supreme People's Court Issues Clarification and Interpretation of the Contract Law*, JONES DAY (Mar. 2010), http://www.jonesday.com/china_supreme_peoples_court/.

22. Zhonghua Renmin Gongheguo Jingji Hetong Fa [The Economic Contract Law of the People's Republic of China] (promulgated by the Nat'l People's Cong., Dec. 13, 1981, effective July 1, 1982), MINISTRY COM. CHINA, available at <http://english.mofcom.gov.cn/aarticle/lawsdata/chineselaw/200211/20021100053738.html> [<https://perma.cc/B5J4-QETD>].

23. *People's Republic of China Foreign Economic Contract Law*, United States Government, Foreign Broadcast Information Service (FBIS), 1 Daily Report: China, March 25, 1985, at K 12 (translation), available at <http://scholarship.law.berkeley.edu/bjil/vol6/iss1/3> [<https://perma.cc/MS3F-KCMU>].

24. Zhonghua Renmin Gongheguo Jishu Hetong Fa [Technology Contract Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., June 23, 1987, effective Nov. 1, 1987), CONSULATE GEN. CHINA N.Y., available at <http://newyork.china-consulate.org/eng/xbwz/kjsw/zgkj/t31701.htm> [<https://perma.cc/F9C7-96CN>].

25. Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa [Law of the People's Republic of China on Chinese-Foreign Joint Ventures] (promulgated by the Nat'l People's Cong., effective July 1, 1979), CHINA.ORG.CN, available at <http://www.china.org.cn/english/DAT/214773.htm> [<https://perma.cc/2WZN-7TQU>].

(CISG) in 1988.²⁶ The CISG represented China's first experience with an internationally-harmonized private law instrument. It also led to the development of a higher level of expertise in the Chinese court system, especially in Chinese arbitration tribunals. For example, the China International Economic and Trade Arbitration Commission (CIETAC),²⁷ China's premier international arbitration association, has demonstrated a somewhat astonishing grasp of the CISG and has proven its ability to interpret and apply Western-style laws in a non-biased manner.

The CISG and its application in China provided a model for constructing a harmonized Chinese law of contracts. Eleven years after the adoption of the CISG, the Chinese government adopted the CCL, which became effective on October 1, 1999. The law repealed the former specialized laws of contract, such as the Chinese domestic Economic Contract Law and the Foreign Economic Contract Law, and replaced them with a single law that covered both domestic and international contract transactions.²⁸ The CCL is the second generation of modern Chinese contract law. Hopefully, the new civil code will incorporate a third generation of contract law that will resolve the gaps and inconsistencies in the CCL.

Part I reviews the 1999 CCL and its sources and coverage. It also focuses on the general CCL principles espoused in articles 1-9, which will be compared in Part II with the general principles enunciated in the *General Rules*. Part II also examines the general principles of the *General Rules*, along with its specific provisions dealing with capacity and expressions of intent. Part III sets the context for evaluating the placement of the general principles in modern Chinese contract law by examining the role of Confucian and socialistic values on how the rule of law is viewed by Chinese society. Part IV provides an extended analysis of how the Western concept of "good faith" has been applied in the context of Chinese cultural norms. Part V proposes the construct of hard and soft law as a way to better understand the application of transplanted Western-style law in the Chinese legal system. The view of Chinese law as a mix of hard and soft law shows that the notion of China as a rule of law society remains somewhere in the future.

I. Contract Law of the People's Republic of China (CCL)

The enactment of the CCL was a milestone in Chinese legal development that led to the establishment of a market economy. It harmonized a

26. United Nations Convention on Contracts for the International Sale of Goods, Vienna, 11 April 1980, S. Treaty Document No. 98-99 (1984), UN Document No. A/CONF 97/19, 1489 UNTS 3.

27. CHINA INTERNATIONAL ECONOMIC AND TRADE ARBITRATION COMMISSION, <http://www.cietac.org/?l=EN> [https://perma.cc/38DG-SYZ3]; see generally Larry A. DiMatteo, *Contractual Excuse under the CISG: Impediment, Hardship and the Excuse Doctrines*, 27 Pace Int'l L. Rev. 261 (2015).

28. The CISG remains China's international sales law, but in non-sales international transactions the CCL is the applicable law.

piecemeal set of contract laws into a thick, comprehensive set of rules based upon Western legal tradition.

A. Sources and Coverage

The CCL is an improvement over the earlier nascent contract laws because it harmonizes Chinese contract law into a single instrument, is a more modern law, and is a relatively comprehensive instrument with 428 articles. The CCL provides both a general law of contract, like the common law, and specialized rules that are applicable to different contract-types more aligned with the nominate contracts in Roman and modern civil law.²⁹ Its “general provisions” follow the Western-style template of rules covering the formation, performance, termination, and remedies related to breach of contract. The “specific provisions” parts provide particularized rules for different types of contracts involving the sale of goods (domestically), gifts (charitable subscriptions), leasing, lending, financial, services, construction, carriage of goods, technology transfers, deposits, bailment, agency, and brokerage. This follows a civil law approach, in contrast to the common law of contracts, which applies directly to many of the listed contracts in the Chinese law’s specific provisions. Similarly, in the United States legal system, the passage of the Uniform Commercial Code (UCC) provided specialized rules for commercial contracts involving the sale of goods, leasing of goods, negotiable instruments, secured transactions (financing), wire transfers, documents of title, letters of credit, and bulk transfers.³⁰

The drafters of the CCL, in their quest to enunciate a truly Western-style, modern free-market contract law, borrowed from a host of different sources, including the CISG, UNIDROIT, Principles of International Commercial Contracts (PICC),³¹ Principles of European Contract Law (PECL),³² German Civil Code (BGB),³³ American UCC, and the common law, among others. The problem with the use of so many different sources

29. A “nominate contract” is a standardized contractual relationship that has a special designation attached to it, such as purchase and sale, lease, loan, and insurance contracts. For example, Justinian identified four types of real contracts, including contracts *in re* (in a thing), *mutuum* (loan for consumption), *commodatum* (loan for use), *depositum* (deposit), and *pignus* (pledge). See BARRY NICHOLS, AN INTRODUCTION TO ROMAN LAW 167 (1962).

30. The Articles of the UCC include: General Provisions (Art. 1), Sale of Goods (Art. 2), Lease of Goods (Art 2A), Negotiable Instruments (Art. 3), Bank Deposits and Collections (Art. 4), Wire Transfers (Art. 4A), Letters of Credit (Art. 5), Bulk Sales (Art. 6), Documents of Title (Art. 7), Investment Securities (Art 8), and Secured Transactions (Art. 9), available at <https://www.law.cornell.edu/ucc> [<https://perma.cc/ZU44-35ZL>].

31. INT’L INST. FOR THE UNIFICATION OF PRIV. L., UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS (2010), available at <http://www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010-e.pdf> [<https://perma.cc/A9D6-MNJC>].

32. COMMISSION ON EUROPEAN CONTRACT LAW, PRINCIPLES OF EUROPEAN CONTRACT LAW, PARTS I AND II (Ole Lando ed., 2000), available at https://www.trans-lex.org/400200/_/pecl [<https://perma.cc/8BRN-J9V8>].

33. BÜRGERLICHES GESETZBUCH [BGB] [Civil Code], translation at http://www.gesetze-im-internet.de/englisch_bgb [<https://perma.cc/7VRF-6QVN>] (Ger.).

is that it led to numerous gaps and inconsistencies in the CCL.³⁴ For example, the CCL borrowed many of the formation rules found in the CISG, but failed to adopt the full set of acceptance rules, leading to a gap subject to different interpretations of if and when a late acceptance leads to a conclusion of a contract.³⁵ In the area of insecurity of performance, the CCL adopts two types of protections with different sets of rules—defense of insecurity, taken from German law, and anticipatory breach, taken from the CISG and the common law. The result is an overlapping system of rules dealing with similar real-world situations, leading to a great deal of inconsistencies in the law and in its application.³⁶

B. General Principles of the CCL

The CCL has three key objectives set out in Article 1 CCL: (i) to protect the lawful rights and interest of the contracting parties; (ii) to maintain social and economic order; and (iii) to promote socialist modernization. The principles set out in subsequent articles serve two functions: (i) to guide the interpretation of specific substantive provisions of the CCL and (ii) to be used as a basis on which gaps in the CCL could be bridged when adjudicating a particular matter.³⁷

The first general principle underpinning all contractual agreements is that of “equality” as found in Article 2’s recognition that the parties are equal and Article 3’s obligation that no party may impose its will upon the other party. This suggests that no coercion in the process of contract formation or contract performance is permissible. However, this general assumption leaves unclear what should happen if there are clear instances of an inequality in the position of the parties: “The one thing that is perhaps missing from the CCL’s agreement-based definition of the nature of the contract is that it is not specified that the agreement must be *intended* by the parties to have the force of law, or—to put it another way—that in making the agreement the parties are demonstrating *consent* to be bound at law.”³⁸ The importance of intention in the bindingness of contractual obligations is clearly implied in the *General Rules*.³⁹

34. See LARRY A. DiMATTEO & LEI CHEN, *CHINESE CONTRACT LAW: COMPARATIVE PERSPECTIVES*, 18, 21, 50, 403, 466, (2017).

35. See Jingen Wang & Larry A. DiMatteo, *Western Reception and Transplantation of Western Contract Law*, 34 *BERKELEY J. INT’L L.* 44, 45 (2016).

36. For example, the CCL adopted both the common law concept of anticipatory repudiation (breach) and the civil law concept of defense of security. These doctrines serve similar purposes but diverge in the area of application. See CCL, *supra* note 20, at arts. 68, 69, 94 and 108.

37. See DiMATTEO & CHEN, *supra* note 34, at 45.

38. *Id.* at 117–18.

39. See *General Rules*, *supra* note 7, at arts.: 133 (“civil juristic acts . . . [include] the establishment, alteration, and termination of civil legal relations through an expression of intention”); 137 (“expression of intention, which is made by dialogue, takes effect when the person knows the content”); and 140 (“persons of civil conduct may make an expression of intention by express or implied ways”).

The second principle is that of “voluntariness,” or party autonomy,⁴⁰ found in Article 4 CCL, according to which parties have “the right to voluntarily conclude contracts.” This concept includes the prohibition that “no unit or individual may illegally intervene therein,” which still leaves open the possibility for restrictions imposed by law on the exercise of the right to conclude a contract. It seems that the principle of “voluntariness” should not be equated too readily with the notion of freedom of contract which is the hallmark of the common law of contract (and, indeed, of all Western legal systems);⁴¹ rather, it might better be understood as freedom to contract. This is more than just semantics—as the discussion of the common law approach will show, freedom of contract is about much more than just enabling parties to enter into legally binding agreements.

Article 3 may be read in different ways. It can be seen as a further emphasis on the importance of freedom of contract as articulated in Article 2. Or, it can be interpreted as focusing on abuse of bargaining power. It states that “parties are equal in their legal status, and no party may impose his own will upon the other party.” The phrase “equal in their status” may be a simple recognition that all civil parties have the freedom to enter into contracts. However, the phrase “no party may impose his own will upon the other party” is vague. It could be viewed narrowly as simply encompassing cases of fraud or coercion (duress) found elsewhere in the CCL. Or, it could be broadly construed as preventing a party with superior bargaining power of overreaching by negotiating a highly one-sided contract. The broader interpretation would recognize a principle not seen in other legal systems.

Article 4 can also be seen as ancillary to the principle of freedom of contract. It states that everyone has the “right to voluntarily conclude contracts.” Freedom of contract is further reinforced by Article 8, which states “contracts concluded according to law are legally binding on the parties.”

The behavior of the parties to a contract is then regulated by the third and fourth general principles: first, in determining their respective rights and duties, the parties must observe the “principle of fairness” (Article 5); secondly, in exercising their rights and performing their duties, parties must observe the principle of “good faith” (Article 6). Unfortunately, the CCL fails to provide factors directly relevant to the application of Articles 5 and 6, leaving it for the courts to specify the factors that will be relevant in establishing whether both parties have complied with the threshold requirements of fairness and good faith. There are other provisions in the CCL, particularly on good faith, which provide greater detail: Article 42 CCL holds a party liable for (i) negotiating in bad faith; (ii) intentionally

40. See Zhang Yuqing & Huang Danhan, *The New Contract Law in the People's Republic of China and the UNIDROIT Principles of International Commercial Contracts: A Brief Comparison*, 5 UNIFORM L. REV. 429, 431 (2000).

41. See JUNWEI FU, MODERN EUROPEAN AND CHINESE CONTRACT LAW: A COMPARATIVE STUDY OF PARTY AUTONOMY 39 (2011); Junwei Fu, *Towards a Social Value Convergence: A Comparative Study of Fundamental Principles of Contract Law in the EU and China*, OXFORD UNIV. COMPARATIVE L. F. 4-5 (2009).

concealing a fact or providing wrong information; and (iii) any other instance which violates the principle of good faith. This suggests that two of the key aspects of “good faith” are honesty and transparency. Moreover, Article 60 requires that the parties observe the principle of good faith in performing their obligations.

The fifth general principle can be summarized as the “compliance with public interest.” “Although China has moved towards a rule of law system, public policy still plays an important role.”⁴² Since fairness is singled out as a public policy concern, the “Chinese courts work more like a court of equity rather than a court of law in an effort to promote fairness.”⁴³ Thus, Article 7 specifies that parties must act in accordance with relevant laws when concluding and performing a contract, respect public morals, and not disturb the social and economic order nor harm the public interest. What seems like a reasonable obligation imposed on the parties could potentially form the basis for far-reaching intervention into the contracting process—from negotiation to content to performance.

Professors Wang Liming and Xu Chuanxi have argued that the general principles of the CCL can be categorized as serving three fundamental values—“freedom of contract (*hetong ziyou*), good faith (*chengxin*), and the fostering of transactions (*guli jiaoyi*).”⁴⁴ The principles of freedom of contract and good faith are contractual bedrock. All contract laws are premised on the freedom of parties to create their own private law (contract). Almost all contract law systems recognize the principle of good faith as a means of facilitating contractual exchange (filling gaps and interpreting contracts) and as a policing mechanism to regulate abuse of freedom of contract.

The more interesting principle flagged by Wang and Xu is the principle of the fostering of transactions. This principle must be placed in the context of the first generation of contract laws, such as the Economic Contract Law and the Foreign Economic Contract Law, and their shortcomings and the advancement of a more modern unified contract by the enactment of the 1999 CCL. They argue that the earlier contract laws too often invalidated contracts by only recognizing the remedy of voidness and not voidability, as well as invalidating contracts due to ambiguity. In contrast, provisions of the CCL foster contractual exchange, when the parties indicate a general intent to enter a contract, as well as giving the victim of an invalidating act the right to reaffirm the contract (voidability).

A brief review of the main differences between the CCL and its predecessor laws will illustrate the contract friendly nature of the CCL. First, Article 58 of the GPCL renders void all contracts where there is evidence of duress, fraud, or exploitation of a party’s vulnerability. Under the CCL, the victim of such conduct has the right to enforce or seek termination.

42. John H. Matheson, *Convergence, Culture and Contract Law in China*, 15 MINN. J. INT’L L. 329, 380 (2006).

43. *Id.*

44. Wang Liming & Xu Chuanxi, *Fundamental Principles of China’s Contract Law*, 13 COLUM. J. ASIAN L. 1, 2 (1999).

Thus, more contracts deemed to be invalid *per se* under the previous law are now fully enforceable. Second, the previous contract laws automatically terminated contracts if they violate a law or regulatory provision. The CCL requires that such termination only apply to national-level laws and regulations.⁴⁵ Third, since the previous laws did not provide rules of interpretation, if courts were faced with a contractual ambiguity, then they commonly held the contract to be invalid due to the ambiguity (lack of mutual assent). In contrast, the CCL provides a number of rules of interpretation, which essentially force the courts to fill in the gaps of an otherwise viable contract.⁴⁶ Article 38 requires that standard terms shall comply with the principle of fairness. Article 41 provides that: (1) standard terms “shall be interpreted in accordance with the usual understanding of the term;” (2) the term is to be interpreted in a way least favorable to the drafter if there is more than one reasonable interpretation; and (3) if in conflict, a non-standard term prevails over a standard term. Article 62 provides a number of gap fillers, including a quality term (“contract shall be performed in accordance with the state standard or industry standard”);⁴⁷ price term (“market price prevailing in the place of performance at the time of the conclusion of the contract”);⁴⁸ performance (“obligation to pay money shall be performed at the place where the party receiving the money resides” and “in regard to other subject matters, the obligation shall be performed at the place where the party performing the obligation resides”);⁴⁹ and time of performance (“debtor may perform the contract at any time and the creditor may demand performance at any time, but the other party shall be given the necessary time for preparation”).⁵⁰ It is important to note that even though the CCL was a major advancement in the development of a Western-style contract law, over the contract laws that came before, it should be viewed as transitional in nature. The CCL needs to be replaced by a third-generation law, one that hopefully fixes the ambiguities, gaps and inconsistencies that have become apparent in the nearly twenty years of experience in the application of the CCL.⁵¹

II. General Rules of the Civil Law of the People's Republic of China

This part reviews the *General Rules* of Civil Law beginning with the structure and coverage of its six chapters: General Principles, Legal Capacity, Legal Persons, Non-Incorporated Organizations, Civil Rights, and Civil Juristic Acts. It then focuses on the ten substantive principles found in

45. See CCL, *supra* note 20, at art. 52.

46. See CCL, *supra* note 20, arts. 38 (standard terms), 41 (standard terms), 53 (exemption clauses), 62 (gap-fillers) & 63 (price), and 66 (sequence of performance).

47. *Id.* at art. 62(1).

48. *Id.* at art. 62(2).

49. *Id.* at art. 62(3).

50. *Id.* at art. 62(4).

51. See, e.g., Wang & DiMatteo, *supra* note 35 (gaps in late acceptance rules and right to cure overlap between defense of insecurity and anticipatory breach).

Articles 1-10 before briefly discussing the provisions on capacity and expression of intention.

A. General Structure

This initial part of what is intended to be the enactment of a grand civil code consists of 206 articles. It is important to note that the title to this 2017 law begins with “General Rules.” It will thus play a crucial role in the framing of the rest of the code. Initial interpretation of its articles will be vitally important in setting the tone for the entire code. As with the CCL, *General Rules* include potentially conflicting principles and articles due to the remaining influence of Chinese customary law and socialist principles. The first twelve articles making up Chapter I, much like what is found in the CCL, provide the general principles to be used in the interpretation and application of the specific rules enunciated in the *General Rules*, as well as parts of the civil code to be promulgated in the future. A detailed analysis of the general principles will be undertaken below.

Chapter II covers the areas of legal capacity including the rights of minors to enter into contracts,⁵² guardianship,⁵³ declarations relating to death and missing persons,⁵⁴ the status of business organizations, and leased farm owners.⁵⁵

Chapter III is entitled “Legal Persons.” It consists of some forty-five articles⁵⁶ and covers not only natural persons, but also an assortment of business organizations including for-profit and not-for-profit businesses or organizations, along with “special persons.” Special persons cover an array of government, quasi-government, and communal organizations. The continuing existence of collective farms, a holdover from the previous communist-socialist view of property, means that the ownership of farming land is based upon contract rights and not real property rights. The title to the land is held by the collective and not by the individual farmers. Article 99 states that: “The rural collective economic organisations shall obtain the legal personality according to law.” This type of system is a product of the historical creation of the communist system in China before its transition into a market economy. Farm cooperatives exist in the United States, but they mainly serve the purposes of marketing and selling goods of small-to medium-sized farms, which are privately owned.

Chapter IV regulates “non-incorporated organizations,” which are defined as “organizations that have no legal personality but may lawfully engage in civil activities under their own names.”⁵⁷ These types of entities can be seen as variants of Western business organizations, such as partnerships, limited liability companies, and professional associations. However, under American law, the limited partnership (LP), limited liability com-

52. *General Rules*, *supra* note 7, at arts. 13-25.

53. *Id.* at arts. 26-39.

54. *Id.* at arts. 40-53.

55. *Id.* at arts. 54-56.

56. *Id.* at arts. 57-101.

57. *Id.* at art. 102.

pany (LLC), limited liability partnership (LLP), and the professional association (PA) all provide limited liability protection for its partners and members. Chapter IV provides that: "If the property of the non-incorporated organization is insufficient to pay off the debts, investors or the founders shall bear unlimited liability."⁵⁸

Chapter V is a wide-ranging section covering "Civil Rights."⁵⁹ But the notion of civil rights is construed to include property rights and is not a listing of fundamental human rights as can be found in the American Bill of Rights⁶⁰ or the United Nation Universal Declaration on Human Rights of 1948.⁶¹ Instead, its focus is on individual property rights. Again, this is a product of the continuing transition from public to private ownership of property. Chapter V covers such areas as property rights,⁶² contract rights,⁶³ privacy rights,⁶⁴ intellectual property rights,⁶⁵ as well as the right to bring actions for breach of contract, tort,⁶⁶ and unjust enrichment.⁶⁷ Other provisions provide for fundamental human rights but are couched in vague, general, and abstract phraseology.⁶⁸

Chapter VI entitled "Civil Juristic Acts" provides a brief framework of contract law. It covers the requirements of contract and contract formation; conditions;⁶⁹ defenses concerning validity relating to breach of contract, such as "fake expression of intent,"⁷⁰ mistake,⁷¹ fraud,⁷² duress,⁷³ and unfairness;⁷⁴ limitation periods (statute of limitations);⁷⁵ termination;⁷⁶ contract interpretation;⁷⁷ and restitution.⁷⁸ Although this litany of provisions covers many areas of contract law, it is vastly short of being a comprehensive contract law in itself. It is strange that the drafters placed substantive contract law rules in the *General Rules*. One explanation is this cursory list of contract law rules serves as a preamble to necessarily more comprehensive bodies of rules and principles—laid out in independent parts, such as the law of persons and the law of obligations—of the general

58. *Id.* at art. 104.

59. *Id.* at arts. 109-32.

60. U.S. CONST. amends. I-X.

61. G.A. Res. 217 (III) A, Universal Declaration of Human Rights (Dec. 10, 1948).

62. *General Rules*, *supra* note 7, at arts. 113-17.

63. *Id.* at art. 119.

64. *Id.* at arts. 111 & 127.

65. *Id.* at art. 123.

66. *Id.* at art. 120.

67. *Id.* at art. 122.

68. See *id.* at art. 109 ("personal freedom and personal dignity"); *id.* at art. 110 ("right to life, health rights, physical rights," as well as the "right of honour"); *id.* at art. 132 ("civil subjects shall not abuse civil rights and damage the national interests").

69. *Id.* at arts. 158-59.

70. *Id.* at art. 146.

71. *Id.* at art. 147.

72. *Id.* at arts. 148-49.

73. *Id.* at art. 150.

74. *Id.* at art. 151.

75. *Id.* at art. 152.

76. *Id.* at art. 152.

77. *Id.* at art. 142.

78. *Id.* at art. 157.

civil code to be enacted in the future. This must be the intent of the drafters since the *General Rules* do not repeal the CCL; that will only come if the law of obligations is later added to the *General Rules*. This raises questions regarding the motivation behind placing a hodge-podge set of rules on contract law in the first part of what is to become a general civil code. Also, left unanswered is how are these contract rules to be applied vis-à-vis the CCL? These questions will be discussed in a later section. The *General Rules* conclude with a chapter on agency law,⁷⁹ civil liability,⁸⁰ and general limitation periods.⁸¹

B. General Principles

This part will examine the general principles enunciated in the first ten articles of the *General Rules*. More specifically, the analysis will focus on the general principles and their application to contract law—interpretation of contract law rules and the interpretation of contracts. This focused analysis is due to two factors. Much of the *General Rules*, as discussed above, are directly related to contract law (rules on intention to be bound, capacity, defenses and validity of contracts, limitation period, and agency law). Second, the principles in the *General Rules* can be compared to the general provisions found in the CCL. In the latter case, this will allow a longitudinal analysis of changes to the values advanced in the 1999 CCL with the 2017 *General Rules*.

1. Rule of Persons and Rule of Law

The ten general principles provided in the *General Rules* include a mix of freedom of contract and freedom of contract-restricting values. A blend of Western-capitalistic values with Confucian-socialistic norms are represented in Article 1, which call for the new law to be “adapt[ed] to the requirements of the development of socialism with Chinese characteristics, and carrying forward socialist core values.”⁸² The phrase “Chinese characteristics” can be traced to Deng Xiaoping who was the supreme leader of China from 1978 to 1997, and was the force behind China’s opening up to Western trade and investment, as well as beginning the transition to a market economy.⁸³ Prior to Deng, China’s Communist-Socialist system was based substantially on the Soviet model.⁸⁴ That model was based on a

79. *Id.* at arts. 161–75.

80. *Id.* at arts. 176–87.

81. *Id.* at arts. 188–205.

82. *Id.* at art. 1.

83. See Carlos Wing-Hung Lo, *Socialist Legal Theory in Deng Xiaoping’s China*, 11 *COLUM J. ASIAN L.* 469, 470 (1997).

84. See Yu Xingzhong, Comment, *Legal Pragmatism in the People’s Republic of China*, 3 *J. CHINESE L.* 29, 32 (1989). The Soviet law influence on China began to wane beginning with Mao Zedong’s split with the Soviet Union and the near destruction of the Chinese legal system during the Cultural Revolution. See, e.g., ODD ARNE WESTAD, *RESTLESS EMPIRE* 343 (2012) (discussing Mao’s role in destroying the Sino-Soviet relationship in the early 1960s); JOHN KING FAIRBANK & MERLE GOLDMAN, *CHINA: A NEW HISTORY* 398 (2d enlarged ed. 2006) (discussing the ways in which Mao’s policies diverged from the Soviet Union). And even when Chinese law borrowed from Soviet law, Maoist law also

centralized planned economy. Deng declared that it was important that China move away from the Soviet model and create a model of socialism (including a socialistic economy) based upon “Chinese characteristics.”⁸⁵ At this time, the idea of a socialist market economy was still viewed in the context of the law as being instrumental to advancing the policies of the State.

At the same time, Deng’s major contributions were advancing the view that all citizens were equal before the law—shifting the Mao mindset that viewed the law as the “rule of persons” (instrumental to government-control of the people) to “rule of law” in which the government is subservient to the law.⁸⁶ In the end, Deng’s view of rule of law was not one that would diminish the power of the State and the Communist Party. Instead, he advanced the notion that law should be a vehicle for the creation of individual wealth and, thus, the use of the legal system and the application of law should aim to improve the material well-being of the people.⁸⁷ Thus, even though the State and the Communist Party remain the dominant forces in China, the broadening of the rule of law has reduced the role of these entities in economic life. More importantly, under rule of law, the judiciary becomes superior to the Party. This is clearly not the case at present, but the idea remains robust and should influence legal development in the future.

2. Normative Tension

All contract law systems demonstrate underlying tensions between the dominant value of freedom of contract and an assorted number of principles aimed at curtailing abuse of that freedom. For example, the principle of good faith is recognized by almost all national legal systems, whether civil or common law. At one end of the spectrum, German law places an extraordinary emphasis on the principle of good faith in the interpretation and enforcement of contracts.⁸⁸ At the other end, English law continues to reject an implied duty of good faith in contracts.⁸⁹ It has become an outlier as other common law systems such as those of Australia,⁹⁰ Canada,⁹¹ New

drew from other sources including civil law, common law, and ancient Chinese legal traditions, as well as Mao’s own Communistic philosophy. See Victor H. Li, *The Role of Law in Communist China*, 44 CHINA Q. 66, 74 (1970).

85. Carlos Wing-Hung Lo, *supra* note 83, at 470.

86. See *id.* at 469, 475–78.

87. *Id.* at 475. Deng viewed the formal law as a means to facilitate wealth creation, but not a Western-style rule of law. See JUNE T. DREYER, CHINA’S POLITICAL SYSTEM 5 (9th ed. 2014) (noting that Deng’s view of the rule of law was not democratic or civil-libertarian but purely instrumental; it was “necessary to resolve disputes . . . before the wheels of production could hum smoothly.”).

88. See BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], § 242, *translation at* https://www.gesetze-im-internet.de/englisch_bgb/index.html [<https://perma.cc/BUD6-SU39>] (Ger.).

89. *But see* Yam Seng Pte Ltd. v. Int’l Trade Corp. [2013] EWHC (QB) 111, [153] (Eng.) (noting that the duty of good faith can be recognized as an implied-in-fact contract term).

90. See *Renard Constructions (ME) Pty Ltd v Minister for Public Works* (1992) 26 NSWLR 234, 263–64 (Austl.).

Zealand,⁹² and the United States⁹³ recognize the principle as an implied term in all contracts. However, the common and civil laws continue to diverge in the area of whether there is a duty of good faith negotiations and the consequences of bad faith conduct in the pre-contract stage. Most civil law countries recognize pre-contractual liability for bad faith negotiations including a tort claim of *contra in contrahendo*.⁹⁴ Although the United States has recognized the claim of promissory estoppel that allows for the recovery of reliance damages in certain cases involving pre-contractual promises,⁹⁵ the common law continues to reject the duty of good faith in pre-contractual negotiations.

The other major counterpoise to unfettered freedom of contract is the notion of fairness of contract, or what James Gordley referred to as “fairness of an exchange.”⁹⁶ Unlike the duty of good faith, the principle of fairness has been more problematic to incorporate into contract law. Good faith can be seen as an implied term because it is a common assumption that business parties expect each other to act in good faith. This assumption often rests on good faith as a trade usage or of mutual benefit to both parties in encouraging the completion of contractual performance. In contrast, the value of fairness is a direct assault on freedom of contract. In a capitalistic system, as long as a contract is based upon mutual consent, harsh or one-sided bargains should be strictly enforced as a product of private autonomy.

Nonetheless, most legal systems are uneasy in enforcing contracts that are a product of overreaching, often due to severe bargaining power and informational asymmetries. In the eighteenth century, the law of contracts was still anchored in the value of the fairness of the exchange.⁹⁷ Thus, the consideration to be exchanged had to be both legally sufficient (something of value) and adequate (relatively of equal value). In equity law, the principle of equitable unconscionability protected the importance of adequacy in the exchange.⁹⁸ By the end of the nineteenth century, the equitable holdover of adequacy of consideration was eradicated from the law of contracts. Thus, as long as there was some consideration—even a “peppercorn” is

91. See *Transamerica Life Inc. v. ING Canada Inc.* (2003), 68 O.R. 3d 457, 468 (Can. Ont. C.A.). Canadian law has since moved further in the direction of recognizing a duty of good faith. See *Bhasin v. Hrynew*, [2014] 3 S.C.R. 494, 498 (Can.).

92. See *Bobux Marketing Ltd v. Raynor Marketing Ltd.* [2001] 1 NZLR 506 (CA) at [41] (N.Z.).

93. See RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. LAW INST. 1981).

94. See Friedrich Kessler & Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401 (1964).

95. See RESTATEMENT (SECOND) OF CONTRACTS § 90 (AM. LAW INST. 1981).

96. James Gordley, *Equality in Exchange*, 69 CAL. L. REV. 1587, 1599 (1981).

97. See LARRY A. DiMATTEO, *EQUITABLE LAW OF CONTRACTS: STANDARDS AND PRINCIPLES* 44-45 (2001).

98. Professor Mallor notes that: “unconscionability originated in courts of equity primarily as a defense to specific performance.” Jane P. Mallor, *Unconscionability in Contracts Between Merchants*, 40 SW. L.J. 1065, 1065 n.3 (1986); see *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 447-48 (D.C. Cir. 1965).

legally sufficient consideration⁹⁹—the courts had a negative obligation not to assess the relative value of the consideration being exchanged. Lon Fuller recognized this fundamental shift in his 1941 seminal article *Consideration and Form*.¹⁰⁰ In this article, Fuller asserts that consideration no longer should be construed as a substantive law doctrine, but only served as a formality, much like the Statute of Frauds' requirement that some types of contracts need to be in written form. Interestingly, Karl Llewellyn, highly influenced by German law,¹⁰¹ reinserted the concept of unconscionability into contract law, not as an equitable principle, but as a doctrine of sales law in writing Article 2 of the American UCC.¹⁰² However, English law continues to reject a formal doctrine of unconscionability though the term unconscionable is commonly seen in English court decisions.¹⁰³

Under § 2-615 of the UCC, the doctrine of unconscionability applies to both business and consumer contracts, but is not heavily used in practice. It has rarely been used to save businesses from one-sided, unconscionable contracts.¹⁰⁴ Its main use has been voiding specific terms in consumer contracts—such as cross-collateral security clauses in rental agreements¹⁰⁵ and forum choice clauses, where the agreed upon venue is deemed to be inconvenient or prohibitively costly for the consumer to bring an action.¹⁰⁶ In these cases, a specific clause may be deemed unconscionable, but not the entire contract. American courts have not recognized that substantively unfair, highly one-sided consumer contracts from a valuation perspective to be unconscionable.¹⁰⁷ In contrast, German law allows termination of contracts for a change of circumstances (hardship) and imbalances in contractual equilibrium.

99. See *Chappell & Co. v. Nestle Co.* [1960] AC 87 (HL) 1 [11] (appeal taken from Eng.) (“Peppercorn does not cease to be good consideration if it is established that the promisee does not like pepper and will throw away the corn.”). See also Edmund Polubinski, Jr., *The Peppercorn Theory and the Restatement of Contracts*, 10 WM. & MARY L. REV. 201 (1968) (discussing the peppercorn theory and nominal consideration).

100. Lon L. Fuller, *Consideration and Form*, 41 COLUM. L. REV. 799 (1941).

101. See James Whitman, *Commercial Law and the American Volk: A Note on Llewellyn's German Sources for the Uniform Commercial Code*, 97 YALE L.J. 156, 171 (1987).

102. See U.C.C. § 2-615 (AM. LAW INST. & UNIF. LAW COMM'N 2013).

103. See, e.g., *Cavendish Square Holding BV v. El Makdessi* [2015] UKSC 67 [687] (appeal taken from Eng.). Lord Mance used this terminology in discussing penalty clauses: “[T]he ultimate question as being whether the shipbuilders had shown that the clause was exorbitant, extravagant or *unconscionable*. . . .” *Id.* at 745 (emphasis added).

104. See Mallor, *supra* note 98, at 1088 (“The danger is that courts will withhold the doctrine from deserving commercial parties.”).

105. See *Williams*, 350 F.2d at 447.

106. See *Magno v. College Network, Inc.*, 204 Cal. Rptr. 3d 829, 832 (Cal. Ct. App. 2016) (holding an arbitration clause as a forum selection clause to be unconscionable); Julie H. Bruch, *Forum Selection Clauses in Consumer Contracts: An Unconscionable Thing Happened on the Way to the Forum*, 23 LOY. U. CHI. L.J. 329, 349 (1992). Some states have enacted statutes voiding certain forum selection clauses in consumer cases. See, e.g., TEX. BUS. & COM. CODE ANN. § 272.001 (stating a forum selection clause in a home repair contract selecting another state is invalid).

107. See Larry A. DiMatteo & Bruce Rich, *A Consent Theory of Unconscionability: An Empirical Analysis of Law in Action*, 33 FL. ST. L. REV. 1067, 1110 (2006) (providing an empirical analysis where claims of unconscionability the courts focus on consent factors and not on substantive unfairness).

The importance of freedom of contract is found in a number of the general principles. Article 3 espouses that personal and property rights “are protected by the law; no organisation or individual may infringe upon such rights and interests.” The notions of individual free will and private autonomy are found in the phrase “equal status,” used in a number of the general principles.¹⁰⁸ Freedom of contract and its basis in mutual consent is made clear in Article 5’s phrase stating, “civil activities shall follow the principles of voluntariness” and that engaging in civil activities, such as entering or terminating a contract, would be recognized “according to the [parties] own intentions.” This view of civil relations based upon voluntary consent is re-emphasized in more specific provisions of the *General Rules*,¹⁰⁹ which will be discussed below.

The remaining principles place constraints on the absoluteness of freedom of contract. They can be viewed both from the perspectives of Confucian-socialist values and Western legal norms. Communitarian and fairness norms are found in all legal systems—the differences are a matter of degree rather than kind. Article 6 requires contracting parties to “follow the principles of fairness in reasonably determining the rights and obligations of all parties concerned,” while Article 7 recognizes that each party “shall follow the principles of good faith, adhere to honesty and keep their commitments.”

The customary nature of Chinese law is evidenced in Article 8’s requirement that civil activities shall not “go against the public order and good customs.” Article 10 again notes that when the rule of law fails to resolve a dispute then “usual practice may be followed, but the public order and good customs shall not be infringed upon.” Finally, a new principle is introduced in the *General Rules*, not found in the CCL or the earlier contract laws. Article 9 states that it is the duty of all legal persons to conduct business in a way that protects the environment. The communal harm caused by China’s rapid industrialization is now recognized as a core concern of Chinese society.¹¹⁰

C. Specific Provisions

The two areas selected for additional coverage in the *General Rules* are those of legal capacity and intention to enter into legal obligations.

1. Capacity

The above general principles also need to be read in relation to the articles on capacity and consent. One uniquely Chinese or Eastern value reflected in the area of capacity is the “legal” duty of children to tend to the needs of incapacitated parents. Article 26 in the “Guardianship” section

108. See, e.g., *General Rules*, *supra* note 7, at art. 2 (“[l]egal persons and nonincorporated organisations as subjects with equal status”); *id.* at art. 4 (“[a]ll civil subjects have equal status in civil activities”).

109. See *generally id.* at Section 2 on “Expressions of Intention.”

110. See *id.* at art. 9 (“[a]ny civil activity conducted by civil subjects shall be conducive to saving resources and protecting the ecological environment”).

states that: "Adult offspring have the obligation to provide for, support and [protect] their parents." The root of this obligation can be seen in numerous sources, including the Confucian virtues of respect for the role of parents and the importance of preserving family relationships; socialist values see the family as the core unit of a collective; economic need, exacerbated by China's one-child policy;¹¹¹ and the lack of sufficient government funding of elderly care.

The age of contracting capacity is multi-faceted. The general rule recognizes eighteen as the age of majority,¹¹² giving persons full capacity to enter into contracts, as it is in most Western legal systems. However, the *General Rules* provide more nuanced ancillary rules that expand capacity unlike what is the norm in the West. Article 18 of the *General Rules* provides that a minor over sixteen years old has "full capacity" when his or her main source of income comes from a job. This is an expansion of the common law's necessity and emancipation doctrines that allow a minor, who has left the care of his or her parents, to obtain implied in fact capacity in order to make a livelihood. In contrast, Article 18 gives full capacity to enter into any and all contracts, even those unrelated to necessities or making a livelihood.¹¹³

Finally, an expansive form of capacity is found in Article 19 of the *General Rules*, which provides limited capacity to a minor as young as eight: "[S]uch minor may independently perform any civil juristic act that has a nature of pure profit or the performance of which is compatible with his/her age and intelligence." This contextual determination of capacity for someone so young is not seen in Western legal systems.¹¹⁴ The core concept is the minor has "independent" capacity.

2. Expression of Intention

The *General Rules* devotes an entire section to the expression of intention. First, it offers a specific rule for contracting by electronic means. Thus, an offer or an acceptance is effective when it enters the receiving party's electronic system (e-mail; voice message), and *not* when the receiving party learns of its existence or opens the message.¹¹⁵ This is the con-

111. See Christine Chan, et al., *The Demographic Consequences of China's One-Child Policy*, INT'L ECON. DEV. PROG. UNI. MICH. 1, 3, 6 (2006) (explaining that the one-child policy limited many Chinese couples to one-child. This was aimed at limiting population growth but had the unintended demographic consequence of leading to the aging of the population.).

112. See *General Rules*, *supra* note 7, at art. 17.

113. In the common law, the necessities doctrine provides capacity to minors in contracts for necessities, traditionally defined as food, shelter, and clothing. The emancipation doctrine can be seen as an expansion of the necessities doctrine when the minor is self-supporting (such as entering contracts to run a business); *id.* at art. 18.

114. There are exceptions in Western laws, for example the case of child entertainers to grant capacity to minors through guardianship or court order; see N.Y. Lab. L. § 186-3.1, 12 N.Y.C.C.R. 186 (2013) (guardian of minor must obtain Temporary Child Performer Permit from the Office of the Commissioner of Labor).

115. See *General Rules*, *supra* note 7, at art. 137.

sensus view in most formal laws that deal with the issue.¹¹⁶ The rationale is that parties that do business through electronic means have a duty to monitor their electronic systems for incoming messages. Article 139 uses the vague term “announcement” as an expression of intention,¹¹⁷ possibly allowing for a broad interpretation of general advertisements as legal offers and not just invitations to offer.

The *General Rules* provide a broad contextual approach to the interpretation of expressions of intent (contracts). Article 142 provides that the meaning of words shall be determined based upon “the use of the words, in combination with the relevant terms, the nature and purpose of the conduct, the habits and the principle of good faith” in order “to determine the genuine meaning of the persons of the civil conduct.”¹¹⁸ Article 151 provides that “if one party uses the state of danger or lack of judgment of the other party resulting in the unfairness in the establishment of the civil juristic acts” that other party may apply to a court or arbitration association to revoke the contract.¹¹⁹ The remedies for breach of contract found in *General Rules* Article 179 include: “eliminate the impact or restore the reputation” and “apologise.”¹²⁰ The importance of status and reputation embedded in Confucian values is at work here—a proper apology or a restoration of reputation being recognized as independent remedies than that of mere payment of damages.

The socialist history of China is seen in Article 185, which allows for civil liability against any person who infringes on the “reputation and honour of heroic martyrs and public interests are damaged.”¹²¹ It is through such provisions that the Communist Party acts as the gatekeeper to the past. In Article 185, the Party guards its legitimacy through provisions that provide civil liability against anyone infringing on the reputation and honor of martyrs. History is itself a source of political legitimacy in China and as such has long been contested politically. Robert Bickers states that: “We cannot understand the resurgence of China now, and its sometimes quiet, sometimes raucous and foul-mouthed anger at the world, unless we understand the traumatic century which followed the first opium war. . . . For mere history matters in modern China, and the past is unfinished business.”¹²² Finally, Article 186 provides that in breach of contract cases a

116. See UNIF. ELEC. TRANSACTIONS ACT, § 15(b)(1), U.L.A. 44 (1999) (“electronic record is received when: it enters an information processing system that the recipient has designated or uses for the purpose of receiving electronic records”); UNIF. COMPUTER INFO. TRANSACTIONS ACT § 214(A), U.L.A. 102 (1999) (“[r]eceipt of an electronic message is effective when received even if no individual is aware of its receipt”).

117. *General Rules*, *supra* note 7, at art. 139 (“[t]he expression of intention made in the form of an announcement shall enter into force at the time of issue of the announcement”).

118. *Id.* at art. 142.

119. *Id.* at art. 151.

120. *Id.* at art. 179.

121. *Id.* at art. 185.

122. ROBERT BICKERS, *THE SCRAMBLE FOR CHINA* 10 (2011). See also FRANK DIKÖTTER, *THE CULTURAL REVOLUTION* 319 (2016) (discussing the Party’s July 1981 resolution on its own history, and the Party’s need to protect its legitimacy through official acts); see

party may sue in contract or tort.¹²³

In the end, one characteristic of the *General Rules*, as well as the CCL, is the vagueness of many of its provisions including the general principles and more specific provisions.¹²⁴ Vagueness in law, especially contract law, can be beneficial in providing flexibility for courts to handle novel cases and to render justice, when strict rule application would cause an injustice:

[V]agueness in the law gives judges the power and latitude to construe laws in ways that serve the public interest. The Chinese courts seem to work more like courts of equity and try to ultimately deliver fairness. The inherent problem with vagueness is that it leads to inconsistency and may serve as a vehicle for corruption.¹²⁵

As intimated in the above quote, the negative consequence associated with vague principles or standards, as opposed to fixed rules, is uncertainty in law application. This is why common law systems generally expunge principles of fairness from their contract law. The rationale being that businesses' distaste uncertainty and prefer hard and fast rules that are clear and applied uniformly.¹²⁶

D. Comparing the General Principles of CCL with the General Rules

The *General Rules* and CCL possess a mix of principles that from the perspectives of the civil, and especially the common law, seem confusing and conflictive, with the potential danger of diminishing the certainty and predictability of contract law. The general principles of the CCL can be divided into two different groups based on their primary functions, namely "private autonomy" and "public regulation." While private autonomy—the right of private parties to create their own law through contract—is fundamental in the Western and Chinese contract law systems, judicial activism or intervention is more likely in the Chinese courts. This is, as explained extensively above, due to cultural norms. The CCL as applied seems to subject contracting parties to greater judicial control:

also Roderick MacFarquhar, *The Succession to Mao and the End of Maoism*, in 15 *CAMBRIDGE HISTORY OF CHINA* 305 (Roderick MacFarquhar & John K. Fairbank eds., 1991) (same); c.f. HONG LIU, *THE CHINESE STRATEGIC MIND* 135–40 (2015) (history is a key strategic asset in Chinese political culture).

123. See *General Rules*, *supra* note 7, at art. 186 ("[i]f the personal rights and property rights of one party have been infringed due to the breach of contract of the other party, the injured party has the right to choose to claim liability for breach of contract or tort liability").

124. See Michele Lee, *Franchising in China: Legal Challenges When First Entering the Chinese Market*, 19 *AM. U. INT'L L. REV.* 949, 980–81 (2004) ("One notable characteristic of Chinese laws is the vagueness inherent in the wording.").

125. Matheson, *supra* note 42, at 378.

126. Businesses prefer certainty and predictability in the law, and such predictability tends to promote macroeconomic efficiency. See, e.g., Justin W. Evans & Anthony L. Gabel, *Legal Competitive Advantage and Legal Entrepreneurship: A Preliminary International Framework*, 39 *N.C. J. INT'L L. & COMM. REG.* 333, 349–56 (2014) (discussing numerous authorities advancing this view and related ideas including, *inter alia*, the Normative Coase Theorem).

Although both systems use comparable labels that set limits to the operation of freedom of contract, there is a clear difference in how widely or restrictively these are applied. English common law generally has a very restrictive approach, and courts are reluctant to interfere in the bargain reached between the parties.¹²⁷

The CCL includes comparable restrictions to those of the *General Rules* but are more broadly restrictive in some instances. Exhibit 2 compares the general principles of the CCL with those of the *General Rules*.

Comparative Analysis of General Principles

Chinese Contract Law 1999	General Rules of the Civil Law 2017
“maintaining social and economic order and promoting socialist modernisation” (Article 1)	“maintaining social and economic orders, adapting to the requirements of the development of socialism with Chinese characteristics, and carrying forward socialist core values” (Article 1)
“contract, as referred to in this law, is an agreement whereby natural persons, legal persons or other organisations, as equal parties” (Article 2)	“civil laws adjust personal relationships and property relationships between natural persons, legal persons and nonincorporated organisations as subjects with equal status” (Article 2)
“contracting parties are equal in their legal status, and no party may impose his own will upon the other party” (Article 3)	“All civil subjects have equal status in civil activities.” (Article 4)
“parties enjoy, according to law, the right to voluntarily conclude contracts” (Article 4)	“civil subjects engaging in civil activities shall follow the principles of voluntariness” (Article 5)
“parties shall observe the principle of fairness” (Article 5)	“shall follow the principles of fairness in determining reasonably the rights and obligations of all parties concerned” (Article 6)
“parties shall observe the principle of good faith in the exercise of their rights and performance of their duties” (Article 6)	“shall follow the principles of good faith, adhere to honesty and keep their commitments” (Article 7)
“respect public morals, and they shall not disturb the social and economic order or harm the public interest” (Article 7)	“civil activities may [not] violate laws or go against the public order and good customs” (Article 8) “any civil dispute shall be resolved in accordance with the law . . . but the public order and good customs shall not be infringed upon” (Article 10)

127. See Christian Twigg-Flesner, *General Principles of Chinese Contract Law: An English Common Law Perspective*, in CHINESE CONTRACT LAW: CIVIL AND COMMON LAW PERSPECTIVES 44, 70 (DiMatteo & Chen eds., 2018).

Contracts concluded according to law are legally binding on the parties. (Article 8)	No Counterpart
No Counterpart	"Adult offspring have the obligation to provide for, support and protect their Parents." (Article 26)
No Counterpart	"Any civil activity conducted by civil subjects shall be conducive to saving resources and protecting the ecological environment." (Article 9)
No Counterpart	"All civil activities within the territory of the People's Republic of China shall be governed by the laws of the People's Republic of China." (Article 12)

First, it should be noted that freedom of contract does not appear in either the CCL or the *General Rules*. The issue of incorporating the language of freedom of contract was highly debated during the drafting process.¹²⁸ Instead, the concept of voluntariness is used in Article 4 of the CCL and Article 5 of the *General Rules*. This was primarily due to the fear that using the word "freedom" would have political consequences. Also, there existed a fear of abuse of freedom of contract by a party to a contract.¹²⁹ However, in most Chinese commentaries, voluntariness is equated to freedom of contract and is now a commonly accepted principle of its contract law with limitations based upon Chinese characteristics.¹³⁰ An example of cultural spillover in the law is the emphasis placed in Chinese law on the mediation of disputes. "People's mediation is a Chinese way of resolving contradictions and settling disputes without resorting to legal proceedings."¹³¹ Mediation is seen as playing an "important role in preventing and reducing civil disputes, resolving social conflicts, and maintaining social harmony and stability."¹³² The problem is that Chinese courts have been known to pressure parties into protracted periods of mediation in order to avoid making a decision on the merits.¹³³

Article 3 of the CCL is problematic since it broadly states that, "no party may impose his own will upon the other party." In the hard negotiations of the free market, a battle of wills is often the means of

128. See Mo Zhang, *Freedom of Contract with Chinese Legal Characteristics: A Closer Look at China's New Contract Law*, 14 *TEMPLE INT'L & COMP. L.J.* 237, 243-44 (2000).

129. *Id.* at 244.

130. *Id.* at 244-46.

131. INFORMATION OFFICE OF THE STATE COUNCIL, CHINA, *The Socialist System of Laws with Chinese Characteristics* (2011), http://english.gov.cn/archive/white_paper/2014/09/09/content_281474986284659.htm [https://perma.cc/P8Q8-CQK5].

132. EMBASSY OF THE PEOPLE'S REPUBLIC OF CHINA, *Full Text: The Socialist System of Laws with Chinese Characteristics* (12) (2011), <http://www.china-embassy.org/eng/zgyw/t871785.htm> [https://perma.cc/BX28-F8C5].

133. See Carl F. Minzner, *China's Turn Against Law*, 59 *AM. J. COMP. L.* 935 (2011) (discussing the practice of Chinese courts in pressuring parties to mediate).

obtaining the most efficient contract. Thus, if this provision is broadly construed it could inhibit the free bargaining needed to create efficient markets. If, however, the imposition of will merely refers to cases of duress or fraud, then the phrase does not pose such a threat. Since the CCL contains specific provisions dealing with duress, fraud, and exploitation, the idea of overcoming a party's will may simply be a reflection of these common policing doctrines.

The most troublesome of the principles from a free market perspective is the fairness principle found in Article 5 of the CCL and Article 6 of the *General Rules*. The idea of a counterpoise to freedom of contract based upon contractual imbalance is an old concept. In English common law, the equitable principle of unconscionability allowed the equity courts to withhold equitable remedies based upon the unfairness of the contract. German law has recognized hardship, in which a contract that was fair upon conclusion becomes imbalanced subsequently due to a change of circumstances. In American law, the doctrine of unconscionability is a principle of law. But, in most cases, Western law requires something much more than simple one-sidedness to intervene, especially in commercial contracts. In fact, the doctrine of unconscionability in Article 2 of the American Uniform Commercial Code legally applies to consumer and commercial sale of goods, but in practice is rarely ever used to police one-sided commercial contracts. Thus, the CCL's mandate that the parties follow the principle of fairness and the *General Rules* call for courts to "follow the principles of fairness in determining reasonably the rights and obligations of all parties" provides an avenue for the courts to abuse their discretion in intervening in merely one-sided contracts. Fortunately, as will be seen in the later discussion of the principle of good faith, the courts often use the principles of fairness and good faith in tandem. This indicates that the courts will require something more than simple one-sidedness before they overturn the express terms of a contract.

III. Modern Contract Law with "Chinese Characteristics"

The concept of law with "Chinese characteristics" will be explored to provide insight on how the Western-style CCL and *General Rules* may be interpreted and applied by Chinese courts. These laws will be placed in the cultural context of Chinese society, including the role of Confucian values, socialistic principles instilled since the Communist revolution of 1949, and the notion of Chinese characteristics as espoused by the State and the Communist Party.¹³⁴ An analysis of the purposes and importance of gen-

134. Non-formal customary practices still influence how contracts are viewed as a private-ordering instrument in China. See, e.g., Zhigang Shou, Xu (Vivian) Zheng & Wenting Zhu, *Contract Ineffectiveness in Emerging Markets: An Institutional Theory Perspective*, 46 J. OPER. MGMT. 38 (2016) (recognizing custom and cultural values on the effectiveness of contract law from the perspective of institutional theory); see, e.g., Baofeng Huo, Dijia Fu, Xiande Zhao & Jingwen Zhu, *Curbing Opportunism in Logistics Outsourcing Relationships: The Role of Relational Norms and Contract*, 182 INT'L J. PROD. ECON. 293 (2016).

eral principles within a legal system will be offered. Finally, a section is devoted to the assertion that the principle of good faith acts as a meta-principle in Chinese contract law. The duty of good faith is a Western concept, especially in civil law systems, imported into Chinese law. It is this principle and its application that reflect the true meaning of law with Chinese characteristics. The notion of good faith contracting is closely aligned with the Confucian concept of virtue and the communitarian perspective of socialism. The result of these influences is a broader role of good faith in Chinese law than is found in Western law.

Chinese contract law can be considered a mixed-jurisdiction-type of law in a number of ways. First, the drafters of the modern contract laws—CCL and expectantly in the drafting of a new civil code—have borrowed from the legal systems of the civil and common laws. In the rules of both Chinese and Scots contract law, one sees the mark of the civilian and the common law traditions. In civilian terms, one finds in the CCL the principle of good faith (Article 6, and elsewhere), the *exceptio non adimpleti contractus* (Articles 66–69), *culpa in contrahendo* (Articles 42–43), third party rights (Article 64), and the *actio pauliana* (Articles 74–75), among others, and one does not find any requirement of consideration in order to validate a contract. In common law terms, the CCL has rules on anticipatory breach (Article 94(2)), material breach (Article 94(4)), and foreseeability of loss as a limitation on recoverable damages (Article 113).

Second, the influence of the predecessor communist-socialist system of law persists.¹³⁵ The communitarian-collective themes attendant to socialistic systems is found in the general principles of the CCL and the new *General Rules*. Third, China has a long history of non-formal customary law that still plays a role in business practice as well as how contracts are viewed as a private ordering instrument. Confucian norms also deter resorting to the court system as a method of resolving contract disputes. Instead, compromise, negotiations, and informal mediation have been the longstanding means of resolving disputes.¹³⁶ This type of resolution is done within the context of the parties' relationship, informal third-party persuasion, and the fear of negative reputational effects.¹³⁷ In this type of

135. See Fu, *see supra* note 41.

136. See Jerome A. Cohen, *Chinese Mediation on the Eve of Modernization*, 54 CAL. L. REV. 1201, 1201 (1966).

137. Cohen notes even during the Ching Dynasty, where local magistrates were given the authority to rule on local disputes, that "the law in action provided a more accurate index of the Chinese predisposition to compromise." *Id.* at 1210. There are patches of such extra-legal, extra-judicial customary law systems in more formal rule of law countries. These types of social or self-help systems are generally trade-related. See Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 115 (1992) (exploring how diamond traders use extra-contractual relations to enforce promises); see Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation, through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724, 1724–25 (2001) (associations—one representing mill owners and another representing cotton merchants—have colluded to create a private resolution system within the cotton industry where reputational effects is a major persuasive force in resolving disputes).

extra-legal system, the party that has been injured is often persuaded to “give way”—that is, not to enforce contract rights with the hope that it can recoup its losses in future dealings.¹³⁸ Thus, relational and social norms play an out-sized role in the negotiation, performance, and enforcement of contracts than is the case in Western legal systems. The normative context in which business operates in China continues to be influenced by traditional values represented by Confucianism and socialist principles.

A. Confucian Values and Norms

Confucianism has dominated Chinese culture for millennia. It is an anti-individualistic ideology that view relationships and collective values to be more important than individual freedom.¹³⁹ A concrete example of the influence of Confucian values and socialistic principles on Chinese contract law is the expansive use by the courts of the principle of good faith. The use of good faith comports with traditional values of the common good and mutually beneficial relationships as opposed to the more individualistic nature of American contract law, where enforcing the parties’ contract as written is deemed to be the courts’ primary role. In contrast, Chinese courts have been more willing to intervene in a contract that they deem as being “immoral” (unfair).¹⁴⁰

Confucianism values morality based upon respect of social status and relational norms over formal law.¹⁴¹ One commentator associates the Chinese view of good faith to the linkage of good faith to the duty of care in fiduciary duties law.¹⁴² Thus, the parties, under the good faith principle, owe a duty of care to one another and to society. As a result, courts may see the strict enforcement of a particular contract as antithetical to the Chinese cultural view of good faith. Thus, the principle of good faith through the lens of Chinese culture is as much a moral principal as it is a legal one. The principle of good faith helps to maintain China’s traditional mores and commercial ethics. By embracing the principle of good faith, the Chinese courts are aligning the principle with China’s traditional morality, which is also consistent with the norms of international commercial practice. With its strong moral force, the principle of good faith can be expected to contribute much to the establishment of a normative transactional order in China.¹⁴³

138. Cohen phrases it as follows: “Moral [persons] did not insist on their ‘rights’ or on the exclusive correctness of their own position, but settled a dispute through mutual concessions that permitted each to save face.” Cohen, *supra* note 136, at 1207-08.

139. See Chunlin Leonhard, *A Legal Chameleon: An Examination of the Doctrine of Good Faith in Chinese and American Contract Law*, 25 CONN. J. INT’L L. 305, 324 (2010).
140. *Id.* at 326.

141. As one commentator has noted, “From the Confucian perspective, law is considered secondary and supplementary.” *Id.* Thus, Confucian values and traditions continue to influence how the Chinese view contracts. See MING-JER CHEN, *INSIDE CHINESE BUSINESS: A GUIDE FOR MANAGERS WORLDWIDE* 143 (2001) (discussing how Chinese society traditionally viewed formal written contracts as unnecessary and an insult to the reputations and integrity of the parties).

142. See Leonhard, *supra* note 139, at 326.

143. Wang & Xu, *supra* note 44, at 13.

Wang and Xu provide a framework for understanding the duties implied under the principle of good faith. In the area of contract negotiations, it requires a duty of loyalty in forming contracts, a duty of honesty and non-deception, a duty to keep promises, and a duty of confidentiality.¹⁴⁴ After formation of the contract, parties have a good faith duty to diligently prepare for performance.¹⁴⁵ During the performance phase, a number of ancillary duties are linked to good faith performance including: a duty of loyalty, a duty to disclose defects, a duty to notify of change in circumstances that may impact performance, a duty to cooperate, and a duty to provide instructions.¹⁴⁶ At the termination of the contract, the parties have a duty to give advanced notice, especially in cases of long-term contracts, the duty not to terminate unless a delay or defect in performance amounts to a frustration of the purpose of the contract, and the duty to not terminate a contract if defects in an installment “comprise but an insignificant part of the entire order.”¹⁴⁷ Good faith also requires the honoring of the post-contractual duties of confidentiality and loyalty.

Finally, the principle of good faith also plays a major role in the interpretation of contracts. It essentially dictates a contextual approach to interpretation where courts are expected to consider “the nature and purpose of the contract, the business customs at the location of the contract’s formation, and so on, so as to arrive at the parties’ true intention and meaning” and “balance the parties’ interests and determine the terms of the contract fairly and reasonably.”¹⁴⁸ Unfortunately, in the broader sense, the contextual approach in Chinese law may refer to a context that is unrelated to the particular parties and their contracts. This broader contextual approach is based on extralegal considerations such as advancing the mandates of the Communist Party and the policies of the Chinese government.

Confucianism’s worldview is that each person has a certain role to play in the creation of a harmonious society and that personal relationships, or *guanxi*, remain a key feature of Chinese society.¹⁴⁹ *Guanxi* suggests that relationships include mutual obligation, reciprocity, and goodwill. This type of view sees contracts as minor reflections of a contractual relationship—instead of seeing breach of contract as triggering a legal right, it sees breach or “adjustment” of the contract as triggering a moral right; “Once *guanxi* is established between two people, each can ask a favor of the other with the expectation that the debt incurred will be repaid sometime in the future.”¹⁵⁰ Thus, Westerners negotiating contracts

144. *Id.* at 17–19.

145. *Id.* at 18.

146. *Id.* at 20.

147. *Id.* at 20–21.

148. *Id.* at 22.

149. See Robert Bejesky, *Investing in the Dragon: Managing the Patent Versus Trade Secret Protection Decision for the Multinational Corporation in China*, 11 *TULSA J. COMP. & INT’L L.* 437, 473–74 (2004).

150. MAYFAIR MEI-HUI YANG, *GIFTS, FAVORS AND BANQUETS: THE ART OF SOCIAL RELATIONSHIPS IN CHINA 1* (1994). This view of the contractual relationship as being much more than the formal written contract is captured in Ian Macneil’s relational theory of

in China should be aware of how constructs like *guanxi* impact the Chinese view of the lesser role of formal contracts compared to the importance of the relationship in drafting the contract, and the normalcy of requests for subsequent changes to the contract.¹⁵¹

Guanxi is just one example that shows the lack of importance of formal law in the long history of China:

The concept and doctrines of legality, unlike the precepts of Confucianism, have never occupied a central role in traditional imperial China. There has not existed a legal culture, with elements like officials' fidelity to law or citizens' consciousness of their legal rights that provides the necessary conditions for the effective operation of a modern, Western-style legal system.¹⁵²

Stanley Lubman has noted that the relationship between informal, normative concepts like *guanxi*, are not necessarily adversarial in nature to the drafting of formal contracts or to formal legal rules. In fact, he argues that they may be complimentary in nature.¹⁵³ Formal contracts and contract rules serve the primary functions that they do elsewhere in the world: they provide a framework for economic relationships, a blueprint of the parties' obligations, and allow parties to plan for the future. The difference is between the formal view of written contracts as static instruments and the sanctity of contractual rights (Western view), versus the view that formal contracts are starting points meant to be flexible and subject to adjustment.¹⁵⁴ Thus, where a Western party sees a Chinese request to re-negotiate terms in the contract as an act of bad faith, the Chinese party sees it as a natural phenomenon of cooperation and mutual interests embedded in the business relationship.¹⁵⁵

There is evidence, however, that the introduction of formal contract law has begun to loosen the grip of cultural norms on contract relationships. The rise of commercial and contract litigation in Chinese courts demonstrates that business and ordinary persons now see the law and litigation as a means of protecting their interests.¹⁵⁶ The rise of contract liti-

contracts, in which cooperation, re-negotiation, and solidarity are primary norms. See generally IAN R. MACNEIL, *RELATIONAL CONTRACT THEORY: SELECTED WORKS* (2001); IAN R. MACNEIL, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 *Nw. U. L. Rev.* 854 (1978).

151. The concept of *guanxi* networking, which includes a heightened loyalty to immediate family, affects the business and contract climate in ways Westerners do not expect. It creates an aversion to conflict and litigation. This changes the structure of negotiations; post-ratification changes are expected and encouraged if it helps avoid a breach and results in a fulfilled contract. See Matheson, *supra* note 42, at 374-75 (citing Patricia Pattison & Daniel Herron, *The Mountains Are High and the Emperor is Far Away: Sanctity of Contract Law in China*, 40 *Am. Bus. L.J.* 459, 488 (2003)).

152. ALBERT HY CHEN, *AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA* 116 (3d ed. 2004).

153. Lubman, *supra* note 5, at 73-74.

154. "Although Westerners view contract formation (signing) as the culmination of the process, this is just the beginning of the process for the Chinese." Matheson, *supra* note 42, at 382.

155. See Lubman, *supra* note 5, at 73.

156. See generally Timothy Lau et al., Note, *Protecting Trademark Rights in China through Litigation*, 47 *STAN. J. INT'L L.* 441 (2011) (arguing that litigation may be a pro-

gation also shows that even though contracting relationships remain influenced by cultural norms and customary law, the institution of formal contract law has expanded the level of impersonal contracting and has undercut the influence of extra-contractual practices and cultural norms on economic relationships.¹⁵⁷

B. Communism and Socialistic Principles

Between 1958 and 1978, the Chinese economic system was based on a planned economic model with all allocation decisions made by government authorities: "The rights and obligations of the parties and dispute resolution arising in these contractual exchanges were, to a large extent, based on custom and relations. There did not exist a comprehensive contract law system, or any formal application of contract law."¹⁵⁸ Communist ideology and socialist principles reinforced the collectivist values of Confucianism. Under the latter, social roles and values were more important than individual interests. The former did not recognize private ownership of property, and therefore had little use for private contract law. In essence, all property was owned by the State, and in all contracts, at least one of the parties was the State.

The remnants of a primitive, functional legal system, which also lingered in the domain of contract law, was destroyed during the era of the Cultural Revolution from 1966 to 1976.¹⁵⁹ In 1978, the Communist Party led by Deng Xiaoping made a radical change in policy, implementing a transition from a planned economy to a market-oriented economy.¹⁶⁰ As reliance on the centrally-controlled economy began to wane, the importance of private contractual exchanges increased, leading to the need for a more formal contract law. But such a law needed to be in sync with a quasi-capitalistic, quasi-socialistic market economy. Thus, the focus needed to move away from the common good and public interest model of exchange based upon Confucian and communistic-socialistic principles, to one focused on economic self-interest and private autonomy. Therefore, the notion of freedom of contract in which private parties determine the

ductive means to protect one's trademark rights in China). See also Benjamin L. Liebman, *Legal Aid and Public Interest Law in China*, 34 TEX. INT'L L.J. 211, 282 (1999) (acknowledging that while the wide-scale protection of individuals is still uncertain, "China's experience with both legal aid and class action litigation demonstrates that, in many cases, governmental policy goals may be consistent with expanding access to the legal system and the vindication of individual rights").

157. See Lucie Cheng & Arthur Rosett, *Contract with a Chinese Face: Socially Embedded Factors in the Transformation from Hierarchy to Market, 1978-1989*, 5 J. CHINESE L. 143, 243 (1991) ("The availability of impersonal contract law institutions provides a competitive alternative to, and therefore potentially undercuts, the networks of informal connections.").

158. Zhong Jianhua & Yu Guanghua, *China's Uniform Contract Law: Progress and Problems*, 17 UCLA PAC. BASIN L.J. 1, 3 (1999).

159. See Wang Chenguang, *Introduction: An Emerging Legal System*, in INTRODUCTION TO CHINESE LAW 1, 5-7 (Wang Chenguang & Zhang Xianchu eds., 1997); JONATHAN D. SPENCE, THE SEARCH FOR MODERN CHINA 704-05 (1990); YUHUA WANG, TYING THE AUTOCRAT'S HANDS 51 (2015).

160. See Chenguang, *supra* note 159, at 4.

content of their contracts without government interference, was made the guiding principle in the drafting of the CCL. However, as explained below, the meaning of “freedom” and “without government interference” was not known or well understood in Chinese law and culture. In reality, especially in the beginning of the free contract era, government interference into private ordering remained commonplace.

Despite the importance of implementing freedom of contract as core principle, the CCL included numerous general principles that limit or police the exercise of freedom of contract. The CCL further incorporated numerous and exceedingly vague provisions stating that free contract was “subject to” other government laws, policies, and authorities. Such provisions are found in CCL Articles 10, 38, 44, 77, 126, 129, 132, 133, 137, 142, and 150. Furthermore, the CCL voids contracts in cases where there are negative third-party externalities on the interests of private parties, the public, or the state.¹⁶¹ “Although China has moved towards a rule of law system, public policy [as stated by the government and government agencies or interpreted by the courts] still plays an important role.”¹⁶² Nonetheless, the recognition of freedom of contract as a fundamental principle of contract law served an important first step in the development of a separate private law regime in China:

Although China has moved to a market economy, administrative institutions still have the inclination to interfere with enterprises, particularly state-owned enterprises, in their business decisions. The freedom of contract provision provides legal means to resist such intervention.¹⁶³

Despite the cultivation of a private ordering system, communism, as represented by the Communist Party, continues to influence Chinese culture with its emphasis on the common good and the importance of maintaining relationships and obedience to superiors in the governmental and societal hierarchy.¹⁶⁴

The outsized power of Chinese local governments is a major challenge for the maintenance of rule of law and certainty in application of the law, as they often interpret the law to advance local needs and sometimes protect local corruption at the expense of enforcing national law and regulations. Despite the rhetoric of rule of law and equality before the law, the reality is that courts are not viewed as superior to state agencies: “In the bureaucratic hierarchy, courts are only parallel to, rather than superior to, other units of the Chinese bureaucracy. When courts seek to enforce judgments, agencies whose actions are required to assist the courts sometimes refuse to cooperate.”¹⁶⁵ This legal localism is reinforced by the fact that

161. See CCL, *supra* note 20, at art. 52 (1), (2).

162. Matheson, *supra* note 42, at 380.

163. Jianhua & Guanghua, *supra* note 158, at 9.

164. See Pattison & Herron, *supra* note 151, at 486. See also, Teema Ruskola, *Law Without Law, Or is “Chinese Law” an Oxymoron?*, 11 WM. & MARY BILL RTS. J. 655, 659-60 (2003) (Chinese society based upon obedience to superiors).

165. Lubman, *supra* note 5, at 29. The influence of government and state agencies in judicial proceedings illustrates that the courts are not considered as independent, but as

local judges are hired and paid by the local government and Communist Party apparatus.

C. Contract Law with 'Chinese Characteristics'

As discussed above, social practices and cultural norms stemming from the long-history of extra-legal mechanisms for dealing with business relationships, influenced by Confucian and socialistic values, has been vital in the creation of modern contract law. Putting it in more concrete terms, the meaning of legal terms, such as good faith, must be understood not from the Western perspective, but rather from the context of Confucian-socialistic norms. Good faith is a powerful example; its use and application quickly became a robust part of Chinese contract law because it is a core value of Confucian thought.¹⁶⁶ Thus, these "embedded structures" (traditions, customs, principles) shaped the understanding of Western legal concepts by the drafters of Chinese contract law, and despite the similarity of terminology between Chinese and Western contract law, these embedded structures continue to guide interpretation and application of Chinese contract law. The same can also be said of embedded structures of the law of equity, which continue to influence the application of common law.¹⁶⁷

Article 1 of the *General Rules* states one of its purposes as the advancement of a private law that "adapt[s] to the requirements of the development of socialism with Chinese characteristics, and carrying forward socialist core values." Again, what does the notion of law with Chinese characteristics mean? At its most abstract level, this notion aims to blend Eastern and Western cultural and business values. Chinese cultural values are represented by customary law, which has evolved over many centuries, as briefly discussed in the previous section's review of the Confucian value system. More recently, the 1949 transition to Communism began the enculturation of Chinese society with communist-socialist principles including the ideas of complete subservience to the state and collectivism. Some of these principles had long been embedded within the Chinese cul-

a quasi-state agency. This is partly due to constitutional shortcomings and the dictatorial rule of Imperial and then Communist China. Thus, "separation of powers is not a concept put to use in the Chinese government." Matheson, *supra* note 42, at 376. In his review of the CCL upon its adoption in 1999, James Hitchingham stated that the "governmental agencies continue to regulate contractual relations [and] newly borrowed contract standards are still undefined. . . . Consequently, in the near term, contracting parties may continue to find contractual justice elusive." James Hitchingham, *Stepping up to the Needs of the International Marketplace: An Analysis of the 1999 Uniform Contract Law of the People's Republic of China*, 1 *ASIAN-PAC. L. & POLY REV.* 1, 28-29 (2000) (citing Daniel Rubenstein, *Legal and Institutional Uncertainties in the Domestic Contract Law of the People's Republic of China*, 42 *MCGILL L.J.* 495, 495-97 (1997)).

166. "A practice's compatibility with familiar social patterns is a factor that will influence the ease of its adoption and use." Cheng & Rosett, *supra* note 157, at 151.

167. See T. Leigh Anenson, *Studies in Equity: The Fusion of Unclean Hands in America* 7 (unpublished manuscript) (on file with the Cornell International Law Journal); Larry A. DiMatteo, *The History of Natural Law Theory: Transforming Embedded Influences into a Fuller Understanding of Modern Contract Law*, 60 *U. PITT. L. REV.* 839, 840 (1999).

tural belief, stemming from the ancient imperial and feudal systems. Socialism reinforced some of these longstanding values, as well as emphasizing new variations of these communitarian norms.

In 2015, the Chinese State Council issued a document entitled “The Socialist System of Laws with Chinese Characteristics (Socialist System of Laws).”¹⁶⁸ This type of instrument seems out of touch and is surprisingly late considering the fact that it has been more than three decades since China opened up its markets to international trade and sought transition to a market economy. The foreword of the document states: “We need to bring into being a socialist system of laws with Chinese characteristics so as to ensure there are laws to abide by for the carrying on of state affairs and social life.”¹⁶⁹ It is important to note that the document is not referring to socialism as an appendage to Communism, but as something that relates to “social democracy.” But, how can such a term be reconciled with the dictatorial nature of the system, where there is dictatorship by consensus among members of the ruling elite, and at times a dictatorship of one (Mao & Xi Jinping)?

The document refers to amendments made to the Chinese Constitution in 1988, 1993, 1999, and 2004. The Constitution now states that the state “practices a socialist market economy,” “exercises the rule of law, building a socialist country governed according to law,” and “respects and protects human rights,” that “citizens’ lawful private property is inviolable,” and that “the system of multi-party cooperation and political consultation led by the Communist Party of China will exist and develop in China for a long time to come.”¹⁷⁰ The crucial question remaining is what the meaning of creating a “socialist market economy” is in Chinese culture and law. One answer can be seen in the Socialist System of Laws’ description of the role of the Constitution:

China’s Constitution defines the basic system and basic tasks of the state. It affirms the leadership of the CPC, establishes the guiding role of Marxism-Leninism, Mao Zedong Thought, Deng Xiaoping Theory and the important thought of the ‘Three Represents,’ which determines the state system as a people’s democratic dictatorship led by the working class and based on the alliance of workers and peasants. It also takes the system of people’s congresses as the form of administration.¹⁷¹

This understanding of the dominance of the Chinese Communist Party explains the inherent conflict caused by intermeshing autocracy and free market, and public and private property. For example, despite the *General Rules*’ recognition of private property, the spirit behind the law is that such property should be used to advance social interests. Private parties cannot own fee title in real estate but can “buy” real estate based upon

168. INFORMATION OFFICE OF THE STATE COUNCIL, *supra* note 131 (earlier version issued October 2011).

169. *Id.*

170. *Id.*

171. *Id.*

long-term leases of 50 to 70 years.¹⁷² Another facet of the Chinese market system, as noted earlier, is the decentralized nature of government regulation where local governments are given substantial power to regulate businesses "in the light of the specific local conditions and actual needs."¹⁷³

Another example of a convergence of long held cultural norms and modern contract law is the Chinese concept of *heli* or reasonableness, which is a major feature of the common law and is especially robust in Article 2 of the American Uniform Commercial Code. The CCL makes numerous references to reasonableness,¹⁷⁴ but again the cultural meaning of *heli* influences the application of such a standard. Thus, it is important to note that the concept of *heli* is much more textured than that of mere reasonableness. In Chinese culture, reasonableness or *heli* is linked with notions of fairness or justice.¹⁷⁵ This linkage has two major consequences. First, Chinese courts, much like arbitral panels,¹⁷⁶ balance the interests of the parties, as well as society and the State, to render fair and equitable decisions. Thus, Chinese courts avoid the strict enforcement of contract rights and contract law rules. Second, such a view of contracts requires a broad contextual approach to contract interpretation including taking into account the background relationship of the parties, the circumstances relating to the formation and performance of the contract, and customary practices in a trade or business. Professor Timoteo explains that judges bring a tripartite framework in the interpretation of law and contracts: *heqing* (feelings, relationship, and circumstances), *heli* (reason), and *hefa* (legal rules). Thus, courts are placed in the position of striking a balance between "relationship, rightness, and law."¹⁷⁷ Timoteo argues that these factors have had an important impact on the creation of operative rules in the Chinese courts.¹⁷⁸

Despite no formal adoption by the CCL, *heli* paved the way for the Chinese courts' recognition of the doctrine of *rebus sic stantibus* or change

172. See YILIN HOU, QIANG REN & PING ZHANG, *THE PROPERTY TAX IN CHINA* 29 (2015).

173. INFORMATION OFFICE OF THE STATE COUNCIL, *supra* note 131. It should be noted that China is a diverse country that includes 155 ethnic autonomous areas, 5 autonomous regions, 30 autonomous prefectures, and 120 autonomous counties. See *id.*

174. See e.g., CCL arts.: 23 ¶ 2 (reasonable time), 39 (reasonable manner), 69 (reasonable time), 74 (unreasonably low), 94 ¶ 3 (reasonable time), 95 (reasonable time), 110 ¶ 3 (reasonable time), 111 (choose reasonably), 118 (reasonable time), 119 (reasonable expenses), 158 (reasonable time), and 426 (determined reasonably).

175. The *li* in *heli* translates into reason or reasonable and "it was used in strict connection with the concept of *yi*, a term that is generally translated as justice or righteousness." Marina Timoteo, *Vague Notions in Chinese Contract Law: The Case of Heli*, 18 EUR REV. PRIV. L. 939, 942 (2010).

176. See Larry A. DiMatteo, *Soft Law and the Principle of Fair and Equitable Decision Making in International Contract Arbitration*, 1 CHINESE COMP. J.L. 221, 253 (2013).

177. Timoteo, *supra* note 175, at 943.

178. See Timoteo, *supra* note 175, at 943. There is a strain of literature on the difference between the "formal rules" and "operative rules" of law. The latter being the actual application of the former. See generally Elizabeth Warren, *Formal and Operative Rules under the Common Law and Code*, 30 UCLA L. REV. 898 (1983); see also Ann Morales Olazábal, *Formal and Operative Rules in Overliquidation Per Se Cases*, 41 AM. BUS. L.J. 503 (2004).

of circumstances in the enforcement of contracts.¹⁷⁹ The SPC recognized, in a *Guiding Opinion*¹⁸⁰ and a *Judicial Interpretation*,¹⁸¹ the doctrine of change of circumstances and the idea of contractual adjustment. The SPC indicates in its guidance that the parties should renegotiate an adjustment of the contract when there is a material change of circumstances and the courts should act to mediate an adjustment if the parties fail to reach agreement.¹⁸² Article 26 of the Interpretation provides that if a material change in circumstances occurs after the formation of a contract, which would render continued performance of the contract manifestly unfair, the court can amend or terminate the contract.

At present, the best that can be said is that China in a short period of time has created a formal legal system and a great body of substantive law; however, it still has a long way to go to be considered as a country governed by the rule of law, at least in the Western sense.¹⁸³ Clearly, it has never been the goal of the Chinese government or Communist Party to evolve China into a liberal democracy based on Western standards.¹⁸⁴ The creation of a modern legal system has served a more instrumental goal of stimulating economic development and wealth creation, but also to maintain the unquestioned power of the government (Party) as the core source of law. In this sense the adoption of Western-style law and the recognition of freedom of contract as an important private ordering instrument has been a key to China's economic growth.

Despite the introduction of the rule of law through the adoption of Western-style substantive law, the impartial, objective, and well-reasoned judicial application of the law has not been a hallmark of the Chinese court system. Important governmental (bureaucracy), Party, and local non-governmental power structures (organizations, rural collectives) continue to influence judicial decision making. As one scholar has noted, the Communist Party is the "ghost hidden in the legal machine."¹⁸⁵ For most courts if there is a perceived conflict between government policy (national, regional, local) and formal law they will most often ignore the law and side with

179. See Timoteo, *supra* note 175, at 944.

180. Guiding Opinions of the Supreme People's Court on Several Issues Concerning Trial of Cases on Disputes over Civil and Commercial Contracts in the Current Situation (promulgated by the Sup. People's Ct. July 7, 2009, effective July 7, 2009).

181. See generally Zuigao renmin fayuan guanyu shiyong "Zhonghua Renmin Gongheguo Hetongfa" Ruo Gan Wenti de Jieshi [Interpretation of the Supreme People's Court on Certain Issues Concerning the Application of the Contract Law of the People's Republic of China (II)] (promulgated by the Sup. People's Ct. Apr. 24, 2009, effective May 13, 2009).

182. See Timoteo, *supra* note 175 at 949.

183. "There is a substantial difference from a normative perspective between the mere existence of a legal system and establishing the rule of law." Orts, *supra* note 1, at 47.

184. See, e.g., Charles Burton, *China's Post-Mao Transition: The Role of the Party and Ideology in the "New Period"*, 60 PACIFIC AFFAIRS 431, 431 (1987) (explaining the overriding purpose of post-Mao reforms "is to preserve the status quo of party rule"); EDWARD TSE, *THE CHINA STRATEGY* 92 (2010) ("For Deng and his successors, maintaining the rule of the [CCP] has been the sine qua non of their agenda.").

185. Orts, *Rule of Law*, *supra* note 1, at 67.

policy objectives.¹⁸⁶

Just as the vague general principles found in the CCL and the *General Rules*, and other borrowed Western legal concepts, the rule of law is an empty vessel to be defined in the unique context of Chinese culture, values, and power structures. The next section will revisit the role of general principles and the example of the good faith principle in the framing of a contract law with Chinese characteristics.

D. Purpose of General Principles

The CCL enumerates several important principles and places them at the very beginning of the instrument to show their importance in understanding and interpreting the CCL. These articles, distinguished from legal rules, are treated as general or "fundamental."¹⁸⁷ The general principles can be used in a number of ways. First, the principles are used to interpret and apply the more specific rules found in the law. Secondly, general principles may be used to prevent injustice due to the strict application of specific contract law rules.¹⁸⁸ Thirdly, the general principles can be used to interpret and fill in gaps of a contract. Fourthly, general principles can be used to police contracts and monitor the improper conduct of the contracting parties. An example of the second and third use of general principles is the Chinese Supreme Court's recognition of change of circumstances (hardship). There is no express provision in the CCL on parties' obligation to re-negotiate a contract that has become a burden on one of the parties due to an unforeseeable change of circumstances. The SPC filled the gap in its "Interpretation of the SPC on Certain Issues Concerning the Application of the Contract Law of the PRC (II)."¹⁸⁹ Article 26 reads as follows:

When after the conclusion of a contract there is a grave change of objective circumstances, which is not foreseeable by the parties at the time of the conclusion of the contract, and which is *not* caused by a force majeure and which should not be classified as commercial risks, to continue to perform the contract will be obviously unfair for one party or will not achieve the purpose of the contract, the party requests the people's court to modify or terminate the contract, the people's court shall determine whether to modify

186. See Perry Keller, *Sources of Order in Chinese Law*, 42 AM. J. COMP. L. 711, 755 (1994). Placing it in the context of the rule of law, a scholar in 1994 stated: "[T]he use of Party policy documents to provide the necessary context for legal interpretation. These doctrines have also sustained the view that law derives its coherence of meaning more from its political and social context than from a reasoned interpretation of statutory language." *Id.* In the following two decades this is still largely the case. But, ongoing improvements in legal education and the training of judges has improved the legal reasoning skills of the judiciary leading to better reasoned legal decisions based on the rule of law, at least in the relatively mundane, apolitical nature of most contract disputes.

187. Shiyuan Han, *General Principles of the CCL*, in CHINESE CONTRACT LAW: CIVIL AND COMMON LAW PERSPECTIVES 29, 29 (DiMatteo & Chen eds., 2018).

188. See *id.* at 7.

189. See generally Interpretation of the Supreme People's Court on Certain Issues Concerning the Application of the Contract Law, *supra* note 181.

or terminate it or not, according to the principle of fairness, and taking the real situations of the case into consideration (emphasis added).

The use of a general principle to supplant a specific rule in order to avoid an unjust result is a controversial concept. In fact, the mainstream view is that specific rules supplant any application of a general principle. The purpose of specific, fixed rules is to provide certainty to the law of contract.

At times, a given dispute raises the issue of how to resolve the application of conflicting principles. One such case is *Xinyu Co. Ltd. v. Feng Yumei*,¹⁹⁰ which involved a shopping center owner's attempt to terminate a contract of sale. After the owner sold shopping space to the defendant, the owner decided to change the theme of the complex and proceeded to buy back the nearly 150 spaces that it sold. The defendant was one of two parties that held out. The complex owner brought an action requesting a termination of the contract. The court held in favor of the complex owner, even though it was the breaching party. The court held that under the principles of fairness¹⁹¹ and good faith,¹⁹² the defendant-purchaser should have cooperated by selling back the shop space given the change in the theme of the complex. Despite the fundamental principles of freedom of contract and *pacta sunt servanda* (sanctity of the contract),¹⁹³ the court believed it was for the greater good to terminate the contract. Such a decision would be considered absurd in most other legal systems.

Professor Shiyuan Han explains the rationale for the decision based upon Chinese cultural traits: "In China, it is generally acceptable to put social public interest before personal interest."¹⁹⁴ He further notes that Chinese judges tend to follow a "result-oriented" method of legal reasoning: "Chinese judges consider not only legal effects (*falu xiaoguo*) of the judgments, but also their social effects (*shehui xiaoguo*)."¹⁹⁵

The idea of placing Chinese normative values inside of a Western-style body of law is explored below using the example of the principle of good faith. Put simply, the duty of good faith has more substantive sweep under Chinese values than it does under Western-style law, including the German law's embrace of good faith as a core private ordering instrument.

E. Good Faith as Meta-Principle?

This section examines the scope of the duty of good faith as culturally dependent, as well as its expansive use in Chinese legal context and practice popularly referred to as the "King clause."

190. *Xinyu gongsi su Feng Yu Mei shangpu maimai hetong jiufen* [Xinyu Company v. Feng Yumei Retail Business Contract Dispute], 1999 SUP. PEOPLE'S CT. GAZ. 37, 37-38 (Sup. People's Ct. 2006) (China).

191. See CCL, *supra* note 20, at art. 5.

192. See *id.* at art. 6.

193. See *id.* at art. 107.

194. Han, *supra* note 187, at 11.

195. *Id.* at 12.

1. Good Faith as Cultural Dependent Principle

In all legal systems, civil, common, and mixed jurisdictions, the freedom of contract principle is the core foundation of contract law. But due to bargaining power and informational asymmetries, there is the threat that freedom of contract, if left unchecked, will lead to abuse (unconscionable or illegal contracts). Therefore, there needs to be a countervailing principle that can be used to police contractual misconduct, overreaching, and abuse. There are numerous more tailored doctrines or principles used to police specific kinds of abuse—“abuse of rights” in French law (enforcement of contract rights); *culpa in contrahendo* in civil law (pre-contractual misconduct); “surprise terms” in German law (standard terms regulation); duty to re-negotiate (change of circumstances); waiver and estoppel in the common law; the penalty rule in the common law; and so forth. But, the general policing doctrine that best responds to abuse of freedom of contract is the principle of good faith. The duty of good faith is explicitly or implicitly found in most national and international contract laws.¹⁹⁶ Although it is important to note that English law, one of the more popular choices of law in international contracts, does not expressly recognize a general duty of good faith, it often reaches similar outcomes by other means, such as through contract interpretation and implied terms.¹⁹⁷ Finally, the principle of good faith has a strong influence in international commercial arbitration.¹⁹⁸

The good faith provision in the German Civil Code¹⁹⁹ has had a pervasive impact on the enforcement and interpretation of contracts, and the

196. See Alexander S. Komarov, *Internationality, Uniformity and Observance of Good Faith as Criteria in Interpretation of CISG: Some Remarks on Article 7(1)*, 25 J.L. & COM. 75, 82 (2005); see generally E. Allan Farnsworth, *Duties of Good Faith and Fair Dealing under the UNIDROIT Principles, Relevant Conventions and National Laws*, 3 TUL. J. INT'L & COMP. L. 47 (1995).

197. The mainstream opinion is that the United Kingdom is an outlier in the area of good faith. It is true that UK courts have soundly rejected such a duty. But, in reality, bad faith contracts have been policed in more covert ways under English law leading to similar outcomes that result in countries that have expressly adopted a general duty of good faith in all contracts. See ELISABETH PEDEN, *GOOD FAITH IN THE PERFORMANCE OF CONTRACTS* 11 (2003) (noting that the duty of good faith “is slowly being introduced into England through European and international initiatives”); Elena Christine Zaccaria, *The Dilemma of Good Faith in International Commercial Trade*, 1 MACQUARIE J. BUS. L. 101, 103 (2004) (noting that English law takes a different “route” to reach results arrived at in civil law, without recurring to good faith). More recently, a UK court has recognized that good faith can be an implied in fact term in a contract in certain circumstances. See *Yam Seng Pte Ltd.*, *supra* note 89, at para. 131. It is also important to note that other common law countries, such as Australia, Canada, and the United States, have adopted the duty of good faith. See generally *Renard Constructions (ME) Pty Ltd.*, *supra* note 90 (setting forth a requirement of reasonableness); *Bhasin*, *supra* note 91; RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981).

198. See generally Bernardo M. Cremades, *Salient Issues in International Commercial Arbitration: Good Faith in International Arbitration*, 27 AM. U. INT'L L. REV. 761 (2012).

199. See BÜRGERLICHES GESETZBUCH [BGB] [CIVIL CODE], *supra* note 88, at § 241.

application of contract law rules.²⁰⁰ One commentator explains that:

Paragraph 242 of the BGB has played an extremely important role in German jurisprudence. The judge or, as the case may be, the arbitrator, acts (a) in exercising his function, to apply the law and, as appropriate, to specify the consequences of what is established by law; (b) to limit the exercise of contractual rights where there may be an excess in the abusive exercise of the right; and (c) even *contra legem*, to impose himself in the form of a true ethical-legal rupture of the legal right. Hence, the German trier of fact has learned how to use the letter of paragraph 242 in a radically different manner depending on the ethical-political demands of the time. The German jurist has introduced, together with the principal obligations of any contract, so-called accessory obligations. These include, for example, the duty of vigilance, the obligation of clarification to the other party, loyalty, the obligation to cooperate, and the obligation to inform.²⁰¹

Good faith clearly acts as a meta-principle in German law in which most issues of contracts are seen through its prism. At the opposite end of the spectrum is English law's rejection of the good faith principle; English law's dislike of the principle is anchored in the view that such an abstract limiting principle adds an unacceptable degree of uncertainty to contract law and the enforcement of contracts.

2. Good Faith in the Chinese Cultural and Legal Context

The Chinese legal perspective of the good faith principle is aligned with German law. In fact, Chinese scholars refer to good faith as the "King clause," referring to the civil law use of the term "general clause" or to what the common law would call a general principle.²⁰² This is not surprising due to the strong influence German law has had on Chinese law—historically it had an indirect influence through the Chinese study of the Japanese Civil Code, which was based on the German Civil Code, and directly in the drafting of China's modern contract laws.²⁰³ Also, the good faith principle aligns with Confucian thought and values.²⁰⁴ Along with its relationship to traditional Chinese values, the principle of good faith has served functional needs. Because of the rapid rate of change in China (both economic and legal), Chinese laws are often filled with numerous gaps in coverage.

200. See Werner F. Ebke & Bettina M. Steinhauer, *The Doctrine of Good Faith in German Contract Law*, in *GOOD FAITH AND FAULT IN CONTRACT LAW* 171, 190 (Jack Beatson & Daniel Friedmann eds., 1995).

201. Cremades, *supra* note 198, at 773–74.

202. Simona Novaretti, *General Clauses and Practices: The Use of the Principle of Good Faith in the Decisions of Chinese Courts*, 18 *EUR. REV. PRIV. L.* 953, 953, 968 (2010).

203. "The legal model chosen by Chinese reformers is the German system, filtered by the Japanese experience." *Id.* at 955 (referencing the drafting of the Chinese (Republican) Civil Code of 1931). Japan adopted the German Civil Code (*Bürgerliches Gesetzbuch* or BGB) in 1898. Given the role of Confucianism in Japanese society, the Japanese enactment of the German law created much interest, and subsequent study, in China. See Keller, *supra* note 186, at 718. This influence was demonstrated by the enactment of the "Six Codes" in the 1930s, which was essentially the Chinese government's "reception of the Romano-German civil law tradition." *Id.*

204. See Leonhard, *supra* note 139, at 310 ("[T]he doctrine recognizes and enforces traditional Chinese notions of morality and business ethics.").

The good faith principle is often used as the gap-filler of choice.²⁰⁵

Similar to other civil law systems, good faith constitutes a fundamental principle of Chinese civil and private law.²⁰⁶ The CCL recognizes a duty of good faith in the negotiation, performance, and enforcement of contracts.²⁰⁷ Chinese scholars have favored the use of the good faith principle by the courts to fill in gaps in statutory law and the interpretation and enforcement of contracts.²⁰⁸ Good faith's importance lies in the fact that it provides the judicial discretion needed to work out new law via the adjudication process. Also, as noted previously, Chinese jurists have a built-in affinity for good faith because of its civil law tradition, as well as its consistency with Chinese cultural norms:

Good faith has not only been one of the general principles for people's everyday conduct but has also been a crucial moral precept in China's commercial practice. By embracing the principle of good faith, the Contract Law is recognizing China's traditional morality and business ethics, which is also consistent with the norms of international commercial practice.²⁰⁹

Professor Novaretti explains the malleability of the good faith term in Chinese legal tradition due to its association with a basket of societal norms. The good faith principle in Chinese culture captures the norms of "honesty and credibility," good intentions, trust, human virtue, integrity, benevolence, solidarity, doing right, morality, loyalty, social justice, fairness, and collective well-being.²¹⁰

This normative set is the context upon which the principle of good faith is applied. The practical implication of this broad societal view of good faith includes: (1) a greater likelihood of avoiding terms of contract in favor of ethical standards and trade practice; (2) reliance on the broader use of contextual evidence; (3) a greater likelihood of considering societal and collective interests and policies of the State; (4) the promotion of contractual justice or a fair balance in the contract;²¹¹ (5) the recognition of a duty to re-negotiate contract terms to achieve fairness in cases where circumstances change; (6) a duty to disclose information;²¹² (7) a duty to

205. *Id.* at 311.

206. See Ewan McKendrick & Qiao Liu, *Good Faith in Contract Performance in the Chinese and Common Laws*, in *CHINESE CONTRACT LAW: CIVIL AND COMMON LAW PERSPECTIVES* 72, 72 (DiMatteo & Chen eds., 2018); see also General Principles of the Civil Law of the People's Republic of China (promulgated by Order No. 37 of the President of the People's Republic of China Apr. 12, 1986, effective Jan. 1, 1987), art. 4, LAWINFOCHINA.COM, available at <http://www.lawinfochina.com/Display.aspx?lib=law&Cgid=2780> [<https://perma.cc/4JT4-6N6N>] (stating that civil activities shall observe the principles of voluntariness, fairness, equality in price and remuneration, and good faith).

207. See CCL, *supra* note 20.

208. See, e.g., Liang Huixing, *Good Faith Principle and Gap-filling*, 2 *CHINESE J.L. 法学研究* 22, 23, 25 (1994).

209. Wang & Xu, *supra* note 44, at 16.

210. See Novaretti, *supra* note 202, at 954, 956, 958, 960 & 962.

211. *Id.* at 965-67.

212. The duty to disclose information may refer to the disclosure of material facts related to the contract and in some cases a duty to disclose alternatives or other available options. See People's Court of Xiling district, city of Yichang (Hubei), Case 4972004, available at www.chinacourt.org/ajdq (posted April 5, 2007).

perform additional duties not formally specified in the contract;²¹³ and (8) the promotion of mediation for contract disputes. Due to the importance placed on collective interests, societal norms, and cultural values, in some instances, the contract can be viewed as a three-party contract: party-to-party and parties-to-society; in an informal way, society can be seen as having third-party rights or being third-party beneficiaries.²¹⁴ Exhibit 1 shows the use of good faith and associated principles throughout the CCL and the *General Rules*.

Exhibit 1
Duty of Good Faith in Chinese Law

Value	Article CCL	Article <i>General Rules</i>	Concrete Application
Good Faith (core)	6	7	In the exercise of their rights and performance of their duties; Adhere to honesty and keep their commitments
Fairness	5	6	In determining their respective rights and duties; In determining reasonably the rights and obligations of all parties concerned.
Bad Faith Negotiation	42		Negotiates in bad faith under the pretext of concluding a contract; intentionally conceals a material fact; other acts that violate the principle of good faith; ²¹⁵ liability under preliminary agreements ²¹⁶
Public Interest	52		Conceals an illegal purpose in a lawful form; violates the public interest
Malfeasance to Third Parties	59		Harm the interests of the state, a collective organisation or a third person

213. See Novaretti, *supra* note 202, at 972-75.

214. See *id.* at 963 (“The principle of good faith as expressed by the General Principles of Civil Law, therefore, is not merely aimed at regulating the relationship among the parties to an agreement but, rather, seeks to weigh the interests of the subjects involved in the legal relationship in question against the interests of the state and society.”).

215. The SPC expanded the reach of Article 42 (3) (“engages in other acts that violate the principle of good faith”) into the area of conditional contracts. So if one party is obligated to register or obtain a government approval “fails to complete such procedures [related to registration or obtaining an approval], such party shall be deemed to have committed ‘any other act in violation of the principle of good faith’ specified in Item (3) of Article 42 of the CCL.” See generally Interpretation of the Supreme People’s Court on Certain Issues Concerning the Application of the Contract Law, *supra* note 181 at art. 1.

216. The SPC broadened the duty of good faith negotiations to include preliminary agreements, stating that: “if one party does not perform the obligation of concluding a sales contract and the other party requests that it assume liability for breach of the preliminary agreements or demands the rescission of the preliminary agreements and claims compensation for damages.” Interpretation of the Supreme People’s Court on Issues Concerning the Application of Law in the Trial of Cases of Disputes over Sales and Purchase Contracts (promulgated by the Sup. People’s Ct. Mar. 31, 2012, effective July 1, 2012), art. 2.

Cooperation, Notice, Confidentiality	60		Observe the principle of good faith and perform such duties as giving notice, providing assistance and maintaining confidentiality in accordance with the nature and purpose of the contract as well as the usage of transaction
Post-Contractual Obligations	92		After contractual rights and obligations are discharged, the parties shall observe the principle of good faith and perform such duties as giving notice, providing assistance and maintaining confidentiality in accordance with the usage of transaction
Contract Interpretation	125	142	In light of the words and expressions used in the contract, the related terms in the contract, the purpose of the contract, the usage of transaction and the principle of good faith; the use of the words, in combination with the relevant terms, the nature and purpose of the conduct, the habits and the principle of good faith shall not be restricted by the used words and sentences, the relevant clauses, the nature and purpose of the conduct, the habits and the principle of good faith shall be considered in combination to determine the genuine meaning of the persons of the civil conduct ²¹⁷
Setting a Reasonable Price relating to debtor	74		Debtor transfers his property at a price that clearly is unreasonably low ²¹⁸
Standard Terms Regulation	39- 40		Comply with the principle of fairness when determining the rights and duties of the parties, shall, in a reasonable manner, draw the attention of the other party to the terms which exclude or limit his liability and term is void if it increases the liability of the other party or deprives the other party of a major right ²¹⁹

217. The role of good faith in contract interpretation is re-emphasized in the Interpretation on Contract Law II, Article 1. The SPC states that a valid contract only needs to provide the name of the parties, subject matter, and the amount, and the court will imply the remaining terms through Articles 61, 62 and 125 of the CCL (principle of good faith).

218. Interpretation on Contract Law II, Article 19 clarifies that an unreasonable low price is one that is 70% lower than the market price.

219. Interpretation on Contract Law II, Article 6 clarifies the Article 39 (CCL) obligation of the party supplying the standard terms to bring them to the attention of the other party in a "reasonable manner." It states that: "[T]he party providing the standard clauses, at the time of conclusion, adopts the word, symbol, character style or other special marks that are sufficient to invite the other party's attention to the exemptible and restrictive clause regarding its liability and render explanations of such clauses upon the other party's request, the people's court shall determine that the former party has 'adopted the reasonable manner' as specified in Article 39 of the CCL." Article 9 again recognizes that in the area of exemption from liability or exculpatory clauses the supplier of the standard terms has the "obligation of reminder and explanations." Failure to do so results in the voiding of the clauses.

Change of Circumstances		SPC	Recognition by Supreme People's Court ²²⁰
Reasonable liquidated damages or penalties	114	SPC	If liquidated damages are excessively higher than the loss incurred, the parties may apply to the people's court or arbitral institution for an appropriate reduction ²²¹
Reasonable time to give notice of non-conformity (defect)	158	SPC	SPC Interpretation on Issues Concerning Disputes over Sales Contracts (effective July 1, 2012), Article 17 states that the court should determine a reasonable time for inspection of goods "based on the principle of good faith"
Agency		61, 62, 170	Restriction on the authority of the legal representative by the Articles of Association of the legal person or the governing body of the legal person shall not confront the counterparties in good faith and limitation on the authority of personnel who complete the tasks for the legal persons or the non-incorporated organisations shall not confront the counterparties in good faith.
Registration of company or organization		65	If the actual situation of a legal person is inconsistent with the registered items, it shall not confront the counterparty in good faith.
Improper Company Resolutions		85	Resolutions between the legal person and the counterparties in good faith shall not be affected.
Company governance		86	A for-profit legal person who engages in business activities shall abide by business ethics, maintain transaction security, accept government and social supervision, and assume social responsibility.
Civil rights		110, 132	Natural persons enjoy the right to life, physical rights, health rights, name rights, portrait rights, reputation, right of honour, privacy, marriage autonomy and other rights. The civil subjects shall not abuse the civil rights and damage the national interests, the social public interests
Public order & social customs		143(3), 153	Civil juristic acts that violate public order and social customs are invalid

3. Good Faith in Chinese Legal Practice

In practice, the actual application of the good faith principle has been characterized by uncertainty. First, good faith is often directly connected with trade practice and in some parts of the CCL the principle of good faith is used interchangeably with trade practice. Article 60 provides that

220. Interpretation on Contract Law II, Article 26 (if an unforeseeable and significant change of circumstances that are not ordinary "commercial risks, and to continue with the performance of the contract will be obviously unfair to one concerned party or will not realize the purpose for which such contract was concluded" then the court may "modify or terminate the contract on the basis of the *principles of fairness*").

221. Interpretation on Contract Law II, Article 29 specifies any reduction in the amount of liquidated damages shall be "according to the principles of equity and good faith." It further states that any liquidated damages amount that is 30% or more than the actual damages incurred will be deemed to be excessively high.

parties in the performance of their obligations shall perform such duties as notification, assistance and confidentiality "in accordance with the nature and purpose of the contract and trade practice." Article 92 states that good faith performance duties after the termination of the contract shall be "in accordance with trade practice."

In the area of contract interpretation, Article 125 provides that the meaning of a contract term should be based upon its wording, the purpose of the contract, trade practice, and the principle of good faith. A reference to a self-standing requirement of good faith may even be qualified by its context. CCL Article 42 extends the good faith duty to the negotiations of contracts, such as: (1) bad faith negotiation with no real intention to contract; (2) deliberate concealment of material facts or the deliberate conveying of misinformation; or (3) "other conduct in contravention of the principle of good faith." The first examples are obvious cases of bad faith conduct; thus, the question is how broad should the third example be construed in the regulation of pre-contract activity? It is unclear whether withdrawal from an ongoing negotiation without a good reason or failure to notify, assist, or protect the other party's interests amounts to "other conduct in contravention of the principle of good faith."²²²

Despite scholarly consensus in support of the use of the good faith principle, there is no general agreement on its practical meaning.²²³ Good faith translates from Chinese into "honesty, trustworthiness, and credibility."²²⁴ Nevertheless, the breadth of good faith has yet to be worked out by Chinese scholars or judges. Must a party disclose confidential information during the negotiation of a contract? How should the implied duty of loyalty be defined and applied? Since specific definitions often fail, Professor Liang suggests the following approach:

[A party is required to] respect the interests of the other party, attend to its affairs with the same care used for one's own affairs, ensuring that each party to the legal relationship obtains its due share of benefit, and not to benefit oneself at the cost of the other' [and, additionally, not to] "harm the interests of a third party or the society by one's own conduct" [and to] "exercise one's right in a way congruent with its social-economic purposes."²²⁵

222. McKendrick & Liu, *supra* note 206, at 77 (citing UNDERSTANDING AND APPLYING THE SPC INTERPRETATION II ON CONTRACT LAW 73 (Shen Deyong, XI Xiaomin & SPC Research Office eds., 2009)).

223. See *id.* (citing Xu Guodong, *Two Notes on the Principle of Good Faith*, 4 CHINESE J.L. 74 (2002)).

224. *Id.* (citing Liu Xiangqian v Anbang Property Insurance Co, Suqian City (Jiangsu) IPC, 2 Nov. 2011, SPC Gazette, 2013, vol. 8 (concealment by insurer of recoverability of insurance compensation); China Everbright Group Co v Liquidator of Beijing Jinghua Trust Investment Co and Beijing Gaodeng Ltd, SPC, 14 Mar. 2011, (2010) Min Ti Zi No. 87 (concealment by lender from guarantor of borrower's unauthorised alteration of use of the loan)).

225. Liang, *supra* note 208 at 24 (citing SHI SHANGKUAN, GENERAL STUDIES ON THE LAW OF OBLIGATIONS (1978); GUODONG XU, INTERPRETING FUNDAMENTAL PRINCIPLES OF CIVIL LAW 78 (1992) (discussing a common conclusion that can be drawn from other scholars, that good faith principles are based on existing rules regarding fairness)).

This is a very abstract and broad view of good faith that is far beyond the notion of good faith in the civil or common law systems. It shows the continuing influence on some scholars of socialistic principles held over from communism. Professor Bing Ling offers a more modern and practical version of the role of good faith as the standard of conduct accepted in a community, such as “in the community in which the transaction takes place,” which can be characterized as the demands of commercial reasonableness.²²⁶

There is also confusion, despite the use of the good faith principle by Chinese courts, regarding its actual importance in judicial reasoning. For example, good faith is often used unnecessarily in the application of specific rules articulated in the CCL.²²⁷ Professors McKendrick and Liu note that “there exists a common practice amongst Chinese courts, particularly courts at the lower level of the hierarchy, of blindly resorting to good faith as an omnipotent solution irrespective of the availability of a direct and specific solution to the dispute before the court.”²²⁸

McKendrick and Liu also note that it is common in Chinese judicial decisions not to cite the good faith principle independently and of also citing other general principles in the CCL, such as the principles of equality, voluntariness, and fairness.²²⁹ This shows that many judges do not make a distinction between the general principles despite the fact that they serve different normative values. For example, parties may act in good faith and still produce a one-sided or unfair contract.²³⁰ Nonetheless, the courts have often used the principle of good faith to evaluate contracts in the interest of fairness to the parties, influenced by concerns of public policy and morals.²³¹

The Chinese courts' recognition of an unlimited duty of good faith is most likely due to cultural influences, such as socialist norms and Confucian values, that have been discussed previously.²³² These norms and values focus on communal or societal interests and not on private autonomy. This is seen in the continuation of rural collectives and public ownership of real property. In such a context, contracts and personal rights are interests that are routinely subordinated to group rights and interests. To some extent, every contractual relationship is regarded as embedded in a

226. See BING LING, *CONTRACT LAW IN CHINA* 54 (2002).

227. See McKendrick & Liu, *supra* note 206, at 79 (citing Luo Yi, *The Application of the Principle of Good Faith in Civil Judgments—An Empirical Survey of 53 Cases Reported in the SPC Gazette*, 11 J.L. APPLICATION 58 (2009)); Xiaoyi City Chenming Coal Char Ltd v. Shanxi Province Gangyu Coal Char Ltd., SPC, 24 Dec. 2012, (2012) Min Er Zhong Zi No. 104 (attempted termination of contract because output capacity did not match what was agreed upon in the original contract; Supreme People's Court held that termination should not be permitted because ensuring a specific output capacity was not the core reason for the parties contracting in the first place).

228. McKendrick & Liu, *supra* note 206, at 79-80.

229. See CCL, *supra* note 20, at arts. 3-5.

230. See Matheson, *supra* note 42, at 351-52.

231. See Yu Fei, *Distinguishing between the Principle of Public Order and Morality and That of Good Faith*, 11 SOC. SCI. CHINA, 146, 161-62 (2015).

232. See Pattison & Herron, *supra* note 151, at 488.

deeper, wider societal relationship. Consequently, the signing of a contract as a symbol of its sanctity is downgraded to merely 'the beginning' of the parties' real business relationship.²³³ It is for this reason not objectionable to raise, beyond the terms of a contract, an expectation that the parties cooperate and help each other out when needed. Equilibrium in the reciprocal exchange between the parties is accepted as an essential part of what contractual justice comprises.

Coupled with a civil law tendency to resort to general clauses found in civil codes,²³⁴ the above cultural factors have led to a reluctance or inability of Chinese lawyers at times to separate law from morality and a corresponding over-anxiousness in them to succumb to the influences of cultural codes of ethics in spite of the direct applicability of fixed rules of law or clear terms of contract.²³⁵ The antagonism between the principle of good faith and that of freedom of contract has not gone unnoticed. In contrast to its Western counterpart, the modern Chinese law of contract seems to have followed a path of evolution in the opposite direction. While the common law countries have moved in the direction of a wider acceptance of the implied duty of good faith, Chinese legal reasoning has become more rigorous resulting in the diminishing of the over use of good faith as the rationale for case decisions.

Since the establishment of the PRC, the notion of good faith gained a foothold and acquired a wide reception in Chinese contract law. The notion was then gradually encroached upon as a result of the rise of freedom of contract.²³⁶ An accompanying development has been the disappearance of cases in which a court relied solely upon such general principles as that of good faith in reaching a decision. Chinese courts are now increasingly aware of the need to identify concrete rules of law applicable to the dispute. However, as noted earlier, there is still a widespread judicial practice that the principle of good faith is invoked together with other, more specific provisions of law, even when the specific provisions deal directly with the issue at hand.

A decision of China's premier international arbitration panel, China International Economic and Trade Arbitration Commission (CIETAC), provides an example of what seems like a case of straight forward contract interpretation to one in which the principle of good faith and reference to customary practices are used to provide additional justificatory weight to the arbitration panel's decision.²³⁷ The case involved the sale and purchase of space heaters from a German seller to a Chinese buyer. The

233. *Id.* at 491.

234. See BASIL S. MARKESINIS, HANNES UNBERATH & ANGUS JOHNSTON, *THE GERMAN LAW OF CONTRACT: A COMPARATIVE TREATISE* 641 (2006).

235. See, e.g., Wang Liming & Xu Chuanxi, *Fundamental Principles of China's Contract Law*, 13 COLUM. J. ASIAN L. 1, 16, 18, 19, 20-21 (1999).

236. See Lou Jianbo & Liu Yan, 'Limits to the Principle of Freedom of Contract and Its Relationship with the Principle of Good Faith', 6 PEKING U. L.J. 35, 43 (1995).

237. Chinese Buyer v. German Seller (Heaters Case), CISG/2005/05, Arbitration Award, CIETAC, China (2005), <http://cisgw3.law.pace.edu/cases/051207c1.html> [<https://perma.cc/42P9-7W8M>]. [hereinafter *Heaters Case*].

obvious time of year to sell such heaters is during the winter season. The contract provided that the buyer could return any unsold units and receive a full refund. This ended up being the case. The buyer sent notice to seller's agent of its intent to return a number of units. The facts show that the buyer delayed in giving notice until after the winter season had come to an end and failed to provide the warehouse location where the seller could take over the goods. Nonetheless, the arbitral panel held in favor of the buyer.

The panel recognized the CISG as the applicable law, but used provisions in the CCL to render its decision considering the issues of the case to be outside the scope of the CISG. The panel began its opinion by unnecessarily confirming two general principles—“reflects the true minds of the two parties and does not violate mandatory provisions of the laws and administrative regulations of China.”²³⁸ Despite the application of specific provisions, the panel's analysis essentially rested on whether the buyer acted in bad faith by delaying notice and not providing sufficient content in its notice or whether the seller acted inappropriately in not making prompt arrangements to take back the goods. The first issue concerned the calculation of the price of the heaters for purposes of setting the refund amount. The court held that the parties had subjectively different interpretations on the appropriate method of calculation. The panel sided with the seller using the reasonable person standard of CISG Article 8(2),²³⁹ “a reasonable person of the same kind as the [Seller] would have understood the contract price as the unit price of each model, but not the total contract price as alleged by the [Buyer].”²⁴⁰

The panel then wrongfully disregarded the CISG interpretive methodology (interpretation through the general principles of the CISG) and, instead, utilized provisions 60 to 62 of the CCL. In the end, it didn't matter since the content of those provisions were the same general principles as provided for in the CISG. In regard to the appropriateness of the buyer's notice and the seller's response, the panel referred to CCL Article 60: “The parties shall fully perform their respective obligations in accordance with the contract. The parties shall abide by the principle of good faith, and perform obligations such as *notification*, assistance, and confidentiality, in light of the nature and purpose of the contract and in accordance with the relevant usage.”²⁴¹ The panel held that the listing of the goods to be returned was sufficient notice since it allowed the seller enough information to prepare for taking back the goods.²⁴²

238. *Id.*

239. Interpretation should provide a meaning “according to [the] intent where the other party knew or could not have been unaware what that intent was” under CISG Article 8(1). If such meaning is not determinable then, under CISG Article 8(2), the interpretation shall be “according to the understanding that a reasonable person of the same kind as the other party would have had in the same circumstances.”

240. *Heaters Case*, *supra* note 237.

241. See CCL, *supra* note 20, at art. 60.

242. The panel should have referred to CISG in determining the reasonableness of the notice. See *Heaters Case*, *supra* note 237 (“[As to the] content of return notice, the Arbi-

In regard to the setting of the refund price, the panel references Article 61 of the CCL: “[If an] agreement is unclear, the parties may agree upon supplementary provisions to such terms through negotiation. In the case of a failure in doing so, the terms shall be determined from the context of relevant clauses of the contract or by transaction usages.” Finally, the panel recognizes the civilian notion of purposive interpretation as noted in Article 62 of the CCL: “[I]f the method of performance was not clearly prescribed, performance shall be rendered in a manner which is conducive to realizing the purpose of the contract.” It is from these open-textured rules (standards), the panel reasons that the buyer’s notice, although not complete in content, was sufficient to trigger the seller’s obligation to take back the goods.

The panel states that the first order rule is the parties’ mutual obligation to negotiate a resolution in good faith. If a negotiation fails, then recourse would be through analogical reasoning from other provisions in the contract and then to applicable trade usage. If this proves unsuccessful, then “the performance shall be rendered in a manner which is conducive to realizing the purpose of the contract.”²⁴³ The purpose of the contract was for the seller to supply a sufficient number of heaters for the winter season and allow the buyer to return the unsold units. In the end, the court reasoned that the seller “violated the honest and good faith principle”²⁴⁴ since it did not attempt to directly negotiate a return of the goods from the buyer, instead using surrogates, and then failing to provide a “letter of entrustment” requested by the buyer stating that the seller’s agents had the authority to negotiate the return. Finally, the seller’s demand that the refund be made in Chinese currency (*renminbi*) instead of the currency stipulated in the contract (euros) “set an unreasonable barrier to the return of the goods.”²⁴⁵ As we can see from this case, the direct interpretation from the provisions of the contract through specific CISG or CCL rules is abandoned in favor of general principles that are expressed or implied by the relevant law—a reasonable person of the same kind; parties shall abide by the principle of good faith; violate the honest and good faith principle; realize the purpose of the contract; and an unreasonable barrier to the return of the goods.

Interestingly, the principle of good faith worked in the seller’s favor on the issue of liquidated damages. The contract provided for one percent per diem as liquidated damages. Yet, the court found the per diem amount too high and reduced the amount to ten percent per annum under Article 114 of the CCL,²⁴⁶ holding that a reduction to ten percent per annum was justified under principles of equality and reasonableness.²⁴⁷

tration Tribunal deems that as long as the models and quantity of the goods were clearly indicated in a notice which would enable the [Seller] to make preparation to accept the goods, the requirements for a reasonable return notice is fulfilled.”).

243. *Id.*

244. *Id.*

245. *Id.*

246. See CCL, *supra* note 20, at art. 114.

247. *Heaters Case*, *supra* note 237.

Professor Novaretti correctly observes that Chinese courts use the principle of good faith to shift the burden of proof from the plaintiff to the defendant.²⁴⁸ For instance, Professor Novaretti discusses a case where a seller delivered a new refrigerator to replace a defective one, and the buyer was unable to personally inspect the new refrigerator at the time of delivery.²⁴⁹ When the buyer noticed mold and other imperfections, the buyer claimed that the seller had delivered a used refrigerator instead of a new replacement. Upon this claim, the court shifted the burden of proof from the plaintiff (consumer) to the defendant (seller) to prove that the refrigerator was new. These instances, and other unjustified intrusions by courts into the autonomy of contracting parties, will continue to occur and will remain a real danger in China without legislation that spells out the boundaries of judicial discretion, a mechanism to guide a court's reasoning in applying specific rules in a timely way, or the hiring of a body of well-trained judges.²⁵⁰

IV. The Paradigm of Hard-Soft Law

This part will use the analogy of hard-soft law found in international law. The CCL and future Civil Code represents hard law and cultural values act as soft law, used to interpret the hard law. The second section makes some recommendations as China advances toward a general civil code.

A. Chinese Contract Law as a Hard and Soft Law System

In international private law, the concept of soft law or customary international law²⁵¹ plays an important role in the performance of contracts and in the resolution of disputes. Courts and arbitral tribunals will at times look outside the applicable hard law, such as domestic contract law or the CISG, to evidence of trade usage, business customs, and commercial practice to interpret contracts and to determine whether there was bad faith performance. In other areas, such as international finance, soft law takes the form of standards and principles. At times, soft law can trump hard law in instances where a court or arbitral tribunal recognizes something as international customary law that preempts the application of attributable domestic hard law (choice of law or conflicts of law).²⁵² Such

248. See Novaretti, *supra* note 202, at 976–78.

249. *Id.* It is important to note that Chinese Civil Procedure Rules provided for such a shift in the burden of proof. Article 7 of the Regulations on Evidence in Civil Proceedings, which the Supreme People's Court issued on November 9, 2003, provides that, "In the event that the present Regulations, existing provisions, and judicial interpretations cannot be adapted to a given legal question in order to determine the burden of proof, the People's Court ought to base the determination on the principles of good faith and fairness, as well as the parties' evidentiary competence."

250. See Lou & Liu, *supra* note 236, at 41.

251. See Larry A. DiMatteo, *Soft Law and the Principle of Fair and Equitable Decision Making in International Contract Arbitration*, 1 CHINESE J. COMP. L. 221, 221 (2013).

252. See, e.g., ICC Case No. 5873 of 1989 (holding that the panel would apply CISG as evidence of international customary or soft law instead of Dutch law because Dutch

a dichotomy is also at work in domestic legal systems.²⁵³ This is especially true in China, which has a long history of informal customary law. Indeed, in China's case hard law (CCL, CISG, *General Rules*, administrative regulations) is insufficient to truly understand the role of law in Chinese society.

Another way to approach the topic of the interrelationship between Chinese law and Chinese culture is to view hard law as theory and customary or soft law as practice. China's new modern, Western-style contract laws provide hard rules that are intended to be the basis for parties to contract. However, this is presently more theoretical than real. First, Chinese cultural norms weigh in favor of mediation, compromise, and relationship-preservation than it does to litigation.²⁵⁴ Second, rational judicial reasoning in the application of hard rules and principles is lacking in the Chinese judiciary because of its lack of skill and familiarity with the Western legal concepts found in the CCL. The Chinese judiciary should improve, and without improvement, there is a great deal of uncertainty because different courts interpret and apply the same contract rules in different ways.

Third, the tradition of Chinese civil law does not harmonize well with the CCL because unlike common law, case-by-case adjudications do not occur—there is no reference to other court decisions. Fourth, the importance of social roles and networks, the importance of the common good and public interest, and the dominant role played by the Communist Party and state agencies continue to influence or bias the judicial process. In a meaningful way, these norms and cultural tendencies are the soft law of the Chinese legal system or “the law beyond the state.”²⁵⁵

In China's case, cultural norms (Confucianism, *guanxi*, socialistic-communal-collective ideals) are, in a sense, the law behind the law. The meaning attached to the hard rules of contract is heavily influenced by this normative background, which one scholar has characterized as the “normative richness of life in China.”²⁵⁶ Cultural norms of the common good (most often set by the State), fairness, and equity will continue to influence the application of contract law and its remedies at the expense of a purely

law had an unusually short statute of limitations—six months—that was contrary to international customary law while Article 39 of the CISG had a two-year limitation period); Larry A. DiMatteo, *Resolving International Contract Disputes*, 53 *Disp. Res. J.* 75, 75–79 (1998).

253. See Jessika van der Sluijs, *Normative Legitimacy of Domestic Soft Law* (Stockholm Fac. L. Research Paper Series, No. 7, 2017), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2951767 [<https://perma.cc/VVK7-K5ZE>] (discussing how soft law is an important element in Swedish law).

254. Confucianism viewed litigation and formal arbitration disgracefully, instead wanting parties to mediate their differences in order to maintain social harmony. See Cohen, *supra* note 136, at 1206–07.

255. The idea of “law beyond the state” has a long history in the Chinese Confucian's view that arbitration and litigation force dispute resolution and disrupt social harmony. Thus, the Confucian value of structure strongly supports the role of informal mediation through negotiation, compromise, and third-party persuasion. In this form of mediation, legal rules are all but irrelevant. See van der Sluijs, *supra* note 253.

256. Keller, *supra* note 186, at 711.

objective application of formal rules.²⁵⁷

B. Towards a General Civil Code

This Article has emphasized how Chinese courts have applied in non-conventional manners legal concepts, rules, and principles taken or borrowed from Western law. Vague principles, like good faith, fairness, and reasonableness, reflect traditional Chinese values. Thus, Chinese courts have applied the principle of good faith in application, not to mimic Western law, but rather to be consistent and coherent with Chinese cultural values. Thus, Western law and Chinese law, while containing the same words, have diverged because Chinese courts interpret Chinese law within the confines of Chinese cultural values and legal traditions.

The Western perspective that foreign legal systems “misuse” Western legal concepts is a product of Western bias. Because the West makes up much of the developed world, it sees the evolution of legal systems based on Western law, as is the case of China, as evidence of its superiority. From this perspective, failing to understand Western law and its application leads to uncertainty and inefficiency.²⁵⁸

This line of Western bias is misplaced. Borrowing foreign law or legal concepts does not require the interpretation and application of that law and those concepts to be in complete harmony with where they originated. Law is never a completely autonomous system because it works within and is influenced by non-legal considerations of historical nuance and cultural diversity. At the same time, there are differences between good and bad applications. Indeed, the SPC in its issuance of “Interpretations”²⁵⁹ and *Guiding Opinions*²⁶⁰ has recognized this fact, aiming to bring greater certainty and consistency in the application of Chinese contract law among the various levels of the Chinese court system.

Nevertheless, the consequences of the above divergence between the meaning of legal concepts in the borrowing country and the originating country are numerous. First, a Western business must understand how the Chinese court system understands well-known legal concepts in peculiarly Chinese ways. Second, the Western businessperson should always place the written contract into a relational mindset. What a Western perspective might view as a fixed term with a clearly defined meaning might be malleable in the face of Chinese cultural norms. Third, the divergence may recede as the Chinese judiciary becomes better trained and sophisticated in the application of legal reasoning to render more objective deci-

257. See Glenn Morgan & Sigrid Quack, *Law as a Governing Institution*, in THE OXFORD HANDBOOK OF COMPARATIVE INSTITUTIONAL ANALYSIS 275, 277, 300 (Glenn Morgan et al. eds., 2010) (observing a recursion effect between context and law, that context influences and changes law and law influences and changes context).

258. See Hendrik Zwarenstejn, *Some Observations of the Comparison of Legal Institutions and the Concepts of Law in Different Societies*, 10 AM. BUS. L.J. 17, 20 (1972) (“[T]he view that our approaches to foreign legal systems . . . are imperceptibly interwoven and inter-connected by our underlying feelings of superiority of own system(s) . . .”).

259. See text accompanying *supra* note 21.

260. See text accompanying *supra* note 18.

sions. Fourth, through continued use of SPC "Interpretations," as well as the full implementation of the *Guiding Opinion* system, divergent opinions in regional and local courts when applying the CCL and the future Civil Code will hopefully be worked out of the system, resulting in greater certainty and consistency in judicial outcomes. Fifth, the Chinese government should continue to improve its contract law. The Civil Code Project provides an opportunity to craft a third-generation contract law that should remain a stable force for decades to come. The CCL's unification of the different Chinese contract law regimes was a major step forward in the unification and modernization of the law. Notwithstanding its achievements, the almost two decades of its existence has illuminated its flaws, those being redundancies, inconsistencies, and gaps. Hopefully, China will meticulously draft its new Civil Code to correct the imperfections of the current CCL.

Conclusion

The movement to a third generation of modern Chinese contract law has begun with the enactment of the introductory part of what is expected to be a Chinese Civil Code. The 2017 *General Rules of the Civil Law of the People's Republic of China (General Rules)* provides the framework for a full-fledged Western-style civil code. The focus of this Article is on the general principles provided in the 1999 Chinese Contract Law (CCL) and the *General Rules*. The comparison reveals that cultural norms, as espoused in Confucian values, and socialistic principles, carried over from the era of the Communist planned economy continue to influence Chinese civil law. It is this normative structure and other extralegal influences, such as the dominant roles played by the Communist Party and its policies, which differentiate the Chinese view of the rule of law with its Western conception.

These cultural influences play a crucial role in the interpretation and application of Western legal concepts embedded in modern Chinese contract law. Based on China's Confucian-Socialistic value structure, which focuses on the value of the collective over the individual and relational structures over formal law, the duty of good faith has become a meta-principle in Chinese jurisprudence. Application of transplanted legal concepts, such as the principle of good faith, in Chinese law shows how the application of law necessarily depends on the interrelationship between the legal, cultural, political, and economic dimensions of society.

Chinese commercial law, including contract, company, and property laws, may very well have to play an outsized role for China to transition to a full-fledged rule of law society. The reasons are three-fold: (1) recognizing personal rights in the transition to a market economy is important; (2) private law is relatively unthreatening to the current power structure; and (3) applying private law may serve as a training device to improve the legal reasoning skills of the Chinese judiciary.

Confucian cultural norms have been waning because the Chinese people have increasingly used the court system to resolve contract disputes.

The recognition of personal property rights and greater acceptance of the right to seek legal redress has increased private autonomy in Chinese society, leading to economic growth due to the creation of an entrepreneurial spirit. As such, people are enabled to move above the "status" into which they were born. Increased mobility from rural to urban centers has aided the movement from societal status to the recognition of individualism. The enactment of business and contract laws, along with the recognition of private property, have been the major forces driving China's rapid economic growth. Thus, the Chinese government has an interest in the judiciary applying laws efficiently and properly.

Finally, the improvement in legal reasoning skills in the judiciary, which the Supreme People's Court aids by offering legal education and guidance through the issuance of "Interpretations" and *Guiding Opinions*, has led to the judiciary delivering more consistent and objective decisions. With these new skill sets, courts will likely move away from extralegal sources of law and issue decisions based on the "rule of law." This will occur in various areas of law, including human rights. However, the lack of an independent court system hampers the impact that the judiciary's improved knowledge of China's Western-style laws and improved legal reasoning skills will have on the overall legal system. There have been some moves in the direction of greater independence, but for the time being, the continued professionalization of the judiciary is the most likely area of improvement. At the same time, it is important to realize that a more independent and objective judiciary is unlikely to change the Chinese concept of the rule of law, which does not assume the eventual creation of a liberal democracy.